ACT 388 OF 2006

THE SHORT COURSE

PRESENTATION TO THE HOUSE TAX POLICY REVIEW COMMITTEE

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Part I Explanatory Notes

Property tax and the State Constitution

The Special Status of Property Tax--General Obligation Debt--Full Faith and Credit

Article X of the state constitution authorizes the state and, when authorized by the law, political subdivisions of the state, including school districts, to incur general obligation debt for public purposes.

Article X provides that the timely repayment of state general obligation debt is secured by a pledge of the "full faith, credit and taxing power" of the state. The taxing power specifically pledged by Article X to secure state general obligation debt is the property tax.

The General Assembly, in the various bond acts, has authorized municipalities, counties, school districts, and special purpose districts to incur general obligation debt for the public purposes of these political subdivisions and pledges the full faith, credit and taxing power of these subdivisions for the timely repayment of this general obligation debt. The bond acts provide that the property taxing power of these political subdivisions secures the general obligation debt they incur.

Various streams of revenue are provided by law to service general obligation debt incurred the state, including motor fuel user fees and various motor vehicle fees for state highway bonds, tuition fees paid by students at state higher ed institutions for state tuition bonds, and state general fund revenues for other types of state general obligation bonds. Similarly, local sales and use tax revenues may be pledged to secure general obligation debt incurred by school districts and counties. However, at the end of the debt servicing day, after all the primary and other statutory "backup" source revenues have been applied, it is a "property tax without limit" that is imposed to guarantee timely payment of general obligation debt.

The property tax millage imposed to guarantee the timely repayment of general obligation is not limited or capped. Instead, it is imposed ministerially and "without limit" by the State Controller General in the case of state incurred general obligation debt and by the county auditor for general obligation debt

incurred by the county, and general obligation debt incurred by a school district, municipality, and special purpose district situated in the county.

State Constitutional Requirements for the Property Tax

The state constitution requires all real and personal subject to property tax to be appraised at fair market value (FMV), or for agricultural use property, appraised at fair market value for agricultural use (FMVAU). There will be more on this subject below in the discussion of Act 388. Appraisals to arrive at fair market value for property tax purposes are performed, depending on the type of property, by either the Department of Revenue, the county assessor, or the county auditor.

To determine the assessed value of taxable property to which millage is imposed, the state constitution currently establishes ten classes of property that include all taxable real and personal property, each with an "assessment ratio." The assessment ratios, ranging from a low of four percent to a high of 10.5 percent, are applied to the FMV of each parcel of real property and each item of personal property included in the particular class. The assessment ratios applicable to property in the class established for agricultural use property are applied to FMVAU. The state constitution allows the assessment ratio assigned to an existing class of property to be changed by statute if the bill making the change is approved by at least a two-thirds majority vote of each house of the General Assembly.

A simple example of this process is represented by a parcel of real property with a commercial building on it appraised by the county assessor as having a fair market value of $300,000. Commercial real property falls in a class with a six percent assessment ratio, so multiplying the FMV by that assessment ratio produces an "assessed value" of $18,000. Multiplying the assessed value by the combined 400 mills imposed by the various property taxing jurisdictions in which the parcel is located produces the property tax due on the parcel. One mill equals one dollar for each thousand dollars of assessed value and thus a millage rate of 400 mills produces a property tax liability of $7200.

Article X of the state constitution establishes ten types of property that are completely or partially exempt from property tax. Article X also allows the General Assembly to enact additional exemptions by statue. To be valid, these additional exemptions have to receive at least a least a two-thirds majority vote in each house of the General Assembly must apply statewide. Increasing an existing homestead exemption or establishing a new homestead exemption requires only a majority vote of each house. As of 2016, the General Assembly has enacted 51 property tax exemptions in addition to the ten constitutional exemptions.

Part II Explanatory Notes

Act 388 of 2006.

The Swap

Act 388 of 2006, beginning with property taxes due for tax year 2007, added a new homestead property tax exemption for millage imposed for school operations on property classified as owner-occupied residential property and assessed for property taxes at four percent of FMV. The exemption is equal to one hundred percent of the FMV of the residence, thus effectively eliminating property tax millage imposed for school operations on all such property

Effective June 1, 2007, the act imposed an increase in the state-imposed sales and use tax, raising that rate from five to six percent. The additional tax did not apply to property subject to the $300 sales tax cap and to the state sales tax on accommodations. Sales tax on cars, boats, aircraft, etc., remains at five percent and the state sales tax on accommodations remains at seven percent. Revenue from the additional state sales tax is credited to the Homestead Exemption, created by Act 388 to receive that revenue and from which school districts are reimbursed to offset the school operations property tax not collected because of the new homestead exemption

As part of the sales tax changes in Act 388, the state sales tax on groceries was reduced from five percent to three percent effective October 1, 2006. In Act 115 of 2007, effective November 1, 2007, the General Assembly eliminated the then three percent sales tax on groceries, thereby fully exempting groceries from state sales tax.

