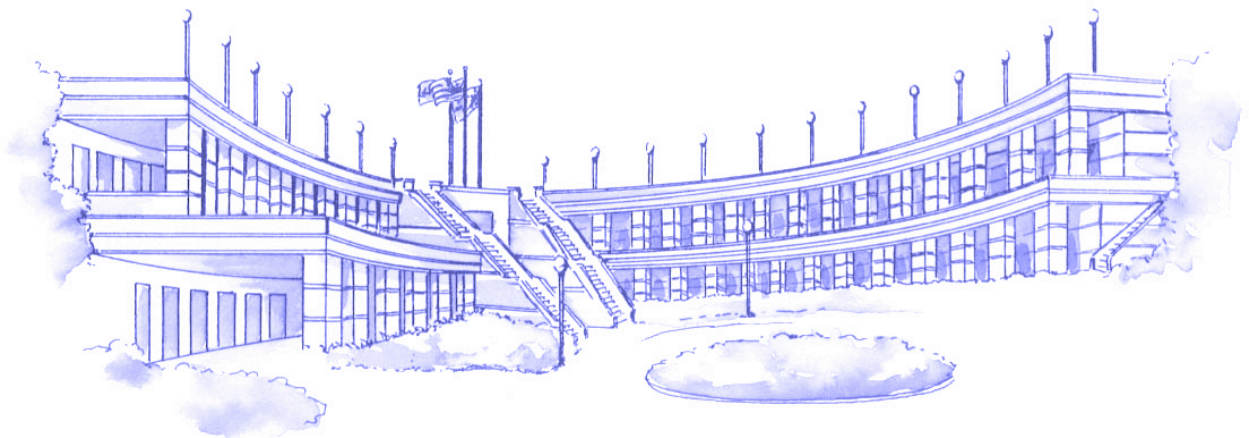


# **HISTORICAL DEVELOPMENT OF SOUTH CAROLINA'S STATE AND LOCAL REVENUE SYSTEM**

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**HISTORICAL DEVELOPMENT OF  
SOUTH CAROLINA'S STATE AND LOCAL  
REVENUE SYSTEM**

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Strom Thurmond Institute of Government and Public Affairs  
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## **Research Project**

*Evaluation of the South Carolina Revenue System*

## **Project Report**

*Ensuring a Competitive Revenue System for South Carolina*  
*Holley H. Ulbrich*

## **Working Papers**

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## FINDINGS

### DEVELOPMENT OF THE STATE REVENUE SYSTEM

- The development of South Carolina's revenue system has followed an evolutionary path that has responded to emerging needs for additional revenue and changes in government structure, as well as to social and economic change. From 1920 to 1990 a series of independent tax study commissions and studies provided guidance and recommendations to policymakers.
- From colonial days into the early twentieth century South Carolina depended almost entirely on taxation of real estate and personal property for state revenue.
- From 1920 to 1951, South Carolina made changes in its revenue system that produced South Carolina's current state tax structure of fees and excise taxes, personal and corporate income taxes, and a sales and use tax.
- Adoption of the individual income tax in 1921 was intended to eliminate state dependence on the property tax so that it would be available exclusively to local governments. The income tax was modified in the 1980s to provide a high degree of conformity between federal and state definitions of taxable income.
- The property tax was phased out completely as a state revenue source by the early 1940s.
- State taxes on inheritance and gasoline and various excise taxes were added in the 1920s and 1930s to shore up state revenue. Many have been repealed, but the excise taxes on gasoline, beer and wine, alcohol, and tobacco are still part of the system. The last major revenue increase at the state level was the one-percent rate change in the gasoline excise tax in 1989.
- Revenue from the state's retail sales tax was originally expected to pay for both an elementary and secondary school building program plus other state needs. However, the revenue has been completely dedicated to funding elementary and secondary education since the inception of the tax.

The revenue from the initial three cents of sales tax, introduced in 1951, funded an extensive building program based on consolidation of public schools by eliminating one-room schools and provided bus transportation to all students for the first time in an attempt to avoid desegregation of elementary and secondary schools.

The fourth cent was adopted in 1969 to improve educational instruction and teachers' salaries. At this time, the current system of distributing state funds to school districts based on the ability to pay was approved by the General Assembly.

In 1984, a fifth cent in sales tax was levied to fund the instructional programs spelled out in the Education Improvement Act.

- A state lottery was adopted in 2000 with net revenue dedicated to education with the stipulation that the revenue supplement, not replace other educational funding.
- Today South Carolina's revenue system—an income tax and sales and use tax at the state level and the property tax at the local level—is considered equitable and balanced because the strength and progressiveness of some taxes balance the regressivity and weaknesses of others.
- However, since 1990 many legislative changes have been made to the three major taxes in South Carolina's revenue structure without considering equity issues and the overall consequences to the state's revenue system. As a result, the balanced and equitable tax system—the income and sales and use tax at the state level and the property tax at the local level—that legislators designed beginning in 1920 is difficult to find. In addition, most changes in the system reduced revenue.
- As South Carolina moves forward into the twenty-first century, it may be time to reinstate the historic tax study commission model to again take a broad look at South Carolina's revenue system. The deliberative process that served South Carolina well in the past as it faced major social and economic challenges may be critical to decision making in today's confusing fiscal times.

## **DEVELOPMENT OF THE LOCAL REVENUE SYSTEM**

- Like state government, municipalities, counties, and school boards in South Carolina historically financed local government using the property tax. The poll

tax provided revenue to all local governments. In some locations, business licenses also provided revenue to municipalities which functioned as independent units of government. Today the property tax continues to be the mainstay revenue source for municipalities, counties, and school districts

- Each county's legislative delegation, the senator and local house members, governed county affairs from Columbia. The county's budget and other legislation related to county and school governance were approved as bills as part of the state legislative process.
- In the 1970s, federal court decisions made South Carolina's county delegation system of governing counties no longer viable and some degree of home rule became necessary. After passage of the Home Rule Act in 1975, counties were governed by elected county councils and received powers similar to those of municipalities.
- However, the Home Rule Act did not provide fiscal home rule to municipalities and counties and did not apply to school districts. Although the property tax is a local government revenue source, the state retains legislative control over its classification ratios and assessment administration.
- With the advent of home rule independent of the General Assembly, local governments began to search for more diversified revenue sources to reduce reliance on the property tax.

The legislature approved an accommodations tax in 1984, and the local option sales tax was made available for adoption by local option in 1990. Local hospitality taxes, local accommodations taxes, and special purpose local sales taxes have been added as local revenue options in the last decade.

After court rulings that said municipalities could enact hospitality fees and other taxes without state approval, the General Assembly in the Fiscal Authority Act of 1997 limited local revenue sources to those approved by the legislature and put other limitations on local government's powers to raise revenue.

- In recent years local government's major source of revenue, the property tax, has been under attack by some taxpayers who are lobbying the legislature for additional relief from property taxes.

## ADMINISTRATION OF THE STATE REVENUE SYSTEM

- Administration of the state's tax system became the responsibility of the State Tax Commission in 1915. The commission was created to solve problems related to the chaotic administration of the state and local property tax system. However, longstanding problems with the equity of property tax assessment systems persisted until 1975.

In 1915 the commission immediately took on the responsibility of valuing business and industrial property. The State Board of Assessors, eliminated with the creation of the commission, previously performed this function. The new commission also was expected to work with local governments to solve longstanding inequities within the local property tax administration and assessment system.

In 1919 because the commission was overwhelmed with its responsibilities related to valuing business and industrial property, the General Assembly created the Joint Special Committee on Revenue and Taxation to evaluate South Carolina's total revenue system.

The Joint Special Committee on Revenue and Taxation became a model for and set the standard for committees, commissions, and consultants, who filled a similar role for seventy years. These groups provided guidance to the legislature as it developed today's revenue system. Their goal was to provide recommendations that produced a balanced and equitable revenue system while maintaining a system that provided adequate revenue to meet state needs and was not out of line with other southern states.

- In spite of many strong recommendations by the State Tax Commission and in the reports of tax study groups, the General Assembly did not reform the property tax assessment system to eliminate inequities and inconsistencies until 1975 when industries withheld tax payments to protest the inequities in the system.

In 1975, in Act 208 the legislature finally took the advice of many past tax study groups and reformed the property tax assessment system by making its application and administration equitable and uniform across the state. The act eliminated longstanding inequities by establishing a uniform property tax assessment system based on market value assessment as the constitution required. Act 208 set up a property classification system based on use, and each class of property was taxed based on an assess-



ment ratio for its classification. Assessment ratios ranged from 4 to 10.5 percent depending on a property's classification.

- In 1994, the Department of Revenue assumed the duties of the Tax Commission and became part of the governor's cabinet under restructuring. In addition to continuing to assess business and industrial property, the department administers state taxes, oversees local property tax assessment, and collects and distributes certain local taxes among other duties.

### **THE UNRAVELING OF SOUTH CAROLINA'S STATE AND LOCAL REVENUE SYSTEM**

- Today, evidence of the reformed, balanced, and equitable property tax system that legislators designed and the state's citizens supported under Act 208 of 1975 is difficult to find.

With the passage of Act 208 of 1975 major property tax reform embedded the current classified system of assessment in the constitution. All property was finally assessed at full market value as the constitution had always required. Assessment ratios were then applied to the assessed market value to determine the taxable value to which the property tax rate would be applied.

- The revenue structure that evolved between 1921 and 1985 has been significantly altered in the last 20 years in response to multiple concerns: local governments seeking a more diversified revenue base, tax protestors demanding relief on many fronts but chiefly from property taxes, and the search for greater economic development that called for tax incentives for new and expanding firms.
- The state responded to these concerns with a complex structure of state and local tax incentives for firms, the authorization of additional local revenue instruments, and a variety of forms of tax relief on the property tax, income tax (primarily for the elderly), and the sales tax (expanded exemptions).
- Property tax relief and industrial location incentives have significantly modified the distribution of the property tax burden embedded in the constitution in 1975. A lower assessment rate on personal vehicles, fee-in-lieu-of-tax agreements with new and expanding firms, property tax relief from school taxes for homeowners, and an expanded homestead exemption for the elderly were the major changes initiated in the 1990s.

- Subsequent legislative and constitutional changes have significantly altered the distribution of the property tax burden, raising equity issues. Tax relief of various kinds has also reduced state revenues making it difficult for the legislature to meet state funding needs.

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## HISTORICAL DEVELOPMENT OF SOUTH CAROLINA'S STATE AND LOCAL REVENUE SYSTEM

The South Carolina tax system dates back to the colonial era. In many ways it is like an old house that has been inherited, occasionally remodeled, and updated, but the essential structure remains intact beneath the surface. In the twentieth century, the legislature made three major remodeling efforts.

In 1921, the state began the process of phasing out use of the property tax for state purposes and reinstating the income tax at the state level. By World War II, the legislature had, for all practical purposes, turned the property tax over to local governments. In 1926 changes in the income tax formed the basis of today's state income tax.<sup>1</sup>

In 1951, the state added a sales and use tax, primarily to raise money for elementary and secondary school construction. Today South Carolina is one of forty states that rely on both a broad-based income tax and a broad-based sales tax as the foundation for state revenue.

The third remodeling effort began in the 1970s, as the state adjusted to federal court decisions that made South Carolina's system of county governance by the county legislative delegation untenable. Home rule came to counties and municipalities, making more taxing options available to counties. However, local governments still relied primarily on the property tax for revenue.

Municipalities and school districts, whose powers were already well defined either constitutionally or in law, experienced few changes as a result of the Home Rule Act. However, the powers of counties were significantly expanded.<sup>2</sup> A push for alternate revenue sources for local government in the seventies had its first success in 1984 when local governments gained access to revenue from an accommodations tax. But, disagreements over fiscal home rule continue to the present.

Between the three major changes in the system, various formal and informal groups and reports made suggestions and recommendations that shaped the form of the major remodel-

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<sup>1</sup>Act I of 1926, Income Tax Act. All acts cited are from South Carolina, *Acts and Joint Resolutions of the General Assembly of the State of South Carolina* (Columbia, S.C.: The State, 1776-).

<sup>2</sup>Holley Hewitt Ulbrich and Ada Louise Steirer, *Local Governments and Home Rule in South Carolina* (Clemson, S.C.: Strom Thurmond Institute of Government and Public Affairs, Clemson University, June 2004), 6.

elings.<sup>3</sup> But today South Carolina's state revenue system no longer resembles the system envisioned by its architects.

### THE COLONIAL ERA AND THE NINETEENTH CENTURY

The earliest revenue act in South Carolina appears to be that of June 8, 1682. It provided for a tax to raise four hundred pounds "for defraying the Publick Charges of this Province."<sup>4</sup> In the colonial period, the government did not provide schools and needed very little revenue except in times of danger when military action was required. Thus in 1702, the General Assembly levied a tax to raise two thousand pounds on personal estates and profits to finance an expedition against the Spanish in St. Augustine. A year later, an additional levy was imposed on furs, skins, liquours and other goods imported into or exported from the province for "defraying publick charges and expences of this Province and paying the debts due to the expedition against St. Augustine" (5).

Every few years thereafter, acts were passed to raise revenue, but to call the money-raising process a revenue system probably stretches the meaning of the word *system*. Not until 1758, with the outbreak of what is now generally known as the French and Indian War, did the colony undertake to raise substantial revenue. In that year, the appropriations act was intended to raise £166,438, a substantial amount of money for the time.

The Appropriations Act of 1760 established what might have been the state's first classification of property for tax purposes. Thirty-five shillings per head was levied on Negroes and other slaves. Thirty-five shillings per hundred acres was levied on land except town lots, for which the rate was seventeen shillings and six pence per centum on value. That rate was also applied to wharves, buildings and other lands within the limits of "any town, village or borough" (7).

An act passed in 1764, to be effective in 1766, placed a tax of one hundred pounds on slaves imported into the province. The act was largely aimed at reducing the importation of slaves at a time when a slave uprising was feared (7).

The first federal constitution after colonial independence made no mention of taxation with power implicitly left to the states. South Carolina's first revenue act after adoption of the Declaration of Independence adopted the following rates:

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<sup>3</sup>George H. Aull and Samuel M. Derrick, *The Fiscal System of South Carolina* (Columbia, S.C.: The State Planning Board, December 1939), 10-27. Also, South Carolina Preparedness for Peace Commission, *Report to the Governor and Members of the General Assembly* (Columbia, S.C.: The Commission, January 1945), 505. Also, Richard D. Young, *State Reorganization in South Carolina: Theories, History, Practices and Further Implications* (Columbia, S.C.: University of South Carolina, 2002), 8.

<sup>4</sup>A.S. Salley Jr, *The Methods of Raising Taxes in South Carolina Prior to 1868*, Bulletin 7 (Columbia, S.C.: Historical Commission of South Carolina, 1925), 4.

Ten shillings per head on all Negroes and other slaves  
Ten shillings per hundred acres on all land, except town lots  
Ten shillings on all free Negroes, mulattoes and mestizoes from ten to 60 years of age  
Five shillings for every hundred pounds on the value of town lots, wharfs and buildings  
Five shillings on every hundred pounds owed to any person on bonds or notes bearing interest  
Five shillings on every hundred pounds of stock in trade, wares and merchandise  
Five shillings per centum on profits of all professions (clergy excepted) (7-8)

The act effectively taxed the range of assets evident in the citizenry, including professional skills. It is worth noting that the last tax on the list was effectively an income tax. In the main, however, the revenue was raised from a combination of taxes on property and poll taxes.

