No. 23-_____

IN THE
Supreme Court of the United States

ELLINGSON DRAINAGE, INC.,

Petitioner,

v.

SOUTH DAKOTA DEPARTMENT OF REVENUE,

Respondent.

On Petition for Writ of Certiorari
to the Supreme Court of South Dakota

PETITION FOR WRIT OF CERTIORARI

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QUESTION PRESENTED

Whether South Dakota's imposition of an unapportioned use tax on the fair market value of Petitioner's movable construction equipment—some of which was used in South Dakota for one day—violates the fair apportionment requirement of the Commerce Clause.

PARTIES TO THE PROCEEDING

All parties to the proceedings below are named in the caption.

CORPORATE DISCLOSURE STATEMENT

Petitioner Ellingson Drainage, Inc. is a wholly owned subsidiary of Ellingson Holdings, Inc. and no publicly held company owns 10% or more of its stock.

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PETITION FOR WRIT OF CERTIORARI

Ellingson Drainage, Inc. ("Ellingson") respectfully petitions for a writ of certiorari to review the judgment of the South Dakota Supreme Court.

INTRODUCTION

Petitioner, a Minnesota company, engages in construction projects in South Dakota and other states. To work on these projects, Petitioner brings its equipment into the state for varying amounts of time, some as short as one day. South Dakota levies a use tax on a taxable use of property in the state. Regardless of how long the equipment is in South Dakota, the state levies the tax on the fair market value of the property. The tax should be apportioned over the period of time in which an asset is used in the state. But because the tax is unapportioned, the amount of time the equipment is used in South Dakota is irrelevant.

Failing to divide the tax base violates this Court's teachings. Apportionment of a state tax is required to comply with the dormant Commerce Clause. *Complete Auto Transit, Inc. v. Brady*, 430 U.S. 274, 279 (1977). To survive this mandate, a tax must be externally consistent. That is, a state tax must "reasonably reflect[] the in-state component of the activity being taxed," *Goldberg v. Sweet*, 488 U.S. 252, 262 (1989), and must not reach "beyond that portion of value that is fairly attributable to economic activity within the taxing State." *Okla. Tax Comm'n v. Jefferson Lines*, 514 U.S. 175, 185 (1995). South Dakota's indifference to the amount of the use of

Petitioner's equipment in the state violates the external consistency requirement.

The South Dakota Supreme Court upheld the tax based on a false syllogism. (1) The purpose of a use tax is to serve as a substitute for the sales tax. (2) A sales tax is not apportioned in the same way as other taxes. (3) Ergo, use taxes do not have to be apportioned either.

For over eight decades, however, this Court has treated a use tax as fundamentally different from a sales tax—they are not jurisprudential twins. *See McLeod v. JE Dilworth Co.*, 322 U.S. 327 (1944); *Gen. Trading Co. v. State Tax Comm'n*, 322 U.S. 335 (1944).

The South Dakota Supreme Court compounds its error that use taxes need not be apportioned by misstating the external consistency doctrine, as well as this Court's precedents.[1]

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[1] Other courts have also misapplied this Court's fair apportionment requirement, *see, e.g.*, *Miller v. Comm'r of Revenue*, 359 N.W.2d 620, 621 (Minn. 1985); *Woods v. M.J. Kelley Co.*, 592 S.W.2d 567, 571 (Tenn. 1980); *Louisville Title Agency for N.W. Ohio, Inc. v. Kosydar*, 43 Ohio St. 2d 109, 330 N.E.2d 899 (1975); *Union Oil Co. v. State Bd. of Equalization*, 60 Cal. 2d 441, 386 P.2d 496 (1963), and even when the taxable property is located and used within the state for only brief periods of the year, *see, e.g.*, *Louisville Title Agency*, 43 Ohio St. 2d 109, 330 N.E.2d 899 (property within state for 1 month); *Randall v. Norberg*, 121 R.I. 714, 403 A.2d 240 (1979) (yacht brought within state periodically for repairs, maintenance, supplies, and brief social visits); *Stetson v. Sullivan*, 152 Conn.

South Dakota provides a credit[2] to Petitioner for any sales or use taxes paid to other states on the equipment brought into the state. But a credit cannot cure the failure to apportion a use tax.[3]

This is a case of first impression; no decision of this Court has examined the constitutionality of an unapportioned use tax on movable assets. But use taxes imposed on intangible property—such as software—and multistate services, have thrust this apportionment issue onto the center stage.

For example, it is common for a taxpayer to license software from a third party. That software is

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649, 211 A.2d 685 (1965) (yacht brought within state for 1 month).

[2] South Dakota provides a reciprocal credit. In other words, it does not provide a credit against its use tax unless the state that imposed a sales tax provides a credit for sales tax paid to South Dakota. *See* S.D. Codified Laws § 10-46-6.1 ("[N]o credit may be given under this section where taxes paid on tangible personal property, any product transferred electronically, or services in another state or its political subdivisions of that state does not reciprocally grant a credit for taxes paid on similar tangible personal property or any product transferred electronically.").

[3] A credit deals with problems of discrimination, not apportionment. Other state cases have blurred this distinction. *See, e.g.*, *Gen. Motors Corp. v. City & Cnty. of Denver*, 990 P.2d 59, 72-73 (Col. 1999); *Int'l Thomson Publ'g v. Tracy*, 79 Ohio St. 3d 415, 420, 683 N.E.2d 1091 (1997); *Ex Parte Fleming Foods of Ala., Inc.*, 648 So. 2d 577, 579 (Ala. 1994); *Whitcomb Constr. Corp. v. Comm'r of Taxes*, 144 Vt. 466, 463, 479 A.2d 164 (1984); *Yamaha Corp. of Am. v. State Bd. of Equalization*, 73 Cal. App. 4th 338, 368 (1999). The South Dakota Circuit Court in this case committed the same error. App. 41a-43a. The source of this confusion might be *D. H. Holmes Co. v. McNamara*, 486 U.S. 24, 31 (1988).

used by remote workers located throughout the country. Taxpayers and the states need guidance on whether use taxes must be apportioned when imposed on property that is used in multiple states.

OPINIONS BELOW

The opinion of the South Dakota Supreme Court is reported at 2024 S.D. 8 and is reproduced in the Appendix ("App.") at 1a. The order and memorandum opinion of the Circuit Court are reproduced at App. 16a and App. 18a. They are unpublished. The final decision of the Office of Hearing Examiners is reproduced at App. 44a. The proposed decision of the Office of Hearing Examiners, which was incorporated into the Final Decision, is reproduced at App. 46a. Both are unpublished.

JURISDICTION

The judgment below, affirming a final judgment on federal constitutional grounds, was entered on February 7, 2024. This Court has jurisdiction under 28 U.S.C. § 1257(a).

CONTITUTIONAL PROVISIONS, STATUTES, AND REGULATIONS INVOLVED

U.S. Const. art. 1, § 8, cl. 3:

> The Congress shall have Power . . . To regulate Commerce with foreign Nations, and among the several States, and with the Indian Tribes.

U.S. Const. amend. XIV, § 1:

> All persons born or naturalized in the United States, and subject to the jurisdiction thereof, are citizens of the United States and of the State wherein they reside. No State shall make or enforce any law which shall abridge the privileges or immunities of citizens of the United States; nor shall any State deprive any person of life, liberty, or property, without due process of law; nor deny to any person within its jurisdiction the equal protection of the laws.

S.D. Codified Laws § 10-45-2:

> There is hereby imposed a tax upon the privilege of engaging in business as a retailer, a tax of four and two-tenths percent upon the gross receipts of all sales of tangible personal property consisting of goods, wares, or merchandise, except as otherwise provided in this chapter, sold at retail in the state to consumers or users.

S.D. Codified Laws § 10-46-2:

> An excise tax is hereby imposed on the privilege of the use, storage, and consumption in this state of tangible personal property purchased for use in this state at the same rate of percent of the purchase price of said property as is imposed pursuant to chapter 10-45.

S.D. Codified Laws § 10-46-3:

> An excise tax is imposed on the privilege of the use, storage or consumption in this state of tangible personal property or any product transferred electronically not originally purchased

> for use in this state, but thereafter used, stored or consumed in this state, at the same rate of percent of the fair market value of the property at the time it is brought into this state as is imposed by § 10-45-2. The use, storage, or consumption of tangible personal property or any product transferred electronically more than seven years old at the time it is brought into the state by the person who purchased such property for use in another state is exempt from the tax imposed herein. The secretary may promulgate rules pursuant to chapter 1-26 relating to the determination of the age and value of the tangible personal property or the product transferred electronically brought into this state.

S.D. Codified Laws § 10-46-6.1:

> The amount of any use tax imposed with respect to tangible personal property, any product transferred electronically, or services shall be reduced by the amount of any sales or use tax previously paid by the taxpayer with respect to the property on account of liability to another state or its political subdivisions. However, no credit may be given under this section where taxes paid on tangible personal property, any product transferred electronically, or services in another state or its political subdivisions of that state does not reciprocally grant a credit for taxes paid on similar tangible personal property or any product transferred electronically.

S.D. Admin. R. 64:09:01:20:

> For the purposes of the exemption in SDCL 10-46-3, tangible personal property or any product transferred electronically must be more than seven years old as determined by its date of manufacture, if documented, or by the date of the purchase by the person bringing the property into this state. In the absence of independent documentary proof of the value of the tangible personal property or any product transferred electronically at the time it is brought into South Dakota, the value of the property is presumed to be the purchase price reduced by ten percent for each year of use of the property by the person bringing the property into this state. Statements, opinions, or depreciation schedules of the owner of the property are not independent documentary proof of the value of the property.

STATEMENT OF THE CASE

A. Relevant Facts

Ellingson Drainage, Inc. is a Minnesota company that specializes in installing drain tile for farming and government applications. App. 47a. Ellingson's principal place of business is in West Concord, Minnesota and, from 2017-2019, it worked in more than 20 different states, including South Dakota. *Id.* Ellingson completed approximately 30 jobs in South Dakota, ranging in price from less than $1,000 to $280,000. *Id.*

Ellingson used eleven pieces of equipment in South Dakota. The use of some of these pieces of

equipment in South Dakota was for as little as one day. The exact number of days each piece of equipment was used is irrelevant for South Dakota use tax purposes. The equipment was taxed the same regardless of how long it was in the state because South Dakota's use tax is imposed on the fair market value of the equipment and is unapportioned. App. 49a.

B. Proceedings Below

The South Dakota Department of Revenue (the "Department") conducted an audit of Ellingson's operations in South Dakota from 2017 to 2020 and assessed a use tax, pursuant to S.D. Codified Laws § 10-46-3, on the fair market value of the equipment of $60,665.44 and $14,862.88 in interest. App. 2a-3a. Ellingson appealed the assessment and objected on grounds that, *inter alia*, the tax violates the dormant Commerce Clause because it is an unconstitutional burden on interstate commerce and is not fairly apportioned. App. 2a, 49a-50a. The Office of Hearing Examiners affirmed the assessment and did not address Ellingson's constitutional arguments because "[t]he constitutional question . . . is outside the jurisdiction of [the] Office and the Department." App. 53a.

