



# *South Dakota Legislative Research Council*

## *Issue Memorandum 95-39*

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### **PROPERTY TAX REDUCTION PROGRAM**

#### **Introduction**

The 1995 Property Tax Reduction Program addressed the local property tax burden and state-aid-to-education with a two-staged approach. The program provided immediate relief for the 1996 property taxes through a 20 percent property tax credit program for ag property and owner-occupied homes. It also limited budget growth specifically funded by property taxes for all political subdivisions, except under certain circumstances. It is important to recognize that these caps apply only to property taxes.

Beginning in 1997, the property tax relief program will be centered around the education formula and property tax budget controls. The program will provide the greatest relief to farmers, ranchers, and homeowners. Homeowners must, however, apply for property tax relief in order to receive it. The actual relief benefit may also hinge on one's federal income tax liability and ability to deduct property taxes.

About 20 percent of the funds used for the property tax reduction program were previously appropriated for personal property replacement dollars. Counties are permitted through the legislation to increase local property taxes to compensate for 50 percent of this lost revenue, reducing the actual property tax relief benefit.

Schools typically make up about two-thirds of the local property tax burden. After the new property tax levy limits are in force, school districts are expected to make up about 60 percent of the property tax burden. Beginning in 1997, the school district formula and the existing local property tax and assessment structure will dictate the amount of property tax relief received by individual owners.

#### **Property Tax Budget Limits**

##### *1996 Budget Cap*

Taxpayers may realize long-term tax benefits from the controls on budget growth. Political subdivisions, including school districts, may increase their property tax budget revenue by the amount of tax revenue generated from the increased value of new construction, not previously taxed. Property taxes may also be increased to pay for financing of facilities not considered in their 1995 budget. If 1996 property taxes are increased above the 1995 levels, the county treasurer must provide a written explanation to each affected property owner.

##### *1997 Budget Cap Constraints*

Property taxes may increase at the rate of

inflation not to exceed three percent a year, beginning in 1997 as defined in SDCL 10-13-38. The local governing board has the option of exceeding the property tax reduction limits, if supported by a two-thirds vote of the governing body. The board's decision may be referred by a petition signed by five percent of the registered voters within 20 days of the action.

A taxing district may increase tax revenue above the budget limitations if there is a corresponding increase in property values resulting from improvements or changes in use, to support the financing cost for new facilities for the political subdivision, or to pay a judgment. Otherwise, there is a limitation in the total property tax revenue that can be received by a governing body. There is no clause, however, preventing property values from increasing or decreasing from market pressures, or property values from being adjusted if they were under or over assessed. This would allow property taxes to increase on a specific piece of property but would require a corresponding decrease in other property taxes on other pieces of property within that political subdivision.

**Uniform Taxes by School Districts**

The primary focus of the property tax reduction program is to alleviate the area where the greatest tax burden lies, in the school districts. The program places ceilings on the school district property tax levies for general fund purposes, thereby providing property tax relief and controls.

The 1997 property tax reduction formula redistributes the property tax relief differently than the 1996 process. To a degree, the formula attempts to nullify the

tax levy variances between school districts with the new property tax caps and increased state-aid-to-education. School districts will essentially be required to operate school systems with equivalent revenue on a per student basis. This may also reduce the potential hurdle of differing tax levels for school districts considering consolidation.

Uniform tax rates will be applied in all school districts in 1997 as listed in the table below. Again, these rates only apply to the levy for general fund purposes and it is required that the property value either be assessed or adjusted to 85 percent of market value. School districts, however, may levy additional property taxes for special education, bond redemption, capital outlays, and retirement over and above the general fund cap limits.

<b>PROPERTY CLASSIFICATION</b>	<b>TAX PER \$1,000 OF VALUE</b>
Agriculture Property	\$6.25
Owner-occupied Dwellings	\$10.00
All Other Non-Ag Property	\$16.75

In 1997, the property tax relief across the state will average 20 percent, but it may vary greatly from one school district to another, and from one classification of property to another. Property located in school districts with a high tax levy along with property assessed within or above the state parameters will receive more tax relief than property located in school districts with a low tax levy and an assessment ratio below the state

parameters. The formula attempts to treat all property owners equally by using the state-aid-to-education as a means to balance the property tax burden.

When reviewing the statistics for taxes payable in 1994, more than 70 school districts are composed of taxable ag property exceeding 80 percent of the total property value, while only 14 school districts are composed of taxable non-ag property exceeding 80 percent of the total property value. Therefore, the property tax formula and state-aid-to education must balance a wide range of situations.

It was found in taxes payable in 1994, that only one school district taxed ag property at less than 6.25 mills, eight school districts taxed non-ag property less than 10 mills, and more than 100 school districts taxed less than 16.75 mills. It is evident that many property owners, including commercial property owners, may realize a property tax cost savings though the cap limitations. It is also possible a few property owners may experience no tax relief in 1997, and in some circumstances taxpayers may see an increase in property taxes.

Increased property taxes could occur in school districts seeking to receive the maximum tax dollars from each classification of property which may now be taxed under these cap limitations. Non-ag property is the most likely property classification to experience this possibility.

