

ECONOMIC BRIEF NO. 36

Equity & Classified Tax Systems

This series of economic briefs explores fundamental concepts in economics and community and economic development.

In S.C. private agricultural land and owner-occupied residential property are assessed at the lowest rate, 4 percent of market value. Commercial and rental property (including commercial agricultural property) are assessed at 6 percent. Personal property (including automobiles), business personal property, utility property and industrial property are assessed at 10.5 percent. Railroad, airlines, and pipelines are assessed at 9.5 percent of market value.

The 2000 referendum on changing the assessment rate on automobiles is not just a chance to vote on a tax break. It also represents a fundamental change in the state's classified system of property taxation. Only 18 states assess different kinds of property at different percentages of their fair market value. Most states have only two or three categories, which makes South Carolina's system of four rates and eight property classes one of the most complicated. The assessment rates for the eight categories of taxable property were established by Act 208 of 1975 and can be changed only by constitutional amendment.

The property tax was originally designed as a tax on wealth, although the share of total wealth that falls under this tax is much smaller than it was in the past. Increasingly, wealth is held in nontaxable forms, including stocks, bonds, commodities, works of art, and even intellectual property rights. But even with this limited base, the property tax remains the only way in which tax burdens are distributed in proportion to wealth as one of

the primary measures of ability to pay (the others are income and consumption spending). States with a single assessment rate are implementing Adam Smith's fundamental principle of proportional taxation. States with a classified system are making more complicated decisions about what is an equitable distribution of the tax burden.

In a classified system, the tax burden is proportional to the market value of property within a particular category, such as owner-occupied residential. But between categories the story is very different. A \$100,000 rental property will pay 50 percent more tax than an owner-occupied property with the same value without even considering school tax relief for S.C. homeowners. A personal vehicle worth \$10,000 will pay the same tax as an owner-occupied mobile home worth \$26,250.

South Carolina's classified system favors agricultural and forest property and homeowners relative to industrial and personal property, with commercial and rental property falling in between. Homeown-

ers and renters are the heaviest users of local public services, especially schools. The combination of assessment rates and service demands for different kinds of property results in a cross-subsidy from other kinds of property owners to residential property. The difficult negotiations in the 1970s that resulted in Act 208 and the current assessment rates created a distribution of the tax burden that was acceptable to all parties at that time. Serial demands for property tax relief in the 1990s, first by homeowners, then new industry, and most recently by owners of automobiles, have redefined that balance. When actual tax burdens as a percentage of market value of property are compared across classifications today, they look different from those created by the constitutional change in the seventies.

Responding to demands for equity in the form of tax relief is one of the major challenges facing elected officials. The referendum on automobile taxes is the most recent step in disassembling the compromises of 25 years ago. It is unlikely to be the last.