

June 14, 2006

TECHNICAL BULLETIN

TO: Council Chairmen
Chief Administrative Officers
Assessors
Auditors
Treasurers
Tax Collectors
County Attorneys
Finance Directors

FROM: SCAC Staff

RE: Property Tax Restructuring Legislation

The General Assembly passed two major pieces of legislation this session relating to the property tax system. The statutory legislation is H. 4449 (R. 417) and was signed into law on June 10, 2006. This legislation is largely statutory implementation of the constitutional changes made in H. 4450 (R. 418). The constitutional changes will be voted on in the November referendum and the General Assembly must then ratify a positive result before the constitution is amended. Those changes would become effective in 2007. Most of the statutory provisions in H. 4449 become effective either January 1, 2007 or upon ratification of the constitutional provisions in H. 4450. Those provisions which become effective upon the signature of the Governor are generally not the major provisions of the legislation. The portions of the bill which are effective immediately will be clearly indicated as such.

This *Technical Bulletin* is an overview of two complicated pieces of legislation designed to give the reader a basis for an in depth study of the acts. By necessity, there are many details not addressed and there may be more than one interpretation of some provisions or combinations of provisions. Please do consult your county attorney and other appropriate authorities before taking any action on these pieces of legislation. Copies of both pieces of legislation are enclosed for your convenience and further study. Of course, the SCAC staff is available to take questions or do additional research. Please feel free to contact the staff at 1 (800) 922-6081.

Constitutional Amendments - H. 4450, R. 418

H. 4450 amends both Article III, Section 29 and Article X, Section 6 of the South Carolina Constitution.

The change to Article III, Section 29 was to state that taxes on real property must be ascertained by methods prescribed by the General Assembly. This is a change in the current constitutional language which requires taxes on real property be laid upon the “actual value” of the property. The amendment does not change the existing language regarding the valuation of personal property.

There are two significant changes in the amendment to Article X, Section 6. First, is an explicit authorization for the General Assembly to define the “fair market value” of real property, when real property has been improved or losses have occurred to change the value of the real property, and when an “assessable transfer of interest” has occurred. These changes are designed to overcome any legal argument based upon the plain meaning of “fair market value” preventing the changes the General Assembly has proposed to the property tax system. The changes also allow the General Assembly more latitude in creating the mechanics of implementing the proposed property tax system changes.

The second change to Article X, Section 6 is the more substantive change. That change states that real property shall be valued by the method prescribed by the General Assembly so that, after adjusting for improvements and losses, its value does not increase by more than fifteen percent every five years, unless the real property is transferred. This is the fifteen percent cap on increases in value resulting from reassessment. The cap is cumulative, meaning that the increase in value is calculated upon the last value and not a base year.

The constitutional amendment must be approved by voters in the November, 2006 referendum and it becomes effective when the General Assembly passes an act to ratify the amendment in the next legislative session.

Statutory Property Tax Restructuring - H. 4449, R. 417

H. 4449 is a lengthy bill with numerous provisions. The Act is broken into six portions labeled as follows:

- Part I - Property Tax Exemption and Sales Tax Increase
- Part II - Distribution of Revenue and Millage Limitations
- Part III - Local Option Property Tax Credits
- Part IV - Valuation of Real Property
- Part V - Miscellaneous Provisions
- Part VI - Time Effective

This summary will follow the order the provisions appear in the legislation. The one exception

to this general approach will be to move some provisions in earlier parts of H. 4449 into the discussion of the entitled miscellaneous provisions. Part V of the Act and the portions moved into that discussion are generally the only portions of the legislation which are effective upon signature of the Governor. The remainder of the Act is generally effective January 1, 2007, or upon ratification of the Constitutional amendment proposed in H. 4450. To assist you in finding the appropriate code section in the Act, the code cite will be placed in the summary in [square brackets].

Property Tax Exemption and Sales Tax Changes - Part I

Beginning June 1, 2007, the statewide sales tax rate will increase by one percent for a total of six percent. That increased rate will not apply to food (defined as unprepared food which may be purchased with food stamps), accommodations, or any items subject to a sales tax cap. [SC Code §12-36-1110.]

Beginning October 1, 2006, the statewide sales tax rate on food will drop to three percent. The Board of Economic Advisors is to estimate the amount of revenue the Education Improvement Act (EIA) Fund does not receive due to the decrease in the tax rate on food. That amount will be transferred from the State general fund to the EIA Fund. [SC Code §12-36-910.] This reduction does not affect any local option sales tax.

