

The South Local Government Funding System: Findings and Recommendations

**A Report to the Local Government Funding
System Steering Committee**

**Submitted By:
The Technical Work Group
Local Government Funding System Reform Project**

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Introduction

This report provides a comprehensive set of findings and recommendations for improving the local government funding system in South Carolina. It reflects the findings of a series of working papers and the deliberations of the Technical Work Group and the Recommendations Subcommittee of that group which comprised a key part of the Local Government Funding System Reform Project research and decision making process. The recommendations themselves reflect the criteria set forth in the legislation created the project and by the Steering Committee in September 1999.

In examining the opportunities for improvement, it is important to affirm that there are some good aspects to the local government funding system as it has developed in recent decades. South Carolina has a reasonably balanced local government revenue system for a state that is not highly urbanized (Note: Urban areas are able to use more diversified local revenue sources, hence, greater balance). The role of the state in South Carolina looms somewhat larger in local fiscal affairs than in many other states. This is a product of our unique history from the proprietary and colonial periods of the late 1600's to the mid-1700' through the 1895 constitution to the home rule legislation of the 1970s. As a consequence of this significant state role, it would seem incumbent on the executive and legislative branches of state government to conduct periodic reviews of how the local government funding system is working and how the state's role might be modified to make it work better.

This project revisits some home rule related issues 25 years after Act 208 (the Home Rule Act) and after the constitutional changes which freed county governments from county legislative delegation control. It also attempts to take a coherent look at the many changes that have taken place in the intervening 25 years, including local government revenue diversification (especially accommodations and local sales taxes), changes in the amount and distribution of state aid to education as well as to cities and counties, and expansion of property tax relief. The sum total of these different changes has modified the local funding system in substantial ways.

While a few of the proposals contained herein represent dramatic changes, many of them represent smaller but significant improvements that make the local funding system fairer, more efficient, and more accountable. A few of them represent radical departures from the experience of the last 30 years. All of the recommendations are based in the findings of the series of working papers that have been developed during the project.

This report is divided into three sections. The first section reviews and expands the criteria set forth by the steering committee and amplified in several of the working papers. The second section identifies six major topical areas within which recommendations are developed, ranging from the very broad to the very specific. Areas examined include: (1) the location of responsibility for oversight in the executive and legislative branches, (2) fiscal home rule, (3) economic growth issues, (4) state-shared revenues, (5) own-source revenues, and (6) structural and administrative issues. The third and final section presents the recommendations from the Technical Work Group.

Criteria

The criteria that are reflected in these recommendations are those contained in the legislation establishing this project and those put forth by the Steering Committee, and are interpreted as follows:

1. **Stability.** A revenue system needs to be stable in two different senses. Citizens and tax administrators need some stability in tax laws and regulations in order to be able to plan, make decisions, interpret the rules, and develop a familiarity with how to comply with or collect the revenue that reduces costs for all involved. This kind of stability might be termed **policy stability**. Frequent tinkering with the tax structure is frustrating to taxpayers and challenging to tax administrators. Private individuals and firms make decisions based on the current tax laws and regulations may suffer unexpected losses if the laws and regulations change suddenly or frequently. Providing a stable tax framework in which individuals can make choices encourages long-range financial planning by providing a higher degree of certainty. Stability also allows tax administrators to have some breathing space in which to learn how to implement tax laws effectively and efficiently. The value of stability should not discourage legislators from making changes from time to time, but the gains from those changes must be weighed against the cost of implementation and the dislocations caused to taxpayers from constantly changing tax laws and regulations.

The second kind of stability is **revenue stability**, which means that local governments should have a dependable stream of revenue on which to make commitments for the provision of services. It is particularly important for local governments to have a stable, dependable revenue stream, because most of them have limited reserves to serve as a cushion against any sudden decline in revenues. While not all revenue sources are going to be stable, there needs to be one or more core major revenue sources that have some degree of certainty and reliability attached to them in terms of the amount of revenue they can be expected to generate. Alternatively, local governments can use a mix of revenues, none of which are highly stable but which offset one another in terms of responses to changes in economic conditions--for example, a local income tax may grow very rapidly and fluctuate greatly with economic conditions, while the property tax grows very slowly and lags behind growth of income and population. In tandem, the two could provide a more stable revenue stream.

2. Balance and diversity. No single revenue source can do the job at either the state or local level. There are good reasons for using multiple revenue sources to ensure that other goals (stability, equity, and adequacy) are met. One tax may be regressive, another progressive, providing some balance in the distribution of the burden. One may offer stability (like the property tax), another (such as the income tax) may be more sensitive to growth in population, income and inflation, which drive demand for public services. Citizens who can successfully avoid or minimize their burden on one kind of tax may be compelled to make some contribution to the cost of public services through another tax. Specialized taxes and fees can ensure that those who demand or make greatest use of a particular service pay a larger share of its cost, such as gasoline taxes, hospitality fees, impact fees, and accommodations/admissions taxes in tourist areas.

Diversity also minimizes some of the undesirable side effects of particular taxes. One desirable quality of a revenue system is to minimize the distortion of individual and business behavior. If revenue is collected from numerous sources with broad bases, tax rates and fees can be low, which will reduce the impact on citizens' private decisions about working, spending, and locating their firms or residences. A broad based tax helps meet the goal of diversification by spreading the burden among more taxpayers. Lower rates also strengthen a state's competitive position relative to other states.

3. Equity. Equity means a fair distribution of the burden among taxpayers that reflects both their ability to pay and their demand for public services. Economists and other technical experts can measure the distribution of the tax burden among individuals by income category, property ownership, family size, wealth or assets, spending habits, or other criteria. They can also measure the amount of the tax burden that falls on individuals as consumers, as workers or employees, and as owners of firms, either directly or as stockholders. Equity is highly subjective and is ultimately a political judgment, but as a general rule, an equitable system imposes similar tax burdens on people in similar circumstances, is proportional to mildly progressive in structure overall, and minimizes taxes on low-income individuals.

In particular, there are three kinds of equity judgments that must be made:

- **Horizontal equity**, or treating people the same when they are in equal economic situations and/or make the same degree of use of public services.
- **Vertical equity**, or treating people with an appropriate degree of difference to reflect different economic situations and/or different degrees of use of public services.
- **Interjurisdictional equity**, or ensuring that people in different jurisdictions within the state do not pay widely varying prices for the same basic services.

Each of these three kinds of equity presents different challenges. Horizontal equity requires a careful definition of equal economic situations, whether it is occupying houses of equal value or having an equal ability to pay income taxes after allowing for costs of earning income, family size, medical expenses, or other relevant considerations. Vertical equity implies that people who have more (more income, more property, more consumption spending) should bear a larger share of the cost of government, but there are no clear guidelines as to how much more. Proportionally more? Progressively more? The

only generally accepted equity rule for vertical equity is that the tax system as a whole should not be regressive (taking a higher percentage of income from lower income households than from higher income households). Somewhere between a proportional to progressive revenue system lies a range of acceptable equity norms for revenue systems.

Finally, interjurisdictional equity is a particular challenge to state governments, which collect revenue from both poor and wealthy counties and distribute some of it back in the form of either state aid or state services to ensure that all citizens are treated equitably regardless of where they live. There can be conflict between the goal of local fiscal autonomy or home rule and the goal of interjurisdictional equity, especially in the case of K-12 education.

4. Accountability. Accountability has several components. One is that the government that spends the money should have some degree of responsibility for collecting it, so that citizens make the connection between taxes or fees and services. A second element is that citizens should have a clear understanding of what the tax rules are and should be involved in the process of changing those rules. Truth-in-taxation calls for notice to taxpayers and hearing on tax increases as one way to provide accountability. Tax expenditure accounting that measures the revenue losses for a particular tax credit or exemption (for example, the homeowners' exemption or the farm and forest exemption on property taxes) is another way to ensure accountability. Yet a third form of accountability means that there be regular assessment of the use of taxes, tax breaks, and fees as methods of accomplishing non-revenue goals such as managed growth, economic development, or investment in human capital through education expenditures by individuals. While such policies are designed and implemented at the state level in South Carolina in many cases, they have an impact on local revenues and local distribution of the burden for many revenue sources, but especially the property tax and the local option sales tax.

5. Adequacy (or sufficiency). Revenue must be sufficient to provide the services that cities, counties and school districts are required or expected to provide, and must grow fast enough to accommodate inflation, growth of the population to be served, increases in mandated services, and increases in service demand from citizens. Generally a diverse revenue base with low rates or fee levels is more likely to ensure adequacy than one that depends heavily on a single source. A revenue system that can produce the desired level of revenue will make it easier to avoid frequent tax increases or spending cuts. Although the practice of earmarking revenue for particular purposes is appealing to voters as a form of accountability, it conflicts with the goal of adequacy or sufficiency, because it limits the ability of governments to reallocate general revenue among competing uses.

6. Ease (efficiency) of administration and compliance. A highly desirable attribute of a revenue system is low costs (including ease and convenience as well as explicit dollar outlay) for tax collection and taxpayer compliance. A good revenue system does not use up a large share of revenue in such "overhead expenses" as determining the amount taxpayers owe, processing tax returns, resolving disputes, or issuing regulations, or impose excessive burdens on taxpayers in maintaining records, filling out forms,

resolving disputes, and paying for professional assistance. Avoiding a maze of taxes, forms, and filing requirements also helps taxpayers to better understand the system to confirm that taxes are being applied fairly and uniformly. In a system that depends heavily on voluntary compliance, it is important that taxpayers feel the system is fair.

There are three ways in which the administrative burden of local taxes and non-tax revenues can be reduced. One is to have greater uniformity among local governments in not only the kinds of taxes used but also in the bases, the rates, and other characteristics. A second way is to reduce the number of taxes collected locally. A third is to use a single collection agency for multiple users of a tax. State collection of local sales taxes and county collection of county, city, and school district property taxes are both ways in which collection and compliance costs are reduced. However, such savings in administrative costs may be at the expense of a system that is less accessible and responsive to the taxpayer. Centralized collection and greater uniformity can both reduce local autonomy. Centralized collection would also offer fewer opportunities for review and resolution of problems, and is likely to make it less apparent to taxpayers how much they are paying to each of several kinds of local governments. All of these considerations must be balanced against other desirable attributes of the tax system in making decisions that affect the collection and compliance burdens either for a particular tax or the system as a whole.

In addition to these six criteria, the Steering Committee also asked that any changes be revenue neutral. Revenue neutrality ensures that the product of this effort is a better, more efficient, more equitable revenue system, not one that will provide either a windfall gain or an unexpected loss of revenue to counties, cities or school districts. Ultimately, the precise revenue impact of any package of changes to the local government funding system will have to be assessed by the Board of Economic Advisors and/or the Department of Revenue. However, this concern is reflected in the set of recommendations that follow, some of which will enhance local revenue, others that may reduce it, and some of which have little impact on revenue but may make taxes more equitable, more stable, or easier to collect or to pay.

Context: Six Areas in Which Recommendations Are Offered

Recommendations are grouped into six broad areas that begin with the major philosophical context of state-local relations and work their way toward the nuts and bolts issues of how the system shall be administered. These six areas are defined as follows:

1. Location of Responsibility at the State Level: In the legislative and executive branches of state governments, where shall the responsibility for dealing with issues of local government funding reside? At present this responsibility is shared among a number of committees in the House and Senate and several parts of the executive branch, primarily the Department of Revenue and the Comptroller General's office. Other states offer models of an integrated approach to dealing with such diverse local funding issues as property tax administration, collection of local option taxes, state-shared revenues, state grants to local governments, infrastructure funding, and assisting local government in marketing and managing their debt issue and debt service.

