# Report of the Task Force on Revenue for World Class Learning

**September 25, 2008**

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**Presented to Jim Rex**
**State Superintendent of Education**

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Department of Education
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## *From the*
## Task Force on Revenue for World Class Learning

The Task Force on Revenue for World Class Learning consisted of a diverse group of leaders from business, education, citizen groups, and government whose task was to address the revenue dimension of ensuring an adequate foundation program for all of South Carolina's children, regardless of the school district in which they live.

For a variety of reasons, 2008 is a timely moment in which to reconsider South Carolina's system of funding education, in determining cost and adequacy distribution among districts, deciding how resources can be generated, and determining how the responsibility of paying for education will be shared between state and local governments, homeowners and businesses, and wealthy and poor South Carolinians in an equitable manner.

South Carolina, like most other states, funds education through a state-local partnership, supplemented by targeted federal aid. The terms of that partnership have changed substantially in the 30 years since the Education Finance Act (EFA) was created. As a primary consideration, the demands on the school system have increased dramatically in recent years, as outlined in the report of the Task Force on Funding for World Class Learning.

But the revenue system that generates the resources to pay for public education also has changed dramatically over the past 30 years. The Education Improvement Act (EIA), passed in 1984, increased the sales tax but earmarked the revenue for specific programs rather than general operations.

The composition of the property tax base, which provides the foundation for the local funding share, has also changed as South Carolina has followed the national trend toward a less manufacturing-based and more service-based economy. In an attempt to attract and retain more industrial and commercial development in an increasingly competitive environment, South Carolina during the 1990s expanded the use of fee-in-lieu-of-tax agreements and multi-county business parks and granted more authority to counties to negotiate these agreements

Compounding these effects is the national movement toward property tax relief that resulted in statewide property tax reduction measures in 1994 and again in 2006, through Act 388. Some of the revenue loss from state-mandated property tax relief was replaced by the state, including homeowner relief for school operating taxes in 1994 and 2006 and the increased homestead exemption for the elderly and disabled. The homestead exemption remained the only dollar-for-dollar reimbursement, however, because the state failed to fully fund the 1994 tax relief soon after its inception. The revenue loss from the reduction in the assessment rate on personal vehicles beginning in 2000 was not replaced by the state and was particularly costly in small, disadvantaged school districts where vehicles were a large share of the property tax base.

Even when the state funded property tax relief, however, the present and future distribution of state funds for education among districts was significantly altered by this property tax relief and especially by Act 388.

South Carolina also has weathered dramatic ups and downs in state fiscal resources over the last 15 years as the economic boom of the 1990s gave way to a severe downturn in revenues in the early part of the twenty-first century, with another downturn projected for the next few years. Tax cuts in other areas, spending commitments to many purposes other than education, and an under-funded "rainy day" fund have threatened both the adequacy and the stability of state funds for education.

Yet the future of education funding is now more heavily dependent than ever on the health of the state revenue system. Between 1982 and 1994, just before the first property tax relief bill was passed, the state's share of education funding declined from 59 percent to 56 percent (excluding federal aid and revenue for capital projects and debt service). The state share of education funding, including property tax relief, increased to 58 percent by 2003 but will increase again with implementation of Act 388.

The restricted ability of school districts to raise local resources, combined with unstable funding from the state revenue system, clearly threatens South Carolina's ability to provide the world class education that our citizens rightly demand and that our state requires to remain competitive in the twenty-first century.

The report of the Task Force on Funding for World Class Learning addressed the question of what is needed in every school district to provide a world class education. Our recommendations focus on ways in which South Carolina might strengthen both local and state revenue systems to support adequate and equitable funding for a world class education in every school.

## Goals and Guiding Principles

The work of the Task Force on Revenue for World Class Learning was governed by one goal and four guiding principles:

**Goal:**
To provide school districts with local and state revenue tools that are stable, flexible, growing, and adequate for both school operations and facilities.

**Guiding Principle 1:**
To improve equity among taxpayers, especially between households and businesses, which has been altered by Act 388.

**Guiding Principle 2:**
To increase equity across school districts and students so that every child has the opportunity to obtain an adequate twenty-first century education.

**Guiding Principle 3:**
To create adequate and stable revenue sources to provide a quality educational program that is not vulnerable to fluctuations in the economy.

**Guiding Principle 4:**
To create a funding system that is simple, transparent, and easy for the average citizen to understand.

To achieve these objectives, the task force proposes recommendations in two broad policy areas, the property tax and state revenue sources:

A. Make the property tax more equitable and more adequate for education funding.

B. Strengthen state revenue sources to ensure adequate education funding in the future while providing for other state needs as well.