Ellingson appealed the Office of Hearing Examiners' decision to the Circuit Court of South Dakota, Sixth Judicial Circuit arguing that, *inter alia*, the tax violates the dormant Commerce Clause. App. 19a. The Circuit Court affirmed the assessment, concluding that the application of the use tax was constitutional. App. 43a.

On appeal to the Supreme Court of South Dakota, Ellingson raised two issues for review. App. 4a. First, whether the use tax as applied to Ellingson violates the Due Process Clause of the Fourteenth Amendment. *Id.* Second, whether the use tax as applied to Ellingson violates the Commerce Clause. *Id.* The Supreme Court of South Dakota, affirming the lower court's decision, stated that the tax does not violate the Commerce Clause or the Due Process Clause of the Fourteenth Amendment. App. 15a.

REASONS FOR GRANTING THE PETITION

This Court will sustain a tax under the Commerce Clause so long as it "(1) applies to an activity with a substantial nexus with the taxing State, (2) is fairly apportioned, (3) does not discriminate against interstate commerce, and (4) is fairly related to the services the State provides." *South Dakota v. Wayfair, Inc.*, 585 U.S. 162, 174 (2018) (citing *Complete Auto Transit, Inc. v. Brady*, 430 U.S. 274, 279 (1977)).

This petition should be granted because this case presents an important federal constitutional issue concerning the second requirement: Must a use tax be fairly apportioned when the tax is imposed on movable property that is temporarily in a state? Although this Court has never directly addressed this specific issue, the South Dakota Supreme Court's decision disregards this Court's external consistency requirement.

I. This Court Requires That a Use Tax Imposed on Property Temporarily in a State Must Be Apportioned to Comply with the Fair Apportionment Requirement of the Commerce Clause.

The use tax imposed on Petitioner by South Dakota does not satisfy the fair apportionment requirement of the dormant Commerce Clause. In fact, it is not apportioned at all. The South Dakota Supreme Court upheld the use tax by equating it to sales tax—a tax on a transaction occurring at a specified location, constituting a "local event"—rather

than a tax on movable property temporarily in the state. This was error.

A. South Dakota's Tax Is Not Fairly Apportioned Because It Reaches Beyond That Portion of Value That Is Fairly Attributable to the State and Violates the External Consistency Doctrine.

This Court has held that to be fairly apportioned, a tax must be "externally consistent." *Jefferson Lines*, 514 U.S. at 185. "External consistency . . . looks to the economic justification for the State's claim upon the value taxed, to discover *whether a State's tax reaches beyond that portion of value that is fairly attributable to economic activity within the taxing State*." *Id.* (emphasis added). South Dakota's use tax easily fails that test.

A use tax is generally imposed on the value or purchase price of tangible property that was used, stored or consumed in this state. *See, e.g.*, S.D. Codified Laws §§ 10-46-2, 10-46-3. The closest analog to the use tax is the property tax, which is also imposed on the value of in-state property. This Court has held that property taxes must be fairly apportioned to comply with the Commerce Clause. *Norfolk & W. Ry. Co. v. Mo. State Tax Comm'n*, 390 U.S. 317 (1968); *see also Standard Oil Co. v. Peck*, 342 U.S. 382, 383-85 (1952). *Norfolk* concerned a Missouri property tax on a railroad's rolling stock. The Court struck down a defective apportionment formula. In *Norfolk*, this Court explained:

> [A] State is not entitled to tax tangible or intangible property that is

> unconnected with the State. . . . The taxation of property not located in the taxing State is constitutionally invalid, both because it imposes an illegitimate restraint on interstate commerce and because it denies to the taxpayer the process that is his due. A State will not be permitted, under the shelter of an imprecise allocation formula or by ignoring the peculiarities of a given enterprise, to project the taxing power of the state plainly beyond its borders.

Id. at 325 (internal citations and quotes omitted); *see also Nashville, Chattanooga, and St. Louis Ry. v. Browning*, 310 U.S. 362, 365-66 (1940). A fortiori, an unapportioned use tax on property used in an interstate enterprise is unconstitutional.

Petitioner's use of equipment in South Dakota is an interstate activity. As such, a use tax must be apportioned to limit the tax imposed to the amount of value used in South Dakota. South Dakota's tax on the entire fair market value of property temporarily in the state, some as short as one day, does not "reasonably reflect" the in-state component of the use of Petitioner's equipment, and "reaches beyond that portion of value that is fairly attributable to economic activity within the taxing State." *Jefferson Lines*, 514 U.S. at 185.

South Dakota's unapportioned use tax applies regardless of the time the equipment is used in the state—whether for one day, one year, or more. The

result is that Petitioner bears "more than a fair share of the cost of the local government whose protection it enjoys." *Cent. Greyhound Lines v. Mealey*, 334 U.S. 653, 663 (1948) (internal quotes omitted).

B. The South Dakota Supreme Court Erred by Equating the Use Tax with a Sales Tax.

The South Dakota Supreme Court rejected the external consistency argument with a faulty syllogism. (1) The purpose of a use tax is to serve as a sales tax substitute. App. 4a-5a. (2) A sales tax is not apportioned. "The taxation of sales has been approved without any division of the tax base among different States." App. 11a (quoting *Jefferson Lines*, 514 U.S. at 186-87) (internal quotes omitted). (3) Ergo, use taxes do not have to be apportioned either.

The difficulty with the syllogism is that sales and use taxes are not jurisprudential twins. Eighty years ago, this Court contrasted the two taxes and struck down a sales tax and upheld a use tax under nearly identical circumstances. In *Dilworth*, 322 U.S. 327, this Court explained that sales taxes and use taxes:

> are different in conception, are assessments upon different transactions, and in the interlacings of the two legislative authorities within our federation may have to justify themselves on different constitutional grounds. A sales tax is a tax on the freedom of purchase—a freedom which wartime restrictions serve to emphasize. A use tax is a tax on the enjoyment of that which was

> purchased. In view of the differences in the basis of these two taxes and the differences in the relation of the taxing state to them, a tax on an interstate sale like the one before us and unlike the tax on the enjoyment of the goods sold, involves an assumption of power by a State which the Commerce Clause was meant to end.

Id. at 330; *see also Gen. Trading*, 322 U.S. 335. This Court has continued to accept that distinction and has never changed its view. *See Nat'l Geographic Soc'y v. State Bd. of Equalization*, 430 U.S. 551 (1977); *Jefferson Lines*, 514 U.S. 175 (1995).

The difference between sales taxes and use taxes has real consequences and is not a mere formalism. Use taxes, for example, cannot be imposed on property owned or used by the federal government or by Indian tribes. Richard D. Pomp, *Overturning Dilworth and the Impact on Tribes*, 108 Tax Notes State 773 (2023). In sharp contrast, a sales tax can be imposed on a vendor selling goods to the federal government or to an Indian tribe. *Id.*

Unlike a use tax, "a sale of goods is most readily viewed as a discrete event facilitated by the laws and amenities of the place of sale." *Jefferson Lines*, 514 U.S. at 186. As such, this Court has consistently approved "taxation of sales without any division of the tax base among different States, and ha[s] instead held such taxes properly measurable by the gross charge for the purchase, regardless of any activity outside the taxing jurisdiction that might have

preceded the sale or might occur in the future." *Id.* In reviewing whether income, gross receipts, excise and property taxes have met the fair apportionment requirement, this Court has had to "set a different course," (*id.*) looking rather to the value of the "in-state component of the activity being taxed." *Goldberg*, 488 U.S. at 262 (citing *Container Corp. of Am. v. Franchise Tax Bd.*, 463 U.S. 159, 169-170 (1983)).

This Court has emphasized other attributes of a sale that distinguish sales taxes from use taxes. *See Jefferson Lines*, 514 U.S. at 190 ("The taxable event comprises agreement, payment, and delivery of some of the services in the taxing State; no other State can claim to be the site of the same combination."); *Goldberg*, 488 U.S. at 262 ("The tax at issue has many of the characteristics of a sales tax. It is assessed on the individual consumer, collected by the retailer, and accompanies the retail purchase of an interstate telephone call"). In *Goldberg*, this Court emphasized that the tax's connection with the value to be taxed was predicated on the calls being billed, paid, or charged to a service address in the state, and provision of the service in the state. These additional considerations make it impossible for another state to claim to be the place of sale, which eliminates the possibility of multiple taxation.[4] Moveable property, however, can be subject to multiple use taxes if it is

[4] In *Goldberg* there was the possibility of one other state imposing a tax, but Illinois provided a credit that eliminated the possibility of multiple taxation.

used in different states unless the taxes are apportioned.

The tax should be apportioned over the time period in which the equipment is used in South Dakota. The amount of the unapportioned use tax on Petitioner's property, however, disregards the time the equipment is used in South Dakota. Property used for one day in South Dakota is taxed the same as if it were used for its entire useful life. The court below justifies this result by misstating the external consistency test as requiring that a tax be fairly related to *benefits* provided to the taxpayer (App. 9a)—rather than requiring that the tax reasonably reflects the in-state component of the activity being taxed, *Goldberg*, 488 U.S. at 262, or the economic justification for a state's claim upon the value taxed. *Jefferson Lines*, 514 U.S. at 185.

The court then compounds its error by misapplying *Commonwealth Edison Co. v. Montana*, 453 U.S. 609, 623 (1981), for the proposition that the only benefit a taxpayer is entitled to is that "'of living in an organized society.'" App. 9a (quoting *Commonwealth Edison*, 453 U.S. at 623). That statement, however, which would nullify the external consistency test, was issued under the fourth prong of *Complete Auto* and not the second prong that is at issue in this case. Furthermore, *Commonwealth Edison* was decided in 1981, and in the ensuing four decades this Court cited the external consistency test five times. *See, e.g.*, *Gen. Motors Corp. v. Tracy*, 519 U.S. 278, 299 n.12 (1997); *Jefferson Lines*, 514 U.S. at 185; *Trinova Corp. v. Michigan Dep't of Treasury*, 498 U.S. 358, 380-81 (1991); *Goldberg*, 488 U.S. at 262-64

(1989); *Container Corp. of Am. v. Franchise Tax Bd.*, 463 U.S. 159, 169 (1983).

The court below continued its error by shifting its focus to the taxation of the Petitioner's *business*—not the taxable equipment. In response to Petitioner's argument that imposing the entire use tax on equipment in the state for as little as one day violated the external consistency doctrine, the court announced, "while working in South Dakota, Ellingson enjoyed the same benefits as any other person or business present in the state." App. 9a. That Petitioner worked in the state for a longer period of time than the taxable asset was used in the state misunderstands the tax at issue and the application of the external consistency doctrine.