After independence, state taxation began to be more innovative. Taxes were enacted on “carts, wagons, and drays” and on theatrical performances. Special increased taxes were placed on absentee property owners so that they paid four times as much as residents (10-11).

During the Civil War, taxes were increased substantially. After the war, a new state constitution in 1868 specifically gave the General Assembly power to

... provide by law for a uniform and equal rate of assessment and taxation, and ... prescribe such regulations as shall secure a just valuation for taxation of all property, real, personal, and possessory, except mines and mining claims, the proceeds of which alone shall be taxed; and also excepting such property as may be exempted for municipal, educational, literary, scientific, religious, or charitable purposes.

That same language from the 1868 constitution was essentially embedded in the constitution of 1895 with a proviso that allowed the General Assembly to establish graduated income and occupational taxes (8).

## THE TWENTIETH CENTURY

During the first half of the twentieth century, the state legislature focused on setting up a system of taxes which would adequately meet the needs of government, tax citizens according to their ability to pay, see that all sectors of the citizenry and economy contributed to the support of local and state government, and eliminate the inequalities created by lax attention to the legal requirement for property assessment at 100 percent of value. The early years focused on dealing with problems related to collection of personal and real property taxes, which along with the poll tax continued to provide almost all state government revenue.

In addition to the property tax, four other taxes and fees contributed about 18 percent of revenue to the state budget by 1919.<sup>5</sup> Insurance license fees and the fertilizer tax were imposed at the end of the nineteenth century. Corporation license fees began in 1904 and automobile registration fees were initiated in 1917 and expanded to trucks within three years (378).

### **THE SOUTH CAROLINA TAX COMMISSION—1915**

In 1915, the legislature created the South Carolina Tax Commission (now the Department of Revenue), which took on the duties of the former State Board of Assessors. Reform of property assessment systems to eliminate inequities and to provide uniformity, the first task taken on by the commission, presented great difficulties. In the process of reform, the commission was also able to add property to the tax rolls that had been escaping taxation.<sup>6</sup>

The commission's work to determine the gross receipts of all utilities and transportation companies for business conducted in the state in 1914 enabled the commission to ascertain the license payments due from companies engaged in interstate commerce in the state. Although eight railroad companies sued, uncontested assessments on receipts of corporations for 1914 totaled \$98 million. Railroads' assessment was \$43.9 million of the total. As a result of the commission's valuation, 1915 assessments were \$9.4 million higher (4-6, 38).

The constitution required property to be assessed at 100 percent of value, but in valuing the state's financial institutions the commission settled on assessment at 50 percent of value of capital, surplus and undivided profits. The assessment at full value would have created other problems.

Because the constitution set a three-mill tax for school purposes and the legislature set its mill rate before assessments were made, an equalized system based on the 100 percent assessment requirement would have produced revenue far in excess of the needs of schools and state government. The commission pointed out in its 1915 report:

The abolition of an arbitrary Constitutional 3 mill school tax, and the authorization of a flexible levy to meet the amount of appropriations made by the General Assembly for State, County and School purposes, is essential to a satisfactory re-adjustment and reform of present taxing methods in this State, and to an equitable assessment and taxation of property for the purpose of meeting the annual appropriations, and the avoidance of inequalities and unnecessary taxation (13-14).

The commission felt the General Assembly should be given more flexibility in using its fiscal powers rather than embedding too many specifics in the constitution.

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<sup>5</sup>Preparedness for Peace Commission, *Report to the Governor*, 374.

<sup>6</sup>S.C. Tax Commission, *First Annual Report of the South Carolina Tax Commission to the Governor and General Assembly, 1915* (Columbia, S.C: The Commission, 1916), 20, 22.

The inequalities the commission was trying to eliminate are obvious in the 1914 assessments for 1913: railroads assessed at 19.84 percent of value, textile industries at 23.58 percent, and real property and improvements at 32.06 percent (17). Real and particular personal property that was assessed by the counties also reflected inequalities even though reassessment occurred in 1914. County boards just followed what had been done in previous years.

Most local boards of equalization made little attempt to clear up inequities between counties. For example, horses and mules in Pickens County were valued at \$28.70 a head, but in Georgetown County at \$86.48 a head. Aiken County assessed land at 50 percent of market value, while Chester County was trying to equalize land assessments at one-third of market value. Colleton County used a flat assessment of \$2.00 per acre, but in other counties land assessments varied based on location and use. In Williamsburg County assessments ranged from 50 cents to \$50.00 per acre (17-19).

The problems with the system of taxation assessment outlined in the Tax Commission's first report were echoed frequently in following annual reports of the commission, which repeated concerns about property escaping taxation, assessment inequities, and constitutional limitations on the legislature's ability to solve the problems. In addition, the legislature did not always appropriate funds enabling the commission to exercise its powers. It was especially difficult to make the real property assessments fairer because the state had not been officially surveyed and mapped since 1825 (25).

### THE JOINT SPECIAL COMMITTEE ON REVENUE AND TAXATION—1920

The first and perhaps most important tax reform effort in the state reflected the work of the Joint Special Committee on Revenue and Taxation, a special legislative committee appointed by the General Assembly in its 1920 session. The adoption of a revised state income tax and the decision to phase out state dependence upon the property tax soon followed the committee's report to the 1921 legislative session. Like most of the state's tax reform efforts, the study produced an agenda of legislative steps that was attacked in phases.<sup>7</sup> During the 1920s and 1930s, the General Assembly added taxes on:

- 1922—inheritance, income (replacing the 1897 tax repealed in 1918), gasoline, and corporate licenses
- 1923—ammunition, candy, and admissions
- 1924—billiards, pocket billiards, mining, and manufacturing
- 1925—soft drinks and cosmetics
- 1927—contractors' licenses, sporting goods, and glassware
- 1928—chain stores
- 1930—radio licenses and vending machines

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<sup>7</sup>South Carolina Tax Commission, *General History of Taxes, 1987* (Columbia, S.C.: Administration-Research, The Commission, 1987), 3-6.



1931—electric power  
1933—beer and wine  
1935—alcoholic liquors  
1937—bank tax  
1939—coin-operated devices

Many of these taxes—especially the ones on retail purchases—have been repealed, some within several years of passage. The soft drink tax was repealed in the nineties. The income tax, the gasoline tax, and the alcoholic liquors and beer and wine taxes are integral parts of the current tax system.

The deflation that followed World War I and a decrease in cotton production had put significant pressure on agricultural operations prompting the legislature to consider introducing an income tax to give some relief from property taxes (3-4). The tax, adopted in 1922, was based on the federal tax act of 1921. It taxed persons and corporations at one-third of the amount paid in federal taxes. In 1926, the state developed its own system, taxing a percentage of personal and corporate income (135-136).

How did the General Assembly decide that such an expanded and varied menu of taxes was warranted? The 1921 report presented extensive analysis that had not been easily available before the enactment of the budget act in 1919, which required the compilation of fiscal data for the first time.<sup>8</sup>

While, the committee on revenue and taxation noted, taxpayers were aware that towns, cities, and school districts were almost totally dependent on property taxes, they were not aware of the extent to which the state general fund also depended on the tax. The committee's analysis of the 1920 appropriations act revealed that of the \$6 million appropriated "every dollar, except a little more than one million dollars, had to be raised by a direct tax upon property." If the analysis had included the three-mill constitutionally mandated school tax or the earmarked two-mill road tax or 80 percent of the automobile license road tax, the state's dependence on the property tax would have been even more dramatic. However, because the revenue from these taxes was spent in the counties, they were not included in the analysis (11).

The committee strongly stated that the state was overly dependent on the property tax and that this tax was failing to provide adequate revenue for the state even though it was not "a pauper colony." The committee pointed out that South Carolina was "spending approximately 2½ times less than the average American Commonwealth for State purposes" and was "probably doing less for its people through governmental agencies than they are enti-

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<sup>8</sup>South Carolina, General Assembly, *Report of the Joint Special Committee on Revenue and Taxation* (Columbia, S.C.: The Committee, 1921), 9.

tled to.” These reasons among others made a *prima facie* case for the committee’s examination of the tax system (16).

When it came to determining whether one industry was shouldering more of the tax burden than it should, the committee confessed it was not able to answer the question. However, if relative tax burdens were compared, inequities seemed obvious: in 1919 merchants’ total property was listed at a value of \$32.7 million, “while the farmers’ mules and horses alone were assessed at \$17.2 million” (41). Part of the problem was, also, that some property—especially farmers’ property—was more visible than other property that could easily be hidden from the tax collector.

As long as the system relied on taxpayers to list taxable property and income for the assessor with no organized system of determining the accuracy of their reports, the loss of revenue from property not reported or undervalued increased the burden on other classes of property or on honest persons. The committee noted that a study of the property tax system would not be complete without including suggestions for the administration of the assessment system (52-54).

The changes adopted after this report focused on restructuring the income tax so that people could not avoid payment, added an inheritance tax (succession tax on inherited assets), and targeted taxation toward items and activities that were not necessities for the ordinary citizen. The taxes on corporations, electric power, contractors, and banks were allowed under the constitutional clause permitting “graduated licenses on occupations and business” (128-135).

In 1932 a change in the constitution removed the property tax on intangible personal property such as stocks, bonds, and mortgages, which frequently escaped taxation, but the state taxed their proceeds as income.<sup>9</sup> The constitutional requirement for a three-mill tax for funding the schools was eliminated in 1939,<sup>10</sup> finally enabling the state to completely give up the property tax as a revenue source in 1940.<sup>11</sup>

The Joint Special Committee hoped that

by a judicious combination of a moderate property tax, a moderate personal income tax and a moderate tax upon business, one mode of taxation dovetailing with and supplementing the other, the tax burden of the State can be more justly and equitably distributed . . . .<sup>12</sup>

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<sup>9</sup>Aull and Derrick, *Fiscal System of South Carolina*, 76-77.

<sup>10</sup>Aull and Derrick, *An Appraisal of the Tax System of South Carolina* (Clemson, S.C.: South Carolina Council for Research, October 1940), n.p. [!].

<sup>11</sup>Tax Commission, *General History of Taxes*, 7.

<sup>12</sup>General Assembly, *Report of the Joint Special Committee*, 135.

The committee saw the income tax as a replacement for the state property tax, which they viewed as more appropriately reserved for funding local governments (92).

The new taxes in the twenties and early thirties broadened the tax base considerably; however twenty years after the 1920 report, the General Assembly had not yet dealt with administration and operation of the property tax system, especially property assessment problems.<sup>13</sup> This system was described in the 1921 report to the General Assembly as “as much of an outlaw business as the gentle art of cracking safes or of distilling moonshine whiskey.” The General Assembly had not yet decided “either to conform the law to the facts or the facts to the law” as the 1920 report had recommended.<sup>14</sup>

### **THE COMMITTEE OF NINE—1939**

As the forties approached, the state embarked on another look at the state’s tax system. In appointing a special committee, informally called the Committee of Nine, at the request of the governor in February of 1939, the joint resolution of the legislature mentioned “reducing the expenses of the State by consolidation of departments and offices” and creating a more equitable system of taxation “by eliminating some of the taxes under the present system and adopting new sources of revenue.”<sup>15</sup>

However, in a preliminary report on March 14, 1939, the committee stated that the more pressing problem was to provide adequate revenue to replace those lost with end of the five-mill state property tax, which had provided \$1.8 million in revenue. The state also had to fund the new program of public assistance approved by the electors. Title I of the 1935 Social Security Act included a federal public assistance program of matching grants to states for aid to the elderly (50 percent match), the needy blind (50 percent match), and dependent children (33 1/3 percent match). The state had funded the program in 1937-38 with \$1.134 million.<sup>16</sup>

The committee suggested allocating 20 percent of the cost of the public assistance program, which was usually provided locally, to local governments while the state would pay 80 percent. The proposal would have required local governments to provide \$1.1 million for public assistance. The committee suggested local governments earmark a one percent local property tax and the increased alcohol taxes now being allocated to them by the state to cover costs of public assistance (3-4, 15-19).

The state would pay its \$4.4 million share by lowering income tax personal exemptions, raising taxes on alcohol and amusements, eliminating crown tax discounts, and retaining

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<sup>13</sup>Aull and Derrick, *Fiscal System of South Carolina*, 91-92.

<sup>14</sup>General Assembly, *Report of the Joint Special Committee*, 25.

<sup>15</sup>Aull and Derrick, *Fiscal System of South Carolina*, 25.

<sup>16</sup>South Carolina, General Assembly, *A General Survey and Investigation of the Tax Situation in South Carolina* (Columbia, S.C.: General Assembly, March 14, 1939), 3-4.

part of the gasoline tax and automobile license revenue for the general fund (4-10). The only suggestions the legislature appears to have taken were to increase the alcoholic liquors tax, estimated to raise \$500,000 dollars, and to retain a small portion of the gasoline tax and automobile license revenue for the general fund. In fact, in spite of widespread discussion and approval of the report's recommendations, the legislature denied requests to provide funds to continue the committee's work.<sup>17</sup>

Since 1924, all gasoline tax revenue had gone to the State Highway Department. The committee pointed out that in 1939-40, 44 percent of revenue in the general fund, school fund, and highway fund was spent on highways (not including federal funds).<sup>18</sup> This was comparable, the report said, "to a family with an annual income of \$2,000 spending from \$800 to \$1000 of it on an automobile" (8).

Again, the benefits of properly assessing local properties at 100 percent of their value were mentioned. Taxes could then be reduced for the overtaxed and increased for those most able to pay (12). A sales tax was strongly discouraged as having "no place in the tax system of this state" because the tax "rests more heavily upon the poor, who necessarily spend all that they have, than upon the wealthy, who spend only a fraction of their total income" (10).

#### **SOUTH CAROLINA STATE PLANNING BOARD AND SOUTH CAROLINA COUNCIL FOR RESEARCH REPORTS—1939**

After the Committee of Nine disbanded, George H. Aull and Samuel M. Derrick, the governor's appointees to the committee, completed two additional reports addressing the legislature's question. In October 1939 the South Carolina Council for Research published *An Appraisal of the Tax System of South Carolina*, and in December the South Carolina State Planning Board published *The Fiscal System of South Carolina*. The foreword to the planning board report acknowledged that the tax structure "does not need a complete overhauling."<sup>19</sup>

As in past reports, much emphasis was placed on administration of the property tax. The authors noted that the General Assembly had implemented almost all the recommendations of the 1920 report except those related to the administration of the property tax. Other notable reports in the thirties made similar recommendations about the property tax to no avail.

The State Planning Board in recommending thirteen of Aull and Derrick's twenty-three recommendations to the General Assembly included property tax recommendations simi-

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<sup>17</sup>Aull and Derrick, *Fiscal System of South Carolina*, 27.

<sup>18</sup>General Assembly, *General Survey and Investigation*, 7-8.

<sup>19</sup>Aull and Derrick, *Fiscal System of South Carolina*, 4.

lar to those offered in the past. No recommendations were included in regards to the question of “reducing the expenses of the state.” Aull and Derrick found that “opportunities for any considerable reduction in public expenditures are very limited” (84). Among their major recommendations were:

- Adoption of a classified property tax system and the institution of scientific methods of assessment
- Provisions for a careful and accurate survey of all property, taxable and nontaxable and that more serious consideration be given to specific properties, which are to be legally exempted from taxation
- Avoidance of a general sales tax
- Abolition of the poll tax
- Study of existing statutes on the taxation of insurance companies for simplification and improvement (5)

Institution of scientific methods of assessment wasn’t hard to justify. The comptroller general’s reports showed that assessed valuation of all property in the state had fallen from \$448.2 million in 1920 to \$365.4 million in 1938 (108). However, it would be more than thirty years before the legislature addressed the inequalities of the property tax system.