Like the Task Force on Funding for World Class Learning, the Task Force on Revenue for World Class Learning made recommendations for immediate action to mitigate the adverse effects of Act 388 of 2006 on school districts. These recommendations are included where appropriate in the property tax and state revenue sections. A summary of task force recommendations related to Act 388 is found in Appendix A.

## A. An Equitable, Adequate Property Tax for Education Funding

The property tax is, and will remain, an essential source of local revenue for public schools. It is a more stable revenue source than the two primary state revenue sources (income and sales taxes), and it ensures some degree of local investment in and ownership of the school system that is critical for the success of public education.

Nevertheless, there is room for improvement in how the property tax is administered, and there are also opportunities to broaden its base and make it more equitable for taxpayers and school districts. Act 388 also invites a reconsideration of how the property tax is integrated into the overall adequacy funding program proposed by the Task Force on Funding for World Class Learning.

There are three distinct patterns of property tax bases and property tax rates among school districts in South Carolina: districts with large, growing, and diversified tax bases and low tax rates; districts with limited and slow-growing tax bases and high tax rates; and suburban districts with tax bases that have a substantial owner-occupied residential component and moderately high tax rates.

As a result of these different property tax situations, a similar taxable property pays very different taxes for school operations depending on where it is located. Inequities among taxpayers and districts have increased as a result of Act 388 because state payments for property tax relief are heavily concentrated in districts whose property tax base has a higher share of high-value owner-occupied residential property. The inequities extend from the tax side to the spending side of local public education.

Education is a shared state and local responsibility. Numerous court decisions have indicated that the quality of a child's education should not depend on the taxable wealth of the district. Taxpayers also deserve to receive the same minimum level and quality of educational services in exchange for the same amount of tax dollars paid regardless of the district in which they live.

At the same time, retaining a local share of education funding not only retains some local ownership and support but also implies some freedom to exceed the minimum standard in both tax rate and educational quality. Equality means leveling up, but not necessarily leveling down in terms of expenditures per pupil.

The task force identified four reforms that would ensure a continued role for the property tax in sharing the cost of education between state and local governments while permitting diversity among districts. The task force recommends that South Carolina:

1. Require a uniform minimum millage for school operations on non-owner-occupied property to constitute the local share of the adequacy program;

2. Continue the ability of school districts to levy additional millage for school operations, in addition to the required minimum millage;

3. Strengthen the base of the property tax and protect it from the risk of additional erosion;

4. Revise the ITA to reflect the change in the taxable status of owner-occupied property caused by Act 388 and earlier property tax relief programs.

**1. Required Uniform Minimum Millage for School Operations**

The task force believes that adoption of the proposed uniform required minimum millage plan is essential to reduce inequities among districts in local property tax effort while guaranteeing that all districts receive sufficient state funding to implement the full adequacy program.

Variants of a uniform required minimum millage are in place in 15 states. Some states use a simple uniform millage or equivalent, while others use a minimum requirement and the option to levy additional millage as needed (Appendix B).

Under Act 388, the uniform millage would apply only to the portion of the tax base that is not owner-occupied homestead property or fee-generating property. It would serve as the local match for the proposed adequacy program, replacing and simplifying the present maintenance of effort requirement and correcting the problems with the ITA that have resulted from state property tax relief legislation as well as use of fee-in-lieu agreements for economic development.

The required minimum mill rate should be set by the General Assembly or its designee so as to generate some desired local percentage of the total cost of the adequacy program and should be adjusted annually as needed to maintain that percentage. In many currently disadvantaged school districts, it should be possible to reduce the mill rate and thus reduce their handicap in attracting industrial and commercial development. Further, under a uniform required minimum millage, business firms in many school districts would find themselves facing lower school operating millage, mitigating some of the tax burden shift toward businesses that occurred under Act 388. Appendix C illustrates how much revenue would be raised by uniform property tax rates ranging from 100 mills to 150 mills.

Elements of the uniform required minimum millage plan are as follows:

A1 (a): Each district should levy the identical school operating millage on all non-owner-occupied property, the rate to be determined annually by the legislature based on the desired state-local division of cost for the adequacy program.

A1 (b): The state should collect revenue from the required uniform minimum millage on state-assessed utility and industrial property, other than properties currently under fee-in-lieu-of-tax agreements. State-collected property tax revenues should not go into the South Carolina General Fund but rather be placed in a separate fund and distributed back to school districts based on weighted pupil units (WPUs).

A1 (c): Any additional property taxes for school operations on rental, commercial, agricultural, and personal property should be collected and retained at the local level.

A1 (d): Because the imposition of an annual uniform required minimum school operating millage would affect different districts differently, the task force recommends phasing in the change in both coverage and mill rate with a corresponding phase-out of the ITA.

A1 (e): Local districts should continue to levy debt service millage on all classes of taxable property.