2. Fiscal Home Rule: An important dimension of local government authority and autonomy is the ability to control their sources of revenue, including setting tax and fee rates and choosing which revenue sources to use. Because they will be held accountable for tax increases or unsatisfactory service provision, they need some degree of flexibility in controlling their revenue streams. This autonomy must be balanced, however, by considerations of accountability. Local governments receive significant amounts of state funds. The state is often called upon to intervene in cases where local school districts, municipalities, or counties are unable to adequately manage their fiscal affairs. The state has a responsibility to ensure basic service levels to all counties and school districts. The state has made great strides in home rule in some areas, less so in others. Home rule for municipalities is greatest and most uniform. Counties vary somewhat in their degree of fiscal autonomy, while school districts have the least fiscal autonomy and also the greatest diversity in their ability to control their own financial affairs.

Fiscal home rule also involves coordination at the local level, because cities, counties and school districts share a property tax base. When the state delegates to one local government the authority to make decisions that impact on that tax base (for example, the 15% cap on increased in assessed valuation), the other local governments affected need to have an opportunity to weigh in on such decisions.

3. Economic Growth and Local Government: Local governments have an important role to play in encouraging economic development, and increasingly, in managing growth (smart growth) so as to ensure quality of life in areas that are developing rapidly. At the same time, economic growth impacts on local governments in terms of additional revenue and additional service demands. The revenue system must ensure that economic growth generates enough additional resources to meet increases in service demands, and local governments need access to revenue tools that will enable them to both encourage and manage growth so as to satisfy the needs of all citizens.

4. State-Shared Revenues: The state is an important source of revenue for local governments--44% of all revenue for school districts, 20% for counties, 9% for municipalities in 1996-97. The amount of revenue distributed, the way it is distributed among different jurisdictions, and the restrictions on its use are all an important part of the fiscal context in which local government operate. Is it sufficient? Is it distributed appropriately? To what extent should state funds be earmarked for particular purposes as opposed to general support? How can there be accountability when revenue is raised by one level of government and spent by another? All of these questions suggest some directions for reform in state aid to counties, municipalities, and school districts. The criteria for revenue systems discussed above play an important part in recommendations for reforming the system of state-shared revenue so as to ensure adequacy, stability, equity, and accountability.

5. Own-Source Revenues: Local governments in South Carolina are constrained in the revenue sources they are permitted to use and the rates that they are allowed to set. The state maintains considerable control over the property tax system in establishing and changing assessment classifications, supervising property tax administration, providing exemptions, withdrawing property from the tax base, and assessing some types of property. The state also determines what other taxes local governments can use, at what rates, on what terms and for what purposes. The state has also mandated some charges and imposed some restrictions on the use of other kinds of fees and charges, which are a significant revenue source for cities and also important for counties. It is appropriate for the state to set some parameters on local revenue sources, but local governments also need some flexibility in meeting diverse local needs, circumstances and preferences. Recommendations in this section address possible changes in the ways in which local governments in South Carolina raise their own-source revenue.

6. Structure and Administration: Finally, there are administrative issues at both the state and local level that could reduce the cost of administering the revenue system and make it easier for taxpayers to comply with, as well as to understand.

Recommendations

Introduction to the Recommendations

This section contains 34 recommendations for reforming the local government funding system, ranging substantively from modest to comprehensive in scope and impact. Each recommendation is related to the findings found in the series of working papers, which are the foundation for these recommendations. Each recommendation is given a preliminary evaluation in terms of the criteria established by the steering committee as well as preliminary judgment about the direction of its revenue impact and other impacts. Some of these recommendations can be considered independently, while others are part of a cluster of interrelated recommendations. There was a high degree of consensus reached on most of the recommendations from the affected stakeholders as well as the technical staff of the project. Where there is disagreement, the nature and rationale of the disagreement has been noted under the relevant recommendation.

The recommendations are presented in the sequence mentioned earlier, based on the central issue that each addresses:

1. Location of responsibility at the state level;
2. Fiscal home rule;
3. Economic growth and local government;
4. State-shared revenue;
5. Own-source revenues; and
6. Structure and administration

However, there are other themes that run through these 34 recommendations that cross the lines of those six categories. One is sorting out the division and commingling of responsibilities of the state and its political subdivisions, which include oversight, technical assistance, fiscal autonomy, and coordination and regionalization. A second set of issues cluster around the balance between uniformity and diversity at the local level. A third set of themes or issues relate to state aid, which has its own category but also spills over into the others. A fourth cluster of issues surrounds the property tax, still the most important overall own-source revenue at the local level. Finally, while many of the recommendations can be considered on their own (even if they relate to other recommendations), there are several clusters of recommendations that need to be considered as a package. Those “linked” recommendations are the fifth and final theme to be kept in mind in reviewing these recommendations.

Sharing responsibility between state and local government. At the state level, the recommendations urge more coordinated oversight, data collection, and technical support and a clearer articulation of the operating rules in recommendations #1, 2, 3, 9, and 31. While the report addresses revenue rather than structural issues, structural issues have important revenue implications. In examining the structure-revenue relationship, the Technical Work Group identified recommendations that address fiscal autonomy in various forms, including setting mill rates, budget approval, mandates, restrictions on fees and charges, access to other revenue sources (#26), and debt limits (#4,5,7,8, and

28). Another structural/revenue issue was coordination and regionalization among local governments (#6, 12, and 30). In addition, it was agreed that an independent review of structural issues of many kinds at the local level is needed (#29).

The partnership between the state and local government in providing and funding various services makes it difficult to disentangle local funding issues from state ones. The state needs to consider its role in local government default (#8), in infrastructure funding (#13 and 17), in collecting court fines and fees (#19), in enforcing motor vehicle registration so that local governments can collect property taxes on personal vehicles (#33), in planning for growth (#10 and 13), and in evaluating the impact of industrial location incentives, especially in regard to schools (#11). Local governments, in turn, need to be responsible partners with the state in growth management and economic development (#10, 11, and 12), and in reporting data to the state in a timely and uniform manner (#34). Because the state sales tax base is now the local sales tax base as well, the State of South Carolina must be careful in strengthening and safeguarding this shared revenue source in the light of internet sales growth, as well as making it more available to local governments (#21, 26, and 27). Likewise, any state action on utility deregulation needs to take into account the potential huge fiscal impact on local governments (#20).

Uniformity and diversity. Uniformity, diversity, and autonomy interact in important ways at the local level. Uniformity is desirable in some instances, particularly in accounting (#34) and in the ability of school districts to respond to new demands and challenges from the state through adequate fiscal autonomy (#7). In other cases, different circumstances call for diversity in treatment, in options, and in degrees of autonomy (#5, #26 and 28) in order to allow them to respond to unique circumstances and demands (e.g. urban vs. rural, tourist centers, etc.).

Revisiting state aid. Another important dimension of the state-local relationship is state aid, which is a highly significant revenue source for local governments, especially school districts. State aid should be distributed in ways that meet equity standards and ensure a reasonable sharing of responsibility between local and state governments for ensuring the quality of local public services, particularly related to schools and infrastructure. Several recommendations suggest revisiting the level, form, and distribution of state aid (#14, 15, 16, 17, and 18) so that state aid is more equitable and more adequate, especially for school districts. Two recommendations also address state and local roles in managing the costs of growth and funding infrastructure (#10 and 13).

Property tax. Many of the recommendations in this report address various features of the property tax, still the primary local government own-revenue source. A total of nine recommendations address various aspects of property taxation. Four of those recommendations relate to improving administration at both the state and local levels (#3, 30, 31, and 32). One addresses the issue of piecemeal property tax relief (#23), while the other four address some significant issues related to assessment and classification – namely, a uniform statewide rate for school property taxes on utilities and industry, the 15% cap, the assessment ratios, and the treatment of farm and forest property and other special exceptions (#15, 22, 24, and 25). Some of the most far-reaching and

interconnected changes are found in these last four recommendations, which deserve particularly careful scrutiny.

Linked recommendations. Many of the recommendations in this report could be implemented independently of each other. Others need to be considered in concert. The following list identifies groups of recommendations that need to be considered jointly.

1. **Recommendation #5, Restrictions on fees and charges, and Recommendation #28, Fees and charges in the local government funding system:** There is some overlap between these two recommendations. Fees and charges are a growing local revenue source in most states, and the state has an interest in ensuring that they are imposed fairly and not used to an excessive degree, while local governments have a need to increase their flexibility in tapping diverse revenue sources.
2. **Recommendation #6, Coordination among local governments using the same tax, and Recommendation #12, partners in economic development:** Both recommendations address the issue of control over the property tax base by one local government in ways that impact on another.
3. **Recommendation #8, Fiscal Autonomy for School Districts:** Recommendation #8 is less critical if districts receive more state aid (#18). However, it may be very important in giving them flexibility in responding to a number of proposed changes in the property tax that will redistribute revenue among school districts (#22, 24, and 25) as well as in addressing any revenue impact of economic development decisions made by the county (#12).
4. **Recommendations #14, 15, 16, 17, 18, and 19:** Most of the state aid recommendations (#14-19) are highly interconnected. State aid tends to be addressed piecemeal rather than as a package, with more emphasis on the level or the average than on the distribution.
5. **Recommendations pertaining to property taxes:** The most important interconnection is among the various property tax recommendations. The change in the assessment ratios discussed in Recommendation #25 would result in a revenue loss, some of which could be made up by using fair market value (#24), taxing utility and manufacturing property for school purposes at the state level (#18), enforcement of motor vehicle registration (#33), and allowing more local revenue diversification (#26). But the distributional effects of the assessment ratio changes would be far-reaching, and school districts in particular would need more fiscal autonomy (#7) in order to adjust mill rates to preserve their revenue stream.

1: Location of Responsibility for Local Government at the State Level

Findings: Local governments are created by their state governments, which define their responsibilities, determine the revenue sources to which they have access, assist them in providing many services, and may be called upon for assistance with their debts in case of defaulting or bankruptcy. In 1996, state government had revenues from all sources of \$10.3 billion, while local governments' revenues were almost $\frac{3}{4}$ as much, \$7.4 billion. About one-third of that local revenue came from state-shared revenues in one form or another. These three kinds of local governments provide many essential day-to-day services on which citizens depend, ranging from solid waste collection and education to street maintenance and police and fire protection. Thus, oversight of and assistance to school districts, counties, and municipalities is an important function of state government that deserves careful and consistent attention.

In the legislative and executive branches of South Carolina state government, responsibility for dealing with issues related to the local government funding system is shared among a number of committees in the House and Senate and several parts of the executive branch, primarily the Department of Revenue and the Comptroller General's office. Other states offer alternative models of oversight and assistance. In some states, there is an integrated approach to dealing with such diverse local funding matters as property tax administration, collection of local option taxes, developing a data base of local revenues, expenditures and debt, distributing state-shared revenues, awarding state grants to local governments, assistance with infrastructure funding, marketing and managing local governments' debt issue and debt service, and monitoring demographic trends that impact on local government revenues and service demands. North Carolina, for example, has a Local Government Commission that provides many of these services. Some thirty of the state legislatures have standing committees that deal with local government fiscal issues.

