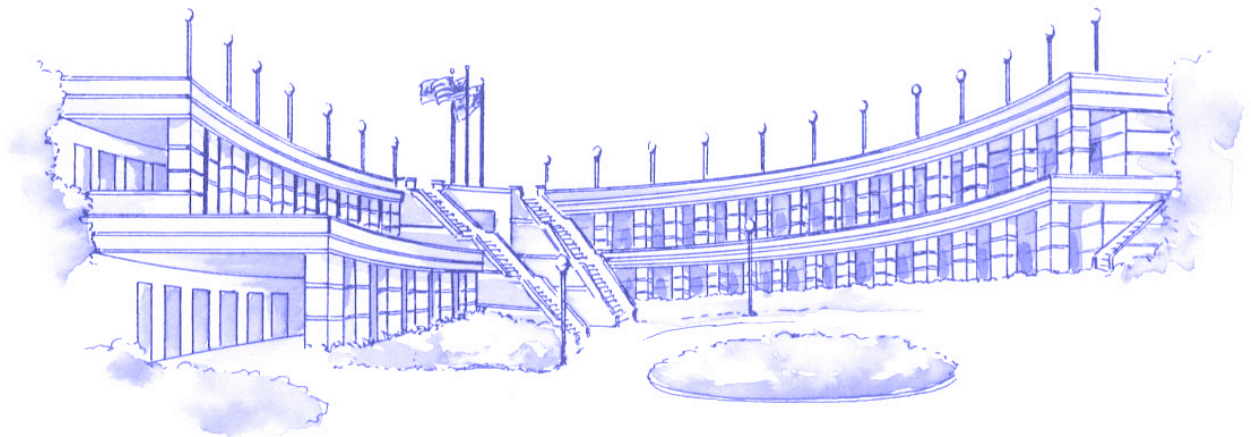


SOUTH CAROLINA'S ROLE IN FUNDING LOCAL GOVERNMENT

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**SOUTH CAROLINA'S ROLE
IN FUNDING LOCAL GOVERNMENT**

By

Holley H. Ulbrich

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Research Project

Evaluation of the South Carolina Revenue System

Project Report

Ensuring a Competitive Revenue System for South Carolina

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ABOUT THE AUTHOR

Holley H. Ulbrich, Ph.D., Alumni Professor of Economics Emerita at Clemson University, is a senior fellow of the Strom Thurmond Institute at Clemson University and the Center for Governance at the University of South Carolina. Ulbrich, the author of six books and well known as a consultant on taxation to government agencies and the General Assembly, has a national reputation. Since the seventies, she has developed recommendations and participated in studies of South Carolina's state and local revenue system that have shaped today's system. In 1997 and 1998 with other colleagues, she completed widely discussed fiscal sustainability research reports that analyzed projected state revenues and expenditures for South Carolina through 2010.

FINDINGS

STATE ROLE IN LOCAL GOVERNMENT FUNDING

- The state's political subdivisions—municipalities, counties, school districts, and special purpose districts—are subject to state regulation in terms of what services they provide and what revenue sources they use.
- Local governments in South Carolina enjoy only a limited degree of home rule. Municipalities have the most flexibility in managing their financial affairs, school districts the least, and counties in between.
- The state's role in local government funding is particularly important in three areas: controlling the property tax, determining what revenue sources local governments may use, and direct state funding for local governments.

STATE ROLE IN THE PROPERTY TAX

- The property tax raised almost \$3.7 billion in fiscal year 2002-03 (special purpose districts excluded) and is still the primary local government revenue source, especially for school districts.
- Although property taxes are locally administered, the state plays a significant role in setting and changing assessment rates, overseeing local assessment, assessing some property at the state level, and providing (and sometimes funding) particular forms of property tax relief.
- South Carolina is one of seventeen states with a classified property tax assessment system, with different assessment ratios for different categories of property. South Carolina's classified system favors homeowners and agricultural property.
- South Carolina gives targeted property tax relief to homeowners, elderly homeowners, owners of farm and forest property, and firms that are being recruited for relocation or expansion. Three-fourths of the states that offer property tax relief base the relief at least partly on need or income, but South Carolina does not.

- A lower assessment rate for personal vehicles provided property tax relief for car owners, phased in starting in 2001. The state did not fund this relief. Personal vehicles constituted 17 percent of the property tax base in 2000, so the reduction in assessment was equivalent to a 7.3 percent reduction in the property tax base.
- Local option sales taxes provide some relief from county and municipal property taxes for all classes of property in the 29 counties that have adopted this tax.
- In addition to legislation permitting the local option sales tax (1990) and the reduced assessment rate on cars (2000), the General Assembly has also provided relief to homeowners from much of their school property taxes (1995) and additional homestead exemption relief for seniors (2000).
- The state places some restrictions on the freedom of counties and municipalities to increase mill rates. Some but not all school districts are also restricted in increasing mill rates.
- In 2002, South Carolina ranked 27th in property taxes as a percentage of personal income and 36th in per capita property taxes among the 50 states and the District of Columbia. Among twelve Southeastern states, South Carolina ranked second in property tax as a percent of income and fourth in per capita property taxes.
- Property tax revenue growth comes from increases in the value of the tax base, either from new construction or changes in the value of existing property, and/or from changes in the mill rate. In the 1990s, as the average mill rate grew more slowly than revenue, the major source of revenue growth was increases in the property tax bases of most counties. Within these tax bases, the fastest-growing components were owner-occupied housing and personal vehicles.
- Property taxes as well as the quality of local services (especially education) influence location decisions for households and business firms. Firms also consider such factors as infrastructure, educational quality, labor force quality, and access to transportation and markets.
- Firms are generally more concerned with the short-term planning horizon (about five years) than the longer time period that is reflected in the state's fee-in-lieu-of-tax agreements. State-authorized fee-in-lieu-of-tax agreements contain no provision for repayment of tax breaks if the firm fails to fulfill its commitments in terms of capital investment, job creation and wages.

STATE ROLE IN OTHER LOCAL GOVERNMENT FUNDING: COUNTIES AND CITIES

- Direct state aid to local governments helps to equalize resources between richer and poorer localities. A per capita distribution helps to ensure that citizens can count on some basic level of local public services wherever they live in the state.
- South Carolina's per capita state aid of \$911 to local governments in 2002 was well below the national average of \$1,235 and 9th among twelve southeastern states.
- The major forms of state aid are state-shared revenues (including the Local Government Fund), state grants, and state reimbursements for property tax relief. Counties received nearly 77 percent of combined aid to counties and municipalities in 2003.
- The largest single source of state aid is the Local Government Fund, which distributes 4.5 percent of the state's last completed fiscal year's General Fund revenues. As the General Assembly has moved certain items off budget (primarily the Trust Fund for Tax Relief), the base on which the Local Government Fund is computed has shrunk, resulting in less state aid to cities and counties.
- In response to demands for local revenue diversification, the General Assembly authorized a statewide accommodations tax in 1984, to be returned largely to the place of origin, and a local option sales tax in 1990, currently adopted in 29 counties. More recently, the state has allowed local governments to adopt a local option accommodations tax, a local hospitality tax on restaurant meals and beverages, and special local option sales taxes for school and county capital projects and transportation.
- The state places a number of restrictions on local revenue authority, including the maximum rate for franchise fees, the terms of impact fees on new development, and the ability to increase the property tax mill rate. The use of funds from the statewide accommodations tax and local option sales tax is also highly restricted.