A1 (f): The present 70-30 split in the cost of the EFA program was based on a broader local tax base that included owner-occupied property, which averages 29 percent of the tax base. With a substantial reduction in the tax base to which the uniform minimum operating millage applies, and an increase in the dollars needed to fund the adequacy program, the local share should be reduced. The exact division of shares, perhaps 75-25 or 80-20 between state and local, should be a legislative determination.

A1 (g): The uniform required operating millage should fulfill the requirement and expectation that local governments will make a reasonable and equitably determined effort to contribute to the cost of the adequacy program. The option to levy additional millage (since the required millage is expected to be lower than actual current millage for about 80 to 90 percent of school districts) will permit districts to provide supplemental revenue for educational programs not included in the adequacy program. The minimum required operating millage would eliminate the need for both the ITA and the maintenance of effort requirement, simplifying the school funding system and making it more comprehensible to both legislators and citizens.

A1 (h): The distribution of state aid for the adequacy program among districts should be based solely on WPUs. Each district should receive the full cost of the adequacy program per pupil, determined as follows: After local school districts have levied the required minimum millage and the state has distributed property tax relief funds, the balance of the funds needed to pay the full cost of the adequacy program should be supplied to each district by the state. These funds would include EFA funds, some EIA funds, and other existing state revenue streams as well as such additional funds as are required.

A1 (i): Some districts may be able to raise enough funds by levying the required minimum millage added to property tax relief so that no state aid is required for the adequacy program. The state should guarantee that every district will receive at least 10 percent of the total cost of the adequacy program. If a district can fund the adequacy program with 10 percent state aid, property tax relief, and less than the required minimum millage, it should be allowed to levy the appropriate reduced millage for purposes of the match to the adequacy program requirement.

A1 (j): The uniform minimum mill rate for school operations should be reviewed and adjusted annually based on changes in education costs. If the program is phased in along with the adequacy program, districts should be held harmless during the phase-in period.

Implementation of a uniform required minimum mill rate for school operations on non-homestead property would result in a much simplified funding formula for education in South Carolina. Each district would be entitled to the total annual amount determined by the adequacy program for each of its WPUs. The base local funding for each district would be only the amount that its required millage raises. To that would be added state property tax relief under the three existing programs, including Act 388. Finally, the state would fund the rest of the adequacy program with general and EIA funds. Every child in South Carolina would have the required funds for an adequate twenty-first century education.

The "filling up the glass" approach to determining state and local funding shares for the adequacy program offered by required uniform minimum millage is a much simpler, clearer, and more equalizing approach to funding the child regardless of the district in which the child lives. Taxpayers throughout the state would make the same level of effort based on uniform required millage. The state would then level-up funding on a per-pupil basis in each district to support the adequacy program.

The few districts that have ample taxable resources and low current mill rates would be protected from a large jump in millage by the 10 percent minimum state funding provision. Because an annual uniform school operating millage would affect districts differently, the task force plan calls for phasing in the change in both coverage and mill rate with a corresponding phase-out of the ITA, over a period of as long as nine years. The negative effects of Act 388 on the equity in distribution of funds to school districts are mitigated by treating Act 388 property tax relief funds as part of overall state adequacy program funding.

**2. Additional Millage for School Operations**

The task force strongly believes that flexible local revenue shares that permit diversity in school curriculums and activities create a stronger sense of ownership and therefore more local support for education. Therefore, the task force recommends that all districts should have access to the same ability to adjust their millage above the required minimum in order to provide adequate funding for their children. This additional millage is intended to meet needs for growth, enrichment, and other special requirements that vary from district to district and are not included in the adequacy program. The task force makes the following recommendations in this area:

A2 (a): Districts should be allowed to levy additional local operating millage on property other than utility, manufacturing, and owner-occupied property up to the pre-Act 388 level. Each year, the maximum millage should be adjusted for the population and inflation growth factor in Act 388.

A2 (b): Districts should be allowed to hold referenda to permit some restoration of operating millage on owner-occupied property with the consent of the voters in the district.

A2 (c): The task force strongly encourages the General Assembly to reconsider the current Act 388 millage caps to make them less restrictive, particularly in providing for additional exceptions such as the need for new schools. Provision should be made for school districts to override the Act 388 millage caps by supermajority vote of the relevant governing body. At a minimum, an additional exemption should be added to Act 388 that overrides the millage cap when new school facilities are built that are financed with bonds issued after local referendum.

A2 (d): The same millage caps should apply to all school districts regardless of any pre-existing local legislation placing restrictions on increases in millage. If school districts are subject to a uniform minimum required operating millage and receive a uniform total amount of that millage plus state aid for each weighted pupil, they should also have the same degree of uniformity in making local choices about educational needs beyond the adequacy program.