Recommendation #1: Creation of a Single Executive Agency for Local Government Fiscal Matters

Findings: At present, responsibility for financial matters relating to local government (collection and distribution of local option sales taxes, distribution of state-shared revenues, funding and monitoring the use of funds by school districts, awarding of state grants, property tax oversight, collection and analysis of data on local government finances, monitoring indebtedness, determining the impact of policy alternatives on local government, etc.) is scattered among a number of state agencies in the executive branch. (Property tax administration is addressed in recommendation #3.) Centralizing some of these other functions in a single place would allow development of more consistent policies based on better information. In addition, this single agency could assume additional functions related to technical assistance, infrastructure funding and debt administration that are not presently being provided in a consistent way by any agency of state government.

At present, fiscal data is collected in a number of different locations and reported on by several different agencies as well as non-governmental groups (such as the Municipal Association of South Carolina). Existing agencies - primarily the Budget and Control Board, the Department of Revenue, the Department of Education, and the Comptroller General's Office--are charged primarily with gathering data and making it available in various forms, usually without analysis of trends or other useful observations about the significance of changes in the data. This dispersion of the data and lack of a central collection place and a consistent and complete plan for analyzing and interpreting the data makes it very difficult for public officials, interested citizens and taxpayers to gain a clear picture of the state of local government finance in South Carolina. Such a clear and consistent picture would provide a solid basis for making public policy decisions.

Population is growing rapidly and unevenly in South Carolina, with some areas losing population, while urban areas, the coast, and areas along the major interstate highways are continuing to attract new industries and residents. In addition to overall population growth, the population mix is changing, particularly with a higher proportion of elderly citizens. Changes in the size and composition of the population impacts on both revenue generation and service demands. Communities with rapid growth suffer pressures on their infrastructure, while declining communities may not be able to maintain their services with a diminishing tax and population base. Of particular importance are demographic trends relating to elderly residents, children of school age, housing patterns (e.g., density, mobile homes, single v. multifamily), income levels and distribution, and municipal vs. non-municipal residents, all of which impact on both state and local revenue and on service demands and capital (infrastructure) requirements. The state government is in the best position to monitor and interpret these trends and to share them both with local governments and with those responsible for making fiscal decisions at the state level that impact on local governments.

Recommendation: We recommend that the state create a single agency or commission with broad responsibilities for overseeing the collection and analysis of data and coordinating fiscal relations between the state and its political subdivisions, including special purpose districts as well as municipalities, counties, and school districts. This commission should also ensure that there is a regular, recurring biennial report that tracks and analyzes relevant demographic data so that the fiscal implications can be shared with local officials, the General Assembly, and other interested parties. This agency or commission should centralize the functions of data collection and analysis, debt monitoring, and such other relevant functions as may be assigned to it, operating under the oversight of either the Comptroller General's Office or the Budget and Control Board.

Criteria: accountability.

Revenue impact: none.

Other impact: some state expenditure impact to create the new commission.

Related recommendations: #3 - State Role in Property Tax Administration; #8 - Limitations on Local Debt; #9 – Defining the Role of the State in Managing and Overseeing Local Government Borrowing and Responding to Default; #17 – Infrastructure Financing; #29 – Local Government Structure; #31 – Recodification of Property Tax Administration Statutes; #34 – Uniformity in Fiscal Years and Accounting.

Reservations/objections: Some concerns were expressed about creating another layer of bureaucracy and ensuring that local governments do not need to submit multiple reports. If such an agency is created, it should occur by reallocation of existing resources. Special purpose districts should be included by statute. If it is located in the Comptroller General's office, additional staffing would be needed.

Recommendation #2: Creation of House and Senate Standing Committees

Findings: At present, responsibility for legislation on local government fiscal matters is scattered among a number of legislative committees. As a result, issues that should be considered simultaneously are split, and the legislature rarely addresses fiscal issues facing local government from an integrated perspective. During and immediately after the debates on county home rule in the 1970s, there was a joint legislative committee that addressed a number of issues related to the structure and fiscal affairs of counties and municipalities. Such a committee could serve the same purpose in the new century in addressing the many challenges facing South Carolina's local governments. Because of the specialized nature of school district responsibilities, it remains appropriate that education fall under a separate committee, but clear lines of communication should exist between the two committees on property tax issues that affect both school districts and other local governments.

Recommendation: We recommend that the S.C. Senate and the House of Representatives each create a standing committee on local government to address issues related to county and municipal fiscal issues as well as matters related to local taxes, which is a major funding source for school districts as well.

Criteria: accountability.

Revenue impact: none.

Other impact: some expenditure impact to support new committees.

Related recommendations: none.

Reservations/objections: The SC School Board Association believes that local tax issues as they pertain to and impact on school district funding should be an integral part of these committees.

Recommendation #3: State Role in Property Tax Administration

Findings: The state's role in property tax administration dates back to the days of a state property tax. Today the property tax is a very minor source of state revenue, but because the regulations, statutes, and constitutional provisions governing the operation and administration of the local property tax are all state matters, the state continues to play an important role in the administration of the local property tax and in funding property tax relief. At present the primary responsibility for overseeing local property tax administration is split between two state entities: the Comptroller General's office, which is headed by a constitutional officer elected independently of the governor, and the Department of Revenue, headed by a cabinet officer appointed by the governor. The Comptroller General's office has primary responsibility relative to collection while the Department of Revenue's responsibilities relate to valuation and assessment. Additional responsibilities relative to property tax administration involve the Department of Education (measurement of maintenance of effort), the Treasurer (debt information which is related to the property tax base), and the Budget and Control Board's Office of Research and Statistics, which collects and disseminates statistics related to property tax collections. The duplication and division of responsibilities at the state level, including overlap in the area of audit, makes it difficult for local officials to obtain clear answers to questions or to find everything they need in one location.

Recommendation: We recommend that the responsibility for property tax administration at the state level be assigned to a single agency, under either the Comptroller General or the Department of Revenue, adequately funded and staffed, with an advisory board that includes representation from local governments (counties, municipalities, and school districts) in order to simplify and clarify the property tax administration process.

Criteria: accountability, efficiency.

Revenue impact: neutral.

Other impact: state expenditures for an adequately staffed agency.

Related recommendations: #15 – Forms of State Aid; #32 – Improving the Property Tax Collection Process.

Objections/reservations: Some concern was expressed about the creation of additional bureaucracy.

Part 2: Fiscal Home Rule

Findings: An important dimension of local government authority and autonomy is the ability to control their sources of revenue, including setting tax and fee rates and choosing which revenue sources to use. The sources of local government revenue nationally and in South Carolina have changed significantly over the past three decades, with more reliance on local sales taxes, charges and fees, and in some states, local income taxes. The most significant change is a lessened reliance on the property tax. Nationally, the property tax has declined from almost one-half of local revenues in 1966 to only about 28% in 1996. In South Carolina, the decline was somewhat smaller but still significant, from 47% of own-source revenues in 1966-67 to 41% in 1995-96.

In 1996, local governments across the nation provided 44.4% of their revenue from local sources, with the remainder coming from state and federal sources. For South Carolina, that local share was much higher than the national average in 1996 at 64.2%, and had increased substantially over the previous thirty years from only 45.8% in 1966. Recognizing pressures on and resistance to the property tax, many other states have given local governments both more direct aid and more discretion in the use of non-property tax revenues. Much of the revenue shift in other states was reflected in increased intergovernmental aid from 30.8% in 1966 to 34.3% in 1996. In South Carolina over the same period, however, intergovernmental aid fell from 45.7% to only 35.8% of local general revenue.

Fees and miscellaneous general revenue have also grown as a source of local revenue in other states from 15% in 1966 to 24% in 1996. The shift to this revenue source was even more dramatic in South Carolina, increasing from 17.5% in 1966-67 to 34.2% in 1995-96.

Because local governments will be held accountable for tax increases or unsatisfactory service provision, they need some degree of flexibility in controlling their revenue streams. This autonomy must be balanced, however, by considerations of accountability. Local governments receive significant amounts of state funds. The state is sometimes called upon to intervene in cases where local school districts, municipalities, or counties are unable to adequately manage their fiscal affairs. The state has a responsibility to ensure basic service levels to all counties and school districts. The state has made great strides in home rule in some areas, less so in others. Home rule for municipalities is greatest and most uniform. Counties also possess fiscal autonomy but a lesser degree of home rule, while school districts have the least fiscal autonomy and also the greatest diversity in their ability to control their own financial affairs. Fiscal home rule also involves coordination at the local level, because cities, counties and school districts share a property tax base.

Recommendation #4: State Mandates

Findings: Mandates are imposed on local governments by both the state and the federal government. Some of the costliest mandates for local governments in the last ten years relate to solid waste management, corrections, the Americans with Disabilities Act, indigent health care, fair labor standards, educational standards, and housing. Without funding from the higher level of government imposing the mandate, local governments must generate more own-source revenue to cover the cost. At the Federal level, efforts were made to address this issue in the Unfunded Mandates Reform Act of 1995, but that policy could be strengthened. At the state level, considerable progress has been made in addressing unfunded mandates. (Section 4-9-55 of the S.C. Code). However, there are still a number of issues to be resolved in order to ensure that local governments are not obligated to provide services or carry out actions without the resources to pay for those services.

Recommendation: We recommend that the legislation protecting cities and counties from the impact of unfunded mandates be extended to school districts, that efforts be made to reduce current exceptions from the unfunded mandates requirement, and that information on the fiscal impact of proposed legislation on local governments be made available to legislators at the committee stage as well as later in the process. School districts need to be explicitly covered, all actions (including budget provisos) that have a fiscal effect similar to mandates need to be included, and measures of fiscal impact need to be made available to legislators earlier in the process. We further recommend that state and local officials work together to encourage members of the South Carolina congressional delegation to strengthen the federal protections for local governments from the impact of unfunded mandates.

Criteria: accountability, adequacy.

Revenue impact: neutral.

Other impacts: none.

Related recommendations: #5 – Moderating Restrictions on Fees and Charges; #8 – Limitations on Local Government Debt; #11 – Economic Development Incentives; #18 – State Aid to Local School Districts.

Reservations/objections: Members of the business community expressed concern about the impact of limiting mandates on the state's ability to adequately administer federal programs in the future.

Recommendation #5: Moderating Restrictions on Fees and Charges

Findings: Counties and municipalities have become increasingly dependent on licenses, permits, fees and charges to supplement the property tax as a revenue source. The use of fees and charges has several advantages in addition to property tax relief; they impose part of the burden of funding public services on those who create the demand, and in doing so, they constrain the growth of service demand. Fees and charges, like local sales taxes, also offer a way to collect revenue from those (mainly commuters and tourists) who use a city's or county's services but do not reside there and therefore do not contribute directly through property taxes. Fees are not always a suitable revenue device for many municipal or county services and are often burdensome on the poor, so they should be used with restraint. The General Assembly has addressed the issue of fees and charges recently in the Local Government Fiscal Authority Act of 1997.

Among its several provisions, the Local Government Fiscal Act of 1997 (Act 138 of 1997) authorizes a local governing body - by ordinance - to charge and collect a service or user fee. Fees specifically require approval of a "positive majority" or "a vote for adoption by a majority of the members of the entire governing body, whether present or not." (S.C. Code of Laws, as amended, Section 6-1-300 (5)). Further, "a local governing body must provide public notice of any new service or user fee, and additionally, is required to hold a public hearing and to receive comment prior to the final adoption of a fee." Also, "revenue from fees are required to be kept separate from the general fund of the imposing governmental entity and must only be used to finance public services for which the fee is imposed." (S.C. Code of Laws, as amended, Section 6-1-330 (A) and (B)).