STATE ROLE IN FUNDING EDUCATION

- South Carolina ranked 32nd in the nation in 2003 in total education funding for school operations per pupil. It ranked 8th among 12 southeastern states in the state share of per pupil revenue.
- Average figures conceal large disparities in tax base, tax rates, and per pupil revenue and operating expenditures among the state's school districts. Operating expenditures in the lowest district (Spartanburg 2, \$5,892 per pupil in 2003) and the highest

district (Allendale, \$11,499 per pupil) show a great deal of variation around a state median of \$7,375 per pupil.

- State aid in 2003 provided 44 percent of operating revenue to school districts—only 39 percent if property tax relief is not counted in the total.
- The primary vehicles for state aid to education are the Education Finance Act (EFA) and the Education Improvement Act (EIA). EFA distributes funds per weighted pupil unit to cover the base student cost of a defined minimum program, with an average of 70 percent coming from the state and 30 percent from local effort. Districts receive more or less than 70 percent depending on their index of taxpaying ability. EIA funds, which come from a dedicated one cent of the five-cent retail sales tax, are distributed on a per pupil basis and are targeted at particular programs and services.
- The EFA base student cost funded by the legislature in 2003 was only 17.2 percent of operating revenue per pupil in that year. Because of higher demands and expectations of schools, teachers, and students, and changes in the technology of education, the 70 percent state share in the EFA formula represents a continuously declining share of actual operating cost.
- The primary tools for equalization among school districts are the EFA, state grants for employee fringe benefits, and certain other programs that are distributed in accord with the EFA formula.

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SOUTH CAROLINA'S ROLE IN FUNDING LOCAL GOVERNMENT

Like most states, South Carolina does not draw clear lines between state and local responsibilities and state and local revenue sources. Education is constitutionally a state responsibility, one that is shared with local school districts both in terms of funding and in terms of the actual service delivery in quality and quantity. Counties have a dual role as an agent of the state for such functions as highways, public safety, libraries, health, and the judicial system and also as a semiautonomous elected local government with the power to raise revenue and provide services.

Municipalities have the most autonomy of all local governments. The state sets the rules for municipal incorporation, dissolution, and annexation, and requires the employment of a city clerk. Otherwise municipalities are generally free to set their own property tax rates, use some or none of the local taxes available by law, impose fees and service charges, and to choose which specific services to provide to their residents.

In any review and evaluation of the state revenue system, three areas of local government finance must be taken into consideration, either because they affect state revenue and expenditure or because the state plays a significant role. These three are the property tax, other sources of local revenue, and funding public education. This paper focuses on how the state is involved in setting budgetary policy rules that apply to local governments.

- ***The property tax*** is the most significant local revenue source for school districts. Counties depend heavily on the property tax, its major revenue source. The property tax is also a significant source of funds for municipalities, especially smaller municipalities. In fiscal year 2002-03,¹ total property tax revenue for all local governments (special purpose districts excluded) in South Carolina, including state reimbursement for property tax relief, was almost \$3.7 billion (BCB 2005b).

The state creates and modifies the basic framework of the property tax, provides property tax relief to selected taxpayers, places restrictions on changes in the property tax rate, oversees assessment, and requires periodic reassessment. Because a portion of state revenue is earmarked for reimbursing property tax relief, and because state aid to education is linked to local property tax contributions, local property taxes are intertwined with state revenue and spending in significant ways.

¹ All years in this report are fiscal years unless otherwise indicated.

- **Other sources of revenue for local governments** have been defined in law by the General Assembly. The state provides state aid to city and county governments and also sets the parameters for raising and using nonproperty tax revenue. State aid to local government is a relatively small but recurrent demand on state resources. In the 1970s, pressure from cities and counties for more state aid resulted in a search for alternative local revenue sources. That search produced a limited and highly constrained set of revenue tools for cities and counties and a modest rebalancing of the shares of total state and local revenue collected at each level.
- Finally, **funding public education**, a major legislative priority, has an impact on state revenue needs and revenue available for other state purposes. A little over 36 percent of state General Fund revenues went to preK-12 education in 2005 (BCB 2005a, 26). The state has a complex system of education funding that includes diverting 20 percent of retail sales tax revenue directly to education programs specified in the Education Improvement Act (EIA). The legislature has also set aside the remaining 80 percent of sales tax revenue, which is part of the General Fund, to fund the state aid to school districts as outlined in the Education Finance Act (EFA).

FRAMING THE PROPERTY TAX: THE STATE'S ROLE

The South Carolina property tax has some features in common with other states and some unique properties that reflect the state's particular tax history. The basic rules governing the property tax are established by the General Assembly. Some features, like the assessment rates for classes of property and borrowing limits tied to the property tax base, are a part of the state's constitution and therefore quite difficult to change.

The General Assembly requires reassessment, setting its frequency and providing assessment oversight, and authorizes counties to cap assessment growth. It has authorized county councils to grant property tax breaks to business and industry, established and funded statewide relief for homeowners and senior citizens, designed a system of school funding that sets the local contribution required to receive state funding, and assesses certain kinds of property at the state level.

The state constitution requires that counties elect an assessor to conduct the local assessment program. The constitution also limits general obligation debt to no more than 8 percent of the assessed value of property, forcing local governments to shift to other vehicles for funding capital investment, such as revenue bonds and lease-purchase agreements.

Most property taxes are collected at the local level,² most often by the county for all local governments (cities, counties, school districts and special districts), although some cities choose to collect their own. Mill rates are set by county councils, city and town councils, special purpose districts with taxing authority, and where they have the fiscal authority, school district boards or county boards of education. The amount that cities, counties and school districts can collect from the property tax and other permitted revenue sources affects the amount of revenue that they require from the state for their operations, so the property tax is a fully integrated part of a comprehensive state and local revenue system.

The property tax is a very old and nearly universal tax. It is levied on an asset that is highly visible, unlike income or sales which can be concealed from the tax collector. In the last 25 years the property tax has come under attack in many states as outdated, unfair, and inequitable. Defenders have pointed to its advantage as a relatively immobile local revenue source and to the connection between the ownership of property and the benefits of local public services. No state has yet succeeded in eliminating the property tax, but many have reduced the level of property taxation or limited its growth, and in particular, many have reduced the role of the property tax in funding education.

Assuming that South Carolina will continue to make the local property tax available as a primary source of revenue for municipalities, counties, and school districts, then the state's decisions on the design of the property tax affect not only local revenue but also the local (especially school district) need for state aid. For this reason, property taxes influence state revenue needs. The amount of revenue required to supplement the property tax and to offset some of its flaws through property tax relief will depend on the design features that can make a property tax more or less equitable, efficient, and adequate.

In designing or redesigning a property tax system, many states including South Carolina make the following structural decisions:

1. What kinds of property should be subject to the property tax?
2. Shall all property be assessed at a uniform percentage of market value?
3. How and by whom should the value of taxable property be determined?
4. Should all property be taxed at a uniform mill rate or should different mill rates be levied on different classes of property?
5. Are there some categories of property and/or categories of taxpayers that should receive some targeted form of tax relief? If so, what should be the purpose of that relief?
6. What governments shall be permitted to levy and collect property taxes? To what restrictions shall they be subject to in setting or changing the mill rate?"

² In 1976, the state decided to levy property taxes on the flight equipment of airline companies operating in the state and private cars operated on railroads in the state. These taxes accrue to the state rather than to local governments.

A recent report on property tax reform in Georgia addressed similar questions and concluded that reforms needed to include greater assessment uniformity, limiting property taxes in relation to income, a larger state share in funding education, property tax relief through local option sales taxes, an indexed homestead exemption, a cap on growth of aggregate assessment rather than individual properties, limits on school taxes per pupil, and a switch to a classified assessment system such as South Carolina already has (Sjoquist 2003). Most of these ideas have been implemented or are under discussion in South Carolina as well.