**3. The Property Tax Base**

The task force believes that strengthening the property tax base is essential in order to mitigate the burden of funding education for both local and state governments and to ensure an equitable distribution of the tax burden among all property owners. A stronger property tax base raises more revenue at a given tax rate. The burden of funding on the state and/or the required minimum millage could be reduced, because each additional mill would yield more revenue. At a minimum, steps should be taken to reduce the erosion of the property tax base.

To generate adequate funds and reduce the pressure on school districts to increase millage by the maximum allowed amount, steps should be taken to ensure that all existing property is fairly taxed and that school districts receive their share of the resulting revenue. The task force recommends strengthening the property tax in the following areas:

A3 (a): Criteria for a farm and forest classification should be strengthened by imposing a higher acreage requirement and requiring some evidence of commercial farm and/or forest activity. Assistance should be provided to local governments in applying new requirements and enforcing the rollback provision when the taxable status of the property changes.

A3 (b): Eligibility for homeowner property tax relief should be limited to South Carolina residents who are individuals, not business firms, and only on their primary residence.

A3 (c): The legislation governing multi-county business parks (which the South Carolina Supreme Court refers to as fee-in-lieu) should be amended to provide a minimum revenue guarantee for school operations before paying for infrastructure improvements or other county expenses related to the new development.

A3 (d): School districts across the state have lost potential revenue from new commercial and industrial development because of the diversion of revenue from fee-in-lieu agreements to non-school purposes, even though the school millage is taken into account in determining the size of the fee-in-lieu property. Revenue from fee agreements and multi-county business parks generated from school district millage should be remitted to the school district. In no case should revenue from school district millage be put into the county general fund.

A3 (e): The ability of schools to borrow for capital projects has been reduced because property in multi-county business parks is not adequately reflected in the computation of the assessed value of property that determines borrowing limits. The legislation governing multi-county business parks should be revised so as to treat property for debt limit purposes in the same manner as other fee-in-lieu-of-tax statutes.

A3 (f): The information and enforcement tools available to local auditors and assessors to collect property taxes on mobile property such as automobiles, boats, motorcycles, and airplanes should be strengthened.

**4. The Index of Taxpaying Ability**

The ITA is a critical element in the distribution formulas for EFA and other funds. The ITA was originally conceived as a way to measure local revenue capacity, or the value of a mill—how much additional revenue a district could raise based on the size of its taxable property base. The ITA is simply a school district’s share of the aggregate state property tax base.

Beginning in the 1990’s, property subject to fee-in-lieu-of-tax agreements was included as the value that the property would have had in order to generate the revenue actually being received. This change made the ITA a good measure of ability to generate revenue at current mill rates, but not the ability to raise additional revenue by raising the mill rate.

As a result of property tax relief programs culminating in Act 388, an increasing share of the property tax base no longer represents a capacity for school districts to raise more revenue through higher mill rates, because an increase in the school operating mill rate will no longer generate any additional revenue from owner-occupied residential property. South Carolina districts vary widely in the share of their tax base that consists of owner-occupied property—from nine percent to 42 percent of total taxable property. As a result, the distribution of non-property tax relief state funds for education using the current ITA will become highly inequitable unless a change is made in how the ITA is calculated.

The task force recommends that the formula for calculating the ITA be adjusted immediately to reflect the change in the taxable status of owner-occupied residential property caused by Act 388 and earlier school property tax relief programs. This change should be considered an interim step to avoid any unintended redistribution of revenue from EFA and other funds distributed on a formula basis using the ITA.

A4 (a): The formula for calculating the ITA should be revised to treat school property tax relief as a revenue stream that enables the Department of Revenue to compute the equivalent assessed value of owner-occupied residential property for inclusion in calculation of the index. The same procedure is already used in calculation of the ITA to account for the value of real and personal property that generates a fee in lieu of tax.

A4 (b): A revised ITA will correctly reflect the revenue potential that school tax relief represents. Because a significant part of the index will reflect the value of property on which the school district receives revenue from which it cannot generate additional revenue with higher millage (owner-occupied residential and fee-in-lieu), consideration should be given to renaming the ITA an index of revenue capacity.

A4 (c): As uniform required minimum millage is implemented, the ITA should be adjusted as necessary. Full implementation of uniform minimum millage as recommended will eliminate the need for the ITA.

## B. State Revenue for Education and Other State Needs

The task force reviewed the current state revenue system in making its recommendations on state revenue sources.

The task force believes that strengthening state revenue sources so as to ensure adequate education funding in the future requires attention to all of the major revenue sources that fund the state's general governmental activities, not only those traditionally relied on for education. Education, despite its importance to the welfare of the state's citizens and businesses, is only one of many services provided by the state. Funding for schools competes with funding for other state agencies and services during every budget cycle, and the competition gets fierce when the economy falters. It is important to create and maintain a state revenue system that is both stable and adequate for the state's needs. This section contains some observations on some of the more desirable ways of strengthening that revenue system.

