Reshaping South Carolina's Property Tax for the 21st Century

Presented to the SC Association of Assessors, Auditors and Treasurers

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THE STROM THURMOND INSTITUTE

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I know that Sandy invited me in part because the Ad Hoc Committee on Tax and Revenue Systems is hard at work in Columbia. I testified a month ago, mainly on industrial incentives, but my presentation was followed by a wide-ranging discussion with committee members over the full range of tax issues. Clearly they are concerned about school funding, both equity and adequacy, so they are interested in the property tax. They are also concerned about how we compare with our neighbors and with how the overall burden of the tax system is distributed—again, property tax looms large in these questions. And, of course, they are concerned about how they dig themselves out of the state's current financial mess, the issue least directly related to property tax. They are listening to everyone and asking good questions.

A second reason for this invitation, I suspect, is related to the Local Government Funding project completed in December 2000, working through the University of South Carolina under the auspices of the Comptroller General's office. That project resulted in 28 recommendations, of which about one-fourth dealt with property taxes. I was the author of the longest of the technical papers, the one describing how local governments are currently funded, and the chief author of the recommendations report.

Sometimes I feel like the lone academic defender of a property tax under constant assault. It's easy to document the faults of the property tax. Assessment comes every five years or so, with big shifts in the property tax burden. It's hard to prove that assessments are fair, especially in rural areas where there is little market reference to support the assessors' claims. The bill comes once a year, unlike most other bills which come in monthly installments. The tax is a major revenue source for not one but three kinds of local governments—schools, counties, and municipalities—so city residents get a triple whammy. The classified system we use in South Carolina was originally designed to protect homeowners and farmers, but in just 25 years we have managed to unravel most of the tough choices that were made in Act 208. Now there's a little relief for just about everyone at the expense of greater complexity and loss of tax revenue. Because rental property and cars carry a large share of the burden, the property tax is probably become increasingly burdensome on the poor. The property tax favors homeowners and elderly citizens without regard to need. New property lags in coming on the books, so we have to supply services right away for new homes that produce trash and fire calls and school children, but may have to wait nearly two years for the tax revenue. Property taxes discourage industry from locating in poorer counties where the mill rates are highest. And my personal pet peeve, we don't seem to be able to enforce car tags, so there are lots of unregistered, untaxed, and uninsured cars driving out state roads and not paying their fair share of the property tax.

All of those issues are addressed in that Local Government Funding Report. When I testified, I called the committee's attention to that report and its 28 recommendations, and Hunter Howard came up next and underscored the same point. A week earlier the County Association and the Municipal Association asked them to review those recommendations. So if you want to hammer at the committee about those recommendations, it won't be new information to them.

But back to the list of complaints about the property tax. Is that list of flaws reason enough to do away with the property tax? Hardly. Many of the problems are peculiar to South Carolina, and they can be remedied with enough political will. We can pool smaller counties to provide an adequate market base for valuation. We can allow taxes to be paid on the installment plan like everything else. We can shift more of the cost of funding schools to the state to reduce the effects of the triple whammy, because the lion's share of the property tax goes to the schools. We can rethink the classification system, a question to which I will return in a moment. We can design relief so it gets to those who need it, a second issue I would like to return to. We can get property on the books faster by looking at the stage of completion on December 31st. We can rethink school property taxes on industry, a third issue to which I would like to return. And it must be possible to enforce vehicle registration. Other states don't seem to have this problem with unregistered cars. As I said earlier, we addressed all of these problems and made recommendations about how to address them in the Local Government Funding Report almost two years ago.

