SOUTH DAKOTA FARM BUREAU

ISSUE MEMORANDUM

PROPERTY TAX OVERVIEW

INTRODUCTION

This issue memorandum aims to provide Farm Bureau members with an in-depth exploration of property tax history, legislative endeavors, and the intricate dynamics surrounding agricultural land assessments. As a fundamental source of revenue for local governments, property taxes have undergone significant scrutiny and reform efforts over the past century. This document delves into pre-2000 history, the evolution of state aid to education, the implementation of property tax limitations, and South Dakota becoming the 44th state to use productivity values for tax assessment of agricultural land. Additionally, it is important to note property taxes are the primary source of revenue for local governments. The State does not collect or spend any property tax revenue.

PRE-2000 HISTORY

Governors, legislatures, and organizations have wrestled with property taxes for decades. In the 1930's, the state briefly adopted an income tax to provide property tax relief. The income tax was repealed in 1943. In 1978, the personal property tax was repealed, and a sales tax increase was approved to replace the revenue. However, the sales tax increase was repealed before it became effective and the contractor's excise tax was implemented in 1979 as a replacement. Over the decades, legislation has been passed either to limit or reduce property taxes. However, the passage of these tax limitations and reduction provisions have not ended comments or criticism of property assessment and taxation.

One of the largest property tax reductions in state history occurred under the second Janklow Administration. After a near passage of Initiated Measure 1 on the general election ballot in 1994, Governor Janklow and the Legislature worked to reduce property taxes for the people of South Dakota. For reference, Initiated Measure 1 would have limited assessment increases to a max of 1% annually or 1.25% annually if improved or transferred ownership. It was similar to Proposition 13 from California which is still used by the state today. Farm Bureau and a host of other organizations were successful in defeating IM 1 by an incredibly narrow margin.

In 1995, in reaction to IM 1 nearly passing, the state enacted a property tax program which is sometimes referred to as Governor Janklow's Property Tax Reduction Program. This program reduced property taxes on certain classifications and limited how property tax revenue may be increased from one year to the next. For example, the new program created the “owner-occupied” classification which, along with agricultural property, received a 30% tax reduction phased in over pay ‘97, pay ’99, and pay ‘01 taxes. The program also influenced the growth of property taxes by updating the state aid to education formula and establishing property tax caps.

STATE AID TO EDUCATION

State aid to education payments replace property taxes for schools that would otherwise be paid by owners of property. The current funding formula for general education is based on a target statewide average teacher salary. By statute, the target teacher salary is set to increase annually by the Consumer Price Index or by 3%, whichever is less. This funding formula was created by a taskforce comprised of various stakeholders, including school representatives and legislators, and was passed during the 2016 session. Prior to this, South Dakota determined the state aid for general education for each school district based on an allocation per student, referred to as the Per Student Allocation. The formula for state aid to education is listed below.

Total Need − Local Effort = General Ed State Aid

Determining the State Aid to General Education starts with calculating a district's total need. Total need is calculated by the following formula:

Total Teacher Compensation + Overhead Costs = Total Need

Property taxes are a key component of local effort. It is important to note that the general school levy which determines property taxes that contributes to local effort is determined each year by the legislature. All other levies are set by the local units of government collecting the property taxes. In 2024, the levy for general education decreased 9.3 percent for the 3 classes of property from last year's levy. Adding the valuation of new property to the assessment increase in existing property allows the levy to be decreased in order to stay within the limitation levels.

Below is a history of the general education levies over the past 20 years. Property taxes collected from these levies result in less than half of the finances for the school districts. The remainder majority is contributed by the state.

	2024	2019	2014	2009	2004
Ag Land:	$1.32	$1.47	$1.78	$2.57	$3.32
Owner Occupied:	$2.95	$3.29	$4.25	$4.42	$5.34
Other:	$6.11	$6.82	$9.10	$8.65	$11.45

While the levies are set by the legislature and state aid makes school districts whole, there are times when extra revenues are required by the school district. SDCL 10-13-36 provides an opt-out mechanism for school districts to raise additional revenues beyond the amount generated by the existing tax levy and money from state aid. An opt-out allows the district to impose a higher tax levy. Once an opt-out is approved by the school board, residents within the district can refer it for a public vote.

It is important to note that the state aid to education budget is a significant portion of the general fund expenditure for the state. For example, almost 60% of the property tax bill is covered through state aid. Without these dollars, property taxpayers would be required to pick up the bill or cut services.