The health of the state's revenue system and the availability of state revenue for schools depend in part on the mix of revenue sources and the restrictions placed on their use. South Carolina's schools are funded by the state with a combination of general revenue and earmarked revenue. General revenue is from taxes and fees that flow into the South Carolina General Fund. Revenue from the retail sales tax and the individual income tax have together comprised 84 percent of general fund revenue in recent years.

Earmarked revenue is limited for use on certain purposes specified by state law and is generally accounted for outside of the general fund. Revenue from the fifth penny of the state retail sales tax goes to the EIA fund and is the largest source of earmarked revenue for schools. Net revenue from the South Carolina Education Lottery is earmarked for preK–12 and higher education.

Both general revenue and earmarked revenue have benefits and drawbacks. General revenue gives legislators the flexibility to respond to critical state needs during the appropriations process, but it reduces the certainty of future revenue to specific agencies and activities. Earmarked revenue gives agencies more certainty, but revenue growth is linked to the specific revenue source (such as the sales tax or the lottery), and shortfalls from slow growth or declines may not be made up from other sources. Earmarks also make it difficult for legislators to quickly respond to opportunities and concerns.

With Act 388, the South Carolina Legislature assumed additional responsibility for state funding of education. It did so by replacing a portion of local property tax revenue with earmarked revenue from an additional penny on the sales tax. This revenue is placed in the new Homestead Exemption Fund, although distributions to school districts are governed by a growth formula that is unrelated to revenue receipts.

Act 388 also increased reliance on the sales tax for funding education. If this revenue does not grow as fast as the formula requires, which is likely in an economic downturn or recession, then revenue from the state's general fund must be tapped to make up the difference.

In the area of state revenue sources, the task force recommends that South Carolina:

1. Improve overall revenue stability;
2. Strengthen the sales tax base; and
3. Improve other state revenue.

**1. Revenue Stability**

Revenue stability is one of the guiding principles of a good revenue system. Revenue stability is particularly important for budgeting for functions that rely heavily on personnel, such as public safety and education, because when positions are cut, services are not delivered. Improvements to state revenue stability can be made in two ways: by diversifying the type of revenue sources used and/or by establishing reserve funds to be used as revenue supplements when current revenue growth slows or declines.

By substituting sales tax revenue for property tax revenue, Act 388 reduced the diversity of revenue used to fund school districts. Now, through the state general fund, the EIA fund, and the new Homestead Exemption Fund, schools are more dependent than ever on the sales tax for revenue. Thus, the task force focused on reserve funds to improve revenue stability for the state general fund and for education specifically.

B1 (a): The South Carolina General Reserve Fund should be strengthened from its present three percent of the prior year's general fund to a level of five to 10 percent to protect funding for all state programs from severe cuts during economic downturns. This recommendation is consistent with general recommendations made by the Government Finance Officers Association, a national organization of state budget officials. An increased commitment to the general reserve fund will improve the ability of many state agencies, not only schools, to weather future revenue shortfalls.

B1 (b): Any surplus sales tax revenue collected over and above what is needed for current property tax relief under Act 388 should be retained in the Homestead Exemption Fund to buffer school districts against any future revenue shortfalls rather than being directed to county property tax relief. Retention of surplus sales tax revenue in the Homestead Exemption Fund will provide an extra cushion for school districts against mid-year budget cuts, which are difficult to make because education is personnel-intensive.

## 2. The Sales Tax Base

The first four percent (out of six percent) of the state's general retail sales tax is a mainstay of the South Carolina General Fund, of which one third is appropriated for preK–12 education. An additional two percent of the sales tax is devoted to preK–12 education, with one percent to the EIA fund and one percent to the new Homestead Exemption Fund for use in providing homeowner property tax relief. Strengthening the sales tax will provide more adequate and stable revenue for education as well as other public purposes.

The sales tax recommendations issued by the task force focus on broadening the base for the sales tax rather than raising the rate in order to minimize effects on low-income households and businesses, which received none of the benefits of property tax relief but pay a disproportionate share of the sales tax. The task force recommends a number of options for broadening the base of the general retail sales tax to generate additional revenue with no further increases in the rate.

B2 (a): Because property assessments on cars have been reduced and competition with neighboring states is no longer a factor, South Carolina should modify the sales tax on cars, boats, and airplanes by removing, raising, or restructuring the $300 cap to increase revenue and distribute the tax burden more fairly across income classes.