Recommendations: We affirm the Local Government Fiscal Authority Act and recommend that it be maintained, monitored, and supported. In accordance with that act, few if any additional restrictions should be placed on the enactment of fees and charges as a local government revenue source provided the fees are used for the specified service. Any proposed or existing restrictions should be carefully reviewed and justified in terms of a state interest in restricting the use of particular kinds of fees or in the groups who may be most impacted.

Criteria: accountability, balance and diversity, equity, adequacy.

Revenue impact: probably neutral.

Other impact: none.

Related recommendations: #4 – State Mandates; #26 – Local Revenue Diversification; #28 – Fees and Charges in the Local Government Funding System.

Recommendation #6: Coordination Among Local Governments Using the Same Tax Base

Findings: School districts, counties and municipalities share the property tax base. The actions of each impact on one another. Citizens are interested in their total tax bill and are not always aware of which local government is responsible for increasing the mill rate. Actions of county councils impact on school districts and municipalities in such areas as offering business location incentives and implementing the 15% cap on reassessment. The delegation of the authority to put a 15% cap on reassessment to counties is an example of failing to consider the interests of municipalities and school districts in such a decision. Their revenues would also be impacted by such an ordinance, and they should be entitled to some voice in the decision. [Note: Issues of consultation on economic development incentives are addressed in the next section.]

Recommendation: We recommend that the state encourage more dialogue among local governments about decisions that impact on the property tax base and/or the mill rate. Specifically, we recommend that school boards and city councils, as independently elected local officials, be asked for their consent to any non-economic development proposal in which the General Assembly has delegated authority to local officials to alter the tax base in some manner.

Criterion: accountability.

Revenue impact: neutral.

Other impact: none.

Related recommendations: #1 – Creation of a Single Executive Agency for Local Government Fiscal Matters; #11 – Economic Development Incentives; #12 – Partners in Economic Development; #13 – Financing the Local Government Costs Associated with Economic Growth; #30 – Regionalization of Property Tax Assessment.

Recommendation #7: Fiscal Autonomy for School Districts

Findings: The state’s 86 school districts have widely varying degrees of control over their budgets and their mill rates, ranging from no autonomy (approval by legislative delegation, county council, or county board of education) to total autonomy. Most school board members are elected by and accountable to citizens, just as members of city and county councils are. They are under considerable pressure to provide quality educational programs under a variety of federal and state mandates with limited funding from state and federal governments. When the General Assembly makes decisions about school districts that may require additional local revenue, the ability of school districts to respond varies greatly according to their degree of fiscal autonomy. The state already has the power to intervene in cases of mismanagement, as it has in the Allendale school district. Decisions about fiscal autonomy should be linked to rethinking some of the maintenance of effort provisions in the funding formula, as described in Recommendation #18 and to the recommendation about changing the assessment ratios found in Recommendation #25.

Recommendation: We recommend that all elected school boards be granted the power to determine their own budgets and establish their own mill rates for school purposes. We further recommend that revenue sources available to school districts be expanded (see Recommendation #26 – Local Revenue Diversification).

Criterion: accountability.

Revenue impact: minimal.

Other impact: reduces authority of some county councils over schools.

Related recommendations: #18 – State Aid to School Districts; #25 – Property Tax Structure – Classification and Assessment Ratios; #26 – Local Revenue Diversification; #28 – Fees and Charges in the Local Government Funding System.

Objections/reservations: Members of the business community expressed concern about providing fiscal autonomy to school districts when they share the same tax base as the county and municipalities, out of concern about possible impact on the total mill rate.

An objection submitted by the S.C. Chamber of Commerce on behalf of members of the business community is as follows:

“We strongly object to this recommendation because there needs to be a final review of tax increases by a body with broader authority, (i.e. county council or local legislative delegation) to ensure a check and balance on tax increases. Fiscal autonomy is a concept, not a structure. It needs careful definition and strong accountability that does not exist in the concept currently. Further, federal and state funds available to schools are dramatically different than those available to local governments; therefore, the revenues and taxes available to all local entities (counties, cities, school and special purpose

districts) need to be reviewed and monitored in total. We also object to expanding revenue sources for school districts without being explicit about the taxes and their incidence.

Recommendation #8: Limitations on Local Government Debt

Findings: In order to address the needs of a growing population, local governments need to be able to develop and maintain the infrastructure required to service that population. The debt ceilings for local government borrowing in South Carolina can be a major impediment for non-revenue-generating projects, i.e., those that must be funded with general obligation debt. The local government general obligation debt limitation in South Carolina is 8 % of the assessed value of taxable property. That limit was established in the 1895 constitution and has been impacted both by Act 208 establishing the current assessment ratios and the implementation of fee in lieu agreements. It will be further impacted by the proposed change in the assessment rate on personal vehicles, which will reduce the indebtedness capacity of all local governments.

Debt in excess of that limit requires a referendum. Any effort to dedicate a particular tax, such as a local option sales tax or hospitality tax, to debt service on bonds (limited tax obligation bonds) as a way to fund borrowing outside the ceiling is hampered by the requirement that such a funding method be approved by referendum. Because of the difficulty in getting referenda approved, many jurisdictions have utilized lease-purchase arrangements for some of their capital spending, an arrangement that is usually more expensive than general obligation debt. Lease-purchase arrangements are not subject to the debt ceiling unless the purchase being financed consists specifically of land and/or construction of buildings.

In neighboring states, four (Louisiana, North Carolina, Virginia, and Georgia), the debt limit is 10% of assessed value. In Mississippi the limit is 1%, in Alabama 5%. In Kentucky the ratio ranges from 3% to 10% depending on population. Tennessee has no limitation. Comparisons with ratios in other states must be used with care because of differences in assessment ratios. In Georgia, for example, the assessment rate is 100% of fair market value. Thus, a \$1 million industrial property would allow \$100,000 in debt in Georgia, but at a 10.5% assessment rate in South Carolina and an 8% debt ceiling, the same property would only allow \$8,400 in borrowing in South Carolina.

Among the options that might be considered in reviewing the debt limit are the following:

- (1) expressing the limit in terms of local operating revenue rather than a percentage of assessed value
- (2) raising the 8% debt ceiling
- (3) revising the constitution to authorize the use of limited tax obligation bonds by ordinance.

Recommendation: We recommend that the state review the present local government debt limitation, considering one or more of the options identified above.

Criterion: adequacy.

Revenue impact: positive to neutral.

Other impact: broadens capital funding options.

Related recommendations: #1 – Creation of a Single Executive Agency for Local Government Fiscal Matters; #9 – Defining the Role of the State in Managing and Overseeing Local Government Borrowing and Responding to Default; #17 – Infrastructure Financing.

Reservations/objections: A single approach might not be the best solution. Members of the business community raise the concern that, in its opinion, too often bonds are used to extend the operating budget as projects that are questionable as true capital projects are financed to free up more operating dollars. The educational representatives wanted to insure that schools are also included in this recommendation.

Recommendation #9: Defining the Role of the State in Managing and Overseeing Local Government Borrowing and Responding to Default

Findings: At present, the state monitors and reports on local government debt and ensures that the level of debt remains within the constitutionally imposed limits. However, each individual entity issues and services its own debt independently. The state has no legal responsibility to intervene in cases of default on local government debt, but in fact can be and sometimes is called upon to do so.

Recommendation: We recommend that the state explore options for “bundling” of local government debt in order to save costs and obtain more favorable interest rates for local government and/or the establishment of a bond bank to enable local governments to borrow directly for their needs. We further recommend that the General Assembly formally address the nature of state responsibility, if any, in cases of local government default, and that the State consider guaranteeing city and county debt as it now does for school districts.

Criteria: accountability, efficiency (cost savings).

Revenue impact: none.

Other impact: possible savings in cost of debt service.

Related recommendations: #1 – Creation of a Single Executive Agency for Local Government Fiscal Matters; #8 – Limitations on Local Government Debt.

Part 3: Economic Growth and Local Government

Findings: Local governments have an important role to play in encouraging economic development, and increasingly, in managing growth (smart growth) so as to ensure quality of life in areas that are developing rapidly. At the same time, economic growth impacts on local governments in terms of additional revenue and additional service demands. The revenue system must ensure that economic growth generates enough additional resources to meet increases in service demands, and local governments need access to revenue tools that will enable them to both encourage and manage growth so as to satisfy the needs of all citizens.

Recommendation #10: Growth Management

Findings: Some of the faster growing areas of the state, particularly along the coast and the I-85 corridor, are developing in an unchecked fashion that not only makes the environment less attractive by reducing open space and increasing highway congestion but also is often more costly for local governments to serve. The pattern in South Carolina replicates the experience of other states, many of which have adopted growth management strategies to preserve natural amenities and control service costs. The Governor's Summit in March 2000 addressed many of these issues, and provided the first steps toward future growth management planning.

Recommendation: We recommend that the state provide support and technical assistance to local governments in growth management. Cities and counties should have access to a broad array of growth management tools of both a fiscal nature (e.g., taxes, special assessments, impact fees, purchase or transfer of development rights) and a non-fiscal nature (e.g., growth plans, zoning).

Criteria: equity, adequacy.

Revenue impact: minimal.

Other impact:

Related recommendations: #13 – Financing the Local Government Costs Associated with Economic Growth.

Recommendation #11: Economic Development Incentives

Findings: In the last decade more of the responsibility for attracting economic development has been shifted in South Carolina to the local level, which results in some intense interlocal competition. While all local governments are interested in encouraging economic development for its positive economic impact (jobs, wages, etc.), there are concerns about some of the costs and the revenue effects (fiscal impact) of using incentives for that purpose. In many other states, incentives are tied to performance, such as the number and quality of jobs created, wage levels, the amount of capital invested, and/or the length of time in which the firm remains in that location. Local governments have limited technical support services that enable them to make adequate cost/benefit evaluations of economic development proposals to determine the economic and fiscal impact on the city, county, and/or school district.

Recommendation: We recommend that the state provide technical support services to local governments and school districts in evaluating and monitoring the impact of proposals, selecting appropriate incentive packages, and ensuring that firms fulfill provisions of the development agreement. We further recommend that any cost/benefit analysis of State sponsored incentives should address the impact on school districts as well as other public entities.

Criteria: adequacy, equity, accountability.

Revenue impact: minimal to none.

Other impact: possible cost saving.

Related recommendations: #6 – Coordination Among Local Governments Using the Same Tax Base; #11 – State Mandates; #12 – Partners in Economic Growth; #13 – Financing the Local Government Costs Associated with Economic Growth.

Recommendation #12: Partners in Economic Development

Findings: The state has made counties important partners in economic development decisions, permitting them to create multi-county business parks and/or to enter into fee in lieu agreements with firms interested in locating or expanding in their county. However, these agreements impact on the revenue and service demands of school districts and sometimes municipalities as well.

Recommendation: We recommend that the authority of counties to enter into such agreements be amended so as to protect the interests of other local government authorities where they will be impacted by the proposed development agreement. Specifically, we recommend that a default distribution of local public revenues from such agreements be established by the General Assembly and that the participation and consent of other local governments be required only when it is proposed that some other distribution be made. In this regard, we recommend that in the case of multi-county industrial parks, net revenues received from a new facility should be divided among the affected local governments in the same proportion as it would have been were it property tax revenue. The amount of the gross fee that could be used for economic development incentives and recruitment without the consent of the school board should be limited to some ceiling percentage.

Criteria: adequacy, equity.

Revenue impact: none.

Other impact:

Related recommendations: #6 – Coordination Among Local Governments Using the Same Tax Base; #11 – Economic Development Incentives; #13 – Financing the Local Government Costs Associated with Economic Growth.