CUTLER-GABRIEL AMENDMENT

A key aspect of the property tax provisions in the Janklow Administration was the Cutler-Gabriel Amendment. Named after two legislators, Steve Cutler and Larry Gabriel, the amendment established a principle that the targeted proportion of local funding and state funding must remain constant when making the school district general fund levy adjustment each legislative session. In other words, the famous amendment means that if local effort goes down, state funding goes up and vice-versa.

PROPERTY TAX LIMITATIONS

A key component of Janklow's property tax reform efforts was property tax limits. After 1995, state law required property taxes for each taxing district to be limited to the property tax dollars received in the previous year plus the annual increase provided by the inflation index factor and growth factor. The inflation index factor is the rate of inflation or three percent, whichever amount is less. The property tax cap can be avoided if an opt-out occurs.

Overall, property taxpayers have realized certain long-term property tax benefits from the controls and limitations on property taxes placed on the taxing districts. This element of the program was designed to reduce local government spending. It was presumed that the size of the local budgets dictated the level of property taxation. The property tax limitation provisions limit the dollars available and as a result control the size of the budget request.

AGRICULTURAL LAND

As stated earlier, South Dakota has three classes of property: Agricultural, Owner-Occupied, and Other. For land to be classified as agricultural, it must meet the following criteria:

- The primary and main use of the land must be devoted to agricultural pursuits, such as the harvesting of crops or the raising of livestock.
- The land must also meet either an acreage requirement or a minimum income.
    - A county's acreage requirement can range from 20 acres to 160 acres.
    - If the land does not meet the acreage criteria, then a minimum gross income of at least $2,500 must be shown to have come from an agricultural pursuit in three of the previous five years.

Historically, there have been legislative fights over the portion that agriculture pays as well as how to appropriately assess agricultural land. For example, after the farming crisis of the 1980s, agricultural land values began to rise. This rise was due to a multitude of reasons such as lowering interest rates, agricultural property being purchased by buyers who may have been primarily motivated to secure land for hunting or investment purposes, higher commodity prices, and land near urban areas purchased for development. These escalating agricultural property market prices caused the Legislature to enact legislation designed to slow or mediate the increases in assessment valuations for agricultural property.

In 1993, the Legislature introduced a new classification known as AG-Y for agricultural property. However, this classification was deemed unconstitutional by the Supreme Court in 1997 as it created two distinct classes of agricultural land, contrary to the constitutional provision limiting agricultural land to a single class. Subsequently, in 1998, the Legislature established a new property classification termed NA-Z. This classification faced legal challenges but was ultimately upheld by the Supreme Court in 2000 as a legitimate property classification. The Legislature annually set a school district general fund levy for the NA-Z classification, aligning it with changes made to the agricultural property classification.

In 1999, the Legislature passed House Joint Resolution 1005, proposing a revision to Article VIII, Section 15 of the South Dakota Constitution. This amendment sought to authorize the Legislature to establish multiple classes of property for school taxation purposes. On November 7, 2000, voters approved this proposed constitutional amendment.

One of the issues with market-based assessments was the limited numbers of sales one had to determine value. During the 2000 Session, the Legislature enacted HB 1005, establishing a task force to conduct a pilot study on utilizing agricultural income value for assessing agricultural land instead of market. The Economics Department at South Dakota State University conducted an analysis of ten counties and presented its findings during the 2001 Legislative interim. Subsequently, HB 1135 was passed in 2002 to extend the analysis to all counties in South Dakota using the income method. Following the completion of the analysis, several years were dedicated to reaching a consensus on revising the valuation system for agricultural property.

The other major issue with market-based assessment was limited sales data. The dwindling number of agricultural land sales due to various rules such as the NA-Z, 150%, and 70-acre rules prompted legislative action. HB 1192, passed during the 2003 Legislative Session, allowed county directors of equalization to use the income method instead of the market method for assessing agricultural land. This method utilized county agricultural land cash-rent data and a 7.75% capitalization rate to determine assessment values. It was applicable when there were fewer than fifteen arms-length transactions of agricultural land in the preceding three assessment years. Again, lack of land transactions was a major contributor for movement away from a market system.

PRODUCTIVITY METHODOLGY

The transition from market-based to productivity-based assessment systems for agricultural land in 2008 marked a significant change, aiming to align assessments with agricultural productivity and economic realities. After the 2007 legislative interim, the interim Property Tax Assessment Committee introduced HB 1005 in 2008 which moved the assessment of agricultural land from the market system to a productivity system. After the bill's passage, the productivity valuation system began with the 2010 assessments for taxes payable in 2011 and was fully implemented in the 2019 assessment year.