WHAT KINDS OF PROPERTY SHOULD BE SUBJECT TO THE PROPERTY TAX?

The most universal basis for property tax is land. Because land is fixed in quantity, a tax on land should have no effect on its availability or use. In the nineteenth century, economist Henry George proposed a single tax on land as the most desirable way to fund government, or at least local government. Of course, land varies in quality and therefore market value, so the same tax will raise very different amounts per acre in different locations. Different rates of taxation on land between localities can influence business or residential location decisions.

The second most commonly taxed property is improvements on property—value added to raw land, most commonly buildings or structures but also improvements to the land itself such as landscaping or irrigation that increase its value. All states tax both land and improvements.

Historically, property taxes have been levied on other visible wealth linked to land and buildings, including capital equipment, vehicles, livestock, farm machinery, etc. Until a few decades ago the annual local government report from the Comptroller General's office had separate line items for mules and hunting dogs!

South Carolina also taxes other assets, including personal vehicles and furnishings in commercial, rental and industrial property. Some other states do not tax personal vehicles, but some (not including South Carolina) tax financial assets like stocks, bonds and mutual funds, or other *intangible* assets.

The Appendix provides a convenient summary of the language and procedure for imposing a property tax in South Carolina.

SHALL ALL PROPERTY BE ASSESSED AT A UNIFORM PERCENTAGE OF MARKET VALUE?

Many states require that assessors value property for tax purposes at 100 percent of market value, sometimes in their constitutions as is the case in South Carolina. However,

South Carolina is one of 17 states that then apply different assessment rates to different classes of property rather than applying the same rate to all property. In South Carolina, a single uniform mill rate is applied to a percentage of the market value based on the classification of the property (Table 1).

Table 1. Assessment Ratios for Real and Personal Property in South Carolina, Applied to Market Value Assessment

Rate	Class of Property
10.5%	Real and personal property for manufacturing, utilities and mining
6.0%	Personal motor vehicles ^a
10.5%	All other taxable personal property
9.5%	Real and personal property of companies offering transport for hire
6.0%	All real property not qualifying for a 4 percent rate, including commercial and rental property and some agricultural property
4.0%	Legal residence by request including up to five acres and family farms

^a Phase-in of rate reduction from 10.5 percent prior to 2001 to 6 percent by 2006.

South Carolina has an exceptionally large number of classification rates, which were established in the constitution in 1975 (Act 208) and companion legislation.³ The original rate on personal vehicles was reduced from 10.5 percent to 6 percent over six years as a result of a constitutional change in 2000. The 10.5 percent assessment rate on real and personal property for manufacturing, utilities, and mining has been modified by fee-in-lieu-of-tax agreements as part of business location incentives, so that the firm’s actual liability may reflect the equivalent of a 4 percent or 6 percent assessment, depending on the size of the investment and other considerations. A proposal to make it easier for corporate-owned farm and forest property to qualify for the 4 percent assessment rate was defeated in a statewide referendum in 2004

HOW AND BY WHOM SHOULD THE VALUE OF TAXABLE PROPERTY BE DETERMINED?

In South Carolina, the state is responsible for valuing and assessing business property, including manufacturing, railways, private car lines, airlines, water and/or sewer companies, providers of heat, light, and power, telephone company property, cable television property, pipelines and mining facilities and equipment. The county assessor is responsible for any real property that is not specifically assigned to the state, including most residential, commercial and agricultural property. The county auditor values and assesses personal property of households and commercial and rental properties, such as cars, boats, and office equipment.

³ For a more detailed discussion of elements of South Carolina tax policy, refer to Ada Louise Steirer and James C. Hite, *Historical Development of South Carolina’s State and Local Revenue System*, in this series.

The state oversees the assessment process for real property by doing periodic checks on the ratio of assessed value to market value. Counties are required to reassess at five-year intervals.

The market is the best guide to property value. One basis for assessment of real property is actual selling price of the property itself or similar properties. The challenge in assessing property by any means other than the value at a recent sale is that some properties are unique or at least not very comparable, while others are located in areas of little turnover and therefore have few market benchmarks for assessment. For this reason, the legislature has been considering a switch to acquisition value, in which property is revalued for tax purposes only when sold, transferred, or inherited.

California has used such a system since 1978 with mixed results (Lyon 1998; McGuire 1999). In California, residential property assessments increase 2 percent each year unless the property is sold, at which time it is assessed for its actual sales price (acquisition value). The advantage of such a system of assessment is that there is always a market reference for any change in value other than the annual 2 percent increment. However, this system favors staying in place over mobility, even locking people into a current residence because the tax burden for the next buyer would make it unattractive (Wasi and White 2005). It also creates serious inequities; two identical homes could have very different tax burdens depending on how recently each had been sold.

Land is generally easier to value than buildings. Buildings can be assessed at replacement cost using well-developed formulas and econometric tools. Personal property such as automobiles and boats have well-established market values. The Kelly Blue Book (<http://www.kbb.com>), for example, values vehicles based on year, model, mileage, and condition.

Legislation in 2000 permitted counties to limit to 15 percent any real property valuation increase after a countywide appraisal program. The increase in market value above 15 percent could be exempt from taxation. However, Charleston County's two attempts to use this section of the code have produced S.C. Supreme Court decisions that have ruled this legislation unconstitutional. Legislation is pending in the General Assembly to change the state constitution to meet the objections raised by the courts. Any kind of assessment ceiling is an adaptation of the alternative system of assessment adopted in 1978 in California as part of the Proposition 13 reforms.

SHOULD ALL PROPERTY TAXED AT A UNIFORM MILL RATE OR SHOULD DIFFERENT MILL RATES BE LEVIED ON DIFFERENT CLASSES OF PROPERTY?

Some states determine the distribution of the tax burden among classes of property by having uniform assessment rates and different mill rates, whereas South Carolina chooses uni-

form mill rates across classes but different assessment rates. Since assessment rates are generally stable in most systems, while mill rates can be changed to reflect changes in revenue needs, the South Carolina system appears to serve the needs of local government effectively.

ARE THERE CATEGORIES OF PROPERTY AND/OR CATEGORIES OF TAXPAYERS THAT SHOULD RECEIVE SOME TARGETED FORM OF RELIEF? IF SO, WHAT SHOULD BE THE PURPOSE OF THAT RELIEF?

South Carolina gives targeted relief to homeowners, elderly homeowners, owners of farm and forest property, and business firms that are being recruited for relocation or expansion. Unlike some other states, South Carolina does not target any residential property tax relief on the basis of income or on tax burden relative to income. To some extent relief for homeowners from school property taxes and for all elderly homeowners from all local property taxes can be viewed as anti-poverty, but it also serves as part of a strategy to attract prosperous retirees.

The oldest form of state property tax relief in South Carolina is the homestead exemption, which funds relief from all local property taxes on the first \$50,000 of market value of owner-occupied residential property for persons who are 65 year of age or older, or are permanently and totally disabled or blind. The value was raised in 2000 from \$20,000 to \$50,000, and the cost to the state in 2005 was \$155 million (BCB, 2005a, 33). Other states provide similar relief to other categories of homeowners, such as disabled, blind, or veterans. Some states also extend property tax relief to renters through mechanisms such as circuit breakers (Cico, et al. 2004).

Property tax relief for homeowners for school taxes on the first \$100,000 of market value was instituted in 1995. The relief is calculated on the basis of 1995 mill rates. Initially the cost of this relief was \$195 million, but by 2005 it had risen to \$249 million, at which level it has been capped for the past several years (BCB, 2005a, 33). Currently the legislature is considering increasing the sales tax rate in order to provide relief to cover all homeowners' school taxes as well as other forms of property tax relief, including personal vehicles and some rebates to renters.