According to the South Dakota Supreme Court, full taxation of equipment is justified because Ellingson "is free to bring the equipment back to work on jobs in South Dakota where Ellingson will continue to enjoy the privilege of conducting its business without being subject to additional use tax." *Id.* Being overtaxed is hardly a *privilege*. And two wrongs—over-apportioning the asset on day one, and under-apportioning it in the future—do not satisfy the external consistency test.

Other states' appellate courts have also misunderstood the need to apportion use taxes on movable property.[5] However, given the absence of clear guidance from this Court, the states have little

[5] *See, supra,* note 1.

incentive to remedy their own revenue-generating constitutional violations.

C. The South Dakota Credit for Sales or Use Taxes Paid to Other States is Not a Substitute for Apportionment.

The availability of a credit for sales or use taxes paid to *other* states cannot cure the failure to apportion South Dakota's use tax. A credit for the amount of tax paid on the purchase of property in a state cannot cure the overtaxation of the property stemming from the failure to divide the tax among those states where the property is used.

CONCLUSION

The South Dakota Supreme Court asserted a false equivalence between sales and use taxes. It compounded this error by misinterpreting this Court's teaching on the external consistency doctrine, misstated one of this Court's precedents, and misunderstood the proper role played by a credit for taxes paid to other states. The South Dakota Supreme Court's holding that the use tax could be applied without regard to the length of time an asset was in South Dakota is unconstitutional and justifies this Court's review.

With the rise in the use of intangible property in interstate commerce, such as the licensing of software, taxpayers and the states need guidance on how the use tax should be applied.

For these reasons, we respectfully request a grant of our petition for a writ of certiorari.

Respectfully submitted,

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May 2024

APPENDIX

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APPENDIX A

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2024 S.D. 8

IN THE SUPREME COURT OF THE
STATE OF SOUTH DAKOTA

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ELLINGSON DRAINAGE, INC.,

Petitioner and Appellant,

v.

SOUTH DAKOTA DEPARTMENT OF REVENUE,

Respondent and Appellee.

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APPEAL FROM THE CIRCUIT COURT OF THE
SIXTH JUDICIAL CIRCUIT
HUGHES COUNTY, SOUTH DAKOTA

* * * *

THE HONORABLE CHRISTINA L. KLINGER, Judge

* * * *

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* * * *

ARGUED OCTOBER 5, 2023
OPINION FILED 02/07/24

SALTER, Justice

[¶1.] The South Dakota Department of Revenue (DOR) imposed a use tax on Ellingson Drainage, Inc. (Ellingson), after an audit revealed it had not paid use tax on equipment used in 30 South Dakota projects but purchased elsewhere. Ellingson filed an administrative appeal challenging the constitutionality of the tax, but the appeal was dismissed because the claim was deemed not cognizable in an administrative forum. Ellingson then appealed to the circuit court, which affirmed the imposition of the tax, holding it did not violate the Due Process Clause of the Fourteenth Amendment or the Interstate Commerce Clause, as applied to Ellingson. Ellingson appeals, and we affirm.

Factual and Procedural Background

[¶2.] Ellingson is a Minnesota-based company with its principal place of business in Minnesota. It specializes in installing drain tile for farming and government applications throughout the United States. Between 2017 and 2020, Ellingson completed approximately 30 drain tile projects in South Dakota. In order to complete these jobs, Ellingson brought into South Dakota several pieces of construction equipment that had been purchased in other states and one piece of rented equipment.

[¶3.] The DOR conducted a tax audit of Ellingson's operations in South Dakota from 2017 to 2020[1] and

[1] The DOR's brief seems to suggest that the date range for the audit was 2016 to 2019, but the parties' stipulated facts set the range at March 2017 through January 2020.

assessed a use tax of 4.5% upon the value of the equipment Ellingson used. After reducing the value for depreciation, the DOR arrived at a combined value of $1,228,120, which yielded a use tax amount of $60,665.44 and $14,862.88 in interest. And though the DOR allows a credit against South Dakota use tax based upon taxes previously paid in other states, it is undisputed that the equipment at issue in this appeal had never been subject to sales or use tax elsewhere.

[¶4.] Ellingson objected to the imposition of the tax, arguing that some of the equipment at issue was used in South Dakota only for one day. Ellingson litigated a constitutional challenge to the application of the use tax statute unsuccessfully in an administrative proceeding[2] before the DOR and later in an appeal to the circuit court, which affirmed the DOR's authority to impose the use tax upon Ellingson's equipment. The court concluded the DOR's application of the use tax statute is constitutional under the United States Constitution's Interstate Commerce Clause and the Due Process Clause of the Fourteenth Amendment.

[¶5.] Applying the four-part test we used in a previous use tax decision, the circuit court found each prong was satisfied and concluded the statute did not violate the Interstate Commerce Clause. The court also concluded there was no due process violation since Ellingson had a sufficient connection to South Dakota and the statute was rationally related to South Dakota values.

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[2] The administrative claim was dismissed for lack of subject matter jurisdiction because the DOR determined that, as an administrative agency, it could not decide the constitutionality of a statute.

[¶6.] Ellingson appeals, raising two issues for our review, restated as follows:

1. Whether SDCL 10-46-3, as applied to Ellingson, violates the Due Process Clause of the Fourteenth Amendment of the United States Constitution under the theory that the tax imposed on Ellingson is disproportionate to its activity in South Dakota.
2. Whether SDCL 10-46-3, as applied to Ellingson, violates the Interstate Commerce Clause of the United States Constitution under the theory that the tax imposed on Ellingson is disproportionate to its activity in South Dakota.

Standard of Review

[¶7.] We review a challenge to the constitutionality of a statute de novo. *Green v. Siegel, Barnett & Schutz*, 1996 S.D. 146, ¶ 7, 557 N.W.2d 396, 398 (citation omitted). We will only declare a statute unconstitutional if it "clearly, palpably and plainly" violates the Constitution. *Id.*

Analysis and Decision

Use Tax and SDCL 10-46-3

[¶8.] The purpose of a use tax is to "serve[] as a sales tax substitute," *W. Wireless Corp. v. Dep't of Revenue*, 2003 S.D. 68, ¶ 6, 665 N.W.2d 73, 75 (citation omitted), ensuring that all property either sold or used in South Dakota is subject to a state tax. *Black Hills Truck & Trailer, Inc. v. S.D. Dep't of Revenue*, 2016 S.D. 47, ¶ 18, 881 N.W.2d 669, 674 (citation omitted). The tax rate for sales and use taxes is identical, and we have observed that the two are "mutually compen-

sating, one supplementing the other, but both cannot be equally applicable to the same transaction." *W. Wireless Corp.*, 2003 S.D. 68, ¶ 6, 665 N.W.2d at 75.

[¶9.] "Use taxes accommodate two vital concerns: (1) the state may lose tax revenue if taxpayers purchase out-of-state goods or services for in-state use, and (2) local providers will lose business if taxpayers purchase out-of-state goods or services to avoid sales tax liability." *Id.* ¶ 7 (citing *Northwestern Nat'l Bank of Sioux Falls v. Gillis*, 148 N.W.2d 293, 298 (S.D. 1967)). Alone, a use tax may seem discriminatory because it is only imposed on goods or services purchased out of state, but these statutes should not be regarded so narrowly. *Id.* ¶ 7, 665 N.W.2d at 76 (citing *Halliburton Oil Well Cementing Co. v. Reily*, 373 U.S. 64, 69, 83 S. Ct. 1201, 1203, 10 L. Ed. 2d 202 (1963)).

[¶10.] When paired with a complementary sales tax statute and viewed in the "context of the overall tax structure," use taxes, which attach after a tangible item is used in South Dakota, properly impose a tax equivalent to that of a tax on an in- state purchase. *Id*. ¶¶ 6–7, 665 N.W.2d at 75–76 (citing *Henneford v. Silas Mason Co.*, 300 U.S. 577, 57 S. Ct. 524, 81 L. Ed. 814 (1937)); *see also* SDCL 10-46-1(17) (defining "use" as, among other things, "the exercise of right or power over tangible personal property . . . except that it does not include the sale of that property in the regular course of business").

[¶11.] The use tax statute at issue here is SDCL 10-46-3, which provides in relevant part:

> An excise tax is imposed on the privilege of the use . . . in this state of tangible personal property . . . not originally purchased for use in this state, but thereafter used, stored or

> consumed in this state, at the same rate of percent of the fair market value of the property at the time it is brought into this state as is imposed by § 10-45-2. The use . . . of tangible personal property . . . more than seven years old at the time it is brought into the state by the person who purchased such property for use in another state is exempt from the tax imposed herein. The secretary may promulgate rules pursuant to chapter 1-26 relating to the determination of the age and value of the tangible personal property . . . brought into this state.

[¶12.] Pursuant to this statutory authority, the DOR has promulgated ARSD 64:09:01:20, which provides a 10% reduction of the property's value for each year after the date of purchase. As the text of SDCL 10-46-3 provides, property brought into South Dakota after seven years is no longer subject to taxation.

[¶13.] Ellingson objects to the DOR's use-tax assessment and makes several individual and recurring arguments, all of which can be distilled to one overarching contention—the use tax imposed on its equipment is unfairly disproportionate to the extent of the equipment's usage in South Dakota. From this, Ellingson claims that the DOR's application of SDCL 10-46-3 violates the United States Constitution's Interstate Commerce Clause and the Due Process Clause of the Fourteenth Amendment.

Ellingson's as-applied challenge to SDCL 10-46-3

[¶14.] The Interstate Commerce Clause grants Congress the power "[t]o regulate Commerce with foreign Nations, and among the several States, and with the Indian Tribes." U.S. Const. art. I, § 8, cl. 3. And where

Congress has not acted, the states are permitted to act. *Okla. Tax Comm'n v. Jefferson Lines, Inc.*, 514 U.S. 175, 179, 115 S. Ct. 1331, 1335, 131 L. Ed. 2d 261 (1995). While we have not previously addressed a claim that SDCL 10-46-3 violates the Interstate Commerce Clause, we have considered a constitutional challenge to a different use tax statute. *See W. Wireless Corp.*, 2003 S.D. 68, 665 N.W.2d 73.

[¶15.] In *Western Wireless*, we held that the DOR may impose a use tax pursuant to SDCL 10-46-2.1 for billing statements relating to services delivered to South Dakota customers but generated by a third-party vendor for a cellular telephone company, both of which were located out of state. *Id.* at 78. To resolve the taxpayer's claim that the imposition of a use tax was "a burden on interstate commerce[,]" we applied the four-part standard described in the United States Supreme Court's decision in *Complete Auto Transit, Inc. v. Brady*, 430 U.S. 274, 97 S. Ct. 1076, 51 L. Ed. 2d 326 (1977):

> A tax is not an unconstitutional burden on interstate commerce if the taxed activity [1] is sufficiently connected to the state to justify the tax, [2] the tax is fairly related to benefits provided to the taxpayer, [3] the tax does not discriminate against interstate commerce, and [4] the tax is fairly apportioned.