The General Assembly also grants a complete state sales tax exemption for the two days following Thanksgiving, November 24 and 25, 2006. This sales tax holiday does not apply to local option sales taxes or the accommodations tax. [Part I, Section E of H. 4449.] This is a one time sales tax holiday in addition to the existing sales tax holiday for school shopping.

The revenue generated by the increased sales tax will then be placed into the Homestead Exemption Fund (HEF), a fund separate and apart from the state general fund. Amounts equal to the reimbursement granted by the state for the school operating tax exemption on homes in SC Code §12-37-251 and the school operating millage reimbursement portion of the homestead exemption for the elderly and disabled in SC Code §12-37-270 are also paid into the HEF. [SC Code §11-11-155.]

Beginning with property tax year 2007 (tax bills mailed in 2007 to fund FY 2007-08), homes receiving the legal residence four percent assessment ratio in SC Code §12-37-220(c) will be exempt from school operating property taxes. [SC Code §12-37-220(B).] These homes will still be taxable for school bond millage and the value of the homes will still be counted for purposes of determining the eight percent general obligation debt limit pursuant to Article X, Section 15 of the State Constitution.

Reimbursement Exemption and Distribution of Sales Tax Revenue - Part II

Beginning in FY 2007-08, school districts will receive a reimbursement on or after January 1 [SC Code §11-11-156(A)(5).] equal to the estimated amount of revenue not collected as a result of the school operating exemption for owner-occupied homes. [SC Code §11-11-156(A)(1)].

Beginning in FY 2008-09, each school district will receive the amount it received in FY 07-08. The total amount to be paid to school districts will be increased by the amount of the increase in the Consumer Price Index (CPI) from the previous year and the percentage growth in the state's population.

The incremental amount to be distributed to the individual school districts is based upon the weighted pupil units from the Education Finance Act (EFA) with a poverty factor of .20 additional weighting for students who qualify for Medicaid or free/reduced lunch. [SC Code § 11-11-156(A)(2) & (3).] Each district will receive that portion of the incremental increase that their total weighted pupil units bear to the statewide total weighted pupil units.

The school districts within a county are guaranteed a minimum \$2.5 million reimbursement. To the extent the school districts within a county collectively receive less than the \$2.5 million minimum reimbursement, the county is paid the difference. That payment is divided among the school districts within the county based upon the 135 day pupil count of students in the school district within that county. Each district within the county receives the percentage of the payment which results from their pupil count being divided by the total pupil count for the county. [SC Code § 11-11-156(B)(1).]

To the extent that the HEF is insufficient to pay the formula reimbursements for school districts, the state general fund is the source of additional funds. [SC Code § 11-11-156(A)(6).]

Once the formula reimbursement has been paid to the schools districts, if there is any remaining money in the HEF, there is a county property tax credit granted. The HEF surplus must be distributed to the counties in the proportion that each county's population bears to the state's population. The county's distribution is then applied as a credit against the county operating property tax liability for owner-occupied homes receiving the four percent assessment ratio. The amount of the credit is determined by dividing the number of eligible parcels into the amount of the county's distribution. Any credit amount which exceeds the county operating tax liability of a parcel would then be distributed in a uniform amount to other eligible parcels. [SC Code § 11-11-156(C).] The credit amount will increase, or decrease depending upon the amount, if any, of surplus in the HEF and the number of owner-occupied homes.

Millage Rate Limitation Revised - Part II

The current millage rate limitation found in SC Code § 6-1-320 was substantially revised as part of H. 4449. Beginning January 1, 2007, the millage rate increase limitation is the percentage increase in the CPI over the previous year plus the percentage increase in the population of the entity over the previous year. SC Code § 6-1-320 applies to counties, municipalities, school districts and special purpose districts. The annual population increase used in this Code section will be determined by the Office of Research and Statistics of the State Budget and Control Board.