The fact that farmers as a class were relatively large holders of taxable property might have explained some of the hesitancy on the part of the General Assembly to reform property tax administration. The analysis of farmers’ taxation problems was also complex and, perhaps, difficult to understand and to explain to the public. For example, research by the S.C. Agricultural Experiment Station<sup>20</sup> showed farms reporting income of \$500 and higher with relatively high acreage and investments “paid taxes which were relatively low both in proportion to income and to investment.”<sup>21</sup> Among other things, their per-acre property assessments were lower than those of farmers with small acreages (19).

A consequence of the breakdown of the property tax assessment system, and also a growing tax delinquency, was pressure for the state to fund services formerly provided by the counties, such as public education and highway construction and maintenance. However, in 1937 a writer for Dun and Bradstreet, Inc. clearly stated another reason:

The State, as the sovereign unit, not only has more varied resources to draw upon than any of its subordinate units, but it has broad powers of taxation enabling it to tax sources of wealth over which the municipalities (counties and local units) have no taxing power.<sup>22</sup>

With 64.5 percent of its revenue earmarked, the state also was losing flexibility and the ability to fund activities not supported by earmarked monies.<sup>23</sup>

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<sup>20</sup>George H. Aull, *Some Economic Characteristics of Owner Operated Farms in South Carolina*, Bulletin 316 (Clemson, S.C.: Agricultural Experiment Station, Clemson College, October 1938).

<sup>21</sup>Aull and Derrick, *Fiscal System of South Carolina*, 22.

<sup>22</sup>Edna Trull, *Resources and Debts of the Forty-Eight States* (New York: Dun and Bradstreet, Inc., 1937), 6. Quoted in Aull and Derrick, *Fiscal System of South Carolina*, 37.

<sup>23</sup>Aull and Derrick, *Fiscal System of South Carolina*, 50-51.

In the final analysis, the report gave a rating of “not particularly bad” to the state’s revenue system:

It is as good, if not measurably better, than that of a large number of States in the nation. It reaches a large proportion of citizens of the State, it is relatively adaptable to changing economic conditions, and it obeys in the main the “ability to pay” principle and it produces reasonably adequate funds for the support of governmental activities (51).

Although a look at statistics on industrial development in the state did not indicate that South Carolina was “less favorable to industrial development than other States,” (35-37) the committee addressed the findings of a report prepared for J.E. Sirrine and Company of Greenville alleging otherwise. Aull and Derrick relied on research at Clemson College looking at the factors affecting location decisions and critiqued the report’s assumptions to bolster their findings.

A publication of the State Planning Board (now the S.C. Department of Commerce) in 1943 supported Aull and Derrick’s findings. The department surveyed all forty-six counties to see whether tax exemptions were effective in attracting industry. The board found, that forty-three granted industrial tax exemptions for property tax for a time to new industries. Horry, Jasper, and Dillon counties, predominantly agricultural, did not grant such exemptions.<sup>24</sup> With sixteen counties replying, the board concluded: “All in all and regarding the returns actually made as an average cross section for the State, it appears to be the considered and collective opinion of the majority of the counties that tax exemptions do not have a controlling influence in locating industry” (8).

In his transmittal letter to Governor Olin D. Johnston and the General Assembly, Robert L. Sumwalt, chairman of the State Planning Board began: “It is rather unusual for an industrial development agency . . . to develop the fact that increased taxes might be favorable and desirable rather than a decrease.” The board’s director in checking out perceptions that taxes were not equitable in South Carolina reported “personal property or inventory taxes were out of line because of inequitable local assessments” (20).

When it came to local taxes, how could an industry compare locations? Information about local assessments and mill rates were in the hands of various local governments, not standardized across the state, and not compiled by the state. Under the existing systems some local governments might have low assessments and high millage and vice versa as well as separate levies for “schools, sewers, highways, levees, etc.”<sup>25</sup> In this tax climate, outsiders might misinterpret high local mill rates as high taxation. For business and industrial property valued at the state level that could mean location in some counties would be more desirable than others. Some larger industries did not favor tax exemptions “as the practice

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<sup>24</sup>South Carolina, State Planning Board, *Is New Industry Tax Exemption Effective?*, Pamphlet No. 9 (Columbia, S.C.: The Board, May 1943), 10.

<sup>25</sup>Aull and Derrick, *Fiscal System of South Carolina*, 70.

would in the long run result in higher taxes to existing industries, which, in time, would include themselves.”<sup>26</sup>

### **PREPAREDNESS FOR PEACE COMMISSION—1942**

In 1942, the legislature was concerned about how to plan for “a peacetime economy and the provision for full employment for veterans and others in the post-war [World War II] economy and the provision for full employment for veterans and others in the post-war period.” The General Assembly created a Preparedness for Peace Commission whose first report, January 1945, outlined the commission’s findings on the organization and administration of state government and the state’s tax system. General proposals for shaping a peacetime economy, to be pursued in more detail in the future, were outlined.

After 1919 revenue from taxes and fee revenue rose steadily until the Great Depression. Revenue began to recover in 1936 so that by 1942 tax receipts of \$45.8 million were double the 1930 predepression revenue of \$23.0 million. During this period few new taxes were added, but the “expansion of business and industry due to the war” made the difference.<sup>27</sup>

Although the state levied almost one hundred “separate taxes, licenses and fees directly imposed by state laws,” the income tax and the gasoline tax provided more than 50 percent of state receipts in 1943 (399). By then income tax revenue, personal and corporate, of \$12.5 million or 27.3 percent of revenue (379) finally surpassed gasoline tax revenue that had become the main source of revenue in 1928. Local governments were still largely dependent on the property tax. By that time the poll tax was the only tax mandated by the constitution (402).

When compared to other states in 1941, South Carolina ranked forty-second with per capita state revenue of \$21.66. With \$13.95 revenue per capita, local governments ranked forty-fourth (445). But, the economic ability to pay taxes was also low (505).

The report of the South Carolina Preparedness for Peace Commission noted that the state’s tax structure was “in line with other states and compares quite favorably” and was flexible. As in previous reports, high marks were given for attention to the “ability to pay principle” (504).

However, the report had harsh words for the property tax system. The system was again faulted for being “inequitably imposed and regressive in its operation, inadequately administered, evaded to a large extent and characterized by a large amount of delinquency” (504-

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<sup>26</sup>State Planning Board, *Is Tax Exemption Effective?*, 20-21.

<sup>27</sup>Preparedness for Peace Commission, *Report to the Governor*, 392-393.

505). The report spent forty-eight pages examining and illustrating the problems with the property tax and emphasized that changes had to be made in its administration (525-573).

### **SOUTH CAROLINA'S DUAL SCHOOL SYSTEM—1944**

In the forties another upheaval was simmering that would stress the state's revenue system—the financial costs of maintaining a school system segregated by race. According to the 1895 constitution, “separate schools shall be provided for children of the white and colored races, and no child of either race shall ever be permitted to attend a school provided for children of the other race.” The problems of unequal finance among school districts, often noted in tax study reports and ignored, would also come to a head. In some districts the three-mill mandated school tax produced less than the one dollar per child.

A federal court decision in 1944 and pressure from proactive black educators and citizens pushed elected officials for parity in salary for black and white school personnel and other improvements in Negro schools. The state's elected leadership responded by trying to find solutions to ward off a change in the state's dual school system.<sup>28</sup>

The financial challenge public officials were facing was daunting. In 1949, the state spent \$111 per pupil for white students and \$50 per Negro student (21). The cost of maintaining the state's separate schools would rise dramatically as the state quickly worked to narrow the differences between schools for white and Negro children to prove that the schools were indeed “separate, but equal.”

A 1948 study by the Peabody Commission added more pressure for costly educational reform. Like the House study committee in 1939, it urged a program to fund the schools on an equal basis since value of local property assessments varied greatly between the more prosperous counties and the poorest counties. The commission also recommended a major building program<sup>29</sup> and the consolidation of the state's 1700 school districts, a number that was deemed “wasteful and inefficient” (167-172).

But, other issues were on the minds of South Carolina's politicians and citizens. In October 1947 President Harry S. Truman's Committee on Civil Rights made Southerners more than angry. It backed desegregation of public accommodations, fair employment practices, repeal of poll taxes, and anti-lynching legislation. The South's answer to the national Democratic Party was J. Strom Thurmond's campaign for president as the candidate of the

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<sup>28</sup>Virginia Ward, editor, *The History of South Carolina Schools: A Tragic Tale*, n.d., 21 <<http://www.cerra.org/publications.asp>> (May 2005) S.C. Center for Teacher Recruitment, Winthrop University.

<sup>29</sup>South Carolina, Education Survey Committee, *Public Schools in South Carolina: A Report* (Nashville, Tennessee: George Peabody College for Teachers, 1948), 313-328.



States Rights Party.<sup>30</sup> The political and social turmoil associated with the States Rights Party campaign of 1948 would continue into the fifties.

Although South Carolina's General Assembly took no action on the Peabody Commission's recommendation, which it considered too expensive, it appointed a committee chaired by Ernest F. Hollings, then a member of the U.S. House of Representatives, to study the issue further. When the Hollings Committee (Committee Appointed to Study Ways and Means to Provide for Public School Education Needs) reported in 1951, its major recommendation was a three-cent sales tax dedicated to education in order to finance a school building program, increased teachers' pay, and a statewide school transportation system. The committee suggested that monies not needed for the education program be used for other state needs.<sup>31</sup>

James F. Byrnes, a nationally prominent South Carolinian, who had served in the administrations of presidents Franklin Delano Roosevelt and Truman, was elected South Carolina's governor in November 1950. Part of his platform was support of a three-cent sales tax to upgrade Negro schools.

In his inaugural address, Governor Byrnes asked the legislature to ratify a change to the state constitution approved by the voters in the recent Democratic primary: the repeal of the long-standing poll tax. The legislature later honored his request. But the major domestic issue addressed related to improvement of the schools:

One cannot speak frankly on this subject without mentioning the race problem. It is our duty to provide for the races substantial equality in school facilities. We should do it because it is right. For me that is sufficient reason. If any person wants an additional reason, I say it is wise.<sup>32</sup>

The governor went on to emphasize that the state constitution required separate schools and that the United States Supreme Court had ruled in 1896 (in *Plessy v. Ferguson*) that separate schools were permitted if they were equal.

A grade school education, at a minimum, should be available to every "white or colored" child in the state, Byrnes stated. And a \$75 million state building program would provide equal facilities. He expressed his hope that law suits pending in the state and at the federal level would not change the status quo, and that "if in a given case there is shown an honest

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<sup>30</sup>William D. Workman Jr, *The Bishop From Barnwell: The Political Life and Times of Senator Edgar A. Brown* (Columbia, S.C.: R.L. Bryan Company, 1963), 140 ff.

<sup>31</sup>South Carolina, General Assembly, House of Representatives, Committee Appointed to Study Ways and Means to Provide for Public School Education Needs, *Report of Committee Appointed to Study Ways and Means to Provide for Public School Education Needs* (Columbia, S.C.: The Committee, 1951?), 5-6.

<sup>32</sup>South Carolina, Governor (1951-1955: Byrnes), *Inaugural Address of the Honorable James F. Byrnes as Governor of South Carolina* (Columbia, S.C.: January 16, 1951), 2.

effort to provide substantially equal facilities, it will favorably influence the opinion of the Court” (2-3).

Having voted down a sales tax in its previous session,<sup>33</sup> the General Assembly did what Governor Byrnes urged in April 1951. They passed a three-cent sales tax to fund a massive school building program to bring school facilities for “colored” children up to the standard of schools for white children. The proceeds of the tax would fund “in a short time what should have been done during the previous 75 years” ([18]). By 1954 only one other state was outspending South Carolina, measured in per capita spending in relation to income ([29]).

A new State Educational Finance Commission allocated the revenue from the new sales tax ([18]). A requirement that school districts should “be consolidated so as to create reasonable and economic units for school administration” in order to receive funds caused some resistance. However, by 1954 the state’s 1,220 school districts had been consolidated into 102. Dr. E. R. Crow, director of the commission, estimated the program would cost \$200 million based on \$20 per pupil per year over a 20-year period ([22]).

The new state sales tax boosted state revenue collections by 45 percent in its initial year. Prior to the adoption of the sales tax by the General Assembly, total tax collections for the general fund were \$94.2 million dollars for the fiscal year ending June 30, 1951. The income tax brought in \$25.5 million in revenue and the gasoline tax \$32.5 million.<sup>34</sup> The next fiscal year, after the adoption of the sales tax, revenue rose to \$137.2 million. The sales and use tax alone brought in \$37.6 million, \$8.3 million more than the income tax and slightly more than the gasoline tax of \$36.7 million.<sup>35</sup>

The tax would fund a remarkable school building program: “between 1951 and 1954, the state committed \$100 million to build 200 Negro and 70 white schools and to improve another 250 schools for both races.”<sup>36</sup> In rural areas 276 inferior white schools and 537 schools for Negroes were abandoned. Most were one-room schools.<sup>37</sup> A new school bus system “offered blacks public transportation to school for the first time in the state’s history, making it possible for African American students in rural areas to reach consolidated high schools.”<sup>38</sup>

Governor Byrnes’ hope that change would not come was dashed when in 1954 the Supreme Court ruled that “separate educational facilities were inherently unequal” (23). The

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<sup>33</sup>South Carolina, State Educational Finance Commission, *South Carolina’s Educational Revolution: A Report of Progress in South Carolina* (Columbia, S.C.: The Commission, 1954), n.p. [6].

<sup>34</sup>South Carolina Tax Commission, *Annual Report, 1951* (Columbia, S.C.: The Commission, 1951), 4.

<sup>35</sup>South Carolina Tax Commission, *Annual Report, 1952* (Columbia, S.C.: The Commission, 1952), 4.

<sup>36</sup>Ward, *History of South Carolina Schools*, 22.

<sup>37</sup>Educational Finance Commission, *South Carolina’s Educational Revolution*, n.p. [1].

<sup>38</sup>Ward, *History of South Carolina Schools*, 22.

sales tax, sold as an education tax at that time but not earmarked for education, would continue to be perceived by the public as an education tax. However, new buildings alone would not improve the quality of education for South Carolina's children. The issue of the adequacy of the sales tax to meet continuing shortcomings in the state's education system would be revisited in 1969 and 1984.

### **THE GRIFFENHAGEN REPORT—1955**

In 1955 the legislature got specific when funding another tax study for the state. It said it wanted the Tax Commission to “engage the services of a recognized firm of experts familiar with the problems of property tax assessments to make a statewide survey regarding equalization of property tax assessments.” They engaged Griffenhagen and Associates of Columbia for the task of looking at a system that had not changed since colonial days.<sup>39</sup>

The consultant's work was comprehensive and specific: a survey of county auditors and others from all forty-six counties, city and school officials, as well as owners of various classes of business, and a review of state-level assessment functions which were critical to the generation of local revenue (1). The report recommended a system and a model for re-assessment (16 ff.) that shaped the legislature's Act 208 of 1975 and constitutional changes based on it. Griffenhagen's major recommendation was the approval of “a pending amendment of the state constitution to permit classification of property for taxation” (xiii). The report was supported by thirty-three charts and tables of data gathered from local and state sources.