W. Wireless Corp., 2003 S.D. 68, ¶ 15, 665 N.W.2d at 78 (citing *Complete Auto Transit, Inc.*, 430 U.S. 274, 287, 97 S. Ct. 1076, 1083); *see also Montana-Dakota Utils. Co. v. S.D. Dep't of Revenue*, 337 N.W.2d 818, 820 (S.D. 1983).

[¶16.] For a separate claim that a tax violated the Due Process Clause of the Fourteenth Amendment, we

consider "whether the tax has relation to opportunities, benefits, or protection afforded by the taxing state." *Montana-Dakota Utils. Co.*, 337 N.W.2d at 820. The Supreme Court has explained that "[t]he Due Process Clause requires some definite link, some minimum connection, between a state and the person, property or transaction it seeks to tax[.]" *Quill Corp. v. N.D. ex rel. Heitkamp*, 504 U.S. 298, 306, 112 S. Ct. 1904, 1909–10, 119 L. Ed. 2d 91 (1992), *overruled by South Dakota v. Wayfair*, 585 U.S. ___, 138 S. Ct. 2080, 201 L. Ed. 2d 403 (2018) (eliminating the physical presence requirement previously needed to establish a sufficient connection).

[¶17.] But despite similar phrasing, the "sufficient connection" requirement of the *Complete Auto* test necessitates a greater link than the "minimum connection" requirement of the Due Process Clause. *Id.* at 312–13, 112 S. Ct. at 1913–14. Therefore, the Supreme Court has held that the *Complete Auto* test "encompasses due process standards," *Amerada Hess Corp. v. Dir., Div. of Tax'n, N.J. Dep't of Treasury*, 490 U.S. 66, 79, 109 S. Ct. 1617, 1625, 104 L. Ed. 2d 58 (1989), and accordingly, that is where we begin our review.

[¶18.] Ellingson makes no argument that SDCL 10-46-3 is unconstitutional under prongs one or three of the *Complete Auto* test. As to prong one, it recognized before the circuit court that it had a sufficient connection to South Dakota because it does business in the state. And as to prong three, Ellingson does not argue that the statute discriminates against interstate commerce by favoring local business over foreign business, nor is there any indication that this is at issue. We agree that prongs one and three are satisfied.

[¶19.] Although prong two requires a tax to be fairly related to the benefits provided to the taxpayer, the only benefit a taxpayer is entitled to is that "of living in an organized society[.]" *Commonwealth Edison Co. v. Montana*, 453 U.S. 609, 623, 101 S. Ct. 2946, 2956, 69 L. Ed. 2d 884 (1981). A tax is simply "a means of distributing the burden of the cost of government," not "an assessment of benefits." *Id.* at 622–23, 101 S. Ct. at 2956 (citation omitted). In fact, "[n]othing is more familiar in taxation than the imposition of a tax upon a class or upon individuals who enjoy no direct benefit from its expenditure[.]" *Id.* at 622, 101 S. Ct. at 2956.

[¶20.] Ellingson points to its one-day use of certain equipment in South Dakota to suggest that the tax is not fairly related to any benefit it has experienced; it did not, in other words, receive commensurate value for the tax it paid. But while working in South Dakota, Ellingson enjoyed the same benefits as any other person or business present in the state. And having paid the use tax on its equipment that had otherwise not been subject to sales or use tax in another state, Ellingson was and is free to bring the equipment back to work on jobs in South Dakota where Ellingson will continue to enjoy the privilege of conducting its business without being subject to additional use tax.

[¶21.] Indeed, the bad-bargain argument that permeates Ellingson's submissions rests on the incorrect factual premise that the tax imposed by the DOR was *limited* to one day of use. It was, of course, not so restricted, and the circumstances underlying Ellingson's as-applied challenge to SDCL 10-46-3 have very little to do with the DOR's application of the statute and relate much more to Ellingson's unilateral decision as to the length of time it would use certain equipment for its South Dakota drain tile projects—something

over which the DOR had no control. Because Ellingson has received all the benefits it is entitled to, prong two is satisfied.

[¶22.] Prong four of the *Complete Auto* test requires a tax to be fairly apportioned, which necessitates both internal and external consistency. *Goldberg v. Sweet*, 488 U.S. 252, 261, 109 S. Ct. 582, 589, 102 L. Ed. 2d 607 (1989), *abrogated by Comptroller of Treasury of Md. v. Wynne*, 575 U.S. 542, 135 S. Ct. 1787, 191 L. Ed. 2d 813 (2015) (abrogated on other grounds). A tax is internally consistent if, theoretically, every state has identical use tax statutes and multiple taxation does not result. *Id.*

[¶23.] Ellingson concedes that SDCL 10-46-3 is internally consistent because the presence of SDCL 10-46-6.1 contemplates a credit for taxes paid in another state on the same piece of property. And if we are to imagine that every state has the same taxation scheme, then there is no question of double taxation, and we agree that the use tax contained in SDCL 10-46-3 is internally consistent.

[¶24.] "The external consistency test asks whether the State has taxed only that portion . . . [resulting] from the interstate activity which reasonably reflects the in-state component of the activity being taxed." *Goldberg*, 488 U.S. at 262, 109 S. Ct. at 589. We must, therefore, "examine the in-state business activity which triggers the taxable event and the practical or economic effect of the tax on that interstate activity." *Id.* Ellingson argues that the statute is not externally consistent, asserting that the tax is unreasonable in light of the fact that 90% of its activities occurred outside of South Dakota. Ellingson contends that taxing the full value of its property, reduced only for

depreciation, "fails to appropriately allocate the tax relative to Ellingson's in-state activities."

[¶25.] However, the activity at issue here is simply an in-state use of equipment that was purchased outside the state without ever having paid sales taxes on the property. This is reasonable, and when the use tax is viewed in the context of what it truly is—a substituted sales tax designed to preclude the loss of revenue by the State or local businesses that might otherwise result without the collection of such taxes—Ellingson's argument is wide of the mark.[3] *See Jefferson Lines, Inc.*, 514 U.S. at 186–87, 115 S. Ct. at 1339 (stating that the taxation of sales has consistently been approved "without any division of the tax base among different States" and is instead measured "by the gross charge for the purchase, regardless of any activity outside the taxing jurisdiction that might have preceded the sale or might occur in the future").

[¶26.] In Ellingson's concept of external consistency, SDCL 10-46-3 should be read to apply only to tangible personal property that "has come to rest [in South Dakota] and has become part of the common mass of property therein." For this proposition, Ellingson cites to *Henneford v. Silas Mason Company*, a case in which the Supreme Court noted that certain property was "at rest" and not "in transit" or within "the operations of

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[3] This case differs from cases in which a state attempts to impose a tax upon an activity which occurs, in part, outside of its state. *See Cent. Greyhound Lines of N.Y. v. Mealey*, 334 U.S. 653, 663, 68 S. Ct. 1260, 1266, 92 L. Ed. 1633 (1948) (holding a tax unconstitutional where it sought to tax the gross receipts from transportation occurring out of state), *and Norfolk & W. Ry. Co. v. Mo. State Tax Comm'n*, 390 U.S. 317, 325–26, 88 S. Ct. 995, 1001, 19 L. Ed. 2d 1201 (1968) (holding a property tax on rolling stock located out of state unconstitutional).

interstate commerce[.]" 300 U.S. at 582–83, 57 S. Ct. at 524, 527.

[¶27.] Ellingson supplements its "at rest" theory with an argument that we should overlook textual distinctions and view SDCL 10-46-3 identically to SDCL 10-46-2, which imposes a use tax for "the privilege of the use, storage, and consumption in this state of tangible personal property *purchased for use in this state*[.]" (Emphasis added.) In Ellingson's view, SDCL 10-46-2 expresses an "at rest" use tax policy because it imposes the tax on tangible personal property that is purchased elsewhere but for use in South Dakota.

[¶28.] We think Ellingson misreads both *Henneford* and SDCL 10-46-2. Initially, *Henneford* does not, itself, state a strict rule under which tangible personal property at rest is subject to a state use tax and property in transit is not. That distinction was simply not at issue in *Henneford* and was not central to the Supreme Court's analysis or decision because the property upon which the State of Washington sought to impose a use tax had been delivered for work on the Grand Coulee Dam in Washington and was unquestionably not in transit.

[¶29.] Still, the at-rest versus in-transit dichotomy is often viewed as significant in the area of state use taxation, but not in the way Ellingson suggests. In Arkansas, for instance, the state legislature has codified the at-rest concept with a statute that declares its use tax "does not apply with respect to the . . . use . . . of tangible personal property" until the property "has finally come to rest within this state" or "has become commingled with the general mass of property of this state." Ark. Code Ann. § 26-53-106(b) (West). The Arkansas Supreme Court has described the meaning of the at-rest text in the following terms:

> [F]or purposes of the "come to rest" test, what is important is not that the property to be taxed actually stopped moving, but that its transportation in interstate commerce had ceased. Under Ark. Code Ann. § 26-53-106(b), property comes to rest in Arkansas when it reaches a point where it can satisfy the purpose—whether for use, storage, distribution or consumption—for which it was put in interstate commerce and sent to Arkansas.

Alcoa World Alumina, L.L.C. v. Weiss, 377 S.W.3d 164, 168 (Ark. 2010).

[¶30.] Ellingson views at rest much differently. Its arguments suggest at-rest status is a temporal state of relative permanency, an indeterminate function of the time the property is used within South Dakota and the owner's subjective intent to keep it in the state. But this idea of property being at rest and subject to taxation is as unworkable as it is legally unsustainable.

[¶31.] Indeed, Ellingson has not identified any authority to support its view of at rest, and what can be gleaned from *Henneford* and jurisdictions where the concept plays a more prominent role is that tangible personal property is at rest when it is used and is no longer in transit through interstate commerce. *See Henneford*, 300 U.S. at 586, 57 S. Ct. at 528 (noting that Washington was seeking to tax "the goods when used in Washington after the transit is completed"); *Alcoa*, 377 S.W.3d at 168 (holding property is at rest when "it reaches a point" where it can be used for the purpose for which it was "put in interstate commerce"). For this reason, the at-rest view that Ellingson seeks to graft to SDCL 10-46-2 and SDCL

10-46-3 is not an accurate reflection of the at-rest/in-transit distinction it espouses.[4]

[¶32.] And, in any event, Ellingson has challenged the constitutionality of SDCL 10-46-3 as it is applied under its existing text. The question we are presented with is not whether there is a better way to interpret SDCL 10-46-3, which, as Ellingson posits it, means a better approach to use tax policy. Instead, we must determine whether the application of SDCL 10-46-3 here violates the Interstate Commerce Clause and the Due Process Clause, and we conclude it does not.

