South Dakota Legislative Research Council

Issue Memorandum 98-18

CONSTITUTIONAL AMENDMENT F

Classification of Property for Purposes of School Taxation

I
Introduction

Article VIII, § 15 of the state constitution authorizes school districts to levy property taxes in addition to the revenues received from the state. A constitutional amendment proposed in 1929 and approved in 1930 added the second and third sentences to this section. The second sentence empowers the Legislature to classify nonagricultural property into more than one class and requires agricultural property to consist of one class for school taxation. The third sentence requires property taxes to be uniform on all property in the same class.

The 1930 constitutional amendment followed a Supreme Court decision that stated there was no reasonable basis for making a distinction for the rate of taxation between agricultural land and other real estate. In a recent court decision, the Supreme Court determined that the 1930 constitutional amendment intended to treat agricultural property as a single class. Otherwise, the court concluded, there would be no reason for the last clause of the second sentence in Article VIII, § 15. That clause reads: *"... and may constitute agricultural property a separate class."*

The constitutional amendment proposed by the 1998 Legislature eliminates the distinction between nonagricultural and agricultural property and empowers the Legislature to classify properties within school districts into separate classes for purposes of school taxation. This memorandum also describes the Property Tax Reduction Program and a recent Supreme Court decision which are related to the proposed constitutional amendment.

House Joint Resolution 1006

The 1998 Legislature adopted House Joint Resolution 1006, proposing to change Article VIII, § 15 of the State Constitution to read as follows:

"§ 15. The Legislature shall make such provision by general taxation and by authorizing the school corporations to levy such additional taxes as with the income from the permanent school fund shall secure a thorough and efficient system of common schools throughout the state. The Legislature is empowered to classify properties within school districts <u>into separate classes</u> for purposes of school taxation~~, and may constitute agricultural property a separate class~~. Taxes shall be uniform on all property in the same class."

Property Tax Reduction Program

The 1995 Legislature passed the Property Tax Reduction Program establishing certain school property tax levies pursuant to SDCL 10-12-42 for the following three classes of property: agricultural property, nonagricultural property, and owner-occupied single-family dwellings. The purpose of the program was to provide tax relief plus uniformity in the taxes levied within each classification for the general

fund of a school district. In addition, the Property Tax Reduction Program requires all property to be assessed and adjusted to where its assessed value represents 85 percent of its market value. Individual properties, however, may not be at 85 percent of each property classification, which is the subject of a 1998 interim study committee.

Although there was only one tax levy provided for agricultural property in SDCL 10-12-42, there were two classifications of agricultural property until a recent Supreme Court decision. SDCL 10-6-58 to 10-6-65, inclusive, (House Bill 1016) were enacted in 1993 requiring any agricultural property that sold for a price which is greater than 150 percent of the agricultural income producing value of the land to be classified separately from any other agricultural property. This agricultural property was identified as AG-Y property. If agricultural property was classified pursuant to the requirements of SDCL 10-6-58, the property was assessed at the price which the property sold multiplied times the level of assessment for agricultural property within the county. Therefore, AG-Y property had a higher assessed value than comparable agricultural property and would be subsequently taxed more for school purposes than other agricultural property. The taxes paid to local governments by AG-Y property owners were also higher because this valuation procedure was also used for property taxes levied by other local units of government. This valuation procedure caused a tax shift to AG-Y property and the impetus for the Supreme Court case on this matter.

The Property Tax Reduction Program and the new state-aid-to-education formula also provided uniformity in school funding based on student population. The state has set a minimum per student cost for educating students and the state allocates sufficient funds to ensure equivalent funding for each school district. Local effort for each school district is determined by the amount of revenue raised locally by taxing property at uniform rates for each classification of property. Local need is determined by multiplying the per student allocation times the adjusted average daily membership for each school district as required by SDCL 13-13-10.1. The difference between local effort (tax dollars levied) and local need (total cost to educate students) is the amount filled by the state through state-aid-to-education. The state-aid-to-education formula does not, however, account for discretionary revenues received by school districts such as taxes paid by rural electric cooperatives or certain telephone companies.

The 1995 Legislature, for purposes of school taxation, created two classes of nonagricultural property: owner-occupied single-family dwellings and nonagricultural property. The 1998 Legislature also enacted legislation creating a third class of nonagricultural property which is called a nonagricultural acreage. Agricultural property constitutes a separate class for purposes of school taxation. The chart below shows the tax levies per thousand dollars of taxable valuation for each property classification since the Property Tax Reduction Program was enacted.