Of all those issues, there are three that are worth some careful revisiting—rethinking classification, need-based relief, and school taxes on industrial property. But before we do that, let's remind ourselves about some good things about the property tax. There's a reason why this very old tax is still with us at the dawn of the 21st century. There are lots of little taxes that will bring in little pots of revenue, like taxes on alcohol and tourism and gasoline, but there are really only three big taxes. You can tax income, or spending, or wealth. We do tax income, both individual and corporate, along with 40 other states and the District of Columbia, the federal government, and local governments in some other states. Income is probably the best single measure of ability to pay taxes. You can also tax spending, which in this country is done primarily through the retail sales tax, a workhorse for state and local governments. Spending is also a measure of ability to pay. Sales taxes are, for reasons I don't fully understand, the least unpopular kind of tax, and state and local governments have turned to it increasingly in recent years. The average state and local rate combined has edged up from about 5% a decade ago to more like 8% today. 45 states and the District of Columbia use retail sales taxes.

And then there is wealth. We don't tax all kinds of wealth. We used to tax wealth when it passed to heirs, but we're moving away from that as the feds abolish the estate tax. So we are left with the property tax as the remnant of using wealth along with income or spending as a measure of ability to pay taxes.

The problem with taxing wealth or assets is that they don't always generate an income to pay the tax. Sometimes you have to sell the asset, or part of the asset, to raise the cash. That raises the specter of little old widows evicted from the family farm to pay the taxes. It happens, but not that much. It's possible to design a tax system that protects the poor, the elderly, the widows and orphans without giving relief indiscriminately to everyone.

The advantage of taxing these particular assets, land and improvements and cars and some other personal property, is that to some degree the benefits from local government are proportional to the value of property owned. A lot of city services in particular are services to property—fire and police protection, streets and street lights, trash pickup. There's also a close connection between home values and school quality. The other advantage in taxing property is that this tax is a lot harder to evade by moving elsewhere or shopping elsewhere. You may move, but the property doesn't. So I think there is still a place for the property tax in our system, but we need to tax fairer and tax smarter.

That's where my three issues come in—to rethink the funding of schools and taxation of industry, to revisit the classification system, and to shift to a needs-based system of property tax relief. The three proposals I am about to describe are not really entirely new or original ideas. I know that most speakers like to impress their audiences with the newness, the novelty, the originality, the creativity of what they propose. None of those qualities sell well in the General Assembly. Those folks want assurance that a proposal is in the mainstream, that it won't get us to far out of line with the neighboring states, that it has been tried somewhere else and worked well. All three of these ideas are reflected, if not necessarily recommended, in the Local Government Funding Report that came out at the end of 2000. That report contains 28 recommendations hammered out between academics and technical people. Indeed, some variant of each of these three proposals exists in other states. Politicians are aware of them and so are representatives of cities, counties, schools, industry and other interested parties.

In South Carolina, we don't leap at new ideas. We listen, we think, we modify, we work out compromises for those who will be adversely affected, we postpone. Mostly we do our serious work in January of odd-numbered years, which is as far away from the next election as we can get. I'm expecting big things out of this coming January, and some of those big things may change the way we do property tax business in this state. So what are the three proposals?

- Number one. A uniform statewide school millage rate on industrial and utility property, to be shared among school districts on a per pupil basis.
- Number two. To work toward a system with just two assessment rates: 4% on undeveloped land, family farms and owner-occupied residences, and 6% on everything else.
- Number three. To replace our present homestead exemptions for the elderly and for school taxes on the first $100,000 of property with circuit breakers, which provide property tax relief when property taxes exceed a certain percentage of income.

Let me flesh out each of these three ideas.

One of the reasons we have 86 school districts, rather than 46, or even fewer, is that each district claims ownership of the industrial property within its boundaries for school tax purposes. So school districts in little rural poor counties like Allendale and Hampton and Williamsburg have almost no industry with which to support the schools, while school districts in Greenville and Spartanburg and York Counties are rich in industrial property and can raise a lot of money for schools with very low mill rates. This system of assigning the right to tax industry has two bad effects. First, it means that local resources for school purposes are highly unequal, and the contribution from the state isn't big enough to make much of a dent in that inequality. Second, it means that those poor rural counties are handicapped in attracting industry. What firm would locate in Jasper County and be the only big taxpayer when it could locate in Berkeley or Charleston County and get better services and better schools for lower mill rates? As one firm's comptroller said to me eight years ago, "I would love to locate in Jasper County, but I can't afford to be the only major taxpayer."

