Dakota Proposition: Initiative Constitutional Amendment Real Property Tax Limitation

Cooperative Extension South Dakota State University

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Dakota Proposition
Initiative Constitutional Amendment
Real Property Tax Limitation

COOPERATIVE EXTENSION SERVICE
SOUTH DAKOTA STATE UNIVERSITY
U.S. DEPARTMENT OF AGRICULTURE
An initiated proposal to amend the South Dakota State Constitution entitled “Real Property Tax Limitation” (more popularly called the Dakota Proposition) will be placed on the 1980 general election ballot. The text of the proposed amendment appears at the end of this fact sheet.

The proposed amendment (hereafter called the Dakota Proposition) contains six sections which may be divided into four major provisions.

1. A limitation of future taxes on real property to 1% of full and true value, as determined by assessments performed in 1977. Improvements taking place after 1977 would be added to the tax rolls using the 1977 guidelines.

2. A ceiling of 2% annual growth in the full and true value of real property for any year during which inflation exceeds 2%. Inflation would be measured by the Consumer Price Index (CPI), an official calculation of general consumer price changes in the U.S. economy.

3. Two-thirds vote requirement of all members elected to each house of the state legislature for passage of any measure designed to increase revenue, whether by increasing the rates or method of computation, with specific prohibitions against any legislative changes in real property taxes or against a tax on the sale of real property.

4. A requirement of a two-thirds vote of the qualified electorate for the passage of special taxes in cities, counties, and special districts and a prohibition on any new taxes on real property within cities, counties, and special taxing districts.

In essence, passage of the Dakota Proposition would:

- substantially reduce the real property tax that owners would expect to pay and local units of government would expect to receive;
- reduce the purchasing power of real property tax revenues for local governments, if the annual rate of inflation is above 2%;
- create pressures for reductions in the quantity or quality of local public services and/or create pressures for new sources of revenue for state and local governments in South Dakota.

Analysis of Impacts

Property tax limitation provision

If it is passed by a majority vote in November 1980, Dakota Proposition is expected to change real property tax assessments in 1981 and taxes payable in 1982. Estimates can be made of the initial impact for real property taxes in 1982.

The difference between what taxpayers would expect to pay (and local units of government would expect to receive) with and without Dakota Proposition has been termed a “rollback.”

It should be recognized, however, that while the real property tax would be less, in general, with the Dakota Proposition some individual real property owners could have an initial increase in their tax burden.

A projection of expected real property taxes in South Dakota for 1982, using the growth rate in real property taxes collectable 1970-1978, suggests that without Dakota Proposition such taxes would total about $252.2 million.

With the approval of Dakota Proposition, on the other hand, the 1977 real property full and true assessment would increase by 2% each year until 1981 and then be multiplied by 1% to obtain the maximum level of real property taxes for 1982. With Dakota Proposition, a figure of about $103.5 million maximum real property tax results.

These calculations suggest a decrease in property taxes payable and local revenues collectable with Dakota Proposition of about $148.4 million, or 59%.

Experience in California after Proposition 13 suggests that a second “adjusted” estimate of the initial impact of the Dakota Proposition should also be calculated. In California, the legislature required reassessment of all property not actually assessed in 1977. Reassessments to more closely reflect actual market values are also possible in South Dakota.

Section one of the proposed amendment states that the amount of tax collectable on real property shall not exceed 1% of the full and true valuation of such real property. Section two provides that the full and true valuation shall be the county assessor’s valuation of real property.

This estimated growth in the real property tax is conservative in that local government spending and thereby real property taxes are influenced by inflation, and inflation rates now are higher than the 1970-1978 average.

These calculations do not include any new real property improvements constructed since 1977. They also do not reflect an expected increase in sales taxes collectable as the result of increased private spending in South Dakota or increased federal income taxes resulting from reduced property tax deductions. The increased sales tax would likely be on the order of $5 million to $10 million in 1982.
property as shown on the 1977 tax statements under "full and true valuation."