HB 1005 also created the Agricultural Land Oversight and Advisory Task Force to monitor the implementation of the productivity system. The task force has eight legislative members with representation from both parties and six non-legislative members representing agriculture and business.

HB 1005 did cause some to worry about the change in how taxes, especially for school districts, are applied from one area to another. Tax shifts were expected to occur as some counties were not assessing property at the same level other counties were assessing property. Therefore, HB 1006 was also enacted in 2008 to ensure school districts would not benefit from this revised assessment system nor would the taxpayers realize an undue burden from changes in assessments. The provisions limited the annual increase in property taxes payable to the lesser of three percent or the index factor.

Due to various levels of assessments on ag land across the state, a provision was adopted in 2008 and amended in 2009 that limited the change in the total taxable value of cropland and noncropland within a county to 10% per year. This provision provided a transition period for taxpayers to adjust to a revised level of assessment and taxation. However, changes in commodity prices and increased yields quickly led to increasing productivity values within a relatively short period of time which was reflected in the crop Olympic average data. The productivity model exhibited annual increases exceeding or near the limited change in the total taxable value permitted by statute.

The Ag Land Task Force introduced HB 1003 during the 2012 Legislative Session creating a three-tier system for increases in agricultural assessments. The tiers allowed an annual increase of fifteen, twenty, and twenty-five percent depending on how the current assessed value relates to the full agricultural income value of property within the county. It also extended the phase-in process for taxes payable until 2019.

ADJUSTMENTS

The productivity value formula is a starting point for assessing agricultural land. The assessed value of agricultural land may be adjusted due to the following factors which may affect productivity. Below are 8 adjustments that can occur to alleviate disagreements in the agricultural land productivity system.

(1) Location;
(2) Size;
(3) Soil survey statistics;
(4) Terrain;
(5) Topographical condition;
(6) Climate;
(7) Accessibility; or
(8) Surface obstructions

If a property owner feels their land may have one of these limiting factors, they can request an ag land adjustment by applying online or contacting their county Director of Equalization office. Additionally, it is important to note that the productivity system does not include actual use. Instead, it is based upon soil types ranked 1-8. Classes 1-3 are cropland, class 4 can be crop or noncropland, and classes 5-8 are noncropland.

CONCLUSION

An analysis of property taxation trends reveals that these taxes are influenced by changes in both the total statewide property taxable valuations and the taxable valuation for each property classification, stemming from shifts in market dynamics. Historically, there has been a consistent uptrend in the total statewide taxable valuation annually. When this increase surpasses the index factor, it typically results in reduced property tax levies. Concurrently, property tax revenue has shown an annual increase. However, these increments in property taxes vary across classifications, taxing districts, and neighborhoods.

Lastly, property taxation serves as a dependable revenue source for local governments. While most citizens prefer others to shoulder the tax burden, we all benefit from the essential services provided by these local government entities, including schools, law enforcement, courts, roads, infrastructure, and basic amenities.

SDFB POLICY

We Support:

- The assessed valuation of ag land that reflects the land's ability to produce under natural conditions and should be adjusted on an annual basis.
- Requiring actual use for property tax valuation.
- Legislation that will allow counties to equalize tax assessments and use the adjustment factors in statute to measure productivity in addition to the soil survey to calculate assessments. The practice of "neighborhooding" in specific geographic areas within a county should be substantially weighted and at least equal in influence with the soil survey.
- Increasing the $10,000 homestead exemption to $50,000 for ag structures.
- Taxation of Public lands as if that land were owned privately. The U.S. Government should pay the tax with no fee increase to the public land user.
- Church property that generates income should not receive preferential tax treatment.
- Municipalities that own income producing real property should be required to make property tax payments.
- Property owners who have been wrongfully assessed taxes should receive compensation from their county, including all expenses incurred through the appeal process.
- Township boards be given more time to have the tax assessments records in order to make their recommendations on valuations to the county assessor.
- A return to the law that assessors be reappointed every five years.

We Oppose:

- Any real estate tax reduction on land under easement.
- Any attempt to raise the tax rate per $1000 of value on ag land to equal that on non-ag land for school purposes.

DISCUSSION

1. The Legislature is going to discuss property tax assessment methodology over the summer. Are there provisions within the productivity methodology that Farm Bureau would seek to improve?
2. What specific challenges or inconsistencies have been identified in the current assessment system, and how do these impact property owners across different sectors, including agriculture?
3. How will the effectiveness of changes to property tax assessments be measured and monitored over time, and what adjustments can be made if unintended consequences arise?
4. What role will technology and data analysis play in improving the accuracy and consistency of property tax assessments?