

## The impact of tax legislation

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Next month, the 117<sup>th</sup> South Carolina General Assembly will convene. Many of the discussions will continue those begun last session. Other efforts will be made to improve past legislation. It is not unusual for the legislature to re-examine legislation. I expect that further analysis of and discussion of the full effect of the property tax legislation that passed this past session will elicit an effort to make adjustments and improvements to it.

This year the General Assembly approved legislation that, among other things, eliminates all school operating taxes on owner-occupied homes and replaces this funding through a one-cent increase on the state sales tax. The intent of the legislation, and a needed reform, is that many homeowners will see a significant reduction in their property tax bills. It is important, however, to be aware of some of the issues that are likely to arise out of the legislation as it currently stands and where improvement may be needed.

William Gillespie, Ph.D, the Chief Economist for the State of South Carolina, recently produced a 29-page report, excluding exhibits, giving an overview of the recent property tax initiatives. This article relies on his report for many of the issues and data regarding the property tax legislation.

The new legislation provides that, beginning January 1, 2008, state dollars collected under the sales tax increase are to be distributed to school districts dollar-for-dollar based on property taxes that would have been collected had the old system remained in effect. Following the passage of this legislation, several localities have, in the course of the final months of 2006, approved significant increases in millage. Kershaw County and the Kershaw County School District were not among these localities.

Critics of these recent increases contend that the higher millage rates have been adopted simply to draw more state dollars under the new funding arrangement and that the increases would not have been imposed if the costs were to be borne locally. Interest has, therefore, been expressed in amending the legislation so that the millage increases approved since June of this year would not be taken into account under the new funding arrangement.

Concerns have been raised regarding the equitable funding of school districts under this legislation. The legislation provides that school districts will be reimbursed on a dollar-for-dollar basis and not on a per pupil basis, meaning that school districts that were already able to spend more money will continue to get that same money. On the other hand, school districts that were already unable to raise funds from their tax base will continue getting less funds. Many argue that the funding formula should be similar to the distribution formula in the Education Finance Act (“EFA”), which, among other provisions includes a poverty factor, thereby providing greater assistance to poorer counties where it is needed.

Growth in reimbursements to school districts is expected to be about 5.4 percent per year, replacing collections from homeowners that were growing at 12 percent per year. According to Mr. Gillespie this 6 percentage point difference amounts to about \$30 million statewide per year. If the state does not cover this gap and the districts choose to make up the difference from their tax base, it will require an increase of 1.5 mills per year, on average, statewide.

The school districts are also concerned that the sales tax is not as reliable a funding source as the property tax. As the sales tax is collected, it is put into an education trust fund. If the sales tax put in the trust fund is not enough to meet the reimbursement obligations in a year, then the shortfall is made up from the general fund of the State. Of course, if the State is hit with a significant economic downturn, tough choices will have to be made as to what programs receive funding and at what amount. In such circumstances, there is no guarantee that school districts will receive full funding.

One additional glitch: the 2 percent reduction in the sales tax for groceries affects the collection of the one penny designated for the Education Improvement Act (“EIA”). In 2007-2008, the tax cut on groceries is estimated to reduce the general fund by \$135 million, \$27 million of which is a reduction in the amount intended for education through the EIA. This means that each year the General Assembly will have to consider maintaining the funding for the EIA in the budget. Again, as long as the economy is doing fine the funding will more than likely be maintained, but in an economic downturn all bets are off.

While funding of public schools has continued to be a point of discussion in the General Assembly, it has received more emphasis in the past few years. Continued interest in a more equitable funding formula and the implications of the new tax legislation prompted the Senate to establish a Senate Study Committee to consider proposals for comprehensive revisions to the way that South Carolina funds its public schools. This Committee’s findings will likely impact changes made in the original property tax legislation.

Cities and counties will also have adjustments to make. This November the citizens of South Carolina approved a 15 percent limit over a 5-year period on reassessments. This means that local governments will no longer be able to count on additional revenues from the natural growth of property values. Mr. Gillespie estimates that the limit will reduce taxes for commercial and rental property by \$230 million, an amount that is not being replaced with a corresponding tax as the sales tax increase replaced the tax on homeowners for school operations. This gap will require between 2 and 3 new mills per year to maintain growth. These millage increases will be uniformly applied over the entire tax base.

A component of the property tax relief legislation was a cap on millage rates. The General Assembly set new spending caps for local governments at no more than the Consumer Price Index (“CPI”) plus population growth. Therefore, cities or counties that have been losing population will have a limit of less than CPI. Taking into account the

funding gaps created in school operating and assessment for commercial and rental property, along with the estimated mills needed to replace those funds of 1.5 and 3 mills, respectively, jurisdictions that have low or negative growth will be particularly hard-pressed to meet their obligations.

As taxpayers, you will be interested to see how the State determines to address the school funding issues, as well as how your local governments are able to handle the expected funding gaps within the newly imposed spending limits.