The next sentence then states, "All real property not already assessed to the 1977 full and true valuation levels may be reassessed to reflect that valuation." The meaning of that sentence is unclear.

It might be interpreted to mean that property which might have escaped assessment in 1977 (or property which is presently tax exempt) could be added to the assessment rolls at the 1977 assessment level. It could also mean that all real property could be revalued to more closely reflect the 1977 market value. Such reassessment would prevent perpetuating errors and inequities which might have occurred in assessments made in 1977.

If 1977 full and true assessment figures are adjusted by using the assessment-sales ratio for 1977, the maximum real property tax for South Dakota would be about $123.2 million. Thus the rollback after adjustment would be about $129 million, or 51.2%.

If a reassessment was made to adjust 1977 full and true values in South Dakota, agricultural land valuations would be most affected. Most other real property full and true values would also be affected but to a lesser degree.

Agricultural land full and true values would be most affected because a 1970 law, revised in 1979, requires that the use value of land be taken into account when fixing full and true values. As a result, the full and true value of agricultural land, in most counties, is lower in relation to its market value than is the case with other non-agricultural real property values.

Both the adjusted and unadjusted estimated impacts of Dakota Proposition for 1982 are shown, by county and in total, in Table 1. Major differences in county impacts are revealed in the table. With a few exceptions, the percentage tax reductions are greatest in the more urbanized counties.

The principal reason for the difference between estimated tax reductions in predominantly urban and rural counties is that agricultural and non-agricultural properties in South Dakota are treated differently for purposes of taxation to support elementary and secondary schools.

The first eight mills required to fund school general fund budgets are applied equally to agricultural and non-agricultural properties. For rates above eight mills, non-agricultural land is taxed at two additional mills for every one additional mill on agricultural property, up to a ceiling of 24 mills for agricultural property and 40 mills for non-agricultural property.

In effect, non-agricultural properties presently are taxed at a higher percentage of their assessed value.

The Dakota Proposition would limit the rate of taxation to 1% of full and true (plus 2% escalator clause) without respect to agricultural non-agricultural differences. This limit has two related consequences.

First, tax savings created would, in general, be more substantial for non-agricultural real property owners than for agricultural real property owners. In a few counties, the taxes on agricultural land might even increase, particularly if the full and true values are adjusted to reflect the market value.

Second, school districts in more urbanized counties would, in general, lose a greater percentage of their property tax revenues than would school districts in more agricultural counties.

Another possible reason for differences in the amount of tax reductions shown in the table might be because of the estimation procedure used. Some counties might have adopted a strategy of delaying needed improvements to keep taxes lower during the recent years of high inflation.

To the extent this strategy occurred, it is projected in the estimation procedure. As a result, the estimate of the tax loss shown in Table 1 would be low. If the same level of services is to be maintained in these counties in future years, taxes eventually will have to rise.

The opposite situation might also have occurred. If tax rates were abnormally high in recent years for any reason, the projected estimate of future taxes would be higher than what would normally be expected and the estimate of tax loss with Dakota Proposition would be high.

There are other explanations for differences in impact among counties.

Citizens and public officials in some counties have been more willing than citizens and officials in others to provide public services through real property taxes. The Dakota Proposition does not take differences in willingness into account, however. The statewide mandate for 1% of full and true would reduce taxes more in those counties which have been willing to tax more.

Finally, some counties (such as Custer and Fall River) have major land areas which are publicly owned. Public ownership tends to reduce the proportion of private agricultural land (and increase the proportion of private non-agricultural land), thereby increasing the impact of Dakota Proposition on those counties.

**Growth ceiling provision**

A second major provision of Dakota Proposition is the creation of a ceiling on changes in the assessed value of real property subsequent to the full and true assessment of 1977. Changes in assessed value would be tied to a measure of prices paid by consumers, the Consumer Price Index (CPI).

