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Assessment Caps and the Point of Sale Provision

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SOUTH CAROLINA'S REAL PROPERTY ASSESSMENT CAP

In 2006 a companion bill to Act 388 (the sales tax for property tax swap) created assessment caps on real taxable property of all kinds. An assessment cap is a maximum percentage increase in the market value of property for tax purposes. The cap is often a maximum percentage increase per year. South Carolina, with five year reassessments, has a cap of 15 percent over the period between assessments.

The assessment cap was enacted in response to complaints from property owners about huge jumps in assessed valuation at reassessment, and thus, in their property tax bills. The particular concern was for people who had purchased homes many years ago and might be forced to sell them because their incomes had not kept pace with the increase in property value—and in tax bills. Despite questions about the actual extent of the problem and proposals to provide targeted relief for affected individuals, the pressure for widespread property tax relief won out. The resulting legislation created not only assessment caps but also millage caps for local governments and property tax relief for homeowners from taxes for school operations.

Assessment caps originated in 1978 in California as part of the famous Proposition 13. Since that time, they have spread from California to at least 11 other states, most recently South Carolina in 2006. South Carolina's 15 percent cap over five years is approximately equal to the rate of population growth plus inflation in recent years, between 2.5 percent and 3 percent a year.

Other states have responded to the problem of property values and tax burdens rising faster than income by identifying those households for whom that is happening and providing targeted property tax relief to just those individuals. About two-thirds of states offer some kind of state-funded property tax relief, most of them targeting households based on income, age, disability or other criteria. South Carolina provides blanket property tax relief regardless of income.

Assessment Caps and Local Government Revenue

Through 2007, a major source of revenue growth for local governments in South Carolina was rising property values, especially rising homeowner property values. Schools don't get much out of growth of homeowner property values after Act 388 replaced homeowner taxes for school operations with state-funded property tax relief, but they do benefit from growth in commercial and rental property values. Cities and counties get more tax revenue from growth in all categories. Prior to assessment caps, local governments were able to generate more revenue without increasing the mill rate, because the tax base grew along with the housing boom. Assessment caps took part of that revenue growth away.

Until 2008, the market value of taxable real property, especially residential property, had been rising faster than the rate of inflation. The overall tax base grew at an average annual rate of 6.5 percent between 2001 and 2007, with owner-occupied property increasing by 9.5 percent a year and commercial and rental property at 11.4 percent a year.[1] Some of that growth was new construction, but a significant part of the growth was accounted for by rising market values of residential and commercial property. The result was a potential revenue windfall to many local governments at the time of reassessment. Local governments are required to roll back millage to reduce the amount of such a windfall, but the rollback provision has loopholes that keep it from being very effective.

If general inflation—not just property values—increases more than 15 percent over five years, the assessment cap will make it difficult for local governments to keep pace with increases in the cost of services that they purchase or provide. Even if inflation is within that range, there will be some properties that appreciate very little. The maximum allowed increase may be 15 percent, but the average increase will be much less when older or deteriorating property is factored in. If property values had continued on their upward trajectory, the assessment cap would have succeeded in slowing the growth of property tax revenue, perhaps to less than the rate of growth of the cost of government purchases and the size of the population being served.

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[1] S.C. Budget and Control Board, *Local Government Report 2007.* http:/www.ors.state.sc.us/economics/economics.asp, accessed September 10, 2009.

Point of Sale Reassessment

Like California, Florida, and other states with assessment caps, South Carolina allows for an assessment cap exception. This exception is known as *point of sale reassessment*, or just *point of sale*. When property is sold, it is assessed at the new market value with no cap on the increase. The stated purpose of the assessment cap was to protect homeowners from losing their homes to rising property taxes that were driven by rising home values (although it also applies to other property as well, mainly commercial and rental property). If the property, owner-occupied or other, is sold at a higher value, there is no good reason to protect the new owners from higher property taxes, since they know that a higher assessment comes with the property transfer.

It's true that the higher tax burden may enter into the price negotiations and the seller may get a lower price for the property, but there is still a significant capital gain at the time of sale—usually more than the maximum 15 percent increase in assessed value over five years. It's also true that the new owners will be facing a higher tax bill and that the point of sale provision means that similar properties will have different tax liabilities, depending on how recently each was sold. Realtors aren't too happy with the exception, because it discourages real estate transfers. But for local governments feeling the effects of state aid cutbacks, declining local sales tax revenue, millage caps, and a sharp drop in new construction that adds to the property tax base, the point of sale provision offers at least one way to generate additional revenue.

In rapidly growing areas of the state like the coastal counties and the Midlands, public officials consoled themselves with the knowledge that there would be a fair amount of property turnover and that with the point of sale provision, turnover would result in higher assessments. In poorer areas, the assessment cap isn't all that restrictive, because property values aren't growing much anyway. But in between the boom areas and the declining rural counties are a lot of areas of the state that were and are impacted by assessment caps. If point of sale is eliminated, as is proposed in pending legislation, these places would lose the one area of growth in tax base and revenue that can make up for tax base losses elsewhere or provide extra funds to offset state cuts.

The point of sale provision has been a focus of controversy in other states with assessment caps. In California, where it has been in effect the longest, there are very large differences in assessed value and tax bills between similar properties. Point of sale encourages people to stay put—a good thing in some respects, creating more stable neighborhoods and communities, a bad thing from the perspective of mobility and response to market signals and opportunities. In Florida, seniors who are downsizing want to somehow carry their assessment cap with them so they can trade down without seeing their new property subjected to a higher tax bill.

The issue of reassessing based on the new market value when an assessable transfer (excluding transfers within families and other special cases) takes place is not an easy one. From the perspective of local government, the point of sale is the only ray of hope for generating more local revenue under an assessment cap that will probably not keep pace with the growth of population and inflation. The complaint of those who demanded the assessment cap ceases to exist when they make an assessable transfer of a property, because they are no longer liable for the property tax bill. From the perspective of the new owner and the real estate industry, assessment caps are a boon but the increased assessment associated with point of sale does result in a one-time increase in the tax liability, which will affect sales and sale prices of homes being transferred. From the perspective of equity among property owners, a fair distribution of the tax burden, it is true that as long as point of sale revaluations are part of the system, similar properties will bear different tax liabilities.

Pending Legislation

A bill (H. 3272) to eliminate the point of sale provision and to apply the 15 percent assessment cap to property transfers was introduced in the 2009 legislative session. It is on the fast track and likely to be passed early in the 2010 session. However, there is no particular urgency to addressing point of sale in the current economic climate. Given the state of the housing market, assessments are as likely to fall as to rise when property is reassessed, resulting in lower tax bills. So this is a good time to reflect, to look at the experience of other states, to get a sense of the current and potential impact of retaining or changing point of sale, and to move deliberately forward with a more thoughtful approach.

It is true that, if local governments had other revenue sources that kept pace with demand for services, then hobbling the growth of revenue from the property tax would be less problematic. It is true that, if legislators were willing to target property tax relief just to those whose home values and property tax bills have grown much faster than their income, the problem with point of sale reassessment would not exist and the entire system would be more equitable. It is true that, if the state were more generous and more dependable in providing aid to education and to local governments, there would be less need to protect the growth of the property tax from continuing legislative tinkering. But as long as local governments rely on the property tax, citizens demand public services, and the General Assembly refuses to consider targeted tax relief, the problem that the General Assembly is attempting to resolve is one that they themselves have created with the assessment cap.

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