[¶33.] Ellingson alternatively argues that if a use tax can be imposed, then the DOR should apply the 4.5% tax to only 1-10% of the equipment's value in proportion to its usage in South Dakota. But this is simply an extension of Ellingson's unsuccessful at-rest theory, and, as we have indicated, use is use. The provisions of SDCL 10-46-3 do not contemplate a formula by which to measure use, nor do we hold that is what the Constitution requires in these circumstances. *See Jefferson Lines, Inc.*, 514 U.S. at 195, 115 S. Ct. at 1343 (citing *Container Corp. of Am. v. Franchise Tax Bd.*, 463 U.S. 159, 170, 103 S. Ct. 2933, 2942, 77 L. Ed. 2d 545 (1983)). The change Ellingson seeks is not a judicial one, but rather one better suited to the formulation of public policy by the Legislature.

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[4] Ellingson has not identified an ambiguity in either SDCL 10-46-2 or SDCL 10-46-3, and neither statute includes a textual at-rest requirement. *See Harrah's Operating Co. v. State, Dep't of Tax'n*, 321 P.3d 850, 853 (Nev. 2014) (refusing to "impose a temporal requirement" on a use tax statute that presumed purchase was not for use or consumption in the state if its "first use" occurred outside of the state).

Conclusion

[¶34.] Because SDCL 10-46-3, as applied to Ellingson, satisfies all four prongs of the *Complete Auto* test, it does not violate the Interstate Commerce Clause or the Due Process Clause of the Fourteenth Amendment. We affirm.

[¶35.] JENSEN, Chief Justice, and KERN, DEVANEY, and MYREN, Justices, concur.

APPENDIX B

STATE OF SOUTH DAKOTA
COUNTY OF HUGHES

IN CIRCUIT COURT
SIXTH JUDICIAL CIRCUIT

———

32CIV22-122

———

ELLINGSON DRAINAGE, INC.

Petitioner/Appellant,

v.

SOUTH DAKOTA DEPARTMENT OF REVENUE

Respondent/Appellee.

———

ORDER

WHEREAS, the Court having entered its Memorandum Decision on January 25, 2023, and having expressly incorporated the same herein, it is hereby

ORDERED, ADJUDGED, AND DECREED:

The South Dakota Department of Revenue's decision concluding that the State's use tax under SDCL 10-46-3 as applied to Ellingson Drainage is constitutional is AFFIRMED.

Pursuant to SDCL 1-26-32.1 and SDCL 15-6-52(a), the Court's Memorandum Decision shall act as the Court's findings of fact and conclusions of law as permitted by SDCL 1-26-36.

Dated this 25th day of January 2023.

BY THE COURT:

/s/ Christina L. Klinger
The Honorable Christina L. Klinger
Circuit Court Judge
Sixth Judicial Circuit

Attest:

Deuter-Cross, TaraJo
Clerk/Deputy
{SEAL}

APPENDIX C

CIRCUIT COURT OF SOUTH DAKOTA
SIXTH JUDICIAL CIRCUIT

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Honorable M. Bridget Mayer
Honorable Margo D. Northrup

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January 25, 2023

RE: 32CIV22-122; Ellingson Drainage Inc. v. South Dakota Department of Revenue

MEMORANDUM OPINION

Ellingson Drainage, Inc. (Ellingson) appeals from a decision of the South Dakota Department of Revenue (Department) adopting a proposed decision by the Office of Hearing Examiners (OHE). The OHE concluded that neither it nor the Department had jurisdiction to consider the issue of whether the taxes imposed are constitutional as an executive branch agency is prohibited by the separation of powers doctrine from declaring a duly adopted law as unconstitutional unless a judicial determination has ordered otherwise, which had not been done in this case. As a result, the tax imposed was presumed constitutional and the OHE went on to conclude that pursuant to SDCL 10-46-2, 10-46-2.2 and 10-46-3 the Certificate of Assessment made on Ellingson should be upheld in its entirety. The Court heard oral argument on January 9, 2023. After reviewing the administrative record and considering the arguments of the parties, the Court now issues this Memorandum Opinion affirming the Department's decision.

FACTS

Ellingson Drainage, Inc. (Ellingson), is a Minnesota company with its principal place of business in West Concord, MN. Ellingson provides drainage services to farmers by installing drain tile for farming and government applications. Ellingson operates its business across the United States, and the company has maintained a South Dakota excise tax license since September 2, 2008. On March 10, 2020, the Department provided Ellingson with a Notice of Intent to Audit for the recording periods of March 2017 through January, 2020. The Department conducted its audit as a "desk audit" meaning all communication between the Department's auditor and Ellingson's Representative was conducted via email. Specific to the use tax audit, the auditor examined job cost reports for each of the company's South Dakota jobs in addition to invoices for equipment used in South Dakota.

In total, the Department found twelve separate instances in which it deemed Ellingson failed to pay use tax.[1] The Department found eleven instances in which use tax was due on equipment used in South Dakota without sale or use tax paid. The Department assessed the taxable amount based on the equipment value at the time it was used in South Dakota. A full

[1] The Department found one instance in which use tax was due on rental equipment used in South Dakota without sale or use tax paid—a November 20, 2018 equipment rental of an Excavator from Northland Capital Equipment Finance for $120,000, taxable amount $120,000. During the audit, there was a disagreement between the auditor and Ellingson's representative regarding the fair market value used to calculate the taxable amount of the equipment—Ellingson believed the Department overstated the fair market value of the equipment, stating "the value of that equipment depreciates much faster than 10% per year."

breakdown of these eleven instances are as follows:

(1) April 19, 2017 SD use of a 2013 Fastrac 3230 purchased from Windridge Implement, LLC (IA) for $148,500 taxable amount $86,625;

(2) September 21, 2017 SD use of a CAT Pullcat D8K purchased from Western Finance & Lease, Inc. (ND) for $62,500 taxable amount $21,354.17;

(3) September 21, 2017 SD use of a 2011 Fastrac 3230 purchased from Windridge Implement, LLC (IA), for $141,500 taxable amount $57,779.17;

(4) October 10, 2017 SD use of 2011 Fastrac 3230 purchased from Windridge Implement, LLC (IA) for $141,500 taxable amount $56,600;

(5) October 17, 2017 SD use of a 2013 Bron 550 Tile Plow purchased from RWF Industries (MN) for $576,500 taxable amount $326,683.33;

(6) April 23, 2018 SD use of a 2011 Fastrac 3230 purchased from Windridge Implement, LLC (IA) for $141,500 taxable amount $55,420.83;

(7) May 16, 2018 SD use of a 2013 Fastrac 3230 purchased from Windridge Implement, LLC (IA), for 148,500 taxable amount $70,537.50;

(8) November 16, 2018 SD use of a 2011 Fastrac 3230 purchased from Windridge Implement LLC (IA) for $153,000, taxable amount $51,000;

(9) November 18, 2018 SD use of a 2017 Bron 585 purchased from RWF Bron (MN) for $196,399, taxable amount $183,305.73;

(10) April 17, 2019 SD use of a 2018 Fastrac H220 purchased from Windridge Implement, LLC (IA) for $189,933 taxable amount $170,939.70; and

(11) October 28, 2019 SD use of a CAT 336EL purchased from Agassiz Excavating, Inc. (ND) for $227,500, taxable amount $147,875.

On July 30, 2020, the Department issued a Certificate of Assessment against Ellingson for the reporting periods of March 2017 to January 2020 alleging unpaid tax and interest totaling $75,528.32. The Certificate of Assessment alleged that Ellingson owed the Department of Revenue $60,665.44 in unpaid use taxes pursuant to SDAR 64:09:01:20, SDCL 10-46-3, and SDCL 10-46-2.1.[2] The Department calculated this number based on a taxable amount of $1,348,120.43 at a tax rate of 4.5%. The certificate also alleged that Ellingson owned $14,862.88 in interest assessed through July 31, 2020 pursuant to SDCL 10-59-6.[3]

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[2] A full breakdown of dates and amounts owed in tax by Ellingson as outlined in the Department's Total Assessment Worksheet and Summary are as follows: $3,898.13 due April 2017; $3,561.00 due September 2017; $17,247.75 due October 2017; $2,493.94 due April 2018; $3,174.19 due May 2018; $15,943.76 due November 2018; $7,692.29 due April, 2019; and $6,654.38 due October, 2019.

[3] Under SDCL 10-59-6, interest charges for unpaid taxes are assessed and determined as follows: "Any person subject to tax under the chapters set out in 10-59-1 who fails to pay the tax within the time prescribed is subject to an interest charge for each month or part thereof for which the payment is late, which interest shall be one percent or five dollars whichever is greater for the first month, and one percent per month thereafter. If the failure to pay tax was with the intent to intentionally avoid or delay the payment of tax, the person who fails to pay the tax within the time prescribed is subject to an interest charge for each month or part thereof for which the payment is late, which interest shall be one and one-half percent or five dollars, whichever is greater."

On September 15, 2020, Ellingson submitted a timely request to the Department for hearing before the Secretary of Revenue pursuant to SDCL 10-59-9, disputing the certificate of assessment. A hearing was conducted by the OHE pursuant to SDCL chapter 1-26 and 1-26D. Ellingson objected to the equipment value determination, asserting that it was incorrect and excessive. Ellingson's position to the OHE was that the value of the equipment for purposes of SDCL 10-46-3 and other statutes and regulations should be proportionate to the value of the company's use of that equipment in South Dakota. Ellingson classified its use in South Dakota as "nominal." Ellingson argued alternatively that to the extent that SDCL 10-46-3 is applied to tax the full value of equipment "nominally used in South Dakota," the statute violates the Full Faith and Credit Clause established by Article IV, Section 1 of the United States Constitution and the Dormant Commerce Clause established by Article I of the United States Constitution.

The parties entered into a Stipulation as to the facts of the case presented to the OHE on October 22, 2021. Accordingly, the parties agree that during the audit period, Ellingson did drain tile installation work in more than twenty different states. During the audit period Ellingson completed about thirty jobs in South Dakota ranging in price from less than $1,000 to $280,000. The equipment at issue was primarily used on jobs performed outside of South Dakota, and the pro- rata usage of the equipment in South Dakota during the audit period ranged from one to ten percent. Additionally, the purchase price of the equipment at issue exceeds the gross receipts Ellingson received for the company's work done in South Dakota during the audit period. Ellingson did not dispute that

the company failed to pay use taxes for each of the twelve instances outlined as part of the audit.