The state also authorizes counties to negotiate favorable tax agreements with business firms as an inducement to locate there. Counties may negotiate fee-in-lieu-of-tax agreements that set the firm's property tax obligation at the equivalent of the current mill rate applied to a 4 percent or 6 percent (rather than 10.5 percent) assessment and freeze that mill rate for periods up to 30 years (DOR 2005b). The state does not fund any of this tax relief.

Most other southern states offer similar property tax incentives for industrial location. The economic justification is that there will be at least some fiscal gain over time (revenue over costs of services provided) and, in most cases, substantial private economic gain in terms of jobs and income, including state income and sales tax revenue.

The most recent form of property tax relief was granted to owners of personal vehicles in the form of a gradually reduced assessment rate. The voters approved this relief as a constitutional amendment in 2000, and the phased reduction of the assessment rate from 10.5 percent to 6 percent will be complete in 2006. The state did not fund any of this relief. Personal vehicles constituted 17 percent of the property tax base in 2000, so the reduction in assessment would be equivalent to a 7.3 percent reduction in the property tax base in that year (BCB 2005b).

Caps on real property value increases at reassessment are attractive to some property owners residing in areas where property is appreciating rapidly. However, caps on rapidly appreciating property come at the expense of other taxpayers whose millage levy will be higher because portions of the increases in property value of some taxpayers are exempt from taxation. To the extent that capped property values reduce local government revenue, public services may also be reduced.

Relief to some farm and forest property is in the form of assessment at use value rather than market value, which results in very low assessments and very low tax burdens on any property that meets fairly lenient requirements for acreage and use. While other states offer similar relief, generally there is a large minimum acreage and/or some required evidence of farm or forest income from the property.

WHAT GOVERNMENTS SHALL BE PERMITTED TO LEVY AND COLLECT PROPERTY TAXES? TO WHAT RESTRICTIONS SHALL THEY BE SUBJECT IN SETTING OR CHANGING THE MILL RATE?

Some states collect their own revenue from the property tax, but in most states, including South Carolina, this tax is designated by the state as primarily a local revenue source, used by cities, counties, school districts and some special purpose districts.

State-imposed limits on fiscal autonomy for school districts in South Carolina vary from district to district. Some have complete fiscal autonomy, some have no authority to raise the mill rate, and others have restrictions on the annual increase.

Cities and counties are required to have absolute majorities (a majority of the fixed number of members of a body, not a majority of those present and voting) in order to increase the mill rate. The General Assembly has considered imposing additional restrictions but has not done so to date.

PROPERTY TAX IN COMPARISON TO OTHER STATES

In 2002, South Carolina ranked 27th in revenue from property taxes as a percent of state personal income among the 50 states and the District of Columbia, a measure of tax burden. The state ranked 36th in per capita revenue from property taxes, somewhat lower in tax adequacy (Table 2). South Carolina is below the U.S. average on both measures, but is not low within the region. The Southeast is well known for low property taxes. Among southeastern states, South Carolina ranks behind only Florida in revenue from property taxes as a percent of income and behind Florida, Virginia, and Georgia in per capita revenue from property taxes.

Table 2. Property Tax Comparisons, Southeastern States, 2002

State	% Income	Rank	Per Capita	Rank
Alabama	1.3	51	\$329	51
Arkansas	1.6	49	\$371	50
Florida	3.2	22	\$944	22
Georgia	2.7	35	\$778	35
Kentucky	1.9	44	\$483	46
Louisiana	1.7	45	\$433	47
Mississippi	2.6	37	\$574	42
North Carolina	2.4	41	\$652	39
South Carolina	3.0	27	\$754	36
Tennessee	2.2	42	\$596	41
Virginia	2.8	32	\$923	27
West Virginia	2.1	43	\$499	43
National Average	3.1	n.a.	\$969	n.a.

Source: Porča a, Saltzman and Ulbrich 2005.

PROPERTY TAX REVENUE GROWTH

Property tax revenue growth comes from new construction, increases in property values for existing property, and/or changes in the mill rate. Measuring growth in property tax in South Carolina is complicated by the fact that in many counties the local option sales tax has been used to replace part of the property tax. From 71 percent to 100 percent of the revenue from this tax goes to property tax relief.

Between tax year 1996 and 2002, the state's property tax base, assessed property value, has grown at an average rate of 5.8 percent a year. Growth of the base results from a combination of new construction and increased valuations of existing properties. Mill rates have risen an average of 1.5 percent a year over the same period, resulting in an average annual increase in property tax revenue of 7.1 percent a year between 1997 and 2003. Mill rates for counties have actually declined on average at a rate of 1 percent a year while school district millage has risen at an average of 1.7 percent a year and cities and special purpose districts combined have raised mill rates by an average of 3.1 percent a year (BCB 2005b).

As Table 3 indicates, the largest share of the property tax base is owner-occupied residential and commercial and rental property, which together account for just over half the tax base. Personal vehicles accounted for 18 percent of the tax base in 2000 and a significant share of the growth, but that growth came to a halt with the phased reduction in the assessment rate on motor vehicles beginning in 2001.

The lack of growth of manufacturing base is partly the result of the use of fee-in-lieu-of-tax agreements and partly the rapid loss of value in abandoned or closed factories as the manufacturing base continues to move to other countries. School districts claim on average three-fifths of total property tax revenue, with the rest going primarily to counties.

Table 3. Value of Property Tax Base, South Carolina, 1996-2002

	Total	% Share	Total	% Share	Average Annual Growth Rate
	\$ Millions		\$ Millions		
	1996	1996	2002	2002	
Property tax base (assessed)	\$10,649	100.0	\$14,964	100.0	5.8
Owner occupied residential	2,439	22.9	3,977	26.6	8.5
Commercial and rental	2,812	26.4	4,521	30.2	8.2
Personal property (vehicles) ^a	1,957	18.4	2,147	14.3	1.6
Personal property (all other)	0	0.0	210	1.4	n.a.
Agricultural	106	1.0	113	0.8	-3
Manufacturing ^b	1,687	15.8	1,281	8.6	-4.5
Business personal property	517	4.9	648	4.3	3.8
Utility	1,131	10.6	1,361	9.1	3.1
Motor carrier	0	0	59.2	0.4	n.a.
Fee-in-Lieu and joint industrial parks	0	0	647.1	4.3	n.a.
Average combined millage rate	260.7	100.0	284.4	100.0	1.5
School districts	1,239	52.3	2,019	53.2	8.5
Counties	661	24.1	894	20.8	5.2
Municipalities and special districts	242	23.6	328	26.0	5.2
	1997	1997	2003	2003	
Property tax revenue	2,142	100.0	3,241	100.0	7.1
School districts	1,239	57.8	2,019	62.3	8.5
Counties	661	30.9	894	27.6	5.2
Municipalities and special districts	242	11.3	328	10.1	5.2

Source: BCB 2005b.

^aSlow growth reflects reduction in assessment rate between 2001 and 2003.

^bExcludes fee-in-lieu-of-tax agreements covering most new property; negative growth reflects plant closings and depreciation on older property.

EFFICIENCY ISSUES: PROPERTY TAXES AND INCENTIVES

Property taxes can affect location decisions, particularly in conjunction with services. Households and business firms evaluate the fiscal surplus or deficit of various alternative locations. Over time, areas with high tax burdens and/or poor services relative to tax burdens will see an exodus of more mobile residents and businesses and a decline in property values reflecting the fiscal package (taxes and services) that are associated with the property.