Recommendation #13: Financing the Local Government Costs Associated with Economic Growth

Findings: The nature of economic development determines the fiscal impact on local governments, including school districts. Manufactured housing and single-family residential developments generate very different revenue streams relative to service demands. Close-in, denser housing developments are less expensive to service than those that are farther out and on large plats of land, but congestion where infrastructure is already heavily utilized can add greatly to local service costs while diminishing quality of life for local residents. Commercial and industrial development generate much less in the way of direct service demands relative to revenue than housing developments, but they do not take place in the absence of new residents to work in their plants, shop in their stores, and dine in their restaurants, so development must be looked at as a total package. Preservation of amenities, including green space, increases housing values and makes a location more attractive to many kinds of other development.

Those who add to a community's costs of doing business should bear a fair share of those costs so that existing local residents are not unfairly burdened. People who occupy newly constructed homes in South Carolina begin using public services immediately but may delay paying property taxes as long as two years. Local governments need an array of fiscal and non-fiscal tools to encourage developmental patterns that are in the best interests of the community and to capture revenues from those who generate service demands.

Because the state often benefits more than local governments in the revenue stream (income and sales taxes in particular) that results from economic growth, it is appropriate that the state share in the cost of providing the infrastructure needed to accommodate that growth. These infrastructure needs have been identified in studies conducted by the Budget and Control Board's Division of Regional Development.

Recommendation: We recommend that the General Assembly encourage local governments to pursue planned growth strategies and empower them with appropriate tools, including fees and charges as well as non-fiscal ordinances, to ensure that planned growth occurs and that new residents pay a fair share of the additional costs they create. We further recommend that the state assist local governments in providing the infrastructure necessary to support economic growth both with state funding for infrastructure and with additional local taxing authority tied specifically to infrastructure projects.

Criteria: adequacy, accountability, equity.

Revenue impact: minimal.

Other impact: some cost to state for funding infrastructure.

Related recommendations: #6 – Coordination Among Governments Using the Same Tax Base; #11 – Economic Development Incentives; #12 – Partners in Economic Development; #17 – Infrastructure Financing; #26 – Local Revenue Diversification;

Reservations/objections: Members of the business community would like to see more specific information about additional local taxing authority.

Part 4: State-Shared Revenues

Findings: The state is an important source of revenue for local governments across the nation. In South Carolina, funds supplied by state governments comprised 44% of all revenue for school districts, 20% for counties, and 9% for municipalities in 1996-97. The amount of revenue distributed, the method of distribution among different jurisdictions, and the restrictions on its use are all an important part of the fiscal context in which local governments operate.

Is the level of funding sufficient and equally important is it distributed appropriately? To what extent should state funds be earmarked for particular purposes as opposed to general support? How can there be accountability when revenue is raised by one level of government and spent by another? All of these questions suggest some new and perhaps even innovative directions for reform in state aid to counties, municipalities, and school districts. The criteria for revenue systems discussed earlier play an especially important part in recommendations for reshaping state-shared revenue so as to ensure adequacy, stability, equity, and accountability.

Recommendation #14: Level and Distribution of State Aid

Findings: Nationally and in South Carolina, local governments have shown three significant trends in financing: 1) greater reliance on “own-source” revenues, particularly as a result of declining federal aid, 2) decreased dependence on the property tax as a share of local revenues as a result of property tax revolt, and 3) increased use of other local taxes (sales, income) and fees. In 1996, states provided an average of 34.3% of all local government revenues, with some increases since that year in a number of states that were targeted to education and/or property tax relief. This share is considerably lower than it was in earlier years; between 1959 and 1982, state aid provided 54-64% of local government revenues.

In 1997, South Carolina was at about the same funding percentage as the national average, 34.8% of all local funding. State aid has been growing more slowly than own-source revenues for South Carolina’s counties and municipalities, but at about the same rate as own-source revenues for school districts.

The combination of local option sales taxes for cities and counties and state-funded homeowner property tax relief has somewhat reduced the growth of property taxes and the share of property taxes in overall local government funding in South Carolina. However, many of the other local revenue instruments used in other states, such as local income taxes, are of more limited potential in a state with fewer large urban areas.

Recommendation: We recommend that the State of South Carolina at least maintain its present share of funding for municipalities and counties. We recommend a review of the share and form of school district funding (see Recommendation #15), in order to provide some equalization between richer and poorer/disadvantaged parts of the state. We further recommend that the range of revenue options of local governments be increased. (See below, Part 5.)

Criteria: adequacy, balance and diversity, equity.

Revenue impact: neutral but redistributed.

Related recommendations: #6 – Coordination Among Local Governments Using the Same Tax Base; #15 – Forms of State Aid; #16 – Ensuring Interlocal Equity, #17 – Infrastructure Financing; #26 – Local Revenue Diversification.

Reservations/objections: The State Chamber of Commerce on behalf of members of the business community objects to the notion of equity funding as follows: “Equity funding for school purposes means someone will pay more and someone else will pay less. For every school whose funding is increased another school will lose state funds. This breeds mediocrity in education. There must be a way to increase under-funded areas without decreasing funds in other schools. If we increase the tax burden in the name of equity we could very easily lose our competitive position. This report does not provide any

information about how this recommendation will impact taxpayers and our state's competitive tax position.”

Recommendation #15: Forms of State Aid

Findings: State aid to local governments in South Carolina comes in a number of different forms. Formula-driven aid is on a per capita or per pupil basis (i.e., the Local Government Fund), sometimes with adjustments for local taxpaying ability or effort, as in the EFA and EIA. A second form of aid goes directly to taxpayers in the form of state-funded relief, which may or may not enhance the ability of local governments to raise funds for public purposes. A third form is state aid directed at particular services, such as libraries and recreation, which may come as per capita aid or may be distributed to particular jurisdictions in the form of grants. The state also includes, for example, in its state-shared revenues certain “local” taxes, primarily the accommodations tax, which is collected by the state and distributed largely on the basis of origin to be spent in accordance with state guidelines. Finally, an increasing share of state aid has taken the form of property tax relief. Each of these forms of state aid is appropriate for certain uses. Guaranteeing basic services supports per capita distribution, interlocal equity calls for adjusting the formula to account for ability to raise funds locally, and the desire of the state to promote certain services or meet a particular need supports the use of specific grants. Responding to citizen concerns about property tax burdens has put much of the additional state aid into the form of property tax relief in the 1990s, so that state funds essentially go back to taxpayers rather than to school districts, cities and counties in the form of additional operating revenue.

To the extent that the primary function of the state in aiding its political subdivisions is equity and service guarantee, the appropriate emphasis in distribution of funds should be per capita (or per pupil) rather than grants. This distribution should include carefully designed adjustments for assisting the poorer/disadvantaged areas of the state so that citizens do not encounter wide disparities in tax burdens for the same level of services or much less service for the same tax bill.

An important source of differences in taxpaying ability is the concentration of utility and manufacturing property in a limited number of school districts. A quality educational system is of benefit to manufacturing concerns as employers wherever they are located in the state, because workers are mobile. If education is a state function, and if an important function of education is to provide capable employees to industry, then the taxes paid by manufacturers, utilities, carlines and airlines should benefit education statewide, not just in the district in which they are located. Such a policy, with a uniform statewide millage, would reduce the present incentive for firms to locate in school districts that already have a large manufacturing/utility tax base rather than in districts where they would be the primary tax resource for the school district. It would make it easier to encourage firms to locate in areas that currently have both high unemployment rates and high property tax rates.

Recommendation: We recommend that total state aid to local governments of all kinds (counties, municipalities, and school districts) favor a modified per capita or per pupil distribution, with some funds (such as the Local Government Fund) on a pure per capita basis and other funds sometimes modified for some measure of local taxpaying ability or other objective indicator (e.g., miles of highways). We further recommend that serious consideration be given to requiring school property taxes on manufacturing, utilities, carlines and airlines to be collected at a uniform rate level and redistributed among school districts on a per pupil basis to further increase interlocal equity. If this recommendation is implemented, it should be phased in; the index of taxpaying ability should be adjusted accordingly; and local school districts should be permitted to levy a supplemental tax if they choose.

Criteria: equity, adequacy, balance and diversity.

Revenue impact: uncertain

Other impact: redistribution among school districts, reduced disincentive to locate in poorer counties

Related recommendations: #3 – State Role in Property Tax Administration; #14 – Level and Distribution of State Aid; #17 – Infrastructure Financing; #25 – Property Tax Structure – Classification and Assessment Ratios.

Reservations/objections: Both members of the business community and the South Carolina Association of Counties expressed reservations about the uniform millage on manufacturing and utility property because of the sweeping nature of the change, the uncertainties surrounding its impact, and the substantial redistribution that would result.

The following objection was submitted by the State Chamber of Commerce on behalf of members of the business community:

“This recommendation is objectionable because it encourages mediocrity and is counter to tenets of home rule. With unified millage there would be no incentive for additional investment in the local government. A preferred approach would be to provide targeted millage relief to high mill counties. Sen. John Matthews has drafted legislation that would create a funding pool for “buying down” the millage in high mill counties to encourage investment in those counties. Again, equity funding for school purposes means someone will pay more and someone else will pay less. For every school whose funding is increased another school will lose state funds. This breeds mediocrity in education. There must be a way to increase under-funded areas without decreasing funding in other schools. As we increase the tax burden in the name of equity we could very easily lose our competitive position. This report does not provide any information about how this recommendation will impact taxpayers and our state’s competitive tax position.”

The SC School Boards Association: "...any consideration of a uniform rate for industrial property must be tied to the rate paid by other classes of property owners. Consideration must be given to maintaining the assessed value for industry in the local tax base for debt service because of prior commitments (long-term bonded indebtedness)."

Recommendation #16: Ensuring Interlocal Equity

Findings: An important function of state government is to ensure that access to certain basic services (including education) of a minimum standard is provided to all citizens, regardless of the wealth of the county, municipality, or school district in which they reside. While this criterion is most often applied to education, it also applies to many other services in which the state plays some role, including libraries, health services, recreation, public safety, and highways. Distribution formulas that are based on population, such as the State's Local Government Fund, contribute to addressing this goal, but some of the other formulas should be weighted more heavily in favor of lower income jurisdictions (as in the case of EFA funding) in order to increase interlocal equity.

Recommendation: While the Local Government Fund is appropriately distributed on a per capita basis, some of the other distributions may increase rather than decrease inequalities among citizens and/or local governments in terms of resources available for provision of public services. We recommend that the total package of state aid, which includes not only the Local Government Fund but also state grants, property tax relief for homeowners, EIA, and EFA be reviewed to evaluate its combined impact on interlocal equity, i.e., whether the total package increases, reduces, or has a neutral impact on the total amount of public resources available to local governments on a per capita or (for school districts) a per pupil basis. Every effort should be made to incorporate such an equity criterion in state grants and non-EFA education funding.

Criteria: equity, adequacy.

Revenue impact: neutral but redistributive

Other impact:

Related recommendations: #14 – Level and Distribution of State Aid; #15 – Forms of State Aid.