The parties had a virtual hearing with the OHE on April 11, 2022. The parties made arguments, but all evidence was received through the stipulated facts and stipulated exhibits for the OHE's consideration. The OHE entered a Proposed Decision on May 13, 2022, affirming the Department's Certificate of Assessment in its entirety. The OHE concluded that pursuant to the separation of powers doctrine it was outside of its jurisdiction to determine duly adopted laws as unconstitutional and it was therefore required to treat SDCL 10-46-2, 10-46-2.2, and 10-46-3 as constitutionally valid since there had not been a judicial determination otherwise.[4] The OHE went on to conclude that based upon statutes above and the facts presented, the Department's Certificate of Assessment should be upheld in its entirety. The Department adopted the OHE's proposed decision in its entirety and ordered that Ellingson's request for hearing be dismissed with prejudice on June 13, 2022. Ellingson appealed the Department's final decision to this Court on July 1, 2022 pursuant to SDCL 1-26-31. Ellingson challenges the constitutionality of SDCL 10-46-3 as applied to the

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[4] The OHE cited cases from Tennessee, North Dakota, and Wyoming: *Colonial Pipeline Co. v. Morgan et al*, 263 S.W.3d 827, 841-44 (Tenn. 2008) (citing *Alleghany Corp. v. Pomeroy*, 698 F.Supp. 809, 813-14 (D.ND. 1990), rev'd on other grounds, 898 F.2d 1314 (8th Cir. 1990) (stating that an agency is without power to adjudicate constitutional issues); *Belco Petroleum Corp. v. State Bd. of Equalization*, 587 P.2 204, 208 (Wyo. 1978) (holding an agency does not determine facial constitutionality of statute or constitutionality of its application). The OHE also cited 73 C.J.S. *Public Administrative Law and Procedure* 65 at 536 and 1 Am.Jur2d *Administrative Law* 185 at 989-90.

circumstances of the case.[5] Ellingson challenges SDCL 10-46-3 first under the Due Process Clause of the Fourteenth Amendment, and second under the Commerce Clause. Specific to the Due Process claim, Ellingson asserts SDCL 10-46-3 is not rationally related to the opportunities, benefits, or protections afforded to Ellingson by the State. Specific to the Commerce Clause claim, Ellingson asserts SDCL 10-46-3 is not fairly related to the benefits provided to Ellingson by the State and is not fairly apportioned.

ISSUES

I. WHETHER THE DEPARTMENT ERRED IN FINDING THE STATE'S USE TAX UNDER SDCL 10-46-3 AS APPLIED TO ELLINGSON DRAINAGE, INC. IS CONSTITUTIONAL?

LEGAL STANDARD

This Court's review of a decision from an administrative agency is governed by SDCL 1-26-36.

> The court shall give great weight to the findings made and inferences drawn by an agency on questions of fact. The court may affirm the decision of the agency or remand the case for further proceedings. The court may reverse or modify the decision if substantial rights of the appellant have been prejudiced because the administrative findings,

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[5] Ellingson acknowledges that the Certificate of Assessment stated that a tax was being imposed under SDCL 10-46-2.1 which imposes a use tax on services, though the Department contends the tax was intended to be imposed under 10-46-2.2 which imposes a use tax on rented personal property; Ellingson does not challenge the application of SDCL 10-46-2.2 to the facts of the case regarding the singular instance of use tax on rental property audited by the Department.

> inferences, conclusions, or decisions are:
>
> (1) In violation of constitutional or statutory provisions;
>
> (2) In excess of the statutory authority of the agency;
>
> (3) Made upon unlawful procedure;
>
> (4) Affected by other error of law;
>
> (5) Clearly erroneous in light of the entire evidence in the record; or
>
> (6) Arbitrary or capricious or characterized by abuse of discretion or clearly unwarranted exercise of discretion.
>
> A court shall enter its own findings of fact and conclusions of law or may affirm the findings and conclusions entered by the agency as part of its judgment.

SDCL 1-26-36. "We give great weight to the findings made and inferences drawn by an agency on questions of fact. We reverse only when those findings are clearly erroneous in light of the entire record. We review de novo issues of statutory and constitutional interpretation." *Jans v. Dep't of Public Safety*, 2021 S.D. 51, ¶ 10, 964 N.W.2d 749, 754 (citations omitted). When an agency's factual determinations are made on the basis of documentary evidence, however, the Court reviews the matter de novo, unhampered by the clearly erroneous rule. *Darling v. W. River Masonry, Inc.*, 2010 S.D. 4 ¶10, 777 N.W.2d 363, 366. Because Ellingson challenges the constitutionality of SDCL 10-46-3 and all facts were based on the parties' written stipulation and documentary evidence, the Court reviews the Department's decision de novo.

The South Dakota Supreme Court has acknowledged that "deciding the constitutionality of a legislative enactment is a solemn and momentous occasion" that the Court does not take lightly. *Metropolitan Life Ins. Co. v. Kinsman*, 2008 S.D. 24 ¶9, 747 N.W.2d 653, 658. Following the Supreme Court's guidance, this Court also acknowledges the serious nature associated with ruling on a statute's constitutionality and refrains from "hasty ventures into constitutional analysis until after any preliminary obstacles have been surmounted and judgment is unavoidable." *Id.* The matter at hand is properly before the Court because Ellingson has timely exhausted all administrative remedies within the Department while simultaneously preserving its constitutional challenge. Though the Department and the OHE reasoned that the constitutional question was beyond their jurisdiction, the Department's conclusion of law is that the taxes imposed by SDCL 10-46-2, 10-46-2.2, and 10-46-3 "*are constitutional* as there are no judicial determinations by a presiding court that have held the statutes to be unconstitutional." Therefore, because the Department's conclusion is that the statutes are constitutional, the question of constitutionality is properly before this Court.

ANALYSIS

I. WHETHER THE DEPARTMENT ERRED IN FINDING THE STATE'S USE TAX UNDER SDCL 10-46-3 AS APPLIED TO ELLINGSON IS CONSTITUTIONAL.

"Our function is not to decide if a legislative act is unwise, unsound, or unnecessary, but rather, to decide only whether it is unconstitutional." *Kinsman*, 2008 S.D. 24 ¶18 at 661 (citations omitted). "There is a strong presumption that the laws enacted by the

legislature are constitutional and the presumption is rebutted only when it *clearly*, *palpably and plainly appears* that the statute violates a provision of the constitution." *State v. Hague,* 1996 S.D. 48 ¶4, 547 N.W.2d 173, 175 (citations omitted) (emphasis added). Statutes are presumed constitutional "unless shown otherwise beyond a reasonable doubt." *Kinsman*, 2008 S.D. 24 ¶18 at 661 (citations omitted). Thus, it is Ellingson's burden to prove beyond a reasonable doubt "that there is no reasonable basis for the Legislature's decision" to impose a one-time use tax on property purchased outside of the state, not previously subject to sales or use tax in any other jurisdiction, and brought into South Dakota for use. *See id.*

The language of SDCL 10-46-3 imposes an excise tax on the use of tangible personal property brought into the state after being purchased outside of the state. The statute exempts any property previously subjected to sales or use tax in other states from being taxed in South Dakota. SDCL 10-46-3 reads in its entirety:

> An excise tax is imposed on the privilege of the use, storage or consumption in this state of tangible personal property or any product transferred electronically not originally purchased for use in this state, but thereafter used, stored or consumed in this state, at the same rate of percent of the fair market value of the property at the time it is brought into this state as is imposed by § 10-45-2. The use, storage, or consumption of tangible personal property or any product transferred electronically more than seven years old at the time it is brought into the state by the person who purchased such property for use in another

> state is exempt from the tax imposed herein. The secretary may promulgate rules pursuant to chapter 1-26 relating to the determination of the age and value of the tangible personal property or the product transferred electronically brought into this state.

SDCL 10-46-3. The statute's reference to SDCL 10-45-2 sets the tax rate at four and one-half percent (4.5%) based on the gross receipts of all sales of tangible personal property later brought into South Dakota for use. SDCL 10-45-2.[6]

ARSD 64:09:01:20 provides exemptions to the use tax and a basis for calculating use tax for property with depreciated value. It reads:

> For the purposes of the exemption in SDCL 10-46-3, tangible personal property or any product transferred electronically must be more than seven years old as determined by its date of manufacture, if documented, or by the date of the purchase by the person bringing the property into this state. In the absence of independent documentary proof of the value of the tangible personal property or any product transferred electronically at the time it is brought into South Dakota, ***the value of the property is presumed to be the purchase price reduced by ten***

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[6] SDCL 10-45-2, which sets the property sales tax, states: "There is hereby imposed a tax upon the privilege of engaging in business as a retailer, a tax of four and one-half percent upon the gross receipts of all sales of tangible personal property consisting of goods, wares, or merchandise, except as otherwise provided in this chapter, sold at retail in the State of South Dakota to consumers or users."

> ***percent for each year of use of the property by the person bringing the property into this state.*** Statements, opinions, or depreciation schedules of the owner of the property are not independent documentary proof of the value of the property.

ARSD 64:09:01:20 (emphasis added).

Ellingson challenges the constitutionality of SDCL 10-46-3 as applied to the circumstances of the case, specifically under the Due Process Clause of the Fourteenth Amendment and the Commerce Clause. "The Commerce Clause and the Due Process clause impose distinct but parallel limitations on a State's power to tax out-of-state activities." *MeadWestvaco Corp. ex rel Mead Corp. v. Illinois Dept. of Revenue*, 553 U.S. 16, 24 (2008) (citations omitted). Thus, the Court reviews each inquiry separately. However, "the broad inquiry subsumed in both constitutional requirements is 'whether the taxing power exerted by the state bears fiscal relation to protection, opportunities and benefits given by the state'—that is, 'whether the state has given anything for which it can ask return.'" *Id.* at 24-25 (citations omitted).

Ellingson first argues that the statute is not rationally related to the opportunities, benefits, or protections afforded to Ellingson by the State of South Dakota under the Due Process Clause of the Fourteenth Amendment.

a. As applied to Ellingson, SDCL 10-46-3 is constitutional under the Due Process Clause of the Fourteenth Amendment.

"Whether a state tax violates the due process clause is determined by whether the tax has relation to

opportunities, benefits, or protection afforded by the taxing state." *Montana-Dakota Utilities Co. v. S. Dakota Dep't of Revenue*, 337 N.W.2d 818, 820 (S.D. 1983) (citations omitted).