As property values fall, so does property tax revenue, forcing mill rates upward to maintain services and making the area even less attractive to newcomers, until finally only the least mobile remain. Conversely, areas with low mill rates and quality services will attract residents and firms, driving up property values and expanding the property tax base. The relationship between mill rates, property values and taxpayer mobility can create either a vicious or a virtuous spiral that widens the gap between rich and poor counties and school districts.

Much of the attention is focused on the role of the property tax in attracting or retaining industry. While it may play a role in making a final choice between locations that are otherwise similar, its role is probably overrated relative to such factors as infrastructure, educational quality, labor force quality, and access to transportation and markets. Studies suggest that the time frame for the firm's decision is also much shorter than the length of the average fee-in-lieu-of-tax agreement (Bartik 1991). Finally, the typical South Carolina agreement at present contains no provision for repayment of tax breaks if the firm fails to fulfill its commitments in terms of capital investment, job creation and wages (DOR 2005c). All of these aspects of fee-in-lieu-of-tax agreements suggest that they could be fine-tuned as incentive devices for attracting or retaining industry.

PROPERTY TAX EVALUATION

South Carolina's property tax is the primary local revenue source for local governments, especially school districts. The classified system favors some types of property because of presumed hardship (farmers, the elderly, homeowners) while others are assigned a larger share because of presumed greater ability to pay (industry, personal property). Recent additional forms of property tax relief enacted by the General Assembly since the 1990s (fee-in-lieu-of-tax agreements, school property tax relief for homeowners, expanded homestead exemption, reduced assessment rates on cars, authorizing a reassessment cap) have further altered the distribution of the property tax burden, not always in ways that have made it more equitable or more efficient (DOR 2005b).

The state is responsible for the structure of the property tax, including assessment rates and frequency or reassessment. The General Assembly is constantly challenged to balance political demands to constrain the growth of property taxes against the need for local governments to have some independent source of income so that they are not entirely dependent on the state or pressuring the state for additional funds.

There is a vocal minority constituency in South Carolina that would like to abolish the property tax altogether, or failing that, to abolish property taxes on owner-occupied housing and/or personal vehicles. Local governments have struggled in the last four years to make up the revenue loss from the reduced assessment rate on vehicles, which was not

reimbursed by the state. Clearly the property tax will be a political bone of contention for some years to come.

STATE AID AND STATE REVENUE CONSTRAINTS ON LOCAL GOVERNMENTS

Local governments are created by and are usually dependent upon their “parent” states, so their finances are difficult to separate. Because the state is responsible for its local governments, South Carolina and other states exercise some authority over and provide financial aid to local governments.

State aid to local governments helps to equalize resources between richer and poorer localities. Most of South Carolina’s aid to cities and counties is distributed on a per capita basis, but that method still results in some redistribution because more of the state’s funds come from richer areas than poorer ones. A per capita distribution helps to ensure that citizens can count on some basic level of local public services wherever they live in the state.

Another purpose of state aid is to help pay for those public services for which benefits are not confined to residents of the city or county that has responsibility for providing them, such as highways or health and recreation facilities. In some cases, state aid reflects a different set of priorities for local services. When the state insists that a service be provided, sometimes it recognizes that a mandate should be accompanied by financial resources to pay for the service.

Finally, local governments operate in a very competitive environment, so it is difficult for them to raise taxes and fees. The state’s greater revenue-raising capacity can be tapped to help local governments limit the amount of revenue they have to raise locally. Table 4 shows per capita state aid to local governments in South Carolina and other southeastern states. South Carolina is well below the national average and ranks 9th among twelve southeastern states in state aid to local governments.

Table 5 summarizes state aid to South Carolina counties and municipalities in 2003. State grants, which must be spent on a specific project or service, provided \$91 million to South Carolina counties and \$27 million to municipalities in that year. State state-shared revenues, which are not earmarked for particular uses (except for accommodations tax revenues), provided \$218 million to counties and \$69 million to municipalities. State reimbursement to counties and municipalities for the homestead exemption for the elderly came to \$36 million for counties and \$10.5 million for municipalities.

The difference in state aid to counties and cities is partly a function of population. All South Carolinians live in a county, but only 36 percent in a city (Census Bureau 2005b). Even after

accounting for the population difference, however, counties are still favored over cities in the distribution of state aid.

Table 4. Per Capita State Aid to Local Governments, Southeastern States, \$, 2002*

State	Per Capita
Alabama	949
Arkansas	1,088
Florida	895
Georgia	1,006
Kentucky	805
Louisiana	939
Mississippi	1,041
North Carolina	1,163
South Carolina	911
Tennessee	730
Virginia	1,017
West Virginia	926
U.S.	1,235

Source: Porčá a, Saltzman and Ulbrich 2005.

*Includes school districts, counties, municipalities and special districts.

Table 5. State Aid to Counties and Municipalities, South Carolina, 2003

	Total \$ Millions	Per Capita \$
Counties	\$357.5	\$86
State shared taxes	218.0	53
Grants	91.3	22
Homestead reimbursement	36.3	9
Manuf. Depreciation Reimbursement	11.9	3
Municipalities	108.0	78
State shared taxes	68.6	49
Grants	27.2	20
Homestead reimbursement	10.5	8
Manuf. Depreciation Reimbursement	1.7	1

Source: BCB 2005b; Census Bureau 2005a, b.

STATE AID TO SUBDIVISIONS

State aid to subdivisions is the official term for state-shared revenue in South Carolina. This state-to-local revenue sharing includes three sources for cities and nine for counties.⁴ The largest source is the Local Government Fund (LGF), which provided \$224 million to cities and counties in 2005 (BCB 2005b).

The amount to be distributed to cities and counties through the LGF was set in 1991 at 4.5 percent of the state's last completed fiscal year's revenues. As the General Assembly has moved certain items off budget (primarily the Trust Fund for Property Tax Relief of \$505

⁴ State aid to subdivisions to cities contains: Local Government Fund, statewide accommodations tax, and merchants' inventory tax. For counties: local government fund, fire department premium tax, brokers' premium fire department tax, statewide accommodations tax, merchants' inventory tax, direct appropriations, solid waste tire fee, vital records fees, and motor carrier property tax.

million in 2005), the base on which the 4.5 percent is computed has shrunk, resulting in less state aid to cities and counties in recent years than they would otherwise have received (BCB 2005a).

LOCAL OPTION TAXES

In 1990, the General Assembly authorized counties to adopt by referendum a 1 percent local option sales tax, with revenue shared between the county and its municipalities on the basis of a formula that was partly population and partly place of sale. At least 71 percent of the revenue must be dedicated to property tax relief, although many counties opted for 100 percent. Twenty-nine counties have now adopted the tax. Collections in 27 counties in 2004 were \$159.8 million (DOR 2005a).

Counties are now also permitted to adopt special local option sales taxes by referendum for school and county capital projects and transportation at rates of 1 to 2 percent. The projects must be specified in the referendum and the tax expires as soon as the projects have been paid for. In 2004, these special local sales taxes generated \$55.6 million in revenue (DOR 2005a).

Georgia has a similar tax and relief requirement for the local option sales tax. In Georgia, the effect of the local option sales tax has been a combination of lower mill rates, slower growth of property tax revenue, and higher overall revenue for local governments (Jung, 2001).

The effect of the local option sales tax on mill rates and property tax revenue growth has been more pronounced in South Carolina than in Georgia because of the high percentage of sales tax revenue that must be dedicated to property tax relief. The property tax base increased on average by 5.8 percent a year between 1997 and 2003. Mill rates declined an average of 1 percent a year during that period for counties while they rose an average of 3.1 percent per year in cities and special districts combined. Overall, own-source revenue rose at an average annual rate of 6.6 percent for municipalities and 6.4 percent for counties during the same period, while average annual growth of property tax revenue was 5.2 percent for both (BCB 2005b).