B2 (b): The list of existing exemptions to the sales tax could be reviewed to determine if any could be removed in order to generate more revenue. The task force does not recommend eliminating the exemptions on energy used by manufacturing or on machinery and equipment because of its impact on the state's economic competitiveness. South Carolina should focus on exemptions that protect low-income households and business firms from further tax increases.

B2 (c): The general retail sales tax could be extended to cover more personal services, as many other states have done.

B2 (d): The state should fully participate in the Streamlined Sales Tax Project, which works with other states and vendors to collect tax on Internet, catalog, and out-of-state purchases for use in South Carolina.

B2 (e): Sales tax holidays should be limited to the one currently in place prior to the start of school in August.

**3. Other Sources of State Revenue**

The task force considered a number of state revenue possibilities and calls attention to four taxes in particular: the lottery, excise taxes, the individual income tax, and the estate tax. The task force emphasizes that any additional revenue should be generated in ways that have a minimal impact on business firms and low-income households, both of which are paying more sales tax and receiving little or no property tax relief under Act 388.

Of the four state revenue sources considered by the task force, the lottery is the only one which provides revenue to schools. But while the lottery was marketed as the South Carolina Education Lottery, a disproportionate share of lottery proceeds is directed toward higher education. In 2007–08, less than 20 percent of the net revenue available for appropriation ($49.6 million out of $258 million) was given to preK–12 education, most of it to the K–5 reading, math, science, and social studies program. In 2004–05, the high-water mark for both lottery revenue and the preK–12 share, preK–12 education received $103 million out of $340 million, or 30 percent.

The task force also encourages reconsideration of several major revenue sources that can be used for general state purposes, not just education. The task force examined excise, individual income, and estate taxes for their ability to strengthen the general fund so as to provide more revenue in a more equitable manner for all public purposes. The task force does not intend for the revenue from these sources to be earmarked for education.

B3 (a): **The Lottery:** South Carolina should allocate 25–30 percent of the lottery net revenue (including unclaimed prize money) to preK–12 education on an annual basis to be used for general operating funds rather than special programs, which should be funded through the Education Improvement Act. South Carolina also should explore options adopted in other states to expand lottery revenues to determine if any are appropriate for South Carolina.

B3 (b): **Excise Taxes:** The admissions tax could be increased from five percent to six percent to match the increase in the general retail sales tax. All South Carolina excise taxes should be compared with rates in other states to evaluate the potential for increased revenue from individual taxes if the rate is increased and/or the rate is indexed for inflation. The base tax rates on tobacco, distilled beverages, and motor fuel should be adjusted to the national average and indexed for inflation. Revenue from the tobacco excise tax should be directed to health services, including those presently paid for from the general fund, and revenue from the motor fuel tax should remain directed to the Department of Transportation.

B3 (c): **Income Tax:** South Carolina should protect the individual income tax from any further erosion of its tax base, such as has occurred in recent years by eliminating the lowest bracket and treating unincorporated business like corporations in terms of rates.

B3 (d): **Estate Tax:** The state estate tax should be restored to its level prior to changes in federal law. If the federal exemptions expire as scheduled in 2011, the current South Carolina exemption linked to the federal tax should not be made permanent.

## A Note on Revenue for School Capital Expenditures

The Task Force on Revenue for World Class Learning shared with the Task Force on Funding a concern that proposals for adequate education funding are incomplete without discussion of funding for school facilities. The task force agrees that funding for school capital must be placed on a sounder footing, with state aid directed toward eliminating critical emergency needs and assisting low-wealth and high-growth districts in a way that is fair to all taxpayers, accountable, and based on a thorough assessment of facilities needs.

The task force endorses all of the recommendations of the Facilities Study Committee as presented in the report of the Task Force on Funding for World Class Learning.

# Appendix A

### Revenue Task Force Recommendation for Revising the Method of Computing the Index of Taxpaying Ability for Fiscal Year 2008-09 and Beyond

The Index of Taxpaying Ability (ITA) was designed to make it possible for each school district in the state to provide local tax revenue with a local tax effort that reflected local taxable resources as its contribution to the Education Finance Act of 1977s (EFA) defined minimum educational program. The EFA's intent that districts' obligation to raise revenue be based on their taxable resources started to come undone with the implementation of the state's first school tax relief program in the mid 1990s. Act 388 of 2006 will completely unbalance the distribution of funds under the EFA formula unless the ITA is revised for fiscal year 2008-09.

**What is the purpose of the ITA?**

The ITA is used to determine a school district's local required support for annual base student cost as defined under the EFA. A detailed explanation of how the ITA works in the EFA funding formula for the state and school districts can be found in the paper *Funding K-12 Public Education in South Carolina* located at: http://ed.sc.gov/agency/offices/finance/HistoricalData.html.