The report pointed out that the economy of the state was benefiting from “a period of rising income and new taxable wealth,” but much of the new property value was escaping taxation because of underassessment (xii). Like many reports before it, this report cataloged the shortcomings of the decades old local assessment system (xii) and applauded the practice of assessing business and industrial property at the state level “without, up to the present time, interfering with virtually complete local autonomy respecting tax rates and assessment of the property tax on farms and other local real estate” (1). It viewed this system of state assessment as a positive factor in the state's expanding industrial development.

The importance of local governments to the economy was also stressed because “one of the requirements of industry coming to South Carolina is likely to be a desirable home community, judged by every standard the corporation officials can apply.” It was this discovery that seemed to be making the assessment system “a political issue” (4). Three classes of property—“houses, lots (and suburban acreage), and timber”—were under-assessed by hundreds of millions of dollars, according to the report, and some taxpayers were paying twice the amount as others holding the same type of property. Merchants who

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<sup>39</sup>Griffenhagen and Associates, *Survey and Recommendations Relating to Equalization of Property Tax Assessments in South Carolina* (Columbia, S.C.: S.C. Tax Commission, 1956), v, 7.

reported their inventories and owners of motor vehicles, if assessed, were paying double (6).

Modernizing of county governments was judged essential because of their assessment responsibilities that affected the abilities of municipalities and school trustees to raise revenue to support their functions. Since counties received large amounts of state aid, they had little incentive to fix the assessment system (3).

Cities often employed their own assessors to keep property valuations current. They received no state aid to speak of at this point, not even for highways (3), so it was in their interest to have a more efficient system. The report noted that Charleston, Berkeley, Georgetown, Horry, and Marlboro counties were adding employees to do assessing, while larger cities like Columbia, Greenville, Greenwood, and Anderson were doing tax mapping (8-9).

The fear of high property taxes was acknowledged as a valid concern, but an adequate system of state aid and frequent reassessment should provide additional money to keep taxes steady. As it was, counties were not completing the now required four-year assessment schedule in any meaningful way. Finding other sources of revenue was also judged essential to keeping the property tax within bounds, especially since growth meant local governments needed to finance new and expanded services. Adequate state aid was also necessary to keep the property tax low (13-15).

The Griffenhagen report recommended that the legislature create a tax study commission to review the state's tax system. In 1958, the General Assembly responded. The charge to the committee was extensive:

... to provide a more easily understandable and workable system of revenue laws ... to propose such changes as necessary in order to make South Carolina's revenue system stable, equitable, and fair when compared with structures of other states; to study alternate sources of revenue found in the tax structures of other states, and to make recommendations for long range revenue planning.<sup>40</sup>

### **SOUTH CAROLINA TAX STUDY COMMISSION—1959 TO 1966**

In 1959, a newly appointed commission began work by holding statewide hearings and bringing relevant officials and interest groups to the table. The work of this commission would stretch over seven years. The commission began work as the state was enjoying phenomenal growth in revenue and industrial expansion, bringing the state one of its "most

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<sup>40</sup>S.C. Tax Study Commission, *Fourth Annual Report of the South Carolina Tax Study Commission to the 1963 General Assembly* (Columbia, S.C.: The Commission, February 1963), 7.

prosperous years in history.” The commission applauded the state’s strong fiscal policies as responsible.<sup>41</sup>

In its first report to the 1960 General Assembly, the S.C. Tax Study Commission noted that they had not “necessarily discarded” many of the comments and ideas they had heard over the past year. “Correcting inequities and ironing out wrinkles in our tax structure is a complicated procedure and takes time,” the commission reported (8).

First priority in 1960 was, as always, the property tax with its administrative and assessment inequities. The tax study commission reminded the legislature of the long history of recommendations related to the property tax, beginning in 1920 to the present day when the legislature had again appointed tax study committees in 1951, 1953, 1957, and 1958 (16-17).

The commission provided proposed legislation to repeal any references in the state constitution to uniform taxation so that a classified system could be developed by the legislature. The preparation of assessment guides and other help to county assessors were also proposed as a way to equalize assessments (19-21). The commission deplored the methods for taxation of automobiles and merchants’ inventories, the only property then assessed at 100 percent of value, as past study committees had (20-21).

A “complete rewrite, modernization and codification of the income tax” was the first item of next year’s agenda [1961] because an update of the state code was going to press in late 1961 (9). The income tax cried out for simplification, according to taxpayers across the state. Many supported using the federal tax rules in order to simplify the filing of state income tax returns. The tax study commission favored some minor changes, reserving major recommendations for change until the next year (25-27).

Over the years, recommendations to repeal parts of the constitution to vest the design of a classified property tax system in the legislature did not attract the support of the General Assembly. This was the approach that creators of *model* constitutions were touting as providing flexibility to states.

It is not clear whether the South Carolina legislature did not want the responsibility or the legislature perceived the populace would not be willing to approve the change. When the legislature did not address the suggested change, the commission commented in its 1961 report:

The basic fault doesn’t lie in any one law or any one person but more in just plain inertia. Few in authority are willing to attempt to unravel the tangle. The failure of the property tax

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<sup>41</sup>S.C. Tax Study Commission, *First Annual Report of the South Carolina Tax Study Commission to the 1960 General Assembly* (Columbia, S.C.: The Commission, January 1960), 6.

system to provide adequate funds at the local level of government lies at the bottom of our educational financing problems; fosters large scale reliance by local governments on state funds; provides opportunity for favoritism in assessments for political gain; all but precludes extensive state-level tax reform, and effectively thwarts long range planning for the capital needs of the state.<sup>42</sup>

In its 1962 report, the study commission evaluated the sales tax as reasonable, easy to collect, and hard to evade. The increasing number of exemptions troubled the commissioners, who worried about erosion of the tax base. New exemptions were routinely added rather than questioning the existing exemption of a similar product. At a minimum, they advised that removing an exemption should be considered as an option if an inequity existed between an exempt and a nonexempt product.<sup>43</sup>

The tax study commission's fourth annual report counted among its successes: effecting administrative change, bringing the state income tax regulations closer to those of the federal tax, substituting a new estate tax for the inheritance tax, and making progress toward more equitable merchants' inventory assessments and achieving better compliance in personal property taxes on automobiles. It was pleased that the "vast majority" of its recommendations had been viewed positively by the General Assembly.<sup>44</sup>

Notably absent was a major change in property tax administration. An extensive compilation of the sources of revenue in other states was finished in November 1963.<sup>45</sup> On the commission's plate was a comprehensive study of insurance taxation.<sup>46</sup>

The property tax was again a major focus of the tax study commission in its fifth report to the 1964 General Assembly. The commission cautioned that failure to change the constitution to give more latitude to the legislature to reform the assessment system might result in future law suits. They were concerned that the state appeared "to be headed for some rather severe court tests."<sup>47</sup>

In response to requests to make state income tax filing simpler, using net taxable income based on the code of the Internal Revenue Service was included among twenty-four recommendations for changes in the income tax. In the process of accomplishing this, the commission recommended tax rates and exemptions be adjusted to produce about the equivalent revenue produced before the change (8, 11, 63 ff.)

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<sup>42</sup>S.C. Tax Study Commission, *Second Annual Report of the South Carolina Tax Study Commission to the 1961 General Assembly* (Columbia, S.C.: The Commission, February 1961), 23.

<sup>43</sup>S.C. Tax Study Commission, *Third Annual Report of the South Carolina Tax Study Commission to the 1962 General Assembly* (Columbia, S.C.: The Commission, February 1962), 7.

<sup>44</sup>Tax Study Commission, *Fourth Annual Report to 1963 General Assembly*, 8.

<sup>45</sup>S.C. Tax Study Commission, *Sources of Revenue by States: A Comparative Study for the Fiscal Year 1961-1962*, supplement to the *Fourth Annual Report of the South Carolina Tax Study Commission* (Columbia, S.C.: The Commission, November 1963).

<sup>46</sup>Tax Study Commission, *Fourth Annual Report to 1963 General Assembly*, 8.

<sup>47</sup>S.C. Tax Study Commission, *Fifth Annual Report of the South Carolina Tax Study Commission to the 1964 General Assembly* (Columbia, S.C.: The Commission, January 1964), 7-8.

In their sixth and seventh reports to the 1965 and 1966 general assemblies, the study commission seemed to be treading water. Although many technical changes had been made in the income tax during their tenure, their major recommendation had not been passed. The possibility of property tax administration reforms seemed quite distant.

The tax study commission felt it necessary to remind the General Assembly that fairness, equity, and erosion of the tax base were linked:

It is axiomatic that an eroded tax base cannot possibly produce a fair and equitable system of revenue, be it in sales, income, property, excise or license taxes. All taxpayers reasonably similarly situated should and must pay shares into the taxing authority in accordance with the same basic criteria. Should such not occur the offending tax ultimately is doomed to failure. This is valid even should exceptions be inherent in the basic concept initially, be instituted subsequently by statute, or be a result of uneven or lax enforcement policies.<sup>48</sup>

In an interesting development, the commission expressed surprise that the South Carolina Electric Cooperative Association, as a representative of the state's electric cooperatives, had asked the commission to evaluate what taxes might be appropriate for the tax exempt cooperatives to pay. On examination, the commission learned that only three other states exempted electric cooperatives from all taxes (7).

As a result, the commission recommended an in-depth look at the exemption of all tax-exempt organizations. The commission did recommend that state chartered building and loan associations no longer be exempt (8-10). In its seventh report, after holding public hearings and extensively studying the exemption question, the commission included legislation for taxation of formerly tax-exempt entities.<sup>49</sup>

In the foreword to its seventh report, the tax study commission proposed options that the General Assembly might consider if it were reluctant to pass legislation that might be considered disruptive to the tax system. The commission suggested making draft legislation available to provide enough time for affected taxpayers to study it and comment, postponing effective dates of legislation, or phasing in changes in the tax burden over a number of years (7).

The commission used these mechanisms in its recommendations to the 1966 General Assembly. For example, after the General Assembly indicated that it was willing to address the question of taxing electric cooperatives as a result of the proposal made to the study commission in 1964, the commission put forth a plan to phase in the changes over three years so that the changes would not disrupt the financial affairs of the cooperatives (13).

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<sup>48</sup>S.C. Tax Study Commission, *Sixth Annual Report of the South Carolina Tax Study Commission to the 1965 General Assembly* (Columbia, S.C.: The Commission, January 1965), 7.

<sup>49</sup>S.C. Tax Study Commission, *Seventh Annual Report of the South Carolina Tax Study Commission to the 1966 General Assembly* (Columbia, S.C.: The Commission, February 1966), 48 ff.

Having had its solution for reforming property tax administration turned down twice, the tax study commission took a different tack. “To make a seven year story short,” it recommended a system of assessment with a goal to assess all property at the state and local level at a uniform 10 percent of value. Because assessment percentages now used by the property tax division of the State Tax Commission ranged from 9.5 percent to 14 percent, striving for a common assessment of 10 percent seemed reasonable. In this way, at least all property would be assessed at the same percentage of its market value. To extend the same program to local governments, the commission would use its voluntary program to help local governments to bring their local assessments to the 10 percent level (18-19).

The tax study commission again reiterated the need for the income tax change, pointing out solutions to what they considered minor objections. The crowded public hearing at the State House in 1964 had not produced objections to the idea, first proposed to the study commission in 1961 by the S.C. Association of Certified Public Accountants and supported by the Richland County Bar Association. To bolster their recommendation, experiences of tax officials in other states with the same system were included in the report (21-28).

#### THE MOODY’S INVESTORS REPORT—1968

Some 20 years after the Peace Commission report, as growth slowed in South Carolina in 1966 and 1967, a report by Moody’s Investors Service, *Opportunity and Growth in South Carolina 1968-1985*, made recommendations for stimulating economic growth in the state in the areas of education, transportation, and health. They were “designed to give the state and its economy a quantum leap forward.”<sup>50</sup>

The consulting group was asked to evaluate the state’s bonding capacity as a vehicle for stimulating growth in the state’s economy. The consultants found the state had the necessary bonding capacity, economy and tax base to provide the financial resources for funding the proposed programs and projects. They also cautioned that failure to implement some would “seriously jeopardize the thrust of others (i-ii).

To launch the suggested programs, the state needed an additional \$45 million in general fund revenue in 1969-1970, specifically to pay for raising salaries for instructional staff in elementary, secondary, technical, and higher education. Under the proposed program, general fund revenue was expected to more than double from the current \$375 million in 1969 to \$792.9 million in 1980 (13, 15).

A six-tenths of one-cent increase in the sales tax, not increased since its adoption in 1951, would bring in \$27 million of the \$45 million needed to meet the education goals. The re-

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<sup>50</sup>Moody’s Investors Service, Inc. and Campus Facilities Associates, *Opportunity and Growth in South Carolina, 1968-1985* (New York: Moody’s Investor’s Services, 1968), ii.



maintaining \$18 million was proposed to come from increases in income, cigarette, and alcohol taxes, according to the report (14-15). Transportation needs would be funded by increases in gasoline taxes and vehicle license fees (439).

In his 1968 State of the State message to the General Assembly, Governor Robert E. McNair expressed his support of Moody's recommendations, emphasizing that funding of the plan would move South Carolina "from growth by momentum to development by decision." The plan would prepare the state's youth for employment in industry and for success in higher education (5-7).

The programmatic shortcomings in the state's elementary and secondary education system, not addressed but evident since the massive building program of the early fifties, would now come to the forefront politically at a time when the state was struggling with the desegregation of public education at all levels. The report most certainly set the stage for Act 274 of 1969, which levied an additional one-cent sales tax "for the support of public schools of the state." It also provided impetus and financial support for expansion of degree programs, faculties, and facilities at the state's universities, viewed as vital to expanding the economy of the state.

In spite of the fact that the state's sales tax would exceed that of neighboring states, the legislature preferred the one-cent sales tax increase over the funding mechanisms recommended in the report. In 1970 the additional sales tax penny produced \$45.9 million of the \$48.1 million in new sales tax revenue for the schools.<sup>51</sup> In 2003-04 each sales tax penny raised \$436.3 million.<sup>52</sup>

To fund the transportation infrastructure outlined in the report, an increase in the gasoline tax from seven cents to eight cents would provide at least \$9.97 million, the revenue one cent produced in 1967-1968. Over ten years the increase was estimated to provide \$110 million. The revenue would enable the highway department to let bonds to cover the cost of the recommended highway construction program.<sup>53</sup>

In 1972, the gasoline tax increased by one cent per gallon. The legislature increased the gasoline tax in one-cent increments in 1977, 1979, and 1980 and then by two-cent increments in 1981 and 1987. Another penny was added in 1989, making the tax sixteen cents on the gallon.<sup>54</sup> Since then no proposals to increase the gasoline tax have succeeded including

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<sup>51</sup>S.C. Tax Commission, *Fifty-Sixth Annual Report of the South Carolina Tax Commission to the Governor and General Assembly*, (Columbia, S.C.: The Commission, 1970), 8.

<sup>52</sup>S.C. Department of Revenue, *2003-2004 Annual Report*, 2004, [15] < [http://www.sctax.org/publications/default.htm#annual\\_report](http://www.sctax.org/publications/default.htm#annual_report) > The Department.

<sup>53</sup>Moody's Investors, *Opportunity and Growth*, 441-444.