When we recruit industry, we recruit them with a lot of state resources. Infrastructure. Income tax credits. Technical education programs. When industry hires workers, workers they hope have been well prepared by the public schools, they don't just come from the local school district, they come from many parts of the state. So the state has an investment in industry, and industry has an investment in all the schools. It makes sense to tap that shared tax base to support all of our children, not just the ones in the shadow of the plant.

There are a number of ways of implementing this proposal. We could charge a uniform statewide mill rate on state-assessed property and send it back to the schools on a weighted per-pupil basis. We'd have to phase it in and work through the existing FILOT agreements, but it could be done. Or we could get more radical and say that industry and utilities only pay for schools, and residential, commercial and personal property pay for city and county services. Of course, either form of this proposal will have tough sledding politically, because no one wants to let go of their tax base and share it with anyone else. But down the road, it would have some side benefits, like more consolidation of school districts as we saw recently in Orangeburg County. The state Chamber of Commerce and the House Ways and Means Committee both see merit in this idea. The ad hoc tax reform committee meeting right now was drawn to the idea because they are zeroing in on school funding, equity and adequacy, as their number one concern. And perhaps we can find some way of persuading the Spartanburgs and Berkeleys and Greenvilles that their future and their fortune really is intimately linked to making life and education better and more prosperous in the Dillons and Jaspers and Williamsburgs and Saludas of our state.

Proposal #2. Reduce the number of classifications to just two, a 4% and a 6%. There's also a lot of support for this idea because it is in fact the direction in which we are already moving. We already have owner-occupied and farm property at 4%, rental and commercial property at 6%. FILOT agreements are usually at 6%, sometimes at 4%. Car tax assessments are ratcheting down to 6% over a six year period. I was opposed to that change, because I knew that it was going to cause some real revenue strains in some of our smaller, more rural counties and school districts and even our small towns. Personal vehicles average 20% of the tax base, higher in some places. There are counties and school districts where cars have been the only part of the tax base that was growing. I said all these things in print and on television and anywhere people would listen, but it's really hard to go against that primal instinct of seeing a ballot question that promises to lower taxes and responding with a hearty "Yes!" Plus those pushing this change weren't real forthright about the fact that the state wasn't footing the bill for this one as it does for homestead exemptions for the elderly and for school property tax relief for homeowners. But that's all water over the dam. It's done, and it isn't going to be undone. The positive side of this change is that it moves us a little farther in the direction of two assessment rates instead of four.

Right now this change would be difficult to implement, because the lower assessment rates on industrial and utility property and business personal property would require a millage hike that would shift a lot of the tax burden to owner-occupied residential property. But as existing industry either ages or expands, and we adapt to the lower rate on cars, it could be feasible in another four or five years. With only two assessment rates, there will be less likelihood of having those with higher assessments screaming for relief from the General Assembly.

Lots of states get by with a single assessment rate. We have chosen to do differently because we have a historic soft spot for homeowners and landowners that goes back to the days of the Lords Proprietor. But this present system was patched together in haste 25 years ago in response to a court challenge to the existing informal system of differential assessment rates. Perhaps it's time to reconsider Act 208. Unfortunately, like so many things in South Carolina, the assessment rates are in the constitution, so it's not going to be easy to change.

Finally, proposal #3. We offer property tax relief to every conceivable category except the poor. We use poverty as the excuse for tax relief, directly or indirectly. Tax relief for new and expanding industry will create jobs and income and help the poor. Tax relief for the elderly will protect the elderly poor from excessive tax burdens—along with the wealthy retirees from Keowee Key in Oconee County to Hilton Head. Tax relief for the elderly will attract wealthy retirees and create service jobs for the poor. Tax relief on cars will help the poor afford cars—although most of the relief goes to those who buy newer, more expensive cars. And so forth. There is some merit in the economic development argument, even if it does mostly succeed in attracting industry to our wealthiest, most developed counties. But the other kinds of relief go mostly to the middle class and the wealthy. If you want to help poor people without sacrificing a lot of revenue you have to target the relief on the basis of income. That's why a number of states use a circuit breaker for property taxes for both homeowners and renters. With a circuit breaker, tax relief kicks in as an income tax refund when your own property taxes, or the property taxes your landlord pays on your rental property, exceed a certain percentage of your income. There's a surprising amount of interest in exploring this idea for South Carolina in the General Assembly, the business community, and among local governments.