The United States Supreme Court has articulated two requirements a tax must meet to satisfy the Due Process Clause of the Fourteenth Amendment: (1) there must be "some definite link, some minimum connection, between the state and the person, property or transaction seeks to tax," and (2) the "income attributed to the State for tax purposes must be rationally related to values connected with the taxing state." *Quill Corp. v. N. Dakota By and Through Heitkamp*, 504 U.S. 298, 306 (1992), overruled on other grounds by *South Dakota v. Wayfair, Inc.*, 138 S. Ct. 2080 (2018) (overruling the "physical presence" rule for the imposition of state sales tax).

i. <u>There is a minimum connection between the tax sought to be imposed by SDCL 10-46-3 and Ellingson's presence within the State.</u>

To satisfy the first requirement, there must be "some definite link, some minimum connection," between Ellingson and the State of South Dakota. The United States Supreme Court has stated that this inquiry is "flexible" and "focuses on the reasonableness of the government's action." *Id.* at 307. Ellingson concedes that there is some connection between South Dakota and Ellingson sufficient to satisfy this requirement under *Quill* because it conducts business within the State. The Court agrees that there is a minimum connection between the tax sought to be imposed by SDCL 10-46-3 and Ellingson's presence within the State sufficient to satisfy the first requirement under *Quill* because Ellingson has voluntarily entered into and conducted business within the state

and has maintained a South Dakota excise tax license since 2008.

ii. The tax income sought to be imposed is rationally related to "values connected with the taxing state."

To satisfy the second requirement, SDCL 10-46-3 must be "rationally related to values connected with [the State of South Dakota]." *Quill*, 504 U.S. 298 at 306. The South Dakota Supreme Court expressed the values associated with the use tax in *Western Wireless Corp. v. Dep't of Revenue* when it stated: "Use taxes accommodate two vital concerns: (1) the state may lose tax revenue if taxpayers purchase out-of-state goods or services for in-state use, and (2) local providers will lose business if taxpayers purchase out-of-state goods or services to avoid sales tax liability." *Western Wireless Corp. v. Dep't of Revenue*, 2003 S.D. 68 ¶7, 665 N.W.2d 73, 75. The South Dakota Supreme Court also described use tax as "complementary and supplemental" to the state's sales tax, ensuring the state government is supported by a single tax for any property sold or used in the state. *Black Hills Truck & Trailer, Inc. v. S. Dakota Dep't of Revenue*, 2016 S.D. 47 ¶18, 881 N.W.2d 669, 674 (citations omitted).

Ellingson argues SDCL 10-46-3, as it applies to Ellingson, is not rationally related to the values articulated by the South Dakota Supreme Court in *Western Wireless* because SDCL 10-46-2 exists to dull and remedy the sales tax fairness concerns outlined in *Western Wireless*, making 10-46-3 unnecessary. SDCL 10-46-2—which imposes a tax on tangible personal property purchased *for use in South Dakota*—exists to prevent South Dakota residents, or companies with a business presence in the state, from purchasing property elsewhere to avoid sales tax with the intent

to use the property in South Dakota. SDCL 10-46-2, as opposed to 10-46-3, Ellingson argues, acts in complementary fashion with the state's sales tax statutes and is rationally related to the state's values for imposing the tax.

Ellingson's ultimate conclusion under its Due Process challenge becomes: because SDCL 10-46-2 exists, SDCL 10-46-3 serves no purpose in the statutory scheme. Ellingson's argument fails because SDCL 10-46-3 serves a separate and distinct role in the statutory scheme, aside from the role SDCL 10-46-2 accomplishes. SDCL 10-46-3's role is rationally related to the values associated with the use tax articulated by the South Dakota Supreme Court in *Western Wireless* and *Black Hills Truck and Trailer*. While 10-46-2 taxes property purchased specifically for use in South Dakota, 10- 46-3 taxes any property that was not purchased specifically for use in South Dakota but was used in South Dakota. This in itself works to further the South Dakota Supreme Court's desire for complementary and supplemental statutes that ensure the state government is supported by a single tax on property used or sold within the state. SDCL 10-46-3 optimizes the state's ability to tax property used within the state in a way that SDCL 10-46-2 does not.

It is important to note that a number of conditions must occur before the State can impose a tax under 10-46-3. SDCL 10-46-3 *only* acts to impose a use tax on property not previously subject to taxation in a different state. If a company or business purchases property in a different state and pays sales tax, South Dakota will not and cannot impose a tax under 10-46-3. If a company purchases property in a different state and does not pay sales tax but is later taxed for using

that property in an entirely different state, South Dakota will not and cannot impose a tax under 10-46-3. One may think of SDCL 10-46-3 as a rarely used, "final option" for the state to recover use tax for property used within the state from a company that derives benefits from the state's infrastructure by conducting business therein. Thus, the tax is rationally related to values connected with the taxing state.

Finally, Ellingson attempts to distinguish the equipment its company used in South Dakota as "merely incidental" to the company's interstate operations because Ellingson is a Minnesota company that operates across the United States. This argument fails to address why SDCL 10-46-3 is not rationally related to the state's values in imposing a use tax and is more fairly situated as an argument relating to the tax's apportionment, which will be addressed below.

There is a minimum connection between the tax sought to be imposed by SDCL 10-46-3 and Ellingson's presence within the State and the tax income sought to be imposed is rationally related to "values connected with the taxing state." Therefore, SDCL 10-46-3 is constitutional under the Due Process Clause of the Fourteenth Amendment.

b. As applied to Ellingson, SDCL 10-46-3 is constitutional under the Commerce Clause.

Ellingson argues next under the Commerce Clause, asserting that the statute is not fairly related to the benefits provided to Ellingson by the State and is not fairly apportioned. In *Western Wireless v. Dept. of Rev*, the South Dakota Supreme Court looked to the United States Supreme Court's holding in *Complete Auto Transit, Inc. v. Brady* for the test to determine

whether South Dakota's imposition of a use tax for telephone billing services was constitutional under the commerce clause. *Western Wireless, Corp. v. Dept. of Revenue*, 2003 S.D. 68, ¶15, 665 N.W.2d 73, 78 (citing *Complete Auto Transit, Inc. v. Brady*, 97 S.Ct. 1076, 1083 (1977). The Court stated, "a tax is not an unconstitutional burden on interstate commerce if the taxed activity is sufficiently connected to the state to justify the tax, the tax is fairly related to the benefits provided to the taxpayer, the tax does not discriminate against interstate commerce, and the tax is fairly apportioned." *Id.* Ellingson argues under the second and fourth prongs of the test—that the SDCL 10-46-3 is not fairly related to the benefits provided by South Dakota and that the tax is not fairly apportioned.

i. <u>There is a sufficient connection between the taxed activity and the State of South Dakota.</u>

In *Western Wireless*, the South Dakota Supreme Court reasoned that there was a "substantial nexus" between South Dakota and the taxed activity because Western Wireless provided cellular service to South Dakota subscribers, owned communications equipment in South Dakota, conducted business in South Dakota, and employed personnel in South Dakota to install and maintain the equipment. See *Western Wireless Corp,* 2003 S.D. 68. Ellingson concedes that there is a sufficient connection between South Dakota and Ellingson sufficient to satisfy the first requirement under *Western Wireless* because Ellingson conducts business within the State. The Court agrees that there is a minimum connection between the tax sought to be imposed by SDCL 10-46-3 and Ellingson's presence within the State sufficient to satisfy the first requirement under *Western Wireless* because Ellingson has voluntarily entered into and conducted

business within the state and has maintained a South Dakota excise tax license since 2008.

ii. The statute, as applied to Ellingson, is fairly related to the benefits and services provided by South Dakota.

A tax must be fairly related to the benefits and services provided to the taxpayer to satisfy the second requirement for constitutionality under *Western* Wireless. In *Western Wireless*, the South Dakota Supreme Court reasoned that the use tax on services imposed on Western Wireless was fairly related to state-provided services because South Dakota's use tax on services applies only when the primary benefit of the service is used or consumed in South Dakota and at the time of purchase, no sales tax was imposed. Specific to the company, Western Wireless had the right and benefit of selling its services to South Dakota residents.

Ellingson argues that the tax sought to be imposed is not fairly related to the benefits provided by South Dakota because the rate at which the Appellant is taxed for using equipment for one day in South Dakota is the same as if it had purchased the equipment in South Dakota for use therein. Ellingson's argument under the second prong misses the mark regarding the actual test used by the South Dakota Supreme Court in *Western Wireless*. In *Western Wireless*, the South Dakota Supreme Court's analysis shows that the standard is: if a company has the right and benefit to sell its services to South Dakota residents, those services may be taxed under the one-time use tax. Though a distinction may be made between the use tax imposed for services in *Western Wireless* and the use tax imposed on the use of tangible personal property in the present case, the Court's standard applies

because Ellingson still receives benefits from South Dakota by using its property in the State. As the Department argues, Ellingson performed approximately thirty jobs within the state during the audit period, and during those jobs, Ellingson had the benefit of accessing all public services available to South Dakota residents supported by taxes including: use of roads and bridges, police protection, and use of the State's courts. As in *Western Wireless*, Ellingson has the right and benefit of operating its business in South Dakota, which involves operating the taxed property in South Dakota. Though Ellingson opposes the state's use tax because it believes the tax should not apply to equipment used minimally in the state, Ellingson may continue to receive the state's benefits indefinitely once the use tax has been paid. As such, the taxing statute and the one- time use tax imposed on Ellingson by SDCL 10-46-3 is fairly related to the benefits and services Ellingson receives from South Dakota when it uses its property within the state.

iii. <u>As applied to Ellingson, SDCL does not discriminate against interstate commerce.</u>

The South Dakota Supreme Court acknowledged the constitutionality of the State's use tax in *Western Wireless* by stating: "Because use taxes are paired with complementary sales taxes, the United States Supreme Court has upheld them: in the context of the overall tax structure, such statutes may properly impose on the out-of-state purchase of goods and equivalent burden to that imposed on an in-state purchase." *Western Wireless Corp. v. Dept. of Revenue*, 2003 S.D. 68, ¶7, 665 N.W.2d 73, 76 (citations omitted). Further, "equal treatment for in-state and out-of-state transactions similarly situated is a pre-

requisite to a valid use tax on goods and services imported from out-of-state." *Id.* (citations omitted).

As the Department argues, South Dakota's use tax ensures that out-of-state businesses are not able to undercut local merchants who are subject to state sales tax. If South Dakota did not have a use tax but maintained a sales tax, individuals and businesses alike would seek to do business from out-of-state merchants to avoid taxation altogether. This would ultimately result in an unfortunate increase in consumer purchase prices within South Dakota. The Department correctly reasons that if out-of-state businesses could avoid taxation but maintain business in South Dakota, demands for infrastructure and services would remain the same, but the flow of tax revenue to support the demands would diminish. By maintaining complementary sales and use tax statutes, South Dakota properly imposes an equal burden on property used in South Dakota, regardless of where the initial purchase of the property occurred. The tax imposed by SDCL 10-46-3 does not discriminate against interstate commerce and satisfies the third prong of the *Western Wireless* test.

iv. As applied to Ellingson, SDCL 10-46 3 is fairly apportioned.

The South Dakota Supreme Court in *Western Wireless* acknowledged the United States Supreme Court's holding in *Goldberg v. Sweet* that a tax is apportioned if it is both internally and externally consistent. *Western Wireless Corp. v. Dept. of Revenue*, 2003 S.D. 68 ¶18-19, 665 N.W.2d 73, 78-79 (citing *Goldberg v. Sweet*, 488 U.S. 252 (1989)).