In 1984, the General Assembly created a hybrid state/local accommodations tax. The rate was fixed at 2 percent on transient accommodations, and the revenue was collected and disbursed by the state, so there was no element of local choice in rates or whether to use the tax at all. However, the revenue did return to cities and counties.

Except for an administrative fee and some required sharing of revenue with small, rural counties, all accommodations tax revenue returns to the place of origin to be used partly for general spending but primarily for tourism promotion and tourism-related activities. In

2004, this tax generated \$34.7 million in revenue (DOR 2005a, 20). Cities and counties are also allowed to impose an additional local accommodations tax of 1 percent in addition to the statewide tax, as well as hospitality taxes of up to 2 percent on restaurant meals, with state-imposed restrictions on how the revenue may be spent.

The state also allows cities and counties to use business licenses, which are listed among fees and charges but are actually a business income tax because the amount is determined by the type of business and its gross receipts. Most medium to large-sized cities use business licenses, but very few counties have opted to use this form of revenue.

RESTRICTIONS ON LOCAL REVENUE AUTHORITY

Municipalities charge franchise fees for the use of local rights of way for telecommunications infrastructure. Prior to 1999, municipalities had been charging rates from 3 percent to 5 percent of local recurring charges. As franchises come up for renewal after 2003, the rate must drop to 1 percent. All other telecommunications companies would begin to pay a comparable rate in 2004. This rate is very low compared to neighboring states.

Impact fees on new development are an important revenue source for rapidly growing municipalities, which provide resources to help address the growing service demands of new residents and firms. The state regulates the use of such impact fees to ensure that the services paid for with impact fees benefit only the newly developed areas.

Cities and counties must have an absolute majority—a majority of council membership, not of those present and voting—to increase the mill rate. Cities and counties are not permitted to use any taxes not specifically authorized by the General Assembly, which are presently limited to property tax, local accommodations and hospitality taxes, local option sales and capital projects taxes, and business licenses and franchise fees. While business licenses and franchise fees are counted among fees and charges, they are in fact local business income taxes authorized by the General Assembly.

EVALUATION

South Carolina is within regional norms in sharing revenue with local government, but there is a degree of uncertainty and unpredictability that makes it difficult for cities and counties to plan, especially when the state also imposes constraints on the use of other revenue sources. The shrinkage in the base of the Local Government Fund has kept this revenue source from keeping pace with inflation and population growth in recent years. Some of that shrinkage was due to declining state revenue, but some was also due to taking more items off-budget.

The addition of new revenue sources such as accommodations taxes and local sales and hospitality taxes has provided only limited fiscal relief because of the constraints placed on the kinds of expenditures these taxes can support—or in the case of local option sales tax, by the property tax relief requirement.

EDUCATION FUNDING

Another important area of state-local interaction is in funding K-12 education.⁵ Funds for education come from federal, state, and local sources. Federal aid is primarily targeted to special needs populations, including developmentally disabled children and children from families below the poverty level. However, federal aid is only about 7 percent of total school funding for operations in South Carolina (BCB 2005b).

The primary responsibility for funding education is shared between the state and the 85 school districts. The proper division of that responsibility and the form and distribution of state aid is subject to continuous debate and revision. Public education funding, as the largest single category of spending, is an important driver of revenue needs in South Carolina.

Like other Southeastern states, South Carolina is below the national average in per pupil revenue. Six of the twelve Southeastern states are above the national average in the share of school funding coming from the state level (Table 6). South Carolina ranked eighth among twelve Southeastern states in the state share of per pupil revenue and was slightly below the national average in state aid per pupil in 2002-03, \$3,993 versus \$4,525. Two of the Southeastern states that rely more on local funding, Florida and Tennessee, have no broad-based state income tax as a revenue source.

Table 6. Education Funding, Southeastern States, 2003: Operating Revenue

State	Pupils	Total Revenue \$ millions	Total Revenue Per Pupil	Rank	State Aid Per Pupil	State Share of Funding %
South Carolina	691,714	\$5,701,083	\$8,242	32	\$3,993	48.4
Alabama	727,898	5,193,757	7,135	46	4,076	57.1
Arkansas	450,132	3,228,309	10,697	11	6,102	74.2
Florida	2,536,699	19,546,222	7,705	38	3,425	44.5
Georgia	1,495,819	13,520,958	9,039	22	4,380	48.5
Kentucky	660,782	4,870,361	7,371	43	4,395	59.6
Mississippi	491,623	3,256,835	6,625	49	3,569	53.9
North Carolina	1,314,632	9,905,507	7,535	41	4,541	60.3
Tennessee	905,059	5,969,796	6,596	50	2,927	44.4
Virginia	1,175,454	10,327,826	8,786	25	3,478	39.6
West Virginia	281,591	2,497,391	8,869	24	5,397	60.9
U.S.	47,632,643	440,316,023	9,244		4,525	49.0

Source: Census Bureau 2005c.

⁵ Or pre-K-12 education, since some school districts offer four-year-old kindergarten programs.

Table 7 summarizes the operating revenue sources for South Carolina's school districts in 2003, including the total and per pupil amounts, the percentage share, and the average rate of growth for each source since fiscal year 1997. Unlike Table 6, Table 7 does not include capital expenditures or bond proceeds. According to Table 7, state aid accounted for 44.4 percent of operating revenue in 2003 if reimbursement for property tax relief is counted as state aid—less if those funds are considered just third-party payment of local property taxes. Local effort accounted for 46.4 percent, most of it from the property tax. State aid in the form of sales tax and other General Fund revenue appropriated for EFA, EIA, and grant programs has declined as a percentage of total operating revenue, from 45.6 percent in 1997 to 38.7 percent in 2003, even though state aid has increased in total and per pupil dollars.

Table 7. Education Funding, South Carolina, 2003: School District Operating Revenue

	\$ Millions 2003	Per Pupil Revenue 2003 ^a	% Share 1997	% Share 2003	Average Annual Revenue Growth 1997-2003 (%)
Total revenue ^b	\$5,995	\$ 9,126	100.0%	100.0%	8.0%
Total state aid (property tax relief reimbursements excluded)	2,318	3,816	45.6	38.7	5.1
Education Finance Act	1,032	1,571	24.9	17.2	1.5
Education Improvement Act	478	728	9.2	8.0	5.5
Grants	749	1,140	11.0	12.5	10.3
State-shared revenue ^c	20	30	0.5	0.3	2.1
Lottery	39	59	n.a.	0.7	n.a.
Federal aid	553	843	8.0	9.2	10.7
Own-Source ^b	2,784	4,238	40.3	46.4	10.6
Property tax	2,044	3,111	32.8	34.1	8.7
Service charges	258	393	5.9	4.3	2.5
Miscellaneous	482	734	1.6	8.0	40.6
Reimbursements for property tax relief	339	517	6.1	5.7	6.5
School tax relief	245	373	5.6	4.1	2.4
Homestead exemption	73	111	0.5	1.2	24.8 ^d
Manufacturers' depreciation	21	32	0.0	0.4	n.a.

Source: BCB 2005b, 3.

^aPer pupil calculations by authors using S.C. Department of Education 2003 average daily membership of 656,873.

^bState funds for reimbursement of property tax relief excluded.

^cExcludes revenue from bonds and leases.

^dHomestead exemption was raised from the first \$20,000 of market value to \$50,000 beginning in 2001.

STATE AID

In South Carolina, state aid to K-12 education comes through funds appropriated for programs specified under the EFA and EIA, as well as state grants. Property tax reimbursement is discussed separately from flow of other state funds to school districts because it does not add to education resources but merely provides third party payment for property taxes.