There is one final issue that I want to bring before you that I mentioned during the discussions around the Local Government Funding Project that didn't make the final cut. Not because of opposition, just because it seemed less pressing than some of the others. But since I have become a municipal elected official, serving on Clemson's city council, this issue has returned to haunt me. One of the biggest property owners in the state of South Carolina is none other than—the state of South Carolina. They own prisons, college campuses, office buildings, hospitals—you name it. Those entities use public services, and the cost tends to fall heavily on cities, especially Charleston and Columbia. In some cases these entities also house public school students, adding students but no property tax revenue to school districts. When I was a graduate student decades ago at the University of Connecticut, the state made payments in lieu of taxes to the little town of Storrs to cover the cost of educating children who lived in faculty housing. So it's not a new idea. When there is a fire in a state building, they call the local fire department.

Trash from state buildings gets picked up by the same collectors and dumped in the same landfills as trash from commercial and residential buildings. State agencies use local public services. They should pay for them. If that were the case, the peculiar situation of Clemson University exercising municipal authority over its campus right next to the real city of Clemson would not exist. Clemson University would not need to have its own fire department, police department, solid waste collection, and even a municipal court whose legal status is somewhat questionable. And students' tuition could go to pay for education instead of municipal services. Now I know that some of you are thinking about all of the private colleges that are tax-exempt, not to mention the churches and YMCAs and other charitable organizations and activities. I belong to a church and I contribute to charities, and I applaud the good work they do and the positive ways in which they shape our society. But I don't see why they should be exempt from local property taxes if they use local public services. That's a pretty radical notion, I know. I'm not prepared to push it as part of a public agenda. I like to pick my fights, and that's not a winnable one right now. But I do think the state should own up to the costs it is shifting to some of its local governments and make payments in lieu of taxes.

So where is the constituency to demand these reforms? Where is the unlikely alliance that will agree to a major overhaul of the way we distribute the burden and the revenue? Surprisingly, my first three reforms have a constituency. The business community supports them, at least cautiously and in principle. Local governments can see the attraction in simplification and fairness in just two assessment ratios and targeting the poor for property tax relief. School districts other than those awash in industrial property would welcome the change in how we finance schools. The real challenge comes in the cost of holding harmless, which is the unwritten law of political change in South Carolina. Can we find a way of transitioning these reforms in so that only new industry is affected by the uniform statewide mill rate? Can we introduce the two assessment rates over a ten year period, accompanied by some easing of restraints on adjusting the mill rates upward where needed? Can we freeze existing tax breaks for existing homeowners and people over 65 but not add them for new homeowners and the next generation of retirees, or let the size of each household's tax break shrink over time by not letting pot of money grow? Can we start small with circuit breakers and work out way into them for the poor for whom residential property taxes really are burdensome? We can if we have an informed public, an alliance of business and local governments, and above all, a recognition that we South Carolinians are all in this together. Williamsburg County's schools and economic development matter to Greenville County. BMW hires workers from all the state's school systems, not just those in Spartanburg County. Cities, counties, and school districts all want taxpayers to feel that the property tax burden is distributed fairly so they won't have to deal with the anger and resentment that results from special treatment of certain classes of taxpayers.

A final thought, just like the end of any good sermon. Any call for leadership to implement change begins with those of you who hear the call. As people who deal with both the tax system and the public on a daily basis, all of you can play an important leadership role in shaping a property tax system that works for a new century. You know how the system works and what its flaws are. Your knowledge and experience gives you credibility. You need to speak out individually and as an association on behalf of constructive reform. We, your constituents, are counting on you to do just that.