**How is the ITA defined?**

The ITA is a school district's fiscal capacity relative to that of all other school districts in the state, based on the taxable value (assessed value) of real and personal property in the district.

$$\text{ITA for School District A} = \frac{\text{District A's Assessed Property Value}}{\text{SC Total Assessed Property Value}}$$

Local tax assessors and the South Carolina Department of Revenue annually calculate assessed property value for various types of property in each school district. DOR computes the final ITA.

In South Carolina and many other states, local tax assessors periodically estimate the market value of most real and personal property. Each property's market value is then converted into a taxable value (assessed value) using an assessment ratio. The assessment ratio*s,* which are fixed in the state constitution, are the percentages of a property's market value that is used to calculate the tax. South Carolina has different assessment ratios for different types of property. The lowest is four percent for owner-occupied residential property and the highest (10.5 percent) is for manufacturing and utility property.

**What effect does homeowner property tax relief have on the ITA?**

The ITA no longer ensures that districts' tax bases accurately reflect their ability to raise local revenue to meet their local required share of the EFA base student cost. Specifically,

- The ITA formula includes the assessed value of owner-occupied residential property even though that property can no longer be taxed for school operations.
- The ITA formula does not include the assessed value equivalent of the tax relief received, even though this relief is revenue to the district.

The ITA started to become unbalanced soon after implementation of the state's first school property tax relief program for homeowners was implemented in fiscal year 1995-96. This program fully replaced local tax revenue for only a short time and by fiscal year 2001-02 total relief statewide was limited to $249 million.

Act 388 of 2006 creates greater problems for the equitable distribution of EFA funds unless the current ITA formula for measuring school district tax effort is corrected. After the first year, additional homeowner tax relief to school districts will be based on annual increases in state population and inflation, not on the local tax base or willingness to tax. Twenty-one districts also receive additional relief above their base amount. The additional funds received have no relation to the local tax base or prior funding levels.

**How can this problem be fixed?**

The DOR has a straightforward way to account for the effect of state-funded property tax relief for homeowners on the ITA formula. This method is already used in the ITA for other properties that generate fees instead of conventional property taxes, such as manufacturing property under long term fee-in-lieu-of-tax agreements. These properties pay the same fees regardless of the current taxable value of the property or the prevailing local tax rate.

When calculating the ITA, the DOR treats fee revenue as if it were conventional property tax revenue. DOR staff then use that figure to calculate what would have been the assessed value that would have generated that amount of revenue, using the appropriate assessment ratio (10.5 percent for manufacturing property, for example) and the school district's current tax rate for operations in mills. This imputed assessed value for fee-generating property is then included in the ITA calculation of a district's share of taxable property resources. For example:

$$\text{Imputed assessed property value} = \frac{\text{Fee revenue}}{(\text{assessment ratio} * \text{tax rate in mills})}$$

State-funded school property tax relief for homeowners acts as fee revenue (rather than tax revenue) in the tax base because it replaces property tax revenue with funds that are not a one-for-one replacement for taxes that could be raised at the prevailing tax rate. The formula for imputing an assessed value for property tax relief on school operations for owner-occupied property is:

$$\text{Imputed assessed property value of tax relief} = \frac{\text{Homeowner school tax relief}}{(4\% * \text{school operations tax rate in mills})}$$

In the ITA formula, the imputed assessed property value of tax relief would be used instead of the assessed property value of owner-occupied residential property.

# Appendix B

## States Using Uniform Required Minimum Millage to Generate Revenue for School Operations

| State | Required minimum property tax rate for school operations* | Can schools tax at higher rate? | Is there a maximum tax rate? | Is property classified for tax purposes?** | Taxable Share of Homestead Property Value* | Revenue from $200K home at req'd. min. rate | Revenue from $200K home at req'd. min. rate |
|---|---|---|---|---|---|---|---|
| | | | | | | In Row State | In South Carolina |
| Alabama | Statewide annual property tax of 3 mills. Required revenue equivalent of 10 mills (may include other local revenues) at district level. | Yes | 6 mills | 4 classes | 10% | $260 | $104 |
| Alaska | 4 mills (on non-petroleum based property only) | Yes | 30 mills for operations | No | 100% | $800 | $32 |
| Arizona | Elementary districts: $2.0647 in revenue per $100 of assessed property valuation. Unified districts: $4.1294 per $100 valuation. County tax of $0.4974 per $100 is levied for equalization. | DK | 10 mills on residential property | 9 classes | 10% | $900 | $360 |
| Arkansas | 25 mills for maintenance and operations. | Yes | No | No | 20% | $1,000 | $200 |
| Georgia | 5 mills | Yes | 20 mills | 10 classes | 40% | $400 | $40 |
| Idaho | 0.3% tax (30 mills) on real property. | Yes | No | 3 classes | 100% | $6,000 | $240 |
| Kansas | 20 mills | Yes | No | 7 classes | 11.5% of FMV less $20K | $460 | $160 |
| Kentucky | Minimum local tax effort for local school districts of 30 cents per $100 of assessed property valuation (may include other local revenues). | Yes | Yes. $1.50 per $100 of property valuation | No | 100% | $600 | $24 |
| Nevada | A tax rate of 75 cents per $100 of assessed valuation is a mandatory levy for local school districts on all personal and mining property with 1/3 of revenue an offset to state guaranteed funding for operations. | No | $0.75 per $100 of property valuation | No | 35% | $5,250 | $600 |
| New Mexico | 0.5 mills | No | 0.5 mills | No | 33.3% | $33 | $4 |