Beginning July 1, 2007, school districts began receiving reimbursements from the Homestead Exemption Fund. In that fiscal year 2007-2008, each school district received from the Homestead Exemption a "Tier 1" reimbursement equal to its prior year's state distribution to offset the former homestead exemption for millage imposed for school operations. That former exemption applied to up to $100,000 of FMV of owner-occupied residential property. Each school district also received a "Tier 2" reimbursement equal to its prior year's state distribution to reimburse the district for property tax it imposed for school operations not collected by the district due to the homestead exemption allowed for homeowners who have attained age 65 and homeowners who are permanently and totally disabled. The "Tier 3" reimbursement each school district received for fiscal year 2007-2008 consisted of revenue of the one percent "swap" sales tax which, together with its Tier 1 and Tier 2 reimbursement, was sufficient to provide a dollar for dollar reimbursement for revenue not collected as a result of the new homestead exemption. Tier 1 and Tier 2 reimbursement amounts received by school districts for fiscal years after fiscal year 2007-2008 are frozen at the fiscal year 2007-2008 amount. After fiscal year 2007-2007, the statewide Tier 3 reimbursement amount is increased annually by the total of the percentage increase in the consumer price index and the percentage increase in the state's total population in the prior year. After fiscal year 2007-2008, a school district receives each year a Tier 3 reimbursement equal to its prior year Tier 3 reimbursement increased by a share of the annual growth in the Tier 3 reimbursement based on the proportion that the district's current number of EFA weighted pupil units is of the total of EFA weighted pupil units statewide. If sales tax revenue in the Homestead Exemption Fund is insufficient to cover the total reimbursements required, the difference is made up from general fund revenues. If the total Tier 3 annual reimbursement made to the school district(s) located in a county is less than $2.5 million, the difference is "topped up." When a county consists of multiple school districts, the "top up" amount is distributed based on a proportionate 135 day average daily membership formula.

The Hard Annual Millage Increase Cap

Act 388 of 2006 amended the millage cap imposed on annual increases in millage imposed for operating purposes by municipalities, counties, special purpose districts and school districts first enacted in 1997 and amended in 1999. In the Act 388 amendment, the annual increase in millage imposed for operating purposes was limited to the total of the percentage increase in the previous year of the consumer price index and the previous year increase in the population of the taxing jurisdiction. Under prior law, the then applicable limit could be exceeded by a "positive majority" vote of the governing body of the taxing jurisdiction. The Act 388 limit allows the limit to be exceeded by a two-thirds vote, but only for very limited purposes relating to financial emergencies or for expenses imposed on the jurisdiction by court orders or by state or federal government mandates.

Since Act 388, this "hard cap" has been revisited multiple times, most notably to allow "unused" millage increases allowed under the cap to carry forward for three years.

Assessable Transfer of Interest--Fifteen percent Cap on Increases over Five Years in Fair Market of Real Property

The sales tax increase and new homestead exemption "swap" and reimbursement features of Act 388 of 2006 did not require any amendment to the state constitution. However, the limit or "cap" in increases in the fair market value of real property for purposes imposing property did require amending the state constitution. The state constitution requires real property to be appraised at its FMV or FMVAU, as applicable, to arrive at the assessed value to which property tax millage is applied to determine the property tax liability. The purpose of the "South Carolina Real Property Valuation Reform Act" enacted as part of Act 388 of 2006 was to limit to fifteen percent over five years increases in the fair market of real property attributable only to inflation or market driven increases in the value as reflected in the implementation every five years of a countywide reassessment program.

The fifteen percent cap does not apply to value attributed to improvements made on a parcel of real property since it's last appraisal for property tax purposes.. The fifteen percent cap continues to apply until the parcel of real property undergoes an "assessable transfer of interest," at which time the property is undergoes a "point of sale" appraisal for property taxes at its then FMV or FMVAU in the hands of its new owner.

A simple example of this system is as follows:

1). A buys a house as his personal residence in 2014 in County B. The purchase price of the house is $150,000. The assessor appraises the FMV of the house and lot at $150,000.

2). In 2018, County B implements a countywide reassessment program and determines that A's house and lot then has a FMV value of $175,000. The fifteen percent cap limits the increase in the value of the property to $172,500 ($150,000 + 15% X $150,000=$172,500.)

3). In 2023, when County B implements its next countywide reassessment program and determines the then FMV of A's house and lot is $204,000, the 15 percent cap limits the increase to $198,375 ($172,500+15% X $172,500=$198,375.).

4) In 2024, A sells his house and lot to C for $215,500. The sale is an "assessable transfer of interest. The County B assessor makes a point of sale appraisal of the house and lot in which he determines that the purchase price represents the FMV and assigns that FMV to C's house and lot for property tax purposes.

To allow a "capped" FMV to be used in calculating the assessed value of A's house and lot as provided in Act 388 of 2006 required an amendment to the state constitution specifically allowing such a "capped" FMV . The required constitutional amendment was proposed by the General Assembly by Joint Resolution 402 of 2006, approved by the voters at the 2006 general election, and ratified by the General Assembly by Act 12 of 2007. The "South Carolina Real Property Valuation Reform Act" portion of Act 388 of 2006 took effect on the ratification of the constitutional amendment

The constitutional amendment also specifically provided that the "capped" FMV of a parcel of real property would continue to apply until the parcel underwent an

“assessable transfer of interest,” a change in the ownership of the parcel that would trigger a point of sale reappraisal of the property. The amendment required that the General Assembly define by general law those ownership transfers constituting an “assessable transfer of interest.” Ownership transfers that are not an assessable transfer of interest do not trigger a reappraisal, and the parcel, in the hands of the new owner, retains the same property tax value it had in the hands of the previous owner. In Act 388, the General Assembly provided a detailed listing of ownership transfer methods and circumstances that are and are not an assessable transfer of interest.

A simple example of application of these rules is a follows:

A and B, a married couple, live in a house owned by A. They have resided in the house for twenty years. In those twenty years, countywide reassessment programs have determined that the FMV of the house is $235,000, but pursuant to Act 388 of 2006, that FMV is currently “capped” at $201,000. A and B divorce in 2029 and in the equitable distribution of the marital property, the ownership of the house and lot is transferred to B. The ownership of the property has been transferred, but Act 388 provides that this transfer is not an assessable transfer of interest, therefore there is no point of sale appraisal, and the FMV of the house for tax purposes in B’s hands remains the capped FMV of $201,000.