The exceptions to the current millage rate cap found in § 6-1-320(B)(1) - (4) and the override provision currently found in § 6-1-320(C) have been repealed. The millage rate cap may be exceeded

upon a two-thirds vote of the entire governing body for the following reasons:

- (1) the deficiency of the preceding year;
- (2) any catastrophic event outside the control of the governing body; such as a natural disaster, severe weather event, Act of God, or act of terrorism, fire, war, or riot;
- (3) compliance with a court order or decree;
- (4) taxpayer closure due to circumstances outside the control of the governing body that decreases by ten percent or more the amount of revenue payable to the taxing jurisdiction in the preceding year; or
- (5) compliance with a regulation promulgated or statute enacted by the federal or state government after the ratification date of this section for which an appropriation or a method for obtaining an appropriation is not provided by the federal or state government,

If items 1 - 5 are used to impose a millage rate increase, it must appear separately on the tax bill as a separate surcharge with an explanation and not included in the millage subject to the CPI plus population inflator. The surcharge may only be continued for the years necessary to pay for the reason imposed.

The millage rate limitation does not apply to fees, or revenue which is not the result of property tax millage and does not supercede any local act of the General Assembly which is more restrictive.

Local Option Property Tax Credits - Part III

Part III of H. 4449 creates an additional local option sales tax authorization to be in addition to all other local option sales taxes, effective January 1, 2007. A referendum for this local option sales tax may be called for by county ordinance or petition signed by seven percent of the county electors at least 120 days prior to the November referendum date. [SC Code §4-10-730.] Upon favorable referendum result, the additional sales tax would be imposed the following July. [SC Code §4-10-750.]

This local option sales tax would be imposed in increments of one tenth of one percent necessary to grant the relief proposed, up to a maximum of one percent, taking into account reimbursements received for property tax exemptions. [SC Code §4-10-730.] This local option sales tax would not apply to accommodations, any item subject to a sales tax cap, or unprepared food. [SC Code §4-10-770.] The rate is to be set by the Office of Research and Statistics of the State Budget and Control Board and is to be targeted to generate no more than is necessary to replace the existing property tax liability of the selected political subdivision(s). [SC Code §4-10-730.]

The revenue from this local option sales tax would provide credits against the county operating property tax, the school operating property tax, or both. [SC Code §4-10-720(2).] The credits would apply to all classes of property, whether residential, industrial, commercial, or personal. Property subject to a fee in lieu of tax agreement under Chapter 4 of Title 12 is not eligible for credits. [SC Code §4-10-720(1).] The credits to be generated appear to be an “all or nothing”

proposition because the definition of “property tax” in §4-10-720(3) “means all property tax millage imposed for operational purposes by a political subdivision.” So the credits would be for all remaining school operating property taxes, all county operating property taxes, or all of the operating property taxes for both schools and the county. The property tax credit for an individual taxpayer is to be calculated in the same manner as is provided in §4-10-40(B) of the original local option sales tax. [SC Code §4-10-740(C).]

There is no revenue sharing provision under which a county would donate or receive from a fund as there is in the original local option sales tax. There is also no provision to change the sales tax rate after the initial adoption.

Valuation of Real Property - Part IV

The provisions of Part IV of H. 4449 implement the constitutional amendments proposed in H. 4450 and are effective upon ratification of the amendments. The one exception is the provision containing the amended version of SC Code §6-1-50, which is discussed in the miscellaneous provisions. The provisions implementing the constitutional amendments are to be in addition to, not in lieu of, other provisions of law, except where those other provisions are inconsistent with H. 4449. [SC Code §12-37-3120.]

Under H. 4449 [SC Code §12-37-3140(C)], the “base year” valuation is the fair market value for the later of:

- (1) December 31, 2006;
- (2) when an “assessable transfer of interest” occurs;
- (3) the value determined on appeal; or
- (4) the fair market value determined in a reassessment program, capped at a 15% increase.

The fair market value of improvements and additions to the property are then added to the base year value. This 15% cap applies to all classes of real property, whether residential, commercial or industrial. The term “assessable transfer of interest” is given a very detailed meaning and will be discussed later.

To illustrate the basic mechanism: Assume a house valued at \$100,000 on December 31, 2006, was reassessed at fair market value to be worth \$150,000. Under the cap, the value could increase, due to reassessment alone, to no more than \$115,000. If the homeowner added on to the house and the fair market value of the addition was \$15,000, the new value would be \$130,000. Assuming a successful taxpayer appeal determined an error was made and the outcome was a value of \$125,000, then the new value would be \$125,000. At the next reassessment, the increase in value would be calculated on the \$125,000 valuation.