Class of Property	1996	1997	1998	1999
Nonagricultural	$16.75	$16.75	$16.49	$16.25

Owner-Occupied	$10.00	$9.20	$9.06	$7.61
Nonagricultural Acreage	--	--	--	$6.66
Agricultural	$6.25	$5.75	$5.66	$4.73

Supreme Court Decisions

Since 1930, legislation was enacted defining agricultural and nonagricultural property (SDCL 10-6-31) and establishing procedures for calculating assessed values of property (SDCL 10-6-33). The nearest example of a court case that dealt with classification of agricultural property was the *Matter of Butte County*, 385 N.W.2d 108, (SD 1986) when the county attempted to designate irrigated farmland as a separate class. The Supreme Court said that irrigated land may not be separately classified, but did say that irrigability is a factor to consider in assessing land value. Not until 1993, when the Legislature attempted to create another class of agricultural land, did the court directly deal with the issues presented by *Gould v. Pennington County Bd. of Equalization*.

In 1997 the Supreme Court issued a decision in *Gould v. Pennington County Bd. of Equalization*, 570 N.W.2d 846, (SD 1997) finding SDCL 10-6-58 to 10-6-60, inclusive, to be unconstitutional. These sections created more than one class of agricultural property in violation of Article VIII, § 15. SDCL 10-6-58, in effect, created two classes of agricultural property: one class that sold for less than 150 percent of its agricultural income value and the other class which sold for more than 150 percent of its agricultural income value. SDCL 10-6-58 to 10-6-60, inclusive, attempted to value, assess, and tax agricultural land without regard to its status as agricultural land.

The Supreme Court said that SDCL 10-6-33 defines the basis for determining the valuation of all property for tax purposes and SDCL 10-6-33.1 provides certain factors to consider in determining the assessed value of agricultural land. The court noted that SDCL 10-6-58 was an attempt to determine a different method of valuation.

The Supreme Court asserted that statutes may define methods of valuing agricultural land, assessing property, and measuring market value. It was concluded by the court that SDCL 10-6-58 did none of these and that SDCL 10-6-58 created two classes of agricultural property in violation of Article VIII, § 15. SDCL 10-6-58 valued property solely on its sales price and did not account for any agricultural factors such as type of soil, terrain, climate, productivity, etc. The court rejected the idea that the property had to be economically self-sufficient and determined that the property should not be separately classified simply because the owner may have paid too much.

Pros and Cons

The Legislature is allowed to define certain types of nonagricultural property and create specific nonagricultural property classifications. More classes of property which reflect more homogenous factors may eliminate volatility in certain assessments and may provide a more stable growth in assessed valuations and possibly a fairer application of property taxes. The classification of property in different classes may change the sales to assessment ratios, especially in certain counties which have aggressive or passive real estate markets. Prices are rapidly inflating in certain areas and for certain types of property which may, for example, be suited for hunting, located

near a large community, or have scenic characteristics.

The proposed constitutional amendment poses a relatively simple question which will have a direct impact on agricultural property owners and indirect impacts on other property owners because of potential tax shifts. The question is whether agricultural property should remain as a single classification or if the Legislature should be allowed to create more than one agricultural classification for the purpose of assessment and taxation for school district purposes. As with most tax related issues there will be people who will benefit and those who will not.

People who will benefit are property owners whose property will be assessed less and therefore taxed less because of the way their property is classified. Others may have their property assessed at a higher value and subsequently pay higher school taxes unless the tax rate per thousand dollars of valuation is decreased enough to compensate for the assessment value increases. No matter what is done with school tax levies, higher assessment values will mean a higher portion of the taxes levied by other governmental units will be paid by these property owners. Legislation could be enacted to create additional classifications similar to the classification owner-occupied single-family dwellings. That legislation may define certain factors or unique characteristics that will distinguish that property from other property.

Conclusion

Property is classified for three purposes: taxation, assessment, and valuation. Each class of property is required to be assessed at 85 percent of market value. This is measured by the sales to assessment ratio and if certain factors or unique characteristics affect the market in such a way to increase market values of certain classifications, then the taxes may correspondently increase.

If the amendment to Article VIII, § 15 is approved, the Legislature could classify agricultural property into more than one class based on certain criteria or factors. The Legislature already possesses this authority for nonagricultural property. If the amendment fails, agricultural property will remain one class of property for assessment and taxation purposes. This may have a significant fiscal impact on the assessed value of agricultural property which may be heavily influenced by sales not necessarily based on agricultural productivity. Regardless whether the amendment passes or fails, there are and will continue to be tax consequences because of the relationship of assessed value to market price and how that relationship is applied.

This issue memorandum was written by Fred Baatz, Senior 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.