Assessed values for real property could change on an annual basis in direct proportion to changes in CPI (either positive or negative changes), except that if the CPI rose by more than 2%, assessed value growth would be limited to 2% only. Since the CPI will almost inevitably rise by more than 2% annually for the foreseeable future, this provision will effectively limit growth in assessed real property values to less than the rate of general consumer inflation. (The CPI rose from 109.8 in 1969 to 217.4 in 1979 for an average annual increase of about 7%.)

Implications of the growth ceiling provision can be viewed in Figure 1. Graph 1 shows that the nominal growth in property taxes collected in South Dakota during the period 1970 through 1978 was 66.4%. If a 2% annual limit on growth is imposed
for that period, however, growth in property taxes would have been limited to 17.2%. Nominal changes do not, however, involve any consideration of the impact of inflation. Graph 2 incorporates the effect of inflation on tax revenues by deflating revenues through the use of the CPI.

If the change in property taxes collected from 1970 through 1978 is calculated in 1970 dollars, so as to reveal changes in the actual purchasing power of property taxes collected, such purchasing power was reduced by 4.6%.

Thus, the additional revenue collected in 1978 could purchase ap-

<table>
<thead>
<tr>
<th>County</th>
<th>Unadjusted decline in revenues ($)</th>
<th>Unadjusted decline in revenues (%)</th>
<th>Adjusted decline in revenues (%)</th>
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<td>979,172</td>
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<td>1,510,141</td>
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<td>Shannon</td>
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<td>(14)</td>
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<td>Faulk</td>
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<td>523,190</td>
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<td>3,718,528</td>
<td>58</td>
<td>3,511,598</td>
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<td>Gregory</td>
<td>1,202,930</td>
<td>54</td>
<td>953,679</td>
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<td>Haakon</td>
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<td>324,906</td>
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<td>Hamlin</td>
<td>851,208</td>
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<td>780,675</td>
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<td>Hand</td>
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<tr>
<td>Hanson</td>
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<td>Jackson</td>
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<td>102,757</td>
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<tr>
<td>Washabaugh</td>
<td>108,955</td>
<td>28</td>
<td>39,510</td>
<td>10</td>
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</table>

Table 1. Expected impact of Dakota Proposition, real property taxes 1982.*


**Adjustments to full and true 1977 were made by using the all median assessment ratios by county. Source: "1977 South Dakota assessment and sales information."
approximately the same amount of goods then as in 1970. If the 2% limit had been in effect during that period, however, the purchasing power of property taxes collected (as adjusted by the CPI) would have declined by 32.8%.

If, as expected, general inflation significantly exceeds 2% annually, the growth ceiling provision would create a major and continuous decline in the purchasing power of the real property tax in South Dakota. Any price increases over and above general inflation for purchases made by local governments would further reduce the purchasing power of the real property tax.

**Two-thirds vote requirement for both houses of the state legislature**

The requirement of a two-thirds affirmative vote in both houses of the state legislature for passage of any laws designed to increase revenues does not differ in effect from a similar constitutional amendment passed by the voters in 1978. The provision does have an added clause which prohibits (makes unconstitutional) any further taxes on real property or the sale of real property.

Therefore, no real property tax may constitutionally be imposed which exceeds 1% of the full and true value as established in 1977 with a 2% escalator factor allowed for every year the rate of inflation is equal to or exceeds 2%. Bond levies passed before the passage of the proposed amendment would not be affected, but any future bond levies would have to be included in the 1% limitation.

This section becomes effective upon the date of passage. The remainder of the proposed amendment would become effective January 1, 1981.

**Two-thirds vote of qualified electorate required to pass local revenue measures**

Section 4 states that cities, counties, and special taxing districts may impose special taxes (but not on real property) if passed by a two-thirds vote of the qualified electorate. Qualified electorate may be defined as everyone in the voting jurisdiction who is legally entitled to vote and has met all registration requirements (everyone, that is, whose name appears on the voter rolls).