Recommendation #17: Infrastructure Financing

Findings: Rapid population growth in some areas and aging infrastructure in others have increased the burden on local governments in South Carolina to ensure that highways, water and sewer systems, school buildings and other public facilities are sufficient in quantity and in a good enough state of repair to meet the needs of our citizens. A 1997 study conducted for the Advisory Commission on Intergovernmental Relations of the State Budget & Control Board analyzed South Carolina’s infrastructure needs for the period 1995-2015. The study, entitled “South Carolina Infrastructure Study: Projections of Statewide Infrastructure Costs, Savings, & Financing Alternatives, 1995 – 2015,” concluded that the state would have \$57 billion in infrastructure needs for the twenty-year period. The report notes the size of the gap between infrastructure needs and the fiscal resources available to address them. One options suggested in the report was to ensure that local governments have the tools necessary to lower costs and raise funds. (An overview of this report was presented to the Local Government Funding System Steering Committee by Mike Shealy of the Division of Regional Development, Budget & Control Board in November 1999.) Since that report, some steps have been taken to address that need for tools, such as the Department of Revenue’s purchase of a CAMA program and the availability of a statewide Geographic Information Systems (GIS) program. However, state and local governments continue to face significant financing challenges in providing adequate public infrastructure in the future.

Recommendation: We recommend that the state provide sufficient funding through a formula-based mechanism to the State’s infrastructure bank or some other appropriate vehicle to assist local governments in meeting these needs in a stable and predictable manner. We further recommend that local governments be provided with suitable taxing mechanisms to fund special infrastructure needs, such as a local gasoline or motor vehicle tax.

Criteria: adequacy, balance and diversity.

Revenue impact: positive to local governments.

Other impact: increases state expenditures.

Related recommendations: #1 – Creation of a Single Executive Agency for Local Government Fiscal Matters; #15 – Forms of State Aid; #26 – Local Revenue Diversification.

Reservations/objections: On behalf of members of the business community the State Chamber of Commerce submitted the following:

“The state’s infrastructure banks should be funded and state projects determined on a priority basis according to a state infrastructure plan. As in other recommendations, the immediate answer seems to be allowing local governments to tax more instead of providing incentives and flexibility for solving infrastructure needs in other ways. Many local governments have faced the challenge of infrastructure funding by utilizing creative strategies. Local governments should be challenged (as are businesses) to be creative—instead of simply increasing.”

Recommendation #18: State Aid to School Districts

Findings: Nationally and in South Carolina, responsibility for education funding for public schools is shared primarily between state and local governments, with the local share coming almost exclusively from the property tax. According to the National Conference of State Legislatures, states fund about 46% of preK-12 education, with 47% coming from local sources and 7% from the federal government. Most federal funds are aimed at the economically disadvantaged, including remedial education and lunch subsidies. There is a national trend toward an increasing state share for education funding in order to ensure both equity among districts and minimum standards for all school children.

In South Carolina, in 1997, the dollar figure entering into the EFA formula was only about 36% of the median operating expenditures per pupil. Increases in the Base Student Cost figure have not kept pace with inflation as measured by the U.S. Bureau of Labor Statistics. The overall state share of education funding has remained stable at about 44% in the 1990s, but is lower than it was two decades ago. As a result, per pupil spending in South Carolina is lower than in many other states in the region—11.6% lower than the average of North Carolina, Georgia, and Texas. In addition, only 48% of state aid to school districts comes in this form of primary aid for general operations, with the remainder coming for earmarked purposes through EIA or in the form of state grants, homestead exemption for the elderly, and reimbursement for school property tax relief. As the basic per pupil grant, EFA should be the vehicle for any increased state funding of education.

Like many states, South Carolina uses formula-based funding to distribute state aid to school districts in two of the four primary forms of aid, EFA and EIA, which together account for about two thirds of state aid. The remainder comes in the form of property tax relief and grants. Recent changes in the distribution of property tax relief will ensure that more of the relief is directed to poorer districts than under the previous formula, which is an improvement, although (as noted below) this kind of aid does not provide actual additional funds to school districts.

The EFA formula is the only part of the entire state aid to school districts system that directs proportionally more funds to districts with less tax wealth, and accounts for less than half of all state aid. EFA funds represent the most flexible form of intergovernmental revenue for school districts because these funds are available for general operations and are not tied to specific programs. The largest share of state grants to school districts is for fringe benefits for district employees. Since fringe benefits are closely tied to salary levels, state grants tend to favor wealthier districts that can afford to pay higher salaries.

State assistance to local governments in the form of state-funded property tax relief is the fastest growing component of state aid to local governments, about \$350 million in the current budget year compared to only \$12 million (in homestead exemption relief) in 1991. This form of aid reflects a national trend toward states providing property tax relief

as a form of aid to local governments that responds to the general dislike of the property tax. However, property tax relief does not provide additional resources for local governments to spend for public purposes unless they are able to raise the mill rate, which may not be possible, either for political reasons or because of existing constraints on local fiscal autonomy. If this source of increase in funds is excluded from state aid to schools, then the state of South Carolina's share of school funding actually declined to 41% in FY1996, compared to 44% in FY1991.

Under the present education funding formulas, the maintenance of local effort requirement often compels school districts to make larger increases in budgeted revenues and expenditures than are justified on the basis of needs-driven budgeting. This unintended effect is the result of the way the base is calculated and the inflation factor is applied. This undue upward pressure on local education spending contributes to a rising overall local mill rate and presents an obstacle to granting all school boards fiscal autonomy.

Recommendation: We recommend that the General Assembly review the state/local division of responsibility between the state and local school districts for funding public education and increase the state share in order to improve educational quality and provide greater equity. In particular, we recommend that the General Assembly review the Base Student Cost figure in the EFA formula and attempt to increase that figure to one that more closely reflects the national average for state support per pupil. We further recommend that increased state aid to school districts in the future be directed to increased EFA funding rather than grants or property tax relief in order to ensure adequate and flexible operating funds for all districts, but especially districts with lower tax wealth. Finally, we recommend that the maintenance of effort requirement in the EIA formula be reviewed to reduce its present tendency to force local spending upward.

Criteria: equity, adequacy.

Revenue impact: potentially positive for school districts.

Other impact: increase in equity and flexibility for school districts in use of funds, reduction in upward pressure on local school spending.

Related recommendations: # 4 – State Mandates; #7 – Fiscal Autonomy for School Districts; #15 – Forms of State Aid.

Reservations/objections: The S.C. Chamber of Commerce: "...there has been no major overhaul of the EIA or EFA programs since they were established over 20 years ago. Educators and school districts often express concerns that outdated programs and requirements drain off badly needed funds. Existing education funding needs to be reviewed and revamped before additional funding is made available."
SC School Boards Association: "It should be noted that support is contingent upon granting fiscal autonomy to school districts prior to any consideration of discarding the local maintenance of effort requirement of the EIA."

Recommendation #19: State Sharing in Locally Collected Court Fees and Fines

Findings: At present, local governments are required to remit a portion of their locally collected court fees and fines to the State. This policy has imposed both a financial and a paperwork burden on local governments. Cities and counties are being held responsible by citizens for high levels of fines and fees that have been increased in order to maintain the amount of revenue from that source. If court fees and fines are a local revenue source, they should be used for that purpose.

Recommendation: We recommend phasing out the practice of requiring county and municipal governments to remit a share of their collections of court fees and fines to the state.

Criteria: adequacy, accountability.

Revenue impact: positive for local government.

Other impact: revenue loss to the state.

Related recommendations: #4 – State Mandates; #28 – Fees and Charges in the Local Government System.

Reservations/objections: These funds are used for special programs such as victim assistance that would have to find funding from other sources.

Part 5: Own-Source Revenues

Findings: Local governments in South Carolina are constrained in the revenue sources they are permitted to use and the rates that they are allowed to set. The state maintains considerable control over the property tax system in establishing and changing assessment classifications, supervising property tax administration, providing exemptions, withdrawing property from the tax base, and assessing some types of property. The state further determines what other taxes local governments can use, at what rates, on what terms, and for what purposes. Finally, the state has also mandated some charges and imposed some restrictions on the use of other kinds of fees and charges, which are a significant revenue source for cities and also important for counties.

It is appropriate for the state to set some parameters on local revenue sources, but local governments also need greater flexibility in meeting diverse local needs, circumstances and preferences. Recommendations in this section address possible changes in the ways in which local governments in South Carolina raise their own-source revenue.

Recommendation #20: Electric Utility Deregulation in Relation to Local Government

Findings: Deregulation of public utilities has profound implications for local government funding. Specifically, the value of utility assets for property tax purposes may change dramatically, creating windfall losses for some jurisdictions and windfall gains for others. Franchise fees for municipalities and revenue from municipal power distribution will also be impacted, as may the expenditure side of local budgets in terms of costs for electric utility services. The proposal (above) that school district taxes on utilities be collected at a uniform statewide rate and disbursed among school districts on a per pupil basis would reduce the impact of deregulation on particular school districts. If local governments were granted more authority to use non-property tax revenue sources, they would be better able to offset any negative impact of deregulation.

Recommendation: We recommend that any utility deregulation take into account the impact on local government revenue, and that local governments be held harmless in some fashion for any loss of utility-related revenues.

Criteria: adequacy, equity, stability.

Revenue impact: uncertain and uneven.

Other impact: change in debt capacity for some jurisdictions.

Related recommendations: #26 – Local Revenue Diversification.

Recommendation #21: Internet Taxation

Findings: The taxation of internet sales and e-commerce has important implications not only for the state sales tax but also for the local option sales tax, EIA funding for schools, and even local business license revenue. Revenue losses from this source to Main Street retailers, and through retailers to local governments could be substantial.

The sales tax is both legally and effectively borne primarily by the buyer and, therefore, should and does belong to the buyer's home state. The seller is merely acting as a collection agent for the state, as collecting from individual buyers is impractical. A sale by a catalog or internet vendor to a resident of another state escapes sales taxation in both the state of origin and the state of the buyer in a large proportion of purchases, which creates inequities between in-state and out-of-state retailers.

At present there is a federal moratorium on expanding taxation of internet sales, which some in Congress propose extending and others wish to make permanent. A number of proposals are being considered at the national level which would exchange greater uniformity in state and local taxation for the privilege of collecting on all sales to a state's residents, whether by local or by out-of-state retailers.

Congress has the power to act under the *Quill* decision (1994), which stated that the present barriers to such vendor collection rested solely on the commerce clause and not also on the due process clause of the Constitution. This decision removed an obstacle to Congressional action dating from the 1967 *National Bellas Hess* decision relating to the taxation of mail order purchases.

Recommendation: We recommend that the State of South Carolina join other states in urging Congress to resolve this problem in a way that protects state and local sales tax revenue from erosion while developing a simpler and more uniform system of taxation so as to minimize the burden on sellers in complying with the tax. Further, we recommend that state government officials in South Carolina be proactive in urging Congress to NOT extend the current moratorium on Internet taxation beyond the statutory October 21, 2001 deadline. Congress should also be urged to ensure that the internet and internet vendors neither receive preferential tax treatment nor be burdened with special, discriminatory or multiple taxes. State and local sales and use tax systems should be simplified and made more uniform, based on cooperative multi-state arrangements, in order to reduce both collection and vendor compliance costs. If states would agree to create simplified systems, Congress should be pressured to require remote sellers to collect sales and use taxes without regard to physical presence or "nexus."

Criteria: adequacy, equity, stability, efficiency.

Revenue Impact: positive.

Other impact: positive effect on state revenue.

Related recommendations: #27 – Strengthening the Local Option Sales Tax.

Recommendation #22: Property Tax Assessment - The 15% Cap

Findings: South Carolina's option to place a 15% cap on the increase in value of a particular property results in inequities between properties that are appreciating rapidly in value and those that are not. While there may be some individual hardships resulting from reassessment, the 15% cap does not discriminate between hardship circumstances and other cases where the higher value reflects a greater ability to pay, the basis of the property tax.

Generally speaking, other states use more targeted methods of property tax relief, such as the "circuit breaker" (utilized in over 30 states) which provides property tax relief in the form of refundable income tax credits in cases where the ratio of property taxes to income is above a certain threshold.