Education Finance Act. The EFA, passed in 1977, distributed \$1.03 billion to school districts in 2003 and \$1.08 billion in 2005. The 2005 value was an increase over the preceding two years but less than in each year from 1999 to 2002 (BCB 2005a, 59). Average daily membership (ADM) in the state's school districts has been increasing despite these fluctuations in funding. In 1997 ADM was 655,375, in 2003 it was 656,873, and in 2005, 667,620 (SDE-Research 1998, 52-53; SDE-Research 2004, Table 40; SDE-Research 2005).

The heart of the EFA is a formula to fund the base student cost of a defined minimum program of public education split 70 percent/30 percent between the state and local school districts. The amount of state aid to a particular district will be more or less than 70 percent based on the district's taxable wealth—its property tax base. Fifteen districts received less than 70 percent state aid for EFA in 2006 because of their wealth. Seventy districts will receive 70 percent or more of the EFA base student cost from the state (SDE-Finance 2005).

The EFA formula is based on the number of pupils, the amount to be funded per pupil (base student cost), and the district's taxpaying ability. In 2005, there were 839,967 "weighted pupil units." Weighted pupil units reflect differences in the cost of serving student populations based on grade level, learning disabilities, physical and emotional learning disabilities, homebound students, and vocational students.⁶ For each weighted pupil unit, the legislature appropriated \$1,852—the base student cost in 2005. In that year, the number of weighted pupils multiplied by the base student cost came to \$1.56 billion, and the state's 70 percent share was \$1.08 billion. For 2006, the legislature appropriated \$1.37 billion for EFA expenditures based on estimated weighted pupil units of 847,426 (BCB 2005a, 59).

The base student cost of a defined minimum program was established in 1977. Since then it has been adjusted for inflation in most years. The state's Board of Economic Advisors presents an inflation-adjusted figure, which the legislature may or may not choose to adopt.

Since the adoption of the EFA, the General Assembly has funded the base student cost at or near the EFA requirements in only 8 years out of 26 (Ulbrich and Steirer 2005, 11). For example, in 2005 the base student cost approved by the legislature was \$1,852, which was less than the \$2,234 that would be the 1977 figure adjusted for 27 years of inflation. However, appropriations for 2006 fully fund the inflation-adjusted base student cost of \$2,290. The base student cost reflects the costs and levels of educational quality desired by the state in 1977. It has not been adjusted since then to account for changes in educational programs or technology.

⁶ About 21 percent of the funding goes to students with various handicaps or learning disabilities, including speech, hearing, visual, orthopedic, emotional and educability handicaps.

The EFA base student cost funded by the legislature in 2003 represented only 17.2 percent of total operating revenues per pupil in that year, down from nearly 25 percent in 1997 (Table 7). The increase in revenue and expenditures per pupil since 1977 reflects not only inflation but also the higher demands and expectations of schools, teachers, and students as well as changes in the technology of education. So EFA's 70 percent state share is not 70 percent of the actual per pupil operating cost for school districts. Instead it is only that percentage of a somewhat artificial number that was set in 1977 and adjusted thereafter, which represents a continuously declining share of actual operating cost.⁷

The EFA also has a requirement for local support—an average of 30 percent of base student cost per weighted pupil, lower in poor districts and higher in wealthier districts. The state's contribution is determined by subtracting local required effort from the formula amount. How much more or less than 70 percent a district receives is determined by the size of its tax base relative to the state as a whole, or the *index of taxpaying ability*, which is calculated annually by the Department of Revenue.

The index of taxpaying ability is the percentage share of total assessed value of taxable property in a particular district, and the sum of the indexes for the state's school districts is 1.00. The index for 2002 ranged in value from a high of 0.105021 (10.5 percent of total assessed value in the state) in Charleston and 0.104579 (10.5 percent) in Greenville to 0.000537 and 0.000514 (0.05 percent) in both Clarendon 3 and Dillon 1 (SDE-Research 2004, Table 103).

The funding formula for the “average” district is $TF = WPU * BSC$ where TF is total funding, WPU is weighted pupil units and BSC is base student cost (Ulbrich and Steirer 2005, 12-13). For example, if BSC was \$2,000 and the average district had 4,000 WPUs, then its total formula funding for EFA would be \$8 million, of which \$5.6 million (70 percent) would come from the state and the remainder of \$2.4 million from local sources, mainly the property tax. In practice, these figures would be adjusted by the index of taxpaying ability so that a poor district with the same number of weighted pupils would receive more than \$5.6 million and a richer district would receive less. Districts where housing values have been growing very rapidly often see an increase in their index of taxpaying ability that results in reduced EFA funding.

Education Improvement Act. In 1984, the General Assembly passed the EIA, increasing the retail sales tax rate from 4 percent to 5 percent, with the extra penny earmarked for school improvement. These funds are distributed on a per pupil basis. Each year the General Assembly sets the priorities for various performance objectives, such as basic

⁷ The original base student cost number was part of the 1976 EFA legislation. Each year the Budget and Control Board provides an inflation-adjusted estimate of the current equivalent amount. The General Assembly may or may not choose to fund that amount.

skills remediation and exit exams, enhancing vocational education, reducing pupil-teacher ratios, improving teacher quality, or making better provision for handicapped students. In fiscal year 2003, the extra penny generated \$478 million in EIA funds,⁸ which was 22 percent of total state aid (property tax relief excluded) to K-12 education and 8 percent of total school district revenue (Table 7). EIA funds are not part of the General Fund and are not available to be appropriated for other purposes.

State grants. State grants are another source of aid to education and provided \$749 million in 2003 (BCB 2005b). While some grants were for highly specific purposes, most of the funds went to districts to help pay the cost of employer contributions to fringe benefits to school employees, distributed among districts on the same basis as the EFA formula of weighted pupil units and index of taxpaying ability.

Property tax relief. State reimbursement for property tax relief accounted for another \$339 million in revenue to school districts in 2003, or 5.7 percent of total revenue. School tax relief for homeowners was \$245 million in that year, along with \$73 million in home-stead relief for the elderly and \$21 million from the manufacturers' depreciation reimbursement (BCB 2005b). These funds come from general revenues but are diverted directly into the Trust Fund for Tax Relief and do not appear in the General Fund where they would have to compete with other demands for state spending.

The local share: property taxes and other sources. Property tax revenue to school districts increased at an average annual rate of 8.7 percent per year between 1997 and 2003. This growth occurred because of increases in the property tax base, because of fluctuations in state revenue not earmarked for tax relief, and, to a lesser degree, because of increases in the mill rate. When state reimbursement for property tax relief is added to property tax revenues, this category increased at an average rate of 8.4 percent per year between 1997 and 2003. Like cities and counties, school districts have leaned harder on service charges and miscellaneous revenues to fund increases in school operating costs, often because they are subject to a variety of limits on their ability to increase their mill rates.⁹

The average school mill rate masks great variation among districts. Total mill rates (operations and debt service) in 2003 ranged from 108.2 in Greenwood 52 to 282.07 in Lexington 4, with a median of 170 mills. Mills for school operations alone ranged from 81.5 in Clarendon 2 to 238.3 in Lexington 1 (SDE-Research 2004, Table 100). Mill rates reflect both the

⁸ The \$478 million in EIA revenue to school districts in 2003 reported in the *Local Government Finance Report* (BCB 2005b) differs from the \$513 million in EIA revenue collections reported by the Office of State Budget in *Historical Analyses* (BCB 2005a).