If the house were sold at this point, the sale to a new owner would be an assessable transfer of interest and the new owner would be taxed at the \$150,000. At the next reassessment, assuming the fair market value of the home were determined to be \$200,000, the new owner’s value would be

capped at \$172,500 (\$150,000 + 15%). If the house had not been sold, the second reassessment would have yielded a new capped valuation of \$143,750 (\$125,000 + 15%)

An “assessable transfer of interest,” which triggers a recognition of the full fair market value of a property, is defined in SC Code §12-37-3130(4) and §12-37-3150. The major categories of transfers which trigger full recognition of fair market value include: conveyance by deed, inheritance through will or intestate estate (except inheritance by a surviving spouse), change in the agricultural use of property, and change in the use when the classification changes as a result of a local zoning ordinance changes. [SC Code §12-37-3150(A).] There are several other transfers which also trigger full recognition in the Act not covered here.

The major categories of transfers which will not trigger full recognition of fair market value include: transfers not subject to federal income tax (such as rebuilding a destroyed structure with insurance proceeds, transfer between spouses as a result of divorce, and others), transfer through foreclosure until the redemption period expires, transfer where the grantor retains a life estate until the life estate expires. [SC Code §12-37-3150(B).] There are other transfers which are also excluded not discussed here.

Every real property tax notice must also contain a certificate to be completed by the taxpayer certifying the details of the property ownership. Knowing falsification of the certificate subjects the owner to a penalty. This is to address some of the “gaming” of the system to avoid detection of an assessable transfer of interest. The Department of Revenue is also given authority to implement Part IV and to examine transactions for their substance to deter “gaming” of the system. [SC Code §12-37-3160.]

These provisions do not affect the valuation of agricultural use property and do not affect the appropriate methods of appraising real property used by the assessor or the Department of Revenue.

One other change made in Part IV was to amend the deadline for valuation appeals in non-reassessment years found in §12-60-2510(A)(4). The March 31 deadline in the current statute was changed to allow appeals within 90 days after the tax notice is mailed. This change is effective upon ratification of the constitutional amendments.

Miscellaneous Provisions

- Early Recognition of New Structures

The existing provision to allow recognition of newly built structures found in §12-37-680 was repealed and replaced with an addition to §12-37-670. The new provision allows a county to adopt an ordinance to add to the tax rolls and send a partial year tax bill to owners of buildings issued a certificate of occupancy prior to July 1 for one half of the year. Buildings for which a certificate of occupancy is issued after July 1, would continue to be added to the tax rolls in December. This became effective June 10, 2006.

- **Installment Payment of Property Taxes**

The existing installment payment of property tax provisions found in §12-45-75 were amended and the details of the authorization were developed more fully. The program still requires the county to adopt an ordinance to make that feature available to taxpayers. The program still requires advance payment of property taxes for the coming year based upon the previous year's tax bill. This revised authorization becomes effective for property tax year beginning after 2006.

- **Alternative Financing / Installment Purchase Financing for School Buildings**

Section 11-27-110(A) of the Code was amended to include school building financing through third parties as general obligation debt for debt limitation purposes. This includes financing plans such as have been used in Greenville and Berkeley. Agreements signed before August 31, 2006, will be grandfathered. The language is drawn to address school building financing only, regardless of what governmental entity enters the agreement. This provision was effective June 10, 2006.

- **Repeal of Existing Local Option Sales Taxes**

Part II, Section 3 of H. 4449 adds a provision which is only effective for this year. By county ordinance or a petition of five percent of the electors may trigger a referendum to rescind any existing local option sales tax. Any petition would have to be submitted at least sixty days prior to the November general election date. A referendum result to rescind the existing local option sales tax would be effective January 1, 2007.

- **Local Option Sales Tax for School Operating Tax Relief**

Part IV of H. 4449 adds another provision relating to existing local option sales taxes. Revenue from any existing local option sales tax for school operating property tax relief on owner-occupied homes would be redirected to provide pro-rata relief for other purposes as the county governing body may determine. It is not clear that there is an existing local option sales tax for school operating property tax relief. This provision is effective beginning June 1, 2007.

- **Financial Reporting**

Existing §6-1-50 of the Code was amended in Part IV of H. 4449. The financial report (annual audit plus other data) counties and municipalities are required to submit to the Comptroller General has been redirected to the Budget and Control, Office of Research and Statistics, Economic Research Section. The annual county financial report's contents and form are to be determined by that office and it is due by November 15 of each year. Failure to submit the report by that date may result in withholding of ten percent of a county's Aid to Subdivisions money otherwise due from the state. An extension may be granted for good cause shown. The chief administrative officer must receive written notice of a failure to timely file at least thirty days before any funds are withheld. This amendment became effective June 10, 2006.