This provision means that any qualified voter who, for any reason, does not vote would, in effect, cast a "no" vote.

In most elections fewer than two thirds of the eligible voters cast ballots. Thus the probability of the passage of any special taxes to replace lost revenues on the local level would be quite remote.3

**Additional Implications of the Proposition**

**Bond issues**

General obligation bonds, the usual method of financing capital improvements on the local level, would be seriously affected by passage of the proposed amendment.

There are two kinds of bond issues: revenue bonds and general obligation bonds. The revenue bond is used to finance income producing utilities and services, with the principal and interest then repaid from user charges or fees. This type of bond issue would not be affected by the passage of Dakota Proposition.

The general obligation bond is another kind of bond and is used to finance low or non-income producing capital improvements such as schools, libraries, auditoriums, city halls, court houses, and swimming pools. The principal and interest on general obligation bonds is repaid in South Dakota from a levy on real property if approved by a 60% majority vote of those voting in the bond election.

The Dakota Proposition does not specifically prohibit the passage of general obligation bond issues, but it does impose a condition under which it is extremely unlikely that a bond issue would be proposed.

Any levy against real property to repay the bonds would have to be taken from the 1% tax allowed by the proposition. The same limitation would also apply to special assessments and any additional capital outlays funds.

If the proposed amendment is passed, another source of revenue will have to be found to finance the major repair, replacement, or building of new capital improvements which could not be financed by revenue bonds.

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3In the 1978 general election, 62% of the registered citizens voted in the gubernatorial election.
Division of property tax revenue among local governmental units

Currently, taxes paid on real property are derived from mill levies based upon the proposed budgets submitted by taxing units such as school districts, municipalities, counties, townships, and special districts. County government is charged with the responsibility of collecting the taxes for all taxing units, and these funds are then distributed to the treasurer or authorized disbursing officer of the various local governmental units.

With passage of the Dakota Proposition, the amount of property taxes collectable would not be based upon local government budgets and mill levies but upon the fixed amount of 1% of the full and true values established in 1977. There is no provision for the distribution of these limited funds among the local governmental units in either the proposition or current state law.

Each of these units of government is governed by locally elected officials; under current law no one of these boards has jurisdiction over the others. How these funds would be distributed would have to be determined by legislative action.

Impact upon federal revenue sharing and other federal grants

Passage of Dakota Proposition would have an impact upon federal revenue sharing and other federal grant payments to local governments, but the degree of impact is unknown at this time.

The total amount of funds to be distributed to state and local governments is determined annually by Congress. The program may be increased, decreased, or even eliminated by 1982. Revenue sharing funds are distributed by a formula which presently takes into account such factors as population changes, income, and local tax effort. Other grants also have local tax effort factors.

If local real property taxes are reduced (and not replaced by another tax), general revenue sharing and other grant payments would be reduced according to the present formula of distribution.

Public sector

The passage of Proposition 13 in California in 1978 resulted in massive state aid to local governments. Such aid is unlikely in South Dakota, given the minimal state surplus and the estimated size of the revenue reduction relative to the total state budget.

Marked increases in state aid would require additional state taxes. At the local government level, elementary and secondary schools would be the units of government most adversely affected in a direct sense by reductions in property tax revenues.

Table 2 reveals that the 1978 property tax was distributed in such a way that primary and secondary schools received almost two thirds of these revenues. (Revenue from property taxes constitutes approximately 70% of total school finances. The other 30% is obtained from state and federal sources.)

Schools also do not have the authority to charge user fees or to enact taxes. In contrast, general purpose governments would have the authority and the incentive, given property tax reductions, to charge or increase fees for goods and services (trash collection, water, building inspection, parks, sewage disposal, etc).

Cities which have not enacted the full 1% municipal sales tax could do so before January 1, 1981, by resolution of the governing body. After that date, if the amendment passes, a two-thirds affirmative vote of the qualified electorate would be required.