**Revenue Alternatives for Municipalities and Counties**

Many municipalities and counties are well below their cap limits, and constraints on property tax budgets may inadvertently

prevent them from ever reaching those limits. As with school districts there are several exceptions for municipalities, counties, and other taxing districts to increase their property taxes and remain under their respective cap limitations.

<b>POLITICAL SUBDIVISION (General Purposes)</b>	<b>TAX PER \$1,000 OF VALUE</b>
Municipalities	\$27.00
Counties	\$12.00
Townships	\$3.00

Political subdivisions which have the ability to levy sales taxes or charge water, wastewater, and solid waste fees may choose to raise additional revenue from these sources instead of property taxes. Approximately 50 percent of municipal revenue is received through sales tax collections, and 25 percent is generated by user fees. The 1995 legislation does not prohibit political subdivisions from pursuing other financing alternatives such as sales taxes or utility fees to provide additional financing for operations and improvements.

It appears that first-class cities may be able to adapt to inflationary pressures or other budget needs more easily because of their other avenues to generate funds. Sioux Falls, for example, receives almost three times more funds from sales taxes than property taxes, while Rapid City receives about four times more. In addition, the utility fees for first-class cities are typically lower than the other communities.

Tax freezes may cause political subdivisions

to postpone construction or improvements to infrastructure until the cap limits are modified or the problem becomes critical. These decisions may be postponed to avoid using the permitted waivers or potential referrals; however, these are local decisions with local consequences.

Counties and several other political subdivisions which rely heavily on property taxes may find themselves in a difficult financial position. Road maintenance, construction, and snow removal are big ticket items faced by counties as well as townships. If the budget is negatively affected by additional damages or costs incurred by bad weather, trials, or indigent persons, counties may be forced to raise taxes periodically. Townships and other special purpose districts are a small fraction of the total tax burden, and they may also find it difficult to maneuver under the property tax revenue limitations.

### **State Revenue for School Funding**

The funding for the 1996 property tax reduction program is obtained from five basic elements: (1) increased sales tax collections from items previously exempted; (2) personal property tax replacement dollars; (3) additional lottery revenue; (4) increased cigarette taxes; and (5) budget balances and other cost saving measures initiated by the state.

Many states have attempted to shift the burden from local taxing districts to the state. The primary weakness of this shift occurs when state revenue is negatively impacted by a downturn in the economy. Education is one of the first places often examined to balance the budget. There is no language in the act addressing state fiscal

appropriations for state-aid-to-education if the state experiences a revenue shortfall.

### **Expectations of Property Owners**

The property tax relief program is expected to alleviate the escalating property taxes for most property owners, including low income and elderly families and the family farm. Property owners were subject to increasing taxes from escalating property values and rising tax levies, which may not reflect ability to pay these taxes.

All ag property automatically qualifies for the tax break property tax levy cap. According to the South Dakota Agriculture Statistics Service, the average farm value is about \$500,000 with an average size of 1300 acres. The Department of Revenue reported that the average value of homes sold in 1994 not including the price of land to be \$34,000. A table using actual tax levies for taxes payable in 1994 can be found at the end of this issue memo. These examples illustrate the potential property tax savings when the school property tax levy caps are in force.

There are 19 homes in Sioux Falls with a value of \$500,000 or more. Each of these homes has an assessed value more than the assessed value of 39 small towns in South Dakota. The total assessed value of those 19 homes are more than the assessed value of 248 towns in the state. These homeowners may receive a disproportionate tax break in relation to their ability to pay.

The information on the tax relief received by individual farmers or farm corporations is not readily available because of the different record keeping systems and the way ownership is filed in each county.

Collecting this information without requiring some form of disclosure by the ag property owners would be extremely difficult.

### **Conclusion**

Owners of ag property and owner-occupied dwellings expect to see continued tax reductions after the initial 1996 property tax reduction. The 1997 tax relief program is based on the school property tax cap formula and budget controls, which may result in varying amounts of tax relief. Property owners may want to examine their current school property tax levy and assessment ratios to determine the potential property tax reduction for 1997. They should compare their 1996 levies for general fund purposes of the school district to the newly established property tax levy caps for schools.

One program benefit is that persons on a fixed income living in an owner-occupied unit may be able to better budget from year to year. The program, however, gives equal consideration to high income individuals with valuable property. If sales tax

collections are the primary long-term source for producing the replacement revenue for property taxes, the property tax reduction program could be more regressive to the average consumer. Property owners will generally expect the same level of services in 1997, but it is also reasonable to expect to some changes in services through improved efficiencies or elimination.

It is difficult to evaluate, without looking at each school district separately, the fairness of the cap levels for each property owner because of the vast difference of property values in urban communities to rural communities. Another consideration is the effect that the assessments and taxes levied by counties, cities, townships, and other political subdivisions would have on the outcome. Unless there is a decrease in expenditures for schools and other government agencies, the program only shifts taxes from one person to another. The question is whether the revised tax structure is more fair.

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This issue memorandum was written by Fred Baatz, Research Analyst for the Legislative Research Council. It is designed to supply background information on the subject and is not a policy statement made by the Legislative Research Council.

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