⁹ Some school districts enjoy full fiscal autonomy; some have limited ability to increase mill rates; while others are subject to a county board of education or county council in financial matters.

district's tax base and the spending desires of its residents. Some districts with relatively high mill rates choose to tax themselves to provide revenue for certain programs. Other

Table 8. School Property Tax Revenue, South Carolina, 1997 and 2003

	1997 (Millions)	2003 (Millions)	Average Annual Growth 1997-2003 (%)
Local property tax revenue (tax relief excluded)	1,239	2,044	8.7
State-funded property tax relief ^a	232	339	6.5
Total property tax revenue ^a	1,471	2,383	8.4
Value, property tax base ^b	10,650	14,964	5.8
Average school mill rate	136.3	151.3	1.7

Source: BCB 2005b.

^a Growth rate calculated by author.

^b Value is for 1996 and 2002, respectively.

districts with high mill rates have a very low tax base and must use a high tax rate to obtain revenue.

The ability to raise the mill rate in order to adequately fund schools varies from district to district, depending on how much fiscal autonomy they enjoy. The fiscal autonomy of individual school districts was set by the General Assembly and can only be changed by legislative action—a relic of the pre-1974 era of government by county delegation.

EQUITY, ADEQUACY AND INCENTIVES: SOME ECONOMIC EFFECTS OF THE EDUCATION FUNDING SYSTEM

The present system of education funding does provide some limited equalization among districts, but the gap between 2003 operating expenditures in the lowest district (Spartanburg 2, \$5,892 per pupil) and the highest district (Allendale, \$11,499 per pupil) shows a great deal of variation around a median of \$7,375 per pupil in 2003 (SDE-Research 2004, Table 104). While the EFA formula results in some equalization, over 75 percent of state aid is distributed on the basis of that formula and less than half of education funding is from the state (state reimbursement for property tax relief excluded), so that only 30 percent of total state and local funding is based on equalization between poor and rich districts.

A long-running court case, *Abbeville County School District v. State of South Carolina*, has attempted to determine whether funding for education, which is a state responsibility, is equitable and adequate. In 2002, the state Supreme Court determined that there was no constitutional obligation for funding to be equitable but that each district had to have at least minimally adequate educational resources. The case was remanded to circuit court to resolve the definition of minimal adequacy. The outcome of that court case was announced in December 2005 and calls for increased early childhood education funding. The decision is likely to be appealed.

EVALUATION

Revenue per pupil appears to be within regional norms for South Carolina school districts, but averages conceal large disparities in tax base, tax rates, and per pupil revenue among the state's school districts. School districts are heavily dependent on state aid, which has been cut in recent years, although the 2006 budget has restored EFA funding to the full amount required by the formula. School districts are heavily dependent on the property tax and do not have access to alternative local revenue sources nor, in many cases, much leeway in raising mill rates in order to cover revenue needs.

CONCLUSION

Most states exercise some degree of parental authority over local governments because it is the state's responsibility to ensure adequate local public services (especially K-12 education) for all of its citizens regardless of the taxable wealth of their particular part of the state. State aid to local government in various forms must compete with demand for other state services in the face of a limited amount of state revenue available for these purposes. The state also feels a responsibility for the fiscal health of local governments because any default on local government obligations is likely to require the state to intervene. The state must weigh these two responsibilities against the need and desire for local fiscal autonomy and accountability.

Different states sort out these conflicting priorities in different ways. In South Carolina, historically, local government has been highly centralized. Home rule for counties is relatively recent, and the state plays a significant role not only in funding education but also in establishing standards and measuring performance. Only cities have some degree of autonomy, but even in that area the state plays a significant role.

As the regions of the state become more diverse in their needs and fiscal resources, there are more pressures from below for a greater variety of local revenue sources, more dependable state aid, less state oversight or regulation, and an increased state share of funding K-12 education. At the same time, citizen groups dissatisfied with the fiscal performance of local governments continue to turn to the General Assembly for relief, arguing not only for more property tax relief but also for more constraints on the fiscal powers of local governments.

The state has tried to provide aid to cities, counties, and school districts through mechanisms such as the Local Government Fund, EFA and EIA—stable and dependable sources with a first claim on state revenue. But in recent years, those first claims have been compromised by the General Assembly not fully funding base student cost in the EFA formula and reducing the base on which the Local Government Fund is calculated.

The state also plays an important role in setting the parameters within which local governments are permitted to raise own source revenue. Along with a short list of permitted taxes (local sales tax, accommodations tax, business license, and hospitality tax as well as impact fees subject to state requirements), the state designs and redesigns the property tax rules that govern the largest source of local government revenue. State regulation of the property tax addresses the five year reassessment and millage rollback, assessment rates for classes of property, state-funded property tax relief, and limits on raising millage. For school districts, there is the added burden of coming up with the required local match for EFA, which comes out of the local property tax.

At this time the state is reconsidering many aspects of property tax funding for local governments, particularly schools. The most prominent proposals are focused on further property tax relief for homeowners (funded with higher sales tax) and some caps or other limits on the amount by which property can increase in value at the time of the every five year reassessment.

Twenty-first century South Carolina and its local governments present a very different picture from the rural, textile mill state of a century ago. Some local governments have excellent professional management, adequate local taxable resources, and a knowledgeable and interested citizenry. Others are less fortunate.

For some, rapid growth of assessed valuation is a challenge that redistributes the tax burden within the county or school district and results in a higher index of taxpaying ability and reduced state EFA aid. For others, the lack of growth in the tax base is the problem, and their primary concern is the high mill rates needed to raise enough revenue. It is difficult to devise equitable, efficient and adequate solutions that meet the needs of both groups of counties, cities and school districts at the same time.

The tension between the state's need and desire to exercise control and local governments' needs for autonomy, accountability, stability, and flexibility has been present for at least 30 years, when counties were first given some degree of home rule. A stable, dependable, efficient, equitable, and accountable mix of funding sources for local government with an acceptable balance of state oversight and local autonomy continues to prove as elusive a goal in the 21st century as it was in the last few decades of the 20th century.

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APPENDIX

How the Property Tax Works in South Carolina

The property tax levied on a particular piece of property is equal to the market value of the property times the assessment rate (=assessed value) times the mill rate minus any credits or relief.

The major assessment rates in South Carolina are:

Owner occupied homes and certain farmland	4.0%
Rental and commercial property including commercial farm land	6.0%
Personal vehicles	6.0%
Industrial property	10.5%
Business personal property	10.5%

Farm and forest property is assessed on the basis of use value rather than market value and therefore has very little taxable value.

An owner occupied house in South Carolina worth \$150,000 would be assessed at 4 percent of market value, or \$6,000. The average mill rate in 2003 for all local governments combined was 271 mills, or 27.1 percent. We assume that 175 mills was imposed for schools and the other 96 mills for city and county purposes. The tax on this house would be \$1,626 if there were no credits or relief.

However, the first \$100,000 is exempt from school property taxes at 1995 mill rates, largely but not entirely funded by the state. If this school district had a 1995 millage of 140, then the bill would be reduced by \$4,000 (assessed value) x .140, or \$560. The resulting bill would be \$1,076, with the other \$560 paid by state tax relief.

If this homeowner were elderly, \$50,000 of market value would be exempt from city, county and school taxes, also funded by the state. This homeowner would receive a further credit of \$50,000 x .04 x .271, or \$542, reducing the bill to \$534.

If this homeowner lived in one of the 27 counties with a local option sales tax, there would be an additional credit for local option sales tax based on the revenues received and the distribution between city and county.

A six-unit apartment building with a value of \$300,000 would be assessed for \$18,000 (6 percent of market value). At 271 mills, the tax bill would be \$4,878. Rental property does not receive school tax relief or elderly relief, but might receive some relief from local option sales tax.