<sup>54</sup>Tax Commission, *General History of Taxes*, 127.

one in the 2005 legislative session. In 2003-04 the gasoline tax (motor fuels tax) provided \$29 million to fund state transportation needs.<sup>55</sup>

Moody's had characterized their revenue forecast as conservative because general fund revenues were "assumed to grow at the rate of 6 percent a year . . . considerably below the state's recent experience."<sup>56</sup> The estimate did prove to be conservative. By 1980 general revenue collections reached \$1.6 billion, twice Moody's revenue estimate of \$793 million.<sup>57</sup>

### THE INFLUENCE OF SENATOR EDGAR A. BROWN—1923 TO 1971

South Carolina is unique in many ways. Perhaps the most significant characteristic for the purpose of this report is the role of the General Assembly and the relatively weak role of the governor. For much of the twentieth century, the most important figure in state finances was the chairman of the Senate Finance Committee, Senator Edgar A. Brown.

Senator Brown exerted substantial influence over the form fiscal policy took during his 50 years in the state House and Senate. After six years in the House, Brown moved to the Senate in 1929 and joined the influential Senate Finance Committee in 1933, "a year of such dire financial crisis for the state" that "school teachers were being paid in script [sic]."<sup>58</sup> He accepted chairmanship of the Senate Finance Committee in 1942 and also almost immediately became Senate President *pro tempore*, which provided a power base that shaped taxation and budgeting in the state until his retirement in 1971 (46).

Brown's insistence on fiscal stability for the state was the watchword of his public career as he focused on going slow in lean times and fiscal restraint in good times. He saw the benefits of paying off the state's debt, some from the Reconstruction era. He supported the elimination of the state property tax and allocation of surpluses in the World War II era to onetime expenditures for capital improvements (30). As William D. Workman, Brown's biographer put it:

. . . he takes pride, not only in those measures which moved into law with his assistance, but also in having sidetracked or killed a great many which he thought detrimental to the state's welfare. Consistency and conservatism have marked most of the bills which have had his blessing, and he has been singularly resistant to the passing fancies of a governor, the public, or even the legislature itself (30-31).

Much of Brown's success in the Senate stemmed from the small size of the Senate and informal agreements on how committee assignments were made. The membership of the

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<sup>55</sup>Department of Revenue, *2003-2004 Annual Report*, [24-25].

<sup>56</sup>Moody's Investors, *Opportunity and Growth*, 15, 423.

<sup>57</sup>South Carolina, Budget and Control Board, Office of State Budget, *Historical Analysis 2005, Budgetary General Fund Actual Revenue Collections*, November 30, 2005, 10.

<sup>58</sup>Workman, *Bishop from Barnwell*, 27-28.

committee was balanced, representing a range of viewpoints because senators were invited to join the committee by the sitting members. Members of the finance committee also agreed to support the budget that came out of committee onto the floor of the Senate, therefore guaranteeing eighteen positive votes of the twenty-four needed to pass the budget. Senator Brown was legendary in his ability to prevail in confrontations with House members on many a budget conference committee by tenaciously waiting them out (49-54).

Fiscal control began to shift when the system of making committee assignments became more formal. Brown consented to accept assignments based on seniority and later regretted his agreement. Under the seniority system disagreements could no longer be worked out by compromise in committee. Senators thwarted in committee now took their amendments to the Senate floor (62-64).

Into the 1990s committee chairs were chosen by seniority independent of party. In 2001 the system changed again when Republicans, having gained a majority of the Senate seats in the 2000 election, organized the Senate on a partisan basis and took control of the Senate for the first time since Reconstruction. Today, committee chairs are all members of the majority party, according to Senate rule changes.

### **SOUTH CAROLINA TAX STUDY COMMISSION AND PROPERTY TAX REFORM—1974 TO 1976**

In 1959 hearings and meetings, the tax study commission again had identified a number of issues related to the rather chaotic administration of property taxes in South Carolina. Testimony of E.C. Rhodes, the Comptroller General of the State, illustrated the nature of the problems at that time:

In the majority of our counties, the law provides for three tax assessors in each school district (and by way of parentheses, I might say that in one county of our state, no Board of Assessor has been qualified since 1919). The assessing Boards are poorly paid and the time in which they are supposed to perform their duties is quite limited. There are thousands of tax returns to be examined, properties to be inspected, questions to be answered, and numbers of other details. We have approximately two thousand tax districts in the State which means we have six thousand tax assessors. In the absence of any standard method of assessment and classification, each tax assessor must use his individual judgment, which means there are some six thousand different ideas of taxable values. In a situation of this kind it would be nothing short of a miracle to expect equalization in assessments.<sup>59</sup>

In 1975, the legislature finally acted to remedy the longstanding assessment problem. As often happens, extraordinary events overcame inertia, pushing a legislative body into action. A \$26 million county- and school-funding crisis finally motivated the legislature to act. Because many manufacturing plants were holding their tax payments in escrow to protest their assessments and law suits were in the offing, the legislature authorized Senator James

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<sup>59</sup>E.C. Rhodes, "Remarks made before the Tax Study Commission by the Comptroller General of South Carolina," 1959, Clemson University Archives, G. H. Aull Papers, Box 10, Folder 6.

M. Waddell, Jr., chairman of the state's Tax Study Commission, to initiate studies of the overall property tax system.<sup>60</sup>

In its 1974 report to the 1975 General Assembly, the tax study commission included a recommended amendment to Article 10 of the state constitution "to provide for assessment of taxable property at actual value, uniformity of assessment rates and classification of property for tax purposes. . . . (49)." The remedy was Act 208 of 1975, which provided a mandate for the State Tax Commission to supervise the reassessment and equalization of all property in the state, subject to approval of the electorate. Under the act each county was required to hire a full time assessor and the State Tax Commission was to monitor the new assessment system via annual ratio studies. Uniform assessment at market value and a classification system were also established.<sup>61</sup> After voters agreed to the constitutional changes in 1976, counties faced the extraordinary task of producing new property maps for tax purposes.

An observer,<sup>62</sup> present in most of the meetings that drafted the act, remembers some debate about whether or not the classification system should be written into the constitution rather than the state code. In the end, the arguments of Senator Waddell for a system that could be easily updated as necessary yielded a compromise that placed the classification system and assessment ratios in the constitution as well as the code. The compromise provided that the classifications and requirements to qualify for such classifications could be defined by statute. While the classifications could not be modified by statute, the assessment ratios could be changed by statute with an extraordinary vote of two-thirds of the membership of each house.

Senator Waddell argued that lower assessment ratios were appropriate for property owners who would be unable to shift the taxes on to others, and so lower assessment ratios of 4 percent were assigned to farm land and owner occupied residences. Owners of income-producing property would pay from 6 percent to 10.5 percent of market value.

These changes paved the way for the Education Finance Act of 1977, because under a uniform assessment system it was now possible to determine the ability of a school district to pay its share of a minimum education program. The act enabled the state to base its aid to local school districts on an ability to pay index.<sup>63</sup>

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<sup>60</sup>S.C. Tax Study Commission, *1974 Annual Report of the South Carolina Tax Study Commission to the 1975 General Assembly* (Columbia, S.C.: The Commission, January 1975), 7.

<sup>61</sup>S.C. Tax Study Commission, *1975 Annual Report of the South Carolina Tax Study Commission to the 1976 General Assembly* (Columbia, S.C.: The Commission, January 1976), 7, 63 ff.

<sup>62</sup>James C. Hite, Department of Agricultural Economics and Rural Sociology, Clemson University.

<sup>63</sup>John H. Walker et al, editors, *The Organization of Public Education in South Carolina* (Dubuque, Iowa: Kendall/Hunt Publishing Company, 1992), 186-188.

In 1976 the state got back into the property tax business. The General Assembly decided to tax the flight equipment of airline companies operating in the state and private cars operated on railroads in the state.<sup>64</sup> Together the taxes yielded \$10.0 million for the state in 2003-04.<sup>65</sup>

### HOME RULE FOR LOCAL GOVERNMENTS—1975, 1976

South Carolina is also unique in that into the 1960s, every county budget was passed as a *supply bill* by the General Assembly.<sup>66</sup> Although the constitution authorized a board of commissioners for each county, in effect, the legislative delegation from each county controlled county finances. Even the smallest decisions related to county government rested in the county legislative delegation.

That system ended when each county ceased to have its own resident senator after the U.S. Supreme Court ruled in *Reynolds v. Sims* in 1964 that both houses of state legislatures must be apportioned on the basis of population.<sup>67</sup> Until that time, the state senator was effectively the *mayor* of his county with veto power over the county budget. The legacy of this system continues today as legislative delegations continue to make some appointments to boards and commissions and control taxation for local schools.

The result of *Reynolds v. Sims* was far reaching in South Carolina. The electorate amended the state constitution in 1975 as recommended by the legislature in Act 283, the Home Rule Act, and new forms of county government were created with new funding powers. Before, state legislators had strong political incentives to keep local taxes low and make generous use of state financial aid. However, with locally elected county councils to take the *heat* for raising local taxes, the legislative delegations had political incentives to shift the tax burdens back to the locals and keep state taxes low.<sup>68</sup>

### ALTERNATIVE SOURCES OF REVENUE FOR LOCAL GOVERNMENTS

Before home rule, municipalities had more extensive powers than counties. While municipalities financed services using the property tax, as counties did, some municipalities had been making use of business license taxes for some time. This limited menu of local tax instruments increasingly produced inadequate revenue, especially in growing municipalities

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<sup>64</sup>Tax Commission, *General History of Taxes*, 9.

<sup>65</sup>Department of Revenue, *2003-2004 Annual Report*, [18, 21].

<sup>66</sup>For a summary of the history of local government from the colonial period to the present, see Jon B. Pierce and Edwin C. Thomas, *General Purpose Local Government in South Carolina*, Local Government Funding System Reform Project (Columbia, S.C.: Center for Governance, University of South Carolina, March 2000), 3-6.

<sup>67</sup>Kermit L. Hall, editor, *The Oxford Companion to American Law* (Oxford: Oxford University Press, 2002), 821.

<sup>68</sup>Horace W. Fleming Jr., "Joining Issues and Academe: Examining Alternative Sources of Revenue for Local Governments in South Carolina," presented at the annual meeting of the Southern Regional Science Association, Savannah, Georgia, April 14-15, 1980 (Clemson, S.C.: Department of Political Science, Clemson University), 20.

and counties where property tax reassessments lagged behind the growth in demand for services as population grew during a period of inflation. Counties and municipalities were also receiving fewer federal monies as general revenue sharing was being eliminated.<sup>69</sup>

At the same time, revenue concerns at the state level were forcing the legislature to choose whether to raise state taxes or make budget cuts. The legislature decided to follow the latter course. State aid to local governments then based on revenue from specific taxes<sup>70</sup> such as the gasoline tax, bank tax, income tax, alcohol sales tax and the insurance premiums tax was capped at \$75 million in 1975. With limited sources of revenue and facing less state and federal aid, county and municipal governments needed a broader menu of revenue sources to supplement the property tax.<sup>71</sup>

In 1976 in response to the local-government funding crisis, the General Assembly established a Special Legislative Study Committee on Alternatives for Financing County and Municipal Government to examine additional funding sources to reduce local dependence on the property tax. The committee contracted with Clemson University to undertake a comprehensive study of local government revenue needs, trends, and alternative revenue instruments. The committee's recommendations were to focus on "making possible a balanced revenue system for local governments in the state and the means by which . . . [they] might become more financially self-sufficient" (14-16).

After many detailed studies by an interdisciplinary team of planners, economists, and political scientists, in its final report in March 1980 the local government finance research group at Clemson University identified a number of possibilities for new local revenue sources. A local income tax, accommodation taxes, a local option sales tax, and increases in state income tax to be earmarked for local governments seemed most realistic and viable.<sup>72</sup> However, until such changes could be made and legislative consensus achieved, state aid to counties and municipalities had to resume. So, "previously impounded funds" were released by the state and state aid to counties and municipalities resumed.<sup>73</sup>

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<sup>69</sup>Holley H. Ulbrich, "New Revenue Sources for South Carolina Local Governments," presented at the annual meeting of the Southern Regional Science Association, Savannah, Georgia, April 14-15, 1980 (Clemson, S.C.: Department of Economics, Clemson University), 3-5. Also South Carolina, House of Representatives, Study Committee on Alternative Sources of Revenue for County and Municipal Governments, *Financing County and Municipal Governments in South Carolina in the 1980s*, Journal of the House of Representatives of the Second Session of the 103rd General Assembly of the State of South Carolina, vol 1, (Columbia, S.C.: General Assembly, March 1980), 2226-2239.

<sup>70</sup>Andrew G. Smith, *Aid to Subdivisions: An Examination of State Shared Revenue in South Carolina* (Columbia, S.C.: S.C. Advisory Commission on Intergovernmental Relations, September 1990), 2-6.

<sup>71</sup>Fleming, "Joining Issues and Academe," 4, 14.

<sup>72</sup>South Carolina, General Assembly, Study Committee on Alternative Sources of Revenue for County and Municipal Governments, final report, *Financing County and Municipal Governments in South Carolina in the 1980's* (Columbia, S.C.: General Assembly, March 1980), 66-68.

<sup>73</sup>Fleming, "Joining Issues and Academe," 18.

The local option income tax was quickly ruled out as burdensome (18), although it was deemed convenient to collect as a piggyback tax with “negligible” administrative costs and would have made the local tax system more balanced.<sup>74</sup> Additional state taxes were ruled out based on the philosophy that public officials spending tax money should have responsibility for raising it. That left the hotel-motel accommodations tax and the shared local-option sales tax as the most promising candidates. Ultimately both were enacted as measures for local governments although not exactly in the forms recommended by the study committee.<sup>75</sup>

In its final report the Special Legislative Study Committee viewed the local option sales tax and the accommodations tax as “short-term remedies for the fiscal imbalances” which had been discovered. They recommended to the General Assembly:

First of all, it is advisable for the General Assembly to begin immediately to review the prospects of writing a comprehensive local government finance act – one which allows local governments to move toward financial self-sufficiency and which is consistent philosophically and practically with the expanded service roles assumed by local governments under the home rule law.<sup>76</sup>

The accommodations tax was added to the menu of local revenue sources in 1984 with a proviso that some of the revenue from localities with significant travel economies would be shared with other parts of the state.<sup>77</sup> The first \$25,000 in revenue was to be deposited in the local government’s general fund (later legislation approved the deposit of 5 percent of the remaining revenue in the general fund). All other revenue was designated for local tourism-related activities. The tax was not adopted by local option, but was a 2 percent tax uniformly applied statewide. In the 1990s, subsequent legislation allowed local governments to impose an additional local tax of 1 percent.<sup>78</sup>

The local option sales tax was not enacted until 1990. It could be adopted by local referendum, with the stipulation that at least 71 percent of the revenue be used to provide a credit against property taxes. Some adopting counties have allocated 100 percent of the revenue for property tax relief. The tax also has a Robin Hood proviso for counties adopting the tax, which requires wealthier counties to share 5 percent of revenue with counties with limited commercial development.<sup>79</sup>

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<sup>74</sup>Rodney H. Mabry, *The Local Piggyback Income Tax: An Alternative for Financing Local Governments in South Carolina* (Clemson, S.C.: Local Government Finance Research Group, Clemson University, November 1978), 3-4.

<sup>75</sup>Fleming, “Joining Issues and Academe,” 21.