The Dakota Proposition does not prohibit the reenactment of the recently repealed personal property tax. At the time of repeal it yielded about $40 million. If the personal property tax were reinstated and this amount were increased at current inflation rates, by 1982 it might amount to about $65 million. This would be considerably below the shortfall created by the real property tax limitation measure.

Private sector

Passage of Dakota Proposition would affect private citizens as well as state and local governments.

Land owners may be more likely to construct or repair homes and make other improvements. Such improvements would be less heavily taxed with Dakota Proposition.

A current land owner may reap the windfall of the rollback and the expected reduction in future property taxes in one or both of two ways. If he continues to own the property, his taxes would be lower. If he sells, the selling price could be higher; the purchaser would be tempted to pay more for a house that has lower taxes.

Passage of Dakota Proposition, other things equal, would mean that prices for land would tend to increase. Prices for homes and other improvements are likely to rise initially, then decline again. The increased price of existing homes would induce builders to construct more new homes, which would eventually tend to drive prices downward. This effect would not apply to land because the supply of land is fixed.

Purchasers of services provided by investor owned utilities may find rates for electricity, gas, or telephone going up more slowly. Regulated utilities have rates set relative to their operating costs so that decreased taxes may be passed along as decreased rates for consumers.

Values and Trade Offs

Values (our sense of the goodness and badness of ideas, events, or
would significantly reduce the property tax burden in South Dakota, other potential consequences should also be considered. For that individual who believes that the property tax is too burdensome, these other potential consequences are likely to be regarded as undesirable. These consequences become trade-offs in a decision to use the Dakota Proposition as a means to reduce the real property tax burden.

Burdensome nature of property tax

Two commonly held values are likely to prompt citizens to support Dakota Proposition.

First, some citizens regard the property tax in South Dakota as too burdensome. Indeed, statistics may be cited to support this view. In South Dakota in 1977, for example, the property tax was $60 per $1,000 of personal income, placing the state 10th among all states; the property tax was 48.8% of total state and local taxes (5th among all states); state revenues as a percentage of total state and local revenues were 46.1% (48th among all states and thereby implying that other states rely relatively more on state rather than local revenues); state and local taxes were $169 per $1,000 income (18th among all states and implying that the total tax burden was not very unusual in South Dakota even while the dependence on the property tax was unusually high. The mix of taxes in South Dakota involves a heavy reliance on real property taxes.

But although Dakota Proposition would significantly reduce the property tax burden in South Dakota, other potential consequences should also be considered. For that individual who believes that the property tax is too burdensome, these other potential consequences are likely to be regarded as undesirable. These consequences become trade-offs in a decision to use the Dakota Proposition as a means to reduce the real property tax burden.

Approval of the Dakota Proposition would increase the probability [not make inevitable] some combination of a loss of local control, a loss of desired programs or levels of services, or an addition to state taxes. Consider first the probability of a loss of local control. If state and national governments are called upon to support local governmental units which have sustained substantial revenue losses, that support is likely to involve guidelines or requirements on how money may be spent. Also, substantial aid from the state could not be made without a new state tax program possibly an income tax, the only common and major tax method not used in the state.

If, in contrast, local governments attempt to sustain very large reductions in revenues without assistance from the state, the quantity or quality of some programs such as elementary and secondary education would be jeopardized. Although the Dakota Proposition, if passed, would roll back real property tax revenues to approximately the 1969 level, general inflation as measured by the CPI has reduced the value of the 1979 dollar to only about half of the 1969 dollar; purchasing power of revenues is thus greatly reduced.

The argument, sometimes heard, that passage of the Dakota Proposition would only result in a reduction of local services back to the 1969 level ignores inflation and the decrease in revenue purchasing power subsequent to 1969.

Inequity of the property tax

A second value behind the move to approve the Dakota Proposition is the belief that the property tax is an inequitable tax. Again, there are identifiable reasons for holding this value.