Targeted methods ensure relief to those who need it without spreading it indiscriminately among other who may not. In addition, as indicated in an earlier section, the 15% cap – as presently constituted – does not allow for the participation of school districts and municipalities in a decision that impacts on their property tax bases.

Recommendation: We recommend repeal of the 15% cap legislation and replacement with some alternative mechanism such as an income tax "circuit breaker," in order to target relief to those cases of demonstrable hardship.

Criteria: equity, adequacy, accountability.

Revenue impact: neutral.

Other impact: some loss of state income tax revenue from circuit breaker.

Related recommendations: #6 – Coordination Among Government Using the Same Tax Base; #23 – Property Tax Relief and the Integrity of the Tax Base.

Recommendation #23: Property Tax Relief and the Integrity of the Tax Base

Findings: Taxpayer demands for relief from property tax burdens have put significant pressures for rethinking both the property tax and local government funding across the nation. When relief is granted piecemeal, to one group at a time, or in patterns that favor one region of the state or one group of counties/school districts over another, the system requires continuous readjustment to satisfy escalating and competing demands for relief, which violates both equity and policy stability values. As the tax base becomes narrower because of exemptions, lower assessment rates, fee in lieu agreements, basing taxes on use value instead of market value, etc., then local governments must raise the mill rate in order to generate the same amount of revenue. This higher mill rate will in turn evoke demands for relief from groups not yet favored by previous granting of tax breaks. One of the most fundamental principles of taxation is that the base needs to be broad in order to keep the tax rates low, and that higher rates cause more distortion of economic behavior and tax protests than low rates. Rather than offering property tax relief to particular groups and thereby narrowing the base, it would be more effective to provide local governments with a broader array of revenue tools so as to reduce the demands on the property tax through higher mill rates while at the same time reducing the pressure on the state budget to fund more property tax relief through the state budget.

South Carolina is far from the only state to respond to the pressures by various interest groups to offer piecemeal property tax relief, despite the fact that our property taxes are generally much lower than in most other states. Nearly every state offers some kind of property tax relief, but in the best cases, such relief is based on some philosophical or policy framework in which the groups receiving relief are identified based on some widely accepted equity criterion or policy goals and not on short-term political pressures. The use of property tax relief to substitute for state aid to school districts, to attract retirees and industry, to respond to complaints resulting from reassessment in a small number of counties, or to continuously readjust the distribution of the tax burden among classes of property does not reflect any clear criteria or goals.

Recommendation: We recommend a moratorium on any further property tax relief legislation pending some fundamental decisions about the purposes, scope, and funding of property tax relief in South Carolina, in order to protect the integrity of the local property tax base and the revenue stability of South Carolina local governments, especially school districts.

Criteria: stability, equity.

Revenue impact: none.

Other impact: none.

Related recommendations: #1 – Creation of a Single Executive Agency for Local Government Fiscal Matters; # 2 – Creation of House and Senate Standing Committees; #18 – State Aid to School Districts; #22 – Property Tax Assessment – The 15% Cap; #26 – Local Revenue Diversification; #28 – Fees and Charges in the Local Government Funding System.

Reservations/objections: SC Chamber of Commerce on behalf of members of the business community: “Property tax relief cannot be discussed in a vacuum; instead it must be part of a greater tax review. Tax burden should be measured as total tax burden.”

Recommendation #24: Consistent Use of Fair Market Value

Findings: The use value rather than market value assessment of farm and forest land in South Carolina was intended to provide tax relief for people engaged in agriculture and forestry. Because of the low minimum acreage and the modest revenue test (requiring proof of some minimum earnings from farming or forestry activity), this classification has been blatantly abused in order to shelter valuable undeveloped property from property taxes. Consistency requires that market value be the basis of all valuation, with exceptions justified on a case-by-case basis. A similar problem is found in a number of special valuation rules that protect common property of subdivisions, which may include golf courses, clubhouses, swimming pools, and other recreational facilities that have considerable market value. If a special classification is retained, other options include a higher acreage requirement, requiring that property be contiguous, disqualification of property leased for commercial use, limiting the exemption to individuals rather than permitting its use by corporations, or imposing an income/means test (the circuit breaker concept) to exclude cases of hardship such as family farms.

Recommendation: We recommend a thorough examination of the purpose and scope of use value assessment and special valuation rules that shift the burden of property taxation among classes of property. We further recommend a phasing-in of a policy of all valuations being based on market value, with special provisions for cases of demonstrable hardship.

Criteria: equity, adequacy.

Revenue effect: positive.

Other impact: redistribution of the tax burden.

Related recommendation: #22 – Property Tax Assessment – The 15% Cap; #25 – Property Tax Structure – Classification and Assessment Ratios.

Reservations/objections: Some concerns were expressed about protecting the timber industry from undue burdens.

Recommendation #25: Property Tax Structure—Classifications and Assessment Ratios

Findings: South Carolina has a complex classified property tax system with five assessment rates and seven classifications (not including Fee in Lieu agreements with effective assessment rates of 4% or 6%). This system represents a larger number of rates and classifications than most of the other 17 states that use assessment classes as part of their property tax structure. This system was the result of lengthy negotiations in the 1970s. However, homeowners' school property tax relief, FILOT (fee in lieu of taxes) agreements on industrial property to reduce the effective assessment rate, and the pending referendum on the assessment of personal vehicles have altered the distribution of the property tax burden. The relative property tax burdens on rental and commercial property and older industrial/utility property have increased in the last five years, raising important issues of equity. The series of changes that has been made suggests that it is time to reconsider the entire classified structure. The Technical Working Group explored several possible scenarios, including 100% assessment and 6% assessment ratios for all classes of property, but chose to focus attention on a two rate structure, which would be a less dramatic change than the others and in keeping with past patterns of preferential treatment for homeowners and non-commercial agriculture.

If the referendum on taxation of personal vehicles is approved in November, the only remaining properties that will not be in the 4% or 6% assessment categories would be manufacturing not under fee in lieu agreements, business personal property, and utilities. These properties constituted 29% of the overall tax base in 1997. A reduction of their assessment rate from 10.5% to 6% (a 43% reduction) would reduce the overall tax base by 12.4%, requiring a proportional increase in millage to raise the same amount of revenue. The net effect of such a change would be a reduction in the tax liability for these three categories. In order to raise the same revenue, the average combined mill rate (municipal, county and school district) would increase from 278.5 to 351.6. For a \$60,000 home with school property tax relief, the average tax liability would increase from the present \$183 to \$253. For a \$100,000 rental property, the average tax liability would increase from \$1,526 to \$2,110. However, for homeowners, approximately \$315 million of the \$821 million in property taxes is paid by the state in the form of homestead and school tax relief. There would be a substantial reduction in the tax liability of industrial and utility property, some of which could be recouped by eliminating the manufacturers' exemption (no county ordinary, and sometimes municipal, taxes for five years on investments of \$50,000 or more) and/or other special exemptions. It would also be possible to mitigate the impact on homeowners if the recommendation that manufacturing and utility property taxes for schools be collected at a uniform statewide rate, because that rate could be adjusted to reduce the shift in tax burdens from manufacturing and utilities to homeowners and rental/commercial property. Finally, a reform of the much abused use-value and special valuation categories could mitigate the necessary increase in the mill rate to generate the same revenue.

While the state controls the classification system, any changes in classifications or assessment ratios made at the state level have significant impact on local government

revenues as well as on the distribution of the tax burden. While homeowners' relief for homestead exemption and school property taxes are reimbursed by the state, local governments will suffer unreimbursed losses from the proposed change in auto tax assessment. Any further changes should make some provision for not only transition but also ensuring adequate local revenue.

Because this change would have dramatic and far reaching impact on such matters as the permissible level of bonded indebtedness and the school funding formula (index of taxpaying ability) as well as on the mill rates required to raise the same amount of revenue, any change would require a careful estimate of the total impact on local governments as well as the distribution of the revenue changes.

Conclusion: The Technical Working Group could not offer a firm recommendation at this time. After considering several options, we investigated more closely the option of reducing the number of assessment ratios and classifications used for taxable property to two, 4% (owner-occupied residential and non-commercial agriculture) and 6% (everything else), with the goal of developing a stable basis for future assessments that is equitable in the distribution of the burden while ensuring adequate local property tax revenue. Such a reduction would result in fewer classifications and a narrower range of assessment rates. We do recommend that no additional piecemeal changes in the assessment system be made. If such a change were made, it would have to be phased in so as to minimize the disruptive effect on both local governments and taxpayers. Any school district or local government that does not have full rate-setting authority would need to be provided with the necessary tools to adjust the mill rate in order to ensure adequate revenue. Finally, if such a change were to be made, it should be accompanied by elimination of the manufacturing exemption and a review of other special exemptions in order to minimize the effect on homeowners, and that change would have to be transitioned in over a period of years.

The Technical Working Group feels that a two rate structure may be the direction in which the state is moving but that this complex issue requires careful study, would require a long phase-in period, and would be highly disruptive of present taxing and financing patterns for individuals, business firms and local governments.

Related recommendations: #8 – Limitations of Local Government Debt; 15 – Forms of State Aid; #24 – Consistent Use of Fair Market Value.

Recommendation #26: Local Revenue Diversification

Findings: In the 1970s, shortly after granting limited home rule to South Carolina counties, the General Assembly commissioned a study of options for local revenue diversification. A number of options were explored, resulting in the passage of the accommodations tax in 1984 and the local option sales tax in 1990. During the 1980s, consideration was given to providing local government bodies with an array of possible taxes from which to select that included local admissions/amusements taxes, local motor vehicle taxes, local payroll/income taxes, and others. Nationally, the two most widely used local taxes are the local sales tax (33 states) and local income or payroll tax (15 states). A local income or payroll tax is a particularly useful tool for larger cities with large numbers of commuters who live in the suburbs and work in the city, using its public services without making much if any contribution to paying for them.

Fourteen states allow some kinds of local business taxes and/or local motor fuel taxes on a per gallon basis. In South Carolina, business licenses are widely used by municipalities and are generally structured to have some of the properties of a business income tax.

A number of states, including South Carolina, permit special taxes either for special purposes (e.g., a sales or excise tax for capital improvements) or directed at special groups (local accommodations and/or hospitality taxes aimed at tourists). The growth in the use of such local taxes reflects pressures for property tax relief as well as a desire to target users of public services who are not effectively reached through the property tax, including tourists and commuters.

Recommendation: We recommend that counties and municipalities be given the option of adopting different kinds of local taxes, including some form of a local income tax, a local motor fuels tax, a local admissions/amusements tax, and/or a local motor vehicle registration tax. Consideration should be given to sharing the revenue of one or more such new taxes with school districts.

Criteria: adequacy, equity, diversity.

Revenue Impact: positive.

Other impact: property tax relief?

Related recommendations: #5 – Moderating Restrictions on Fees and Charges; #23 – Property Tax Relief and the Integrity of the Tax Base; #28 – Fees and Charges in the Local Government System.

Reservations/objections: The SC Chamber of Commerce on behalf of members of the business community: “Giving more revenue options to local government does not resolve what are the proper funding levels and mechanisms for local government. We have limited information about the impact of these recommended alternative funding sources. Do these funding sources improve the system in terms of the guiding principles we determined of efficiency, equity, stability and low compliance costs, or is it another piecemeal approach to finding additional revenue?”