<sup>76</sup>Study Committee on Alternate Sources of Revenue, *Financing County and Municipal Governments*, 86-87.

<sup>77</sup>Act 316 of 1984.

<sup>78</sup>Act 138 of 1997, the Local Accommodations Tax Act.

<sup>79</sup>Act 317 of 1990.

Adoption of the local option sales tax was subject to referendum in 1990 in all counties in the first statewide election after its approval by the legislature, but only six counties adopted the tax. By 2004, the local option sales tax generated \$159.8 million in revenue for 27 counties and their municipalities.<sup>80</sup> At present 29 counties have adopted the local option sales tax.

Because sales tax receipts fluctuate with economic conditions, the amount of property tax relief varies from year to year. Yet in many counties, the local option sales tax has provided substantial relief for property owners and passed along some of the tax burden to non-residents, especially in tourism-oriented cities and counties and communities with a concentration of commercial establishments that draw customers from a broad region.

To avoid disruption of local budgets and services and to offset the instability of some state revenue sources, local governments worked with the legislature in 1991 on a revised system of state aid to local governments.<sup>81</sup> Today, county and municipal governments receive and share 4.5 percent of the previous fiscal year's general fund revenue off the top of general fund revenue before state budgeting begins. The legislation includes requirements that make it somewhat difficult for the legislature to easily change this agreement.<sup>82</sup>

This change, however, does not insulate counties and municipalities from cuts in lean revenue years. In 2001-02 and 2002-03 the local government fund was subject to mid-year cuts. Also, as the legislature has transferred more revenue in the general fund into special funds, the growth of revenue for aid to subdivisions has slowed.<sup>83</sup>

Because many local governments allocated 100 percent of the local option sales tax to property tax relief and only a limited amount of accommodations taxes could be used in the general fund, few local governments gained significant discretionary funds from the new taxes. The legislature recently has authorized three additional county sales taxes designated for capital, transportation, and school projects for adoption by referendum and a local hospitality tax on prepared food for adoption by ordinance.<sup>84</sup>

## INDUSTRIAL TAX INCENTIVES

The practice of granting property tax abatement to new industrial development prevailed in most counties before the passage of Act 208 of 1975. After Act 208, however, the practice of tax abatement of county property taxes, but not school taxes, was formalized in the

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<sup>80</sup>Department of Revenue, *2003-2004 Annual Report*, n.p. [16?].

<sup>81</sup>Smith, *Aid to Subdivisions*, 13-21.

<sup>82</sup>S.C. Code, 1976, §6-27-10 ff., State Aid to Subdivisions Act.

<sup>83</sup>Holley H. Ulbrich, *Local Government Funding in South Carolina: Trends and Challenges* (Columbia, S.C.: Local Government Funding System Reform Project, Center for Governance, Institute of Public Affairs, University of South Carolina, July 11, 2000), 64.

<sup>84</sup>All local government revenue sources are discussed extensively in Ulbrich, *Local Government Funding*.



state constitution and code. After July 1, 1977, all new manufacturing property, as well as later capital additions valued at \$50,000 or more, received property tax abatement from county property taxes, not including school taxes, for five years.<sup>85</sup> After July 1, 1985, municipalities were permitted to exempt similar establishments from municipal property taxes by ordinance. Soon after, the state began a legislative program to improve the state's economy by encouraging location of new industries through the use of state tax incentives.

In the mid-eighties the state enacted its first statute permitting negotiation between new manufacturing plants and counties for payment of a fee in lieu of property taxes. This statute provided tax relief by effectively lowering the industrial assessment ratio from 10.5 percent to as low as 4 percent, the residential property tax ratio, in special cases.<sup>86</sup>

Industry can also receive protection from future tax increases and payment of other fees and taxes during the period of the agreement. Fee agreements are generally for a period of twenty years but can extend up to forty years under special circumstances. Properties under fee-in-lieu of tax agreements are not subject to rollback taxes for conversion of agricultural land.

Today, South Carolina provides a complex array of tax incentives to new industrial development and industrial expansions in addition to fee-in-lieu-of-tax agreements such as job tax credits and retention of a portion of workers' income tax withholding for specific purposes, an incentive unique to South Carolina.<sup>87</sup> Some inducements like those in the Rural Development Act are structured to reward location in less developed rural counties, while others apply statewide. For example, the Enterprise Zone Act, originally targeted to particular areas, now defines the whole state as an eligible zone.<sup>88</sup>

In 1995 the Fee-In-Lieu Simplification Act lowered many requirements of the original act, expanded the list of qualifying businesses and made replacement property eligible for the fee. The ability to transfer fee-in-lieu contracts and benefits was enhanced considerably. The amount of investment and the number of jobs created by an investment were lowered dramatically. Other legislation also broadened eligibility for jobs tax credits (9).

From 1995 to 1996, the governor and General Assembly supported an unprecedented number of laws aimed at bringing more business into the state. In 1995 alone capital investments of \$5.4 billion were announced by South Carolina, which "led a 17-state region

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<sup>85</sup> S.C. Code, 1976, §2-37-220. Machinery and equipment are counted in determining the value of capital additions.

<sup>86</sup> S.C. Department of Revenue, *State Tax Economic Development Incentives, 1995-1996: A Two Year Legislative Overview of the Beasley Administration* (Columbia, S.C.: The Department, [1996]), 9.

<sup>87</sup> S.C. Department of Revenue, *South Carolina Tax Incentives for Economic Development*, 2005 ed. (Columbia, S.C.: The Department, 2005), 14-72, 120-146.

<sup>88</sup> Department of Revenue, *State Tax Economic Development Incentives, 1995-1996*, 4-6.

in investment and expansion” according to the Southern Economic Development Council (13).

The use of tax incentives has introduced a whole new dimension into the reform of the property tax system. Business tax credits and sales tax exemptions reduce state income tax and sales tax revenue, so revenue of the three major governmental taxes is affected by the incentive system. The State Department of Commerce also sweetens the deal, using state funds available for infrastructure and support through the technical education system and other agencies.

In 1975, the State Tax Commission saw the assessment ratios as providing a balanced system with each sector of the system paying an appropriate share in property taxes. Changing the tax system to meet an economic goal shifts a heavier burden for providing public services to other classes of property and also gives up future state and local revenue. Evaluating how tax incentives impact the state and local tax system is difficult because incentive agreements are negotiated at the county level and the state did not keep records of local incentive agreements until 1997.

A recent study using county-level development data illustrates the difficulty of making such assessments at the local level. A look at the fiscal impact of incentives on revenues of the Greenville County school district points out some of the revenue distortions inherent in fee-in-lieu-of-tax agreements, multi-county business park agreements, special source revenue bonds, and infrastructure tax credits. For example, property under fee-in-lieu-of-tax agreements in Greenville County which increased from \$40.8 million to \$83.2 million in value from 1998 to 2002 would have brought in \$4.6 million more in revenue to the school district in 2002 if assessed at 10.5 percent than it did under fee agreements.<sup>89</sup>

However, economic development professionals point out that some of that development would not have located in Greenville County without the inducements of reduced taxes through fee agreements. There is no way of knowing how much of the development would have taken place in Greenville County without the tax inducements, but some of the effects of the incentive programs such as fixed millage agreements which free development projects from millage increases for new school construction are a cause of concern (6, 13).

The study points out that approval of some types of incentives to companies that would have located or expanded in Greenville County anyway “is merely shifting the tax burden to other classes of property.” In fact, residential property assessments in 2002 were 26.7 percent of the assessed value of all property in the county, an increase of 4.7 percent over a 1989 percentage of 22.0 before fee agreements, according to data from the S.C. Depart-

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<sup>89</sup>Miley and Associates, Inc., *The Fiscal Impacts of Economic Development Incentives on the Greenville County School District* (Columbia, S.C.: Miley and Associates, November 19, 2003), 5.

ment of Revenue. While the phase-in of lower vehicle assessments and other factors have contributed to this shift, it appears that “an additional factor has been the large number of companies” with fee-in-lieu-of tax agreements (14-16).

Surveys by researchers in the regional development field confirm the view that tax incentives are less important in location decisions than one would think. However, states are caught up in a competition to provide an incentive package that provides economic success. That economic success has been forecast by one researcher to cost the state of South Carolina, in fiscal terms, \$353.4 million in foregone revenue by 2010.<sup>90</sup>

In discussing the efficacy of tax incentives, some critics point to South Carolina’s incentives to companies like BMW Group as jeopardizing the state’s fiscal health and thus the financial resources to build and improve roads, schools, bridges, and water and sewage facilities. BMW’s deal with South Carolina—the company began production in 1994—is estimated to free it from income taxes well into the twenty-first century.<sup>91</sup>

The company pays one dollar a year to lease its state-owned site, which is valued at \$36 million. Initial incentive agreements reduced tax liability for buildings and equipments by 43 percent, and the second-phase development has enjoyed a 62 percent tax abatement even though the company had been “landed” and the expansion would obviously be built in the same location (n.p.).

Because state lands are exempt from taxation, Spartanburg County receives no property tax on the land BMW sits on. In 1994 established companies without incentives agreements located on land worth \$36 million, assessed at 10.5 percent of market value, could expect to pay \$265 thousand in county taxes (70.1 mills) and an average of \$790 thousand in school taxes (209 mills average) on the land. In fact, when the state acquired the land for BMW, the total market value of property in Spartanburg County fell, diminishing the tax revenue that could be raised without raising the millage.

These fiscal consequences have received some scrutiny in recent years, but looking at revenue foregone when structuring or restructuring a tax system should not be overlooked. No matter how the state and local governments answer the questions of how much tax revenue should be given up and for how long in order to bring jobs to the state, it is important to examine the effects of such decisions upfront and after the fact in order

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<sup>90</sup>Daniel V. Rainey, *Business Incentives: Projected Fiscal Costs*. Series on Fiscal Sustainability of the South Carolina Revenue and Expenditure System, 1997-2010 (Clemson, S.C.: Strom Thurmond Institute of Government and Public Affairs, Clemson University, October 23, 1997), 6, 12, 15.

<sup>91</sup>Jay Hancock, “S.C. pays dearly for added jobs: South Carolina’s economy was supposed to improve, but taxes exploded while services crumbled,” SunSpot: Maryland’s Online Community, a news site of the *Baltimore Sun*, October 12, 1999.

to “weigh the revenue loss against the benefits.”<sup>92</sup> Perhaps, states and local governments might, as some suggest, even consider an economic development policy based on “providing the foundations for growth through sound fiscal practices, quality public infrastructure, and good education systems—and then letting the economy take care of its self.”<sup>93</sup>

## A STUDY OF EXEMPTIONS TO THE SALES AND USE TAX—1991

When the first sales and use tax of 3 percent was adopted in 1951, the law allowed nineteen exemptions. By 1991, the total number of exemptions had grown to forty-nine with a resulting revenue loss of \$731 million.<sup>94</sup> Today, the number of exemptions has expanded to sixty-two,<sup>95</sup> primarily reflecting the political influence of particular interests. Revenue loss from current exemptions was estimated to be \$1.3 billion in 2004-05.<sup>96</sup>

In its original form, the sales and use tax exempted gross proceeds of sales of:

- Tangible personal property or the gross receipts of any business, which the state is prohibited from taxing under the Constitution or laws of the United States or under the constitution of this state
- Text books used in elementary, high schools and institutions of higher learning
- All livestock
- Feeds used for poultry or livestock
- Insecticides, chemicals or fertilizers or soil conditioners or seeds or seedlings for farm purposes
- Boxes, crates, bags, bagging, ties, or other containers for agricultural purposes and for fuel, lubricants, and mechanical supplies for use aboard ships in intracoastal trade or in foreign commerce
- Newsprint, newspapers and religious publications and the Holy Bible
- Coal, coke, and other fuel sold to manufacturers in power companies and transportation companies
- School lunches
- Communications, transportation and water when rates are fixed by the Public Service Commission
- Fuel, lubricants and mechanical supplies used aboard ships
- Wrapping paper, twine, paper bags, and containers
- That portion of proceeds of sales of automobiles, furniture or appliances represented by the value of such article transferred to vendor in partial payment
- Gasoline and motor fuel
- Farm machinery
- Fuel used in curing agricultural products
- Electricity
- Railroad cars and locomotives

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<sup>92</sup>Robert D. Ebel, Holley H. Ulbrich and Lawrence Marks, *Financing Government in the Palmetto State: A Study of Taxation in South Carolina* (Columbia, S.C.: S.C. Advisory Commission on Intergovernmental Relations, February 1991), 100.

<sup>93</sup>Alan Peters and Peter Fisher, “The Failures of Economic Development Incentives,” *Journal of the American Planning Association* 70, 1 (Winter 2004): 35-36.

<sup>94</sup>James C. Hite and Holley H. Ulbrich, *An Examination of Exemptions in the South Carolina Sales and Use Tax* (Clemson, S.C.: Strom Thurmond Institute of Government and Public Affairs, Clemson University, September 1, 1991), 1.

<sup>95</sup>S.C. Code, 1976, §12-36-2120.

<sup>96</sup>Robert Martin, S.C. Department of Revenue, e-mail message to Ada Louise Steirer, Strom Thurmond Institute of Government and Public Affairs, July 20, 2005, 3:51 p.m.

Products of farm, grove or vineyards and gardens sold in original state of production by producer or immediate family<sup>97</sup>

In 1991 during a period of recession and unexpected state expenditures related of the destruction of Hurricane Hugo, the S.C. Tax Study Commission funded a study of exemptions to the sales tax. The study begins with the observation that to deal with the state's economic hardships "state government faces a need to reduce or eliminate funding for existing programs or to find new revenues or to consider some combination" of the two. New revenue could be found by eliminating some of the exemptions to the sales tax, according to the study.<sup>98</sup>

The study considered thirteen exemptions "most promising for elimination" and recommended some be eliminated on the basis of both fairness and efficiency. The exemptions recommended for elimination totaled \$265 million in 1991 dollars or about 17 percent of the revenue collected by the sales and use tax in that year (2).

The elimination of the \$300 tax cap on the buying and leasing of aircraft, motor vehicles, motorcycles, boats, and other motorized vehicles such as recreational vehicles was recommended because the "buyers of less expensive vehicles pay a higher percentage sales tax than buyers of more expensive vehicles, making [the] sales tax more regressive." The argument that only a small group of dealers and well-to-do purchasers of more expensive vehicles were benefiting from the exemptions did not gather support for repeal. In 1990-91 tax revenue foregone because of this exemption amounted to \$63.8 million (62, 75). By 2004-05 revenue lost to the vehicle tax cap exemption totaled \$93.4 million.<sup>99</sup>

The report also recommended examining the taxation of services as a future revenue source. Because "as incomes rise a larger and larger percentage of income is spent on services and a smaller and smaller percentage of tangible goods," it is expected that in the future the "sales and use tax will become increasingly regressive and will not produce revenues that grow in rough proportion to growth in personal income."<sup>100</sup>

## **THE UNRAVELING OF ACT 208 OF 1975 AND OTHER LEGISLATIVE CHANGES TO THE STATE AND LOCAL REVENUE SYSTEM—1994 TO 2000**

The assessment rates established in the constitution under Act 208 in 1975 became the target for a series of battles over property tax relief from 1993 to 2000 for various groups, fueled by the anti-property tax movement that began with Proposition 13 in California in 1978. Industry felt singled out to bear an undue share of the burden with a 10.5 percent as-

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<sup>97</sup>Paraphrased from Article VII, Act 379 of 1951, the Appropriations Act, whose title includes ". . . Enact A General Retail Sales Tax, And To Pledge Sufficient Revenue Therefrom To retire the Bonds Authorized In This Act, . . ."