If ability to pay is measured by income, the property tax is not necessarily tied to ability to pay. A common example used by those who hold that the property tax is inequitable is that of the family whose income is reduced and held at a fixed level by retirement but whose property tax continues to increase at a rate approximately equal to the rate of inflation.

The property tax may also tax equal income earners unequally. Farmers, for example, are required by the nature of their occupation to hold sizable investments in real property. Other income earners require less property so that their tax burden is likely to be lower than farmers with equal incomes.

Finally, the property tax is not necessarily tied to benefits received. Through tax contributions to public education, for example, families with real property but without children help subsidize families with children.

For those individuals who support the Dakota Proposition because they believe the property tax is inequitable, some likely trade-offs resulting from passage of the proposition should again be considered.

If local public programs are reduced by the loss of local revenues, those reductions may themselves result in what some would view as inequities. Quantity or quality of educational programs, assistance to the needy, and programs for the elderly might be reduced in varying degrees depending upon the county or city. Moreover, if program reductions are avoided by the passage of new revenue measures, those new sales taxes, personal property taxes, income taxes, or user charges may or may not be more equitable than the property tax itself.

An argument may be made, however, that the tax system in South Dakota could be improved by revising the state's tax mix, thus reducing the property tax burden. The question for voters then follows: is the Dakota Proposition the way to reform the tax system?
Initiation of this proposed constitutional amendment as well as other efforts in South Dakota and elsewhere to limit or reduce tax payments and government spending suggest the need to reexamine our public finance methods. We have the opportunity—and indeed the responsibility—to reexamine what our state and local governments do and how government is financed.

Dakota Proposition would have major impacts on the public finance of state and local governments in South Dakota. Voters in November will need to weigh the reduction in real property tax burden, the expected reduction in real property tax purchasing power, the potential threat to local services, and the potential for new state taxes.

**Initiative Constitutional Amendment - Real Property Tax Limitation**

Be it enacted by the people of the state of South Dakota

That Article VI, Section 28 be added to the South Dakota Constitution to read:

Section 1. (a) The maximum amount of the existing real property taxes in force and effect by the present statutes of this State on real property shall not exceed one per cent (1%) of the full and true valuation of such real property. The one per cent (1%) tax is to be collected by the counties and apportioned according to law to the districts within the counties.

(b) The limitation provided for in subdivision (a) shall not apply to assessments to pay the principal, interest and redemption charges on any indebtedness approved prior to the time this section becomes effective.

Section 2. (a) The full and true valuation shall be the County Assessor's valuation of real property as shown on the 1977 tax statements under "full and true valuation," or thereafter, the appraised value of newly constructed real property which shall be based upon the 1977 assessment valuation guidelines. All real property not already assessed to the 1977 full and true valuation levels may be reassessed to reflect that valuation.

(b) The full and true valuation may annually reflect an inflationary rate not to exceed two per cent (2%) for any year subsequent to the 1977 taxable year. A decline in the full and true valuation, as shown by the United States Department of Labor Consumer Price Index, shall be reflected in a commensurate tax decrease in the full and true valuation.

Section 3. From and after the effective date of this article, any changes in State or Local taxes enacted for the purpose of increasing revenues collected pursuant thereto, whether by increased rates or changes in methods of computation, must be imposed by an act passed by not less than two-thirds of all members elected to each of the two houses of the Legislature, provided that no new taxes on real property or sales taxes on the sales of real property may be imposed.

Section 4. Cities, counties and special taxing districts, by a two-thirds vote of the qualified electors of said districts, may impose special taxes on said districts, except that no new taxes on real property within said City, county or special taxing districts may be imposed.

Section 5. This article shall take effect for the taxable year beginning on January 1, following the passage of this Amendment, except Section 3 which shall become effective upon the passage of this article.

Section 6. If any section, part, clause or phrase hereof is for any reason held to be invalid or unconstitutional, the remaining sections shall not be affected but shall remain in full force and effect.