Recommendation #27: Strengthening the Local Option Sales Tax

Findings: The Local Option Sales Tax has been one of the most successful innovations in South Carolina local government funding in this decade. After a slow start in 1990, it has spread to 27 counties. We expect this tax to be adopted in more counties in the future, following patterns of adoption in other local option sales tax states such as Georgia and Wisconsin, although the state's large urban counties have been slow to adopt it. Counties and municipalities that have adopted this tax have used it primarily for tax relief, with the result that growth in the mill rate has been slower in those counties. Some of the initial concerns about the effects of the tax on location of retailers in counties with or without the tax do not appear to have been realized. Generally a tax differential must be larger than one or two percent to significantly affect retail sales location decisions by either consumers or retailers.

Some form of local sales tax is the most widely used local tax revenue source after the property tax. This tax is found in more than 8,000 jurisdictions nationally, including school districts and special purpose districts in some states as well as or instead of municipalities and counties. The local sales tax is the mainstay of city and county revenue in New Mexico, while property taxes are devoted to public education. South Carolina has benefited from the experience of other states with using this tax both as a general revenue source and as a special purpose tax to fund capital improvements or capture tourism revenues. After ten years of experience, it appears to be a good choice for most South Carolina counties and municipalities.

Because the base of the local option sales tax is the same as the state general sales tax, any changes that are made to the state's sales tax base will impact on LOST revenue to cities and counties as well as on EIA funds for public education.

Recommendation: We recommend that the remaining counties be given the power to institute the local option sales tax by ordinance. We further recommend that any changes in the base of the state sales tax be evaluated for its impact on local government funding through the Local Government Fund, the Educational Improvement Act, and the Local Option Sales Tax.

Criteria: adequacy, stability.

Revenue impact: neutral to positive, depending on level of rollback.

Other impact:

Related recommendations: #21 – Internet Taxation.

Reservations/objections: See comments on Recommendation #26.

Recommendation #28: Fees and Charges in the Local Government Funding System

Findings: User fees and charges are the fastest growing local revenue source across the nation and in South Carolina. Together with licenses and permits (more heavily used by municipalities), fees and charges of various kinds provided 12.6% of all local revenue and 21.6% of locally raised (own-source) revenue in 1996-7. Fees and charges can be used to relieve pressure on the property tax, manage demand for public services, ensure that heavy users pay their fair share of the cost, and influence behavior in desirable ways (e.g., control solid waste disposal). One of the most widely used additions in recent decades is impact fees, designed to control growth and ensure that the costs of providing infrastructure and added services to new residents/firms does not unduly burden current residents. Impact fees are used by South Carolina municipalities and counties to some degree but are not available to school districts for the construction of new school buildings to accommodate growth. Another widely used fee in South Carolina is a solid waste fee, which encourages recycling and other conservation actions by residents in order to minimize the amount of solid waste going into landfills.

Fees and charges are one type of revenue for which local governments need maximum flexibility, because the usefulness of a particular fee or charge (in terms of acceptability, equity, and revenue yield) will vary greatly between regions of the state and by size of municipality, whether a county is urban or rural, and other factors.

However, there are also drawbacks to using fees and charges. They tend to be regressive (more burdensome on lower income households), may discourage people from using public services, and generate resentment toward local government when people have to pay for services that they think should be provided through their tax dollars. Local officials must weigh these advantages and drawbacks in deciding what kinds of fees and charges to level and at what rate. When local governments are fiscally stressed by declines in other revenues (for example, from the proposed change in the assessment on personal vehicles), and under pressure to hold down the mill rate, more or higher fees and charges are often the only way to balance the budget. While fees and charges have a role to play in funding local government, they need to be balanced with other, more equitable, more dependable revenue sources to create a healthy local revenue system.

Recommendation: We recommend that local governments be granted considerable latitude as well as technical support and assistance in designing and implementing fees and charges as part of the overall revenue system. We also recommend that state aid and other local tax revenue sources continue to provide at least 75% of county and 60% of municipal revenue needs to avoid excessive dependence on fees and charges. We further recommend that school districts be permitted to use school impact fees in order to provide the school facilities needed to support population growth.

Criteria: adequacy, equity, accountability.

Revenue impact: positive.

Other impact: possible property tax relief.

Related recommendations: #5 – Moderating Restrictions on Fees and Charges; #7 – Fiscal Autonomy for Schools; #26 – Local Revenue Diversification.

Reservations/objections: See on Recommendation #26.

Part 6: Structure and Administration

Findings: Local revenue systems do not exist in a vacuum. They operate in a structural context consisting of 86 school districts, 46 counties, and 269 incorporated municipalities of widely varying sizes. Structural changes that resulted in local governments of a more efficient size could make local governments more effective service providers, allowing better services for the same tax burden or lower taxes for the same level of services.

Local governments who depend on these revenue systems to fund their operations are often handicapped by administrative problems that make it difficult to manage the tax system, especially the property tax system, fairly and equitably. Administrative recommendations range from recodification of present state laws governing local revenue sources to exploring consolidation of local governments to streamlining and simplifying the process of collecting property taxes. Most of these administrative recommendations should result in some significant cost savings as well as a greater perception of fairness and clarity for the average taxpayer.

Recommendation #29: Local Government Structure

Findings: Revenue cannot be entirely separated from local government structure. South Carolina has a large number of school districts relative to population and a very large number of municipalities, many of them quite small. Structural issues need to be considered separately, including such questions as school district consolidation, regionalization of some functions, minimum size for cities, incorporation and annexation requirements, and the possibility of having classes of local governments with differing degrees of fiscal autonomy and service responsibility based on size.

Recommendation: We recommend that there be a study of alternative ways of configuring the structure of local government, including special districts as well as school districts, municipalities, and counties. Relative to all local governments the study would address regionalization of services and scale economies. For counties and municipalities the study would address metropolitan government in urban areas and political consolidation. Additionally, for municipalities the study would address procedures for incorporation (this would include the question of criteria), annexation, and dissolution of municipal governments. Examination of the issue of consolidation of school districts would be considered as well as the related issue of optimal size. The role of special purpose districts and procedures for the dissolution of such districts would also be examined.

Criteria: accountability, efficiency, equity.

Revenue impact: neutral.

Other impact: expenditures for study.

Related recommendations: #1 – Creation of a Single Executive Agency for Local Government Fiscal Matters.

Reservations/objections: Members of the business community believe that such a study of structure should precede rather than follow the revenue study. The SC School Boards Association feels that any decisions regarding consolidation should be made at the local level.

Recommendation #30: Regionalization of Property Tax Assessment

Findings: One of the most important aspects of property tax assessment is the valuation of property for tax purposes. Valuation determines the distribution of the tax burden, and small differences in valuation at low assessment ratios can lead to inequities in tax burdens. Smaller counties find it more challenging to provide a quality assessment process because of the limited pool of market comparison data and the high cost of professional appraisal services. Cost is also high for maintaining an assessor's office for a relatively low volume of activity; assessment appears to have some economies of scale.

Recommendation: We recommend that the General Assembly explore the feasibility of regionalizing the assessment process for counties on a voluntary basis in order to promote equitable valuation of property, professional standards in assessment, and reduced cost of property tax administration.

Criteria: equity, efficiency, ease of administration and compliance.

Revenue impact: neutral.

Other impact: expenditure savings.

Related recommendations: #32 – Improving the Property Tax Collection Process.

Reservations/objections: Members of the business community would like to include the auditor also.

Recommendation #31: Recodification of Property Tax Administration Statutes

Findings: With numerous changes to the statutes governing property tax administration, the code of laws is presently a patchwork that is difficult to understand, to administer, to interpret, and to defend. An already unpopular tax is rendered even more unpopular by the effort one must undertake in order to find and apply the relevant law, whether as a public official or as a taxpayer.

Recommendation: We recommend that recodification of property tax administration statutes be undertaken by a committee with representatives of the Comptroller General's office, the Department of Revenue, and local officials involved in property tax administration, with appropriate legal staff support to ensure clarity in drafting.

Criteria: accountability, ease of administration and compliance.

Revenue impact: neutral.

Other impact: state expenditure for recodification committee.

Related recommendations: #1 – Creation of a Single Executive Agency for Local Government Fiscal Matters.

Recommendation #32: Improving the Property Tax Collection Process

Findings: While income and sales taxes are collected in relatively small increments, property taxes appear as a single large bill that must be paid all at once. There have been many innovations in methods of payment, such as credit cards, electronic funds transfer, and even internet payments, but few of these innovations have appeared in property tax administrators' offices. In addition, in some jurisdictions bills are sent at different times by the county and the municipalities, with different collection offices, further inconveniencing the taxpayer. The method of collection is rigid and inflexible, and not in keeping with changes that have taken place in most other kinds of transactions, both public and private.

Recommendation: We recommend that state statutes and state technical support be directed to facilitating innovation in the property tax collection process, so that taxpayers may make use of more contemporary forms of payments. We further recommend that the state strongly encourage consolidated billing and collection for all taxing jurisdictions in a county and that other taxing entities be paid promptly for sums collected on their behalf.

Criteria: efficiency, ease of administration and compliance.

Revenue impact: neutral.

Other impact: possible cost savings.

Related recommendations: #3 – State Role in Property Tax Administration; #15 – Forms of State Aid.

Recommendation #33: Enforcement of Motor Vehicle Registration

Findings: At present, South Carolina appears to have a rather high proportion of unregistered vehicles or out-of-state registrations for long term residents. These vehicles are not contributing their fair share of property tax and are often uninsured as well, so that vehicle owners who comply with the law pay more tax and higher insurance premiums to cover those who do not. There is a substantial property tax revenue loss from such unregistered vehicles. A number of factors contribute to the problems of enforcement, including the right to drive for 120 days without a tag, the “snowbird” registration problem permitting out-of-state plates for up to 185 days, the issuance of two year tags, the lack of effective penalties by statute, and the lack of incentives to enforce registration at the state level. State and local cooperation in enforcement is essential, with information sharing and penalties that generate enough revenue to cover the additional cost of strict enforcement. Stricter enforcement might also mitigate some of the expected local government revenue loss from reducing the assessment rate on personal vehicles.

Recommendation: We recommend that stronger penalties for failure to register and shorter grace periods to register vehicles be enacted and that priority be given to cooperative law enforcement efforts to reduce the number of unregistered vehicles as a way of protecting both property tax revenue and the insurance requirement.

Criteria: equity, adequacy.

Revenue impact: positive.

Other impact: insurance enforcement.

Related recommendations: #25 – Property Tax Structure – Classification and Assessment Ratios.

Recommendation #34: Uniformity in Fiscal Years and Accounting

Findings: Good public policy decisions about local governments must rest on good information. It is difficult for policy analysts to obtain or interpret such information when political subdivisions operate on different fiscal years with different charts of accounts. Counties already use a uniform fiscal year that matches that of a state, and are making progress toward a uniform chart of accounts. If the state provides oversight, financial aid, and technical support to local governments, it has a right to require that they provide accounting in a timely manner and in a uniform format. Property tax oversight by the state, likewise, would be simplified by having all property tax calendars uniform with the same due dates for payments and the same penalties.

Recommendation: We recommend that local governments be required to report financial information based on a July-June fiscal year and to adopt a uniform property tax calendar and schedule of payments for municipalities to be consistent with those prescribed for counties. We further recommend that local governments be encouraged to adopt a uniform chart of accounts in order to facilitate the collection and analysis of local government fiscal information.

Criteria: accountability.

Revenue impact: neutral.

Other impact: some cost in conversion to new system for some local governments.

Related recommendations: #1 – Creation of a Single Executive Agency for Local Government Fiscal Matters.