| | | | | | | | |
|---|---|---|---|---|---|---|---|
| Ohio | 20 mills | Yes | No | No | 35% | $1,400 | $160 |
| Oklahoma | Local school boards: 15 mills. Districts also are guaranteed proceeds from a countywide 4-mill levy. | Yes | No | No | 11-13.5 % | $418 | $152 |
| Utah | Required basic levy set annually by legislature. | Yes | 3.2 mills in locality with taxable value >$100 million; 3.6 mills where taxable value <$100 million | 2 classes | 55% | $3,520 | $256 |
| Vermont | Statewide education property tax of $1.10 per $100 of property valuation for most property. | Yes | No | No | 60% | $1,320 | $88 |
| Wyoming | 12 mills levied statewide, 6 mills countywide, 25 mills for districts. | Yes | n.a. | 2 classes | 9.5% | $817 | $344 |
| South Carolina | No | Yes | No | 8 classes | 4% | NA | NA |

Notes: DK = don't know; NA = not applicable.
* 1 mill = $1 per $1,000 assessed property valuation; 10 mills = $1 per $100 assessed property valuation.
** Some states classify real and personal property by type for tax purposes to allow different levels of taxation on different properties. The South Carolina constitution identifies eight different classes of property for tax purposes. The assessment ratio for each class of property determines what percentage of the estimated fair market value (or use value) of that property may be taxed. The classifications and assessment ratios are: manufacturing (10.5% of FMV); utility (10.5% of FMV); railroads, private carlines, airlines and pipelines (9.5% of FMV); primary residences (4% of FMV); agricultural-private (4% of use value); agricultural-corporate (6% of use value); other real estate (6% of FMV); and personal property (6% of income tax depreciated value).

Sources:

National Council of State Legislatures, Education Finance Database (www.ncsl.org/programs/educ/ed_finance). Data from the National Center for Education Statistics publication, *Public School Finance Programs of the United States and Canada: 1998-99* (http://nces.ed.gov/pubsearch/pubsinfo.asp?pubid=2001309)

Hamill, Susan Pace, *As Certain as Death: A Fifty-State Survey of State and Local Tax Laws* (Durham, NC: Carolina Academic Press, 2007)

# Appendix C

## Potential Revenue from a Required Uniform Minimum Property Tax Rate
## Tax Year 2005

| Type of Property | Revenue @ Current Mills (millions) | Revenue @ 150 Mills | Revenue @ 125 Mills | Revenue @ 100 Mills |
|---|---|---|---|---|
| ***Tax Revenue from real & personal (homestead excl.)*** | **$1,489** | **$1,775** | **$1,479** | **$1,183** |
| | | | | |
| ***Tax Revenue from Fees & Tax Relief*** | **$1,002** | **$1,002** | **$1,002** | **$1,002** |
| Nontaxable property (FILOT, motor carrier, etc.) | 141 | 141 | 141 | 141 |
| Old state property tax relief for homeowners | 338 | 338 | 338 | 338 |
| Act 388 school property tax relief (for TY2008) | 522 | 522 | 522 | 522 |
| | | | | |
| ***Total*** | **$2,490** | **$2,777** | **$2,481** | **$2,185** |
| | | | | |
| **Uniform Mill Revenue less Current Mill Revenue** | | $286 | ($9) | ($305) |
| | | | | |
| # districts with higher mills | n.a. | 46 | 14 | 3 |
| # districts with lower mills | n.a. | 39 | 71 | 82 |

- Uniform mills for school operations would be levied on real and personal property, such as agricultural, commercial and rental, utilities and manufacturing not under fee agreements, and personal property.
- Property tax revenue from fee in lieu agreements, tax relief, or other fixed payments would be unchanged by use of uniform mills, but it would be included in total revenue.
- Uniform mills would require a phase in period to protect some districts from experiencing a large jump in the mill rate.
- If a uniform millage is phased in, the task force recommends that uniform mills first be applied to personal property, which is valued the same throughout the state but is subject to a wide range of tax rates.