<sup>98</sup>Hite and Ulbrich, *Examination of Exemptions*, I.

<sup>99</sup>Martin, e-mail to Steirer.

<sup>100</sup>Hite and Ulbrich, *Examination of Exemptions*, 78-79.

assessment rate. Owners of personal vehicles were late in demanding relief, but finally obtained property tax relief in the form of reduced assessment rates phased in between 2001 and 2006.

Homeowners, who have the most favorable assessment rate, have also been the most vocal in complaining about property taxes and have won several changes that have not altered the nominal assessment rate but have reduced their share of the tax burden. Presently, anti-tax groups are pushing for the elimination of the property tax on residential property and supporting an increase in the state's general sales tax as a replacement. Each time relief is granted, another category of property taxpayers steps up to the plate to demand comparable relief. Thus far, the primary effect of property tax relief has been to shift a larger share of the burden to the 6 percent assessment categories of rental and commercial properties and old industry.<sup>101</sup>

Prior to 1984, the state negotiated five-year tax relief for new and expanding industry, but beginning that year, the responsibility shifted to counties, which could negotiate fee-in-lieu-of-tax agreements at rates equivalent to either a 4 percent assessment or a 6 percent assessment, depending on the size of the project. Expanding industries were also included. Only the older industrial property stayed at a 10.5 percent assessment rate, and often that property was heavily depreciated. The 10.5 percent rate on personal vehicles is being reduced over a six-year period to 6 percent. Except for old industry, utilities and business personal property, taxable real property is now primarily assessed at two rates, 4 percent and 6 percent.

Relief for homeowners took place outside the assessment rate, but the effect was the same, a reduction in their share of the tax burden. In 1995 the legislature approved state-funded relief from school taxes for homeowners on the first \$100,000 of market value of their primary residence. In 2000, additional relief was given to home-owning senior citizens with an increase in the homestead exemption from \$20,000 to \$50,000.

It also should be noted that school districts receive no benefit from the property tax relief from school taxes granted to homeowners by the legislature. The tax relief goes directly to the taxpayer and does not show up in local school district bank accounts, although the legislature considers the tax relief money to be state aid to schools.<sup>102</sup> The state no longer rebates to school districts revenue sufficient to cover 100 percent of revenue lost by

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<sup>101</sup>Holley H. Ulbrich, *Funding Government in South Carolina* (Columbia, S.C.: Institute for Public Service and Policy Research, University of South Carolina, 2002), 93.

<sup>102</sup>Holley H. Ulbrich and Ada Louise Steirer, *Financing Education in South Carolina: A Citizen's Guide* (Clemson, S.C.: Strom Thurmond Institute of Government and Public Affairs, Clemson University, June 2005), 15. Also, Local Government Funding System Steering Committee, *The South Carolina Local Government Funding System: Findings and Recommendations*, a report to the General Assembly (Columbia, S.C.: The Center for Governance, Institute of Public Affairs, University of South Carolina, December 28, 2000), 44.

school districts under the program. Therefore, districts must cut budgets or increase revenue to sustain the same level of programming.

The General Assembly authorized the use of assessment caps (limits on how much property values can increase at the five-year reassessment). However, the S.C. Supreme Court has ruled unconstitutional actions taken under this law to apply the cap to homeowners' primary residences or to all property. A recent legislative proposal is an acquisition value assessment under which owner-occupied residential property is reassessed only when sold or improved. Local option adoption of caps by referendum is also under consideration.

Taken together, legislation enacted in the 1990s and still under active consideration in the twenty-first century has resulted in and could further result in a redistribution of the tax burden that is very different from what was intended by the constitutional changes that set up the current property classification system thirty years ago. Then, much importance was placed on how the burden for paying for local services should be distributed. While recent changes may have "mitigated some inequities and aggravated others," it cannot be ignored that the "consequences of any rule changes fall on local government, limiting effective home rule."<sup>103</sup>

In addition to making changes related to the property tax system and providing property tax relief from school taxes, from 1994-95 to 2000-2001 the General Assembly made eighteen legislative changes to the income tax, two changes to the corporate income tax, and four changes in the sales tax, all of which reduced state revenue. During the same period the soft drink tax was repealed, eliminating \$27 million in revenue.<sup>104</sup>

### **VIDEO GAMBLING AND THE S.C. EDUCATION LOTTERY—2000**

A simple word change in state laws governing pinball machines, passed as part of a license fee increase in the state budget bill, created a loophole that legalized cash payouts from video poker machines. Thus, the stage was set for a video gambling industry in South Carolina in the 1990s. Machine operators reported that almost 37,000 machines were in use at the peak of the video poker craze in the second quarter of 1999. Annual gross profit per machine averaged almost \$24,000 on average gross receipts of \$85,000 per machine in 1999.<sup>105</sup>

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<sup>103</sup>Ulbrich, *Funding Government in South Carolina*, 94.

<sup>104</sup>Louis R. Lanier and Ellen Weeks Saltzman, *South Carolina Revenues and Expenditures: Historical Trends and Projections to 2010-11*, Fiscal Sustainability Report Series (Clemson, S.C.: The Jim Self Center on the Future, Strom Thurmond Institute of Government and Public Affairs, Clemson University, August 29, 2001), 4-5.

<sup>105</sup>S.C. Department of Revenue, "South Carolina Video Game Machine Quarterly Reports," fourth quarter 1999, April 2000.

In September of 1999 as a statewide referendum on video poker was approaching, the state's chief economist estimated that under the proposal the annual return to the state from taxes and fees on video gambling machines would be about \$139 million annually.<sup>106</sup> The machines became a source of both license fee revenue and controversy before finally being prohibited by a decision of the South Carolina Supreme Court on October 14, 1999.<sup>107</sup> The referendum never took place because it was declared unconstitutional by the S.C. Supreme Court. By June 30, 2000, the machines were gone because it was illegal for them to be located in the state.

In 2000, the voters approved a constitutional amendment that permitted a much less addictive and more controlled form of gambling as South Carolina became the thirty-seventh state to authorize a lottery. The lottery with proceeds earmarked for *education* began operating in January 2002. The S.C. Education Lottery legislation stated that

proceeds of lottery games must be used to support improvements and enhancements for educational purposes and programs as provided by the General Assembly and that the net proceeds must be used to supplement, not supplant, existing resources for educational purposes and programs.<sup>108</sup>

The lottery, as a percentage of state appropriations, is not a significant revenue source in South Carolina or in other states.<sup>109</sup> In its 2005-06 appropriations act the General Assembly allocated \$228.5 million in lottery funds for scholarships—\$107.3 million for LIFE scholarships and \$43 million for tuition assistance to students at technical colleges and 2-year colleges. Of \$48.5 million appropriated for K-12 education, \$46.5 million will fund the K-5 reading, math, science and social studies program.<sup>110</sup>

In 2004-05 the lottery generated \$284.5 million. In its peak year, 2003-04, \$292.0 million was deposited in the state treasury. The S.C. Education Lottery has deposited more than \$881.8 million into the S.C. Education Lottery Fund through November 2005.<sup>111</sup> The lottery administration makes monthly transfers of lottery proceeds to the Office of the State Treasurer. The Department of Revenue does not administer lottery funds.

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<sup>106</sup>"Economist refigures gambling impact," *Greenville (S.C.) News*, September 5, 1999, 2B.

<sup>107</sup>See "Gambling in S.C.: The Battle Rages On," *State (Columbia, S.C.)*, June 26, 2005, D1, D4, for a timeline of the rise and fall of video poker gambling.

<sup>108</sup>Act 59 of 2001.

<sup>109</sup>From J.L. Miskell, "Lotteries in State Revenue Systems: Gauging a Popular Revenue Source after 35 Years," *State and Local Government Review*, vol. 33, no. 2: 87. Cited by Richard D. Young in *State Lotteries: History, Practices, Issues and the South Carolina Education Lottery* (Columbia, S.C.: Institute for Public Service and Policy Research, College of Liberal Arts, University of South Carolina, January 2004), 12.

<sup>110</sup>S.C. Budget and Control Board, Office of State Budget, *Historical Analysis 2005*, "Education Appropriations," 2005, 77-78 <<http://www.budget.sc.gov/OSB-historical.phtm>> The Office.

<sup>111</sup>Office of State Budget, *Historical Analysis 2005*, "Education Lottery Deposits," 76.



## THE LOCAL GOVERNMENT FUNDING SYSTEM STEERING COMMITTEE—1999

The Local Government Funding System Steering Committee<sup>112</sup> has provided the most extensive look at government funding in the state in recent years. In fact, its work is also the first comprehensive look at local government funding since the seventies when additional sources of revenue were first suggested to supplement the property tax. At the request of the legislature, the committee provided a comprehensive look at the state's funding system for local government in a report to the General Assembly in December 2000. The committee's mission was

... the development of a local government funding system reform plan that addresses the needs of local government for a stable and diverse funding system that is accountable to the taxpayers and ensures equitable sharing of the tax burden.<sup>113</sup>

This study followed a period of fiscal activism by several municipal governments during a period of falling financial aid to local governments from the state and constituent pressure to slow the growth of the property tax. Fiscal home rule had not been explicitly mentioned as part of the Home Rule Act,<sup>114</sup> although the courts supported local government's ability to use fees and charges to provide public services and supported the imposition of a local hospitality tax by the city of Charleston as constitutional.

The legislature eliminated any doubt about local government's authority to use methods of taxation not expressly forbidden by the legislature with the passage of the Fiscal Authority Act in 1997.<sup>115</sup> Just as the property tax system set up by Act 208 of 1975 has suffered from piecemeal legislative change, so too has the system of local governance granted by the Home Rule Act as the General Assembly put more restrictions on raising the mill rate, use of impact fees, and expenditure of funds from such new revenue sources as the accommodations tax and the hospitality tax.

In its final report the committee notes that the system of funding the state's local governments is "reasonably balanced for a state that is not highly urbanized." However, the report also noted that state government is much more involved in local fiscal affairs than in most other states. This pattern is consistent with the legislature's historical involvement in controlling local affairs from the state capital. The report's introduction suggests that, for this reason, it would be desirable to conduct a periodic review of the workings of the local government funding system and of "how the state's role might be modified to make it work better."<sup>116</sup>

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<sup>112</sup>Act 100 of 1999.

<sup>113</sup>Local Government Funding System Steering Committee, *Interim Report to the General Assembly of South Carolina*, April 1, 2000, 1 <[http://www.iopa.sc.edu/grs/LGPR\\_interim\\_report\\_4100.htm](http://www.iopa.sc.edu/grs/LGPR_interim_report_4100.htm)> (8/03/05) Institute of Public Affairs, University of South Carolina.

<sup>114</sup>Study Committee on Alternative Sources of Revenue, *Financing County and Municipal Government*, iii.

<sup>115</sup>Act 138 of 1997.

<sup>116</sup>Local Government Funding System Steering Committee, *Local Government Funding System*, 6.

The report focused on local government revenue systems, changes in state aid to cities and counties, and the growth of property tax relief. Although the Home Rule Act did not address school district governance and funding, this report also took a look at this issue that had not been addressed comprehensively since the passage of the Education Finance Act. It brought to the fore a concern voiced by previous studies that districts with more economic resources were able to provide a better educational program than districts with smaller tax bases.

As tax study committees before them had, the Local Government Funding System Steering Committee first set forth comprehensive criteria against which the best tax systems are judged. The committee provided a practical primer of criteria specifically related to South Carolina's system of local government in the first part of its report. The focus was on policy and revenue stability, balance and diversity, equity in distribution of the tax burden, accountability, adequacy or sufficiency, and ease of administration and compliance (7-10).

Committee recommendations covered diverse issues, but the most numerous recommendations centered on the property tax. The impact of growth on local revenue needs and school districts' fiscal and governance issues were also emphasized (11, 18, 24). The committee's first recommendation emphasized the need to collect and analyze local government data so the fiscal implications of current policy and future policy changes can be examined using the same criteria presented in the report (12-14).

In recommending a moratorium on additional property tax relief legislation, the report pointed out the revenue consequences of past changes such as the addition of exemptions, lower assessment rates, fee-in-lieu-of-tax agreements, and use value assessments rather than market value assessments. Often such changes have meant higher taxes on property owners not enjoying special exemptions or consideration.

The committee recommended the moratorium to protect "the integrity of the local property tax base and the revenue stability of South Carolina local governments, especially school districts" while some fundamental decisions were being made "about the purposes, scope, and funding of tax relief in South Carolina" (35). Special mention was made of the practice of sheltering development property in the farming and forestry classification made easy by the low minimum acreage and low revenue test,<sup>117</sup> strengthening calls for looking at the "scope of use value assessment and special valuation rules that shift the burden of property taxation among classes of property."<sup>118</sup>

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<sup>117</sup>S.C. Code, 1976, §12-43-220. Current assessment of agricultural land in the state is based on a formula that uses the fair market value of agricultural land in 1991. Farm real estate values are available annually from the Economic Research Service of the U.S. Department of Agriculture.

<sup>118</sup>Local Government Funding System Steering Committee, *Local Government Funding System*, 36.

Recommendations related to school districts in the local government funding system study asked the General Assembly to consider permitting to all elected school boards to approve their budgets and set mill rates, to explore other types of local taxes for school districts to reduce their dependence on the property tax, and consider allowing school districts to impose development impact fees in order to provide school facilities needed to support population growth. The study indicated that increases in state aid to local districts through the EFA rather than as grants or tax relief were a more effective way to provide adequate funding for all districts, but especially those with lower tax bases and thus lower wealth. The committee also supported a review of the “share and form of school district funding, in order to provide some equalization between richer and poorer/disadvantaged parts of the state” (18, 44-46).

Since the passage of the EFA, which established a formula for state funding of a defined minimum educational program for school districts, the cost of providing the program has risen more rapidly than the rate of inflation used to adjust funding each year. In addition, the pressing question of continued disparities among districts in assessed value per pupil, mill rates, and operating revenue per pupil at the district level will again come to the fore with the anticipated ruling in *Abbeville v. South Carolina*.<sup>119</sup>

The General Assembly’s desire to improve the quality of education by increasing salaries, reducing class size, improving teachers’ credentials, meeting federal requirements, and providing more accountability and testing has contributed to increased costs. As a result, the EFA funded only about 21 percent of total school district operating expenditures in 2002-03 as opposed to 53 percent in 1980. In the twenty-six years since adoption of the EFA, the base student cost in the EFA formula has been funded at or near the legislative requirement only eight of those years. The ability of school districts to respond in a timely manner to changing needs for revenue to finance newly mandated state or federal programs and to pressures for quality education programs often is hampered by lack of fiscal autonomy (11-12).

#### **OTHER RECENT TAX STUDY COMMITTEES AND COMMISSIONS—1994 TO 2003**

After the State Tax Study Commission made its report to the legislature in 1976, its activity continued with little public attention into the eighties when it focused on conforming the state income tax code to the code of the Internal Revenue Service.<sup>120</sup> The commission was “dormant for most of the 1990s, and it was repealed in 1999.” Some considered the com-

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<sup>119</sup>Ulbrich and Steirer, *Financing Education in South Carolina*, 18.

<sup>120</sup>See reports by Peat, Marwick, Mitchell and Company and Peat, Marwick Main and Company to the S.C. Tax Study Commission from 1987-1989.

mission to be duplicating the work of standing committees of the General Assembly after the restructuring of state government in 1993.<sup>121</sup>

With the demise of the commission, which had focused on exercising “great care” in reviewing state tax laws with a focus on “simplicity and fairness,” (9) the legislature created a series of study committees. All of the new committees including the Steering Committee on Local Government Funding (2000), whose work was discussed earlier, gave attention to particular parts of the revenue system or particular issues rather than providing an overview as in the past. In addition, the work of the Ad Hoc Committee on Tax Structure (1994), Property Tax Accountability Reform Group (1995), Joint Tax Study Commission (1997), Tax Reform Task Force (1999) and the Joint Committee on Taxation (2002) did not approach that of former study committees and consultants and produced few reports.

Observers of the government scene during those years report that “most of the piecemeal legislation passed in response to study group conclusions actually made the state’s fiscal situation worse.” They describe the meetings of the Ad Hoc Committee on Tax Structure as “gripe sessions on property taxes, resulting in the \$100,000 residential exemption and the ensuing shortfall of school funds.”<sup>122</sup>

The Joint Tax Study Commission, publishing one of the few study group reports during this period, came to a startling conclusion. In discussing political acceptability and responsibility, the commission concluded that spending “half of the last five years’ surplus . . . on recurring expenditures . . . is an indicator that recurring revenue fell short of funding essential services as determined by the Legislature.”<sup>123</sup>

In defining criteria to be used in evaluating the state’s tax system, the commission recognized the standard criterion of reliability and added one unique to South Carolina—*responsibility*. This criterion stated that no more revenue than that which was needed to function should be raised. If revenue surpassed this criterion, “tax rates should be examined” (4). However, the report’s recommendations did not address revenue shortfalls which *Governing* sees as a “structural budgetary imbalance” brought on by tax cuts, generous tax incentives, and inattention to spending practices. The Joint Tax Study Commission only addressed windfalls, not shortfalls.<sup>124</sup>

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<sup>121</sup>Mike Shealy, “The South Carolina Joint Committee on Taxation,” *Public Policy and Practice: An Electronic Journal Devoted to Governance and Public Policy in South Carolina* 2-2 (January 2003), 2, <<http://ipspr.sc.edu/ejournal/scjointtax.asp>> (6/21/05) University of South Carolina, Institute for Public Service and Policy Research.

<sup>122</sup>“The Way We Tax,” The Government Performance Project, *Governing: The Magazine of States and Localities*, vol. 16, no. 5 (February 2003): 85.

<sup>123</sup>South Carolina, General Assembly, Joint Tax Study Commission, *Joint Tax Study Commission Progress Report* (Columbia, S.C.: The Commission, January 1999), 12.

<sup>124</sup>“The Way We Tax,” *Governing*, 85.

The commission put forth two recommendations for changes in the current tax system. Under their *responsiveness to competition* recommendations, the commission advocated ending the income tax for senior citizens. Under their *political acceptability and responsibility* criterion removing the sales tax on food for home consumption was recommended. No information was provided on the revenue consequences of the suggested changes or the overall impact on the tax system.<sup>125</sup>

The appointment of the Joint Committee on Taxation raised hopes<sup>126</sup> that the committee with powers and duties like those of the previous tax study commission, which looked at “tax law from a systems perspective” would, as the legislation stated,

... recommend changes in the basic tax structure of the State and in the rates of taxation, together with predicted revenue effects of the changes together with proposed alternate sources of revenue, to the end that our revenue system may be stable and equitable, and yet so fair when compared with the tax structures of other states, that business enterprises and persons would be encouraged by the economic impact of the South Carolina revenue laws to move themselves and their business enterprises into the State . . . [and] make recommendations for long-range revenue planning and for future amendments of the revenue laws of South Carolina.<sup>127</sup>

After taking extensive testimony in 2003 the committee work halted and no report has yet been published. The legislation requires that reports and recommendations be made to the General Assembly and to the public by June 30 of 2006, when the committee will dissolve.

Today, legislative committees in both houses of the General Assembly are actively promoting property tax relief for homeowners linked to increasing the state sales tax as a revenue replacement. However, many of the revenue system effects that have commanded the attention of study groups in the past and the desire for the stable and equitable revenue system mentioned in the legislative charge to the Joint Committee on Taxation seem to be receiving little reflection. Proposed changes will also put the state government in charge of funding a major portion of local government services once again, just as state government is the major funder of school districts’ educational programs.

#### THE SOUTH CAROLINA DEPARTMENT OF REVENUE—1994

The S.C. Department of Revenue, formerly the S.C. Tax Commission, is a crucial player in the state and local revenue scene. The department is the collection agent for some thirty taxes, as well as some local taxes, which are rebated to local government.

Since the 1994 governmental reorganization, when the Tax Commission was replaced by the S.C. Department of Revenue, the agency director has served in the governor’s cabinet

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<sup>125</sup>Joint Tax Study Commission, *Joint Tax Study Commission Progress Report*, 15-16.

<sup>126</sup>Shealy, “South Carolina Joint Committee on Taxation,” 2, 4.

<sup>127</sup>Act 334 of 2002.

as an appointed official. As an ex-officio member of the Board of Economic Advisors, the department director is heavily involved in preparing revenue forecasts.

In addition to collecting and reporting general fund revenue, including sales, income and excise taxes, the Department of Revenue also has a property division that does sales ratio studies, computes the indexes of taxpaying ability for the EFA formula, oversees homestead exemptions, assesses about one-third of the total tax base, and oversees the assessment process for county-assessed properties. The Department of Revenue also has various regulatory, legislative, and statistical reporting responsibilities. Together with the state treasurer, the comptroller general, and the chairs of the House Ways and Means Committee and the Senate Finance Committee, the director of the Department of Revenue has major responsibilities for seeing that the state receives all or most of the revenue that the legislative tax structure provides.

According to the department's annual report, in 2003-04 the sales and use tax and individual income tax provided 81 percent of revenue for the general fund. Other taxes provided 11 percent and the corporate income tax 3 percent. The remainder was nonrecurring revenue or revenue from sources other than taxes. The almost \$500 million in revenue from the tax on gasoline and diesel fuel used by motor vehicles, enacted in 1922, is not available for general appropriation.<sup>128</sup>

The Department of Revenue now administers these statewide taxes deposited in the general fund:<sup>129</sup>

- 1922—corporate license fee
- 1922—estate tax
- 1923—admissions tax\*
- 1923—deed recording fee\*
- 1923—tobacco business license and tax on tobacco products
- 1927—individual income tax
- 1927—corporate income tax
- 1931—electric power tax
- 1933—beer and wine tax and license
- 1935—alcoholic liquor tax and license
- 1937—bank tax
- 1939—coin operated devices
- 1951—sales tax\*
- 1951—use tax\*
- 1951—retail license fee
- 1957—savings and loan tax

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<sup>128</sup>For a narrative of events relating to the independent operation of the Department of Transportation (formerly the Highway Department), see *Workman's Bishop from Barnwell*, 38-44.

<sup>129</sup>Portions of taxes marked with an asterisk (\*) are earmarked, but most of the revenue is part of the General Fund. Twenty percent of the sales and use tax is set aside for funding of the Education Improvement Act. The remainder is deposited in the general fund for funding of the Education Finance Act. Lists are from the Department of Revenue's *2003-04 Annual Report*.

1976—aircraft property tax  
1976—private carlines property tax  
1982—bingo tax\*  
1993—controlled substance tax  
1997—telephone service tax (900/976 numbers)

The department distributes revenue from some taxes to agencies, special funds, and projects:

1922—motor fuel tax  
1982—casual excise tax  
1983—low-level radioactive waste tax  
1989—indigent health care—hospital tax  
1995—dry cleaning facility registration fees and surcharges  
1996—911 users fee

Some local taxes are collected by the department and sent back to local governments:

1962—business personal property  
1984—accommodations tax  
1991—local [option] sales and use tax  
1991—solid waste excise tax  
1994—local school district sales tax  
1995—local transportation sales tax  
1997—local capital projects sales tax  
1997—motor carrier property tax

## **RECENT TAX DEVELOPMENTS**

Today the state sales and use tax of five cents on the dollar funds education. The fifth penny, the state's last major tax increase (1984), is deposited in a fund dedicated to the requirements of the Education Improvement Act of 1984. The proceeds of the other four cents are deposited in the general fund, but earmarked by the legislature for support of the Education Finance Act of 1977.

Local sales taxes are adopted by referendum for specific purposes. Any county may propose adoption of a local sales tax to the county electorate. Counties with the local option sales and use tax shared revenue of \$160 million in 2003-04 for property tax relief and other county purposes.

The local transportation sales tax is little used, providing \$43,011 in 2003-04. The local capital projects sales tax is more widely adopted, producing \$45.6 million for local projects in 2003-04. The local school district sales tax, permitted by the General Assembly in ten counties by 2003-04, raised \$9.9 million for Cherokee, Chesterfield, Clarendon, Darlington and Jasper counties in the same fiscal year.

Municipalities with hospitality taxes on prepared food and beverages collect their own taxes. Local taxes on accommodations are also collected locally.

The state income tax statute is presently conformed to federal income tax statutes and uses federal taxable income as the basis for determining state income tax liability. Today the tax falls on both individuals and corporations with certain exemptions for retirees and credits for corporate investments in worker training. In 2003-04, the individual income tax and corporate income tax, respectively, generated \$2.4 billion and \$73.6 million or 41 percent of state revenue.

The property tax continues to be the mainstay of local government funding in spite of increasing use of fee and charges by municipalities and counties and targeted sales taxes by counties. School districts are heavily dependent on property taxes and state aid to fund local elementary and secondary education. In 2002-03, 28.3 percent of municipal funding and of 43.4 percent of county funding on average came from the property tax, while school districts received 30.4 percent of their funding from property taxes.

## THE FUTURE

The South Carolina tax system is and always has been a work in progress. Periodically and usually in association with some fiscal, social, political, or economic crisis, the system's structure is revisited and alterations are made. Some of the alternations have been major, as when the income tax was added and property taxes phased out as a source of state revenue and, again, when a sales tax was adopted. The move to reform property tax administration in the 1970s might also qualify as a major alteration. But beneath the surface of the tax system, it is easy to find the remains of the older structure that dates from the colonial era.

Over the last century, the state has steadily but cautiously moved from a revenue system based almost solely on taxation of real and personal property to one now based on a three-pronged approach to taxation: the property tax, the income tax, and the sales tax. Today that system, in place since 1951, can be described as reasonably balanced because it relies on three traditional revenue sources, each with its own limitations offset by the others' strengths. In its 2003 government performance project, *Governing* describes the state's revenue system as very balanced, especially when state and local taxes are looked at together:

This blend of wealth, income and consumption taxes gives the state a nice mixture of stable taxes and those that are more responsive to changes in the economy. This provides South Carolina with the same benefits of a diversified investment portfolio that balances high-yield



instruments with safer ones. In terms of tax burden, the state is right in the middle in the percentage of income taxed and on the lower end in terms of taxes per capita.<sup>130</sup>

One cloud on the horizon, however, is the question of revenue sufficiency. In 2001-02 for the first time in fifty years the state's revenue system took in less than it had the previous year (2). A series of revenue shortfalls followed. As 2006-07 approaches, state revenue is expected to be at 2002-03 levels.

How did the state successfully move from a tax system that suited the state's economy when it was largely agrarian to today's system? At crucial times in the state's history its political leadership established committees and commissions and engaged consultants to make in-depth studies of the state's tax system and with much deliberation moved forward with changes appropriate to the times. Admittedly, some changes were much delayed and finally implemented only to avert an impending crisis.

After the S.C. Tax Commission was established in 1915 to deal with improving the chaotic and inconsistent administration of the property tax assessment system, it soon became apparent that the commission had its hands full with that one issue. At that point, the decision was made by the legislature in 1920 to set up the Joint Special Committee on Revenue and Taxation to look at broader taxation issues.

The work of the Joint Special Committee on Revenue and Taxation set a standard for groups that followed. Its report was considered "superior" and comprehensive. It succeeded in "identifying critical issues." It was based on an understanding of tax theory. It posed and confronted difficult questions. Its findings and recommended reforms were "well documented and reasoned."<sup>131</sup> From that point forward, the legislature depended on similar tax study commissions and consulting groups to evaluate the state's revenue system and to provide advice for strengthening the system at critical junctures related to the state's economic future.

In the sixties, for example, the state's political leadership, leaders in higher education and elementary and secondary education, and members of the industrial and business community recognized the need to improve the state's economy by improving the state's support of the educational, health, and transportation infrastructure. A consultant's report, *Opportunity and Growth in South Carolina 1968-1985*, helped lead the way to infrastructure funding improvements that underlie today's economy and the addition of the fourth cent in statewide sales tax to fund program improvements in elementary and secondary education.

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<sup>130</sup>"South Carolina Supplemental Report." Supplement to *Governing: The Magazine of States and Localities*, February 2003, 3 <<http://governing.com/gpp/2003/gp3scsup.htm>> (5/3/05).

<sup>131</sup>Paul E. Alyea, *The Role of the State: South Carolina in the Taxation of Property* (Columbia, S.C.: Bureau of Governmental Research and Service, University of South Carolina, 1965), 44-47.

The report confirmed that the state had enough bonding capacity to expand higher education institutions and outlined a way to fund an expanded highway system.

For the seven decades after the establishment of the Joint Special Committee on Revenue and Taxation to the end of the 1980s, extensive evaluation of the revenue system, either by special committees, commissions or consulting firms, took place by action of the General Assembly or at the request of the governor. The work of these groups provided continuing assessments of the adequacy, equity, stability, and efficiency of the revenue system, as well as recommendations for change to the system as circumstances and state and local needs changed.

The work of these groups was successful because it was conducted independent of the politics of the times. The director of the Local Government Funding System project has noted that the clear message to the project's technical working group by the steering committee was to proceed without "concern for the politics" of the moment. In his opinion, this admonition led to technically sound and objective recommendations.<sup>132</sup>

Over the past twelve years the state has moved away from the independent tax commission model and individual changes have been made to the revenue system without sufficient consideration of the impact on the overall revenue system. In the 1997-98 session of the General Assembly alone over 260 bills were introduced to do away with or change various taxes. Of 338 changes in tax law added to the State code in the four previous sessions, 204 reduced or changed revenue.<sup>133</sup>

As South Carolina moves forward into the twenty-first century, the existing revenue system must contend with an economy shifting from manufacturing to services, an aging population with its impact on government revenues and expenditures, continued questions about the equity of its system for funding education, and costly identified infrastructure needs, among other issues. In this economic climate, changes in the tax code that alter the state's revenue stream warrant careful consideration.

Is South Carolina at an important crossroads again? Although *Governing* notes that the state has recently had "more tax study groups than taxes,"<sup>134</sup> it may be time for reinstatement of the tax study commission, based on the historic model. The deliberative processes used in the past may be just what South Carolina needs in such confusing fiscal times.

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<sup>132</sup>Jon B. Pierce, "The Local Government Funding System Project: An Effort to Reform the System—Part I," *Public Policy and Practice* (Oct.-Dec. 2001), 9.

<sup>133</sup>Joint Tax Study Commission, *Joint Tax Study Commission Progress Report*, 3.

<sup>134</sup>"The Way We Tax," *Governing*, 85.

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