1. As applied to Ellingson, SDCL 10-46-3 is internally consistent.

"To be internally consistent, a tax must be structured so that if every State were to impose an identical tax, no multiple taxation would result." *Id.*, 2003 S.D. 68 ¶18 at 79. Ellingson concedes that SDCL 10-46-3 is internally consistent because SDCL 10-46-6.1[7] exists to grant a tax credit for property previously taxed in another state upon purchase or first use.[8] The Court

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[7] SDCL 10-46-6.1 states:

> The amount of any use tax imposed with respect to tangible personal property, any product transferred electronically, or services shall be reduced by the amount of any sales or use tax previously paid by the taxpayer with respect to the property on account of liability to another state or its political subdivisions. However, no credit may be given under this section where taxes paid on tangible personal property, any product transferred electronically, or services in another state or its political subdivisions of that state does not reciprocally grant a credit for taxes paid on similar tangible personal property or any product transferred electronically.

[8] In *Western Wireless*, the South Dakota Supreme Court recognized that SDCL 10-46-6.1's conditional reciprocity "could present a problem in the future because it is critical that the statutory 'credit provisions create a national system under which the first state of purchase or use imposes the tax.'" *Western Wireless Corp. v. Dept. of Revenue*, 2003 S.D. 68 ¶19, 665 N.W.2d 73, 79 (citations omitted). The South Dakota Supreme Court stated that because Western Wireless did not argue that any sales or use taxes had been paid on all or part of the services taxed in any other state and because Western did not seek any credit for payment of taxes, the point is moot. The same is true for Ellingson. Ellingson concedes that the tax is "likely internally consistent" as applied, and the company agrees it has not previously paid sales or use tax on the equipment in question. Thus, the issue is moot in this matter.

agrees that SDCL 10-46-3 is internally consistent as applied to Ellingson because, as reasoned by the South Dakota Supreme Court in *Western Wireless*, the credit provision in SDCL 10-46-6.1 "avoids actual multiple taxation, and thus, the tax does not threaten interstate commerce" under *Goldberg*. *Id.*, 2003 S.D. 68 ¶18 at 79.

2. As applied to Ellingson, SDCL 10-46-3 is externally consistent.

Though SDCL 10-46-3 is internally consistent as applied to Ellingson, it must also be externally consistent. "To be externally consistent under *Goldberg*, a state may tax 'only that portion of the revenues from the interstate activity which reasonably reflects the in-state component of the activity being taxed." *Id.* In *Goldberg*, the United States Supreme Court explained the external consistency test by stating "we thus examine the in-state business activity which triggers the taxable event and the practical or economic effect of the tax on that interstate activity." *Goldberg v. Sweet*, 488 U.S. 252, 262 (1989). The external consistency test is "essentially a practical inquiry." *Id.* at 264. Finally, "apportionment does not require [a] State to adopt a tax which would 'pose genuine administrative burdens.'" *Id.* at 265 citing *American Trucking Associations, Inc. v. Scheiner*, 483 U.S. 296 (1987).

Ellingson argues that the tax imposed under SDCL 10-46-3 seeks to impose a tax on the value of an out-of-state entity's equipment it "temporarily used" in South Dakota at a rate equivalent to the rate it would have been charged if it purchased that equipment in the state, or if it purchased the equipment with the specific intent to use the equipment in South Dakota. Ellingson argues that because only approximately ten percent of the company's "taxable activity" occurred in

South Dakota throughout the audited period, the scheme fails to apportion the tax to Appellant's in-state activities. Ellingson also argues that the fact that Ellingson has not been charged sales or use tax on the equipment in the equipment's primary states of use does not render South Dakota's tax reasonable because the tax should be imposed with respect to the value and activities located within South Dakota, without respect to whether another state could be collecting a tax.

Essentially, Ellingson is asking the Department to turn a one-time use tax on property used in South Dakota not previously subject to sales or use tax, into a personalized, use-based ratio tax calculated on a business-by-business basis by examining how frequently each business subjected to the tax uses each piece of equipment taxed in the state. Ellingson's proposition seems implausible. The taxation scheme as it currently exists works to impose *one* tax on property used in the state of South Dakota not previously subject to tax. Once the tax on that property is paid, the business or individual using that property in South Dakota never has to pay South Dakota taxes on the property again. If the Legislature were to adopt Ellingson's proposed scheme, the Department would be subjected to a never-ending cycle of calculating and re-calculating how frequently a business is using a piece of property in South Dakota to ensure they are appropriately taxed for the property's use. It is clear that Ellingson's proposed replacement taxation scheme for SDCL 10-46-3 would "pose genuine administrative burdens" for the South Dakota Department of Revenue as deemed unnecessary by the United States Supreme Court in *Goldberg*.

Ultimately, Ellingson's argument fails because the United States Supreme Court in *Henneford v. Silas Mason* held that a similar Washington state use tax—which imposed a two percent use tax on property brought into the state—was constitutional, stating:

> Equality is the theme that runs through all the sections of the statute. There shall be a tax upon the use, but subject to an offset if another use or sales tax has been paid for the same thing. This is true where the offsetting tax became payable to Washington by reason of purchase or use within the state. It is true in exactly the same measure where the offsetting tax has been paid to another state by reason or use or purchase there. No one who uses property in Washington after buying it at retail is to be exempt from a tax upon the privilege of enjoyment except to the extent that he has paid a use or sales tax somewhere. Every one who has paid a use or sales tax anywhere or, more accurately, in any state, is to that extent to be exempt from the payment of another tax in Washington.

Henneford v. Silas Mason, Co., 300 U.S. 577, 583-84 (1937). As in *Silas Mason*, SDCL 10-46-3 may be applied to the entire value of Ellingson's equipment because South Dakota provides a credit towards taxes paid in other states. Ellingson has not presented a valid reason as to why South Dakota should be barred from assessing a one-time use tax for Ellingson's first use of a piece of equipment within the state. Ellingson sought contracts for business in South Dakota, completed a large number of jobs in the state, and competed with South Dakota businesses for those jobs.

Ellingson shall accordingly be subjected to the state's applicable taxes.

CONCLUSION

Ellingson Drainage has challenged the constitutionality of SDCL 10-46-3 under the Due Process Clause of the Fourteenth Amendment and the Commerce Clause. The language of SDCL 10-46-3 imposes an excise tax on the use of tangible personal property brought into the state after being purchased outside of the state. The statute exempts any property previously subjected to sales or use tax in other states from being taxed in South Dakota. Statutes are presumed constitutional unless proven beyond a reasonable doubt that there is no reasonable basis for the Legislature's decision in enacting the statute. Ellingson has failed to meet its burden. As applied to Ellingson, SDCL 10-46-3 is constitutional under the Due Process Clause of the Fourteenth Amendment because there is a minimum connection between Ellingson and South Dakota and because the statute is rationally related to the values of the taxing state. As applied to Ellingson, SDCL 10- 46-3 is constitutional under the Commerce Clause because there is a sufficient connection between the taxed activity and the state, the statute is fairly related to the benefits and services provided to Ellingson by South Dakota, the statute does not discriminate against interstate commerce, and finally the statute is fairly apportioned. Accordingly, the Final Decision and Order is affirmed. A corresponding Order shall be entered accordingly.

Dated this 25th day of January 2023.

BY THE COURT

/s/ Christina Klinger
Christina Klinger Circuit Court Judge

APPENDIX D

STATE OF SOUTH DAKOTA
OFFICE OF HEARING EXAMINERS

DOR 21-14

ELLINGSON DRAINAGE, INC.,

Petitioner,

v.

SOUTH DAKOTA DEPARTMENT OF REVENUE,

FINAL DECISION

After reviewing the record and the Proposed Decision of the Hearing Examiner in this matter,

IT IS HEREBY ORDERED that pursuant to SDCL 1-26D-6, the Hearing Examiner's Proposed Decision dated May 13, 2022, is adopted based on the Findings of Fact, Reasoning, and Conclusions of Law in the Proposed Decision.

IT IS FURTHER ORDERED that Petitioner's request for hearing is dismissed with prejudice.

Parties are hereby advised of the right to further appeal this Final Decision to the circuit court within thirty (30) days of receiving such decision pursuant to the authority of SDCL 1-26.

Dated this 13th day of June 2022.

/s/ David Wiest
David Wiest, Deputy Secretary
Department of Revenue

STATE OF SOUTH DAKOTA
OFFICE OF HEARING EXAMINERS

DOR 21-14

ELLINGSON DRAINAGE, INC.,

Petitioner,

v.

SOUTH DAKOTA DEPARTMENT OF REVENUE,

NOTICE OF ENTRY OF ORDER

TO: SHAWN NICHOLS, ATTORNEY FOR PETITIONER ELLINGSON DRAINAGE, INC.

NOTICE IS HEREBY GIVEN, that attached hereto is a true and correct copy of the Final Decision in the above-captioned matter.

Dated this 16 day of June 2022.

/s/ Joe Thronson
Joe Thronson
Staff Attorney
S.D. Department of Revenue
445 East Capitol Avenue
Pierre, SD 57501
Joe.Thronson@state.sd.us

APPENDIX E

SOUTH DAKOTA DEPARTMENT OF
REVENUE BY THE OFFICE OF HEARING
EXAMINERS BUREAU OF ADMINISTRATION
STATE OF SOUTH DAKOTA

DOR 21-14

ELLINGSON DRAINAGE, INC.,

Petitioner,

v.

SOUTH DAKOTA DEPARTMENT OF REVENUE,

Respondent.

PROPOSED DECISION

This above-entitled matter is under the jurisdiction of the South Dakota Office of Hearing Examiners, pursuant to SDCL 1-26D-4. The parties, having agreed the issues are a matter of law and not of fact, have agreed to have the Hearing heard on Brief. The parties stipulated to the evidence and submitted briefs. A short oral argument was held on April 11, 2022, via videoconference. Appearing for Petitioner, Ellingson Drainage Inc., were attorneys Andrew Hurd and Shawn Nichols. Appearing for the Department were attorneys Joe Thronson and Anita Fuoss.

ISSUES

1. Whether the Petitioner owes excise tax to the State of South Dakota, pursuant to an audit conducted by the Department of Revenue and commenced March 10, 2020, for the period of March 2017 through

January 2020? SDCL §§ 10-46-2,10-46-2.1, 10-46-2.2, 10-46-3, 10-59-7, and ARSD 64:09:01:20

2. Does the imposition of excise tax upon Petitioner, pursuant to SDCL §10-46-3 and ARSD 64:09:01:20, violate the U.S. Constitution under the 14th Amendment's Due Process Clause and Article I, Section 8, Clause 3 of the U.S. Constitution, the Commerce Clause?

A. The Due Process Clause – the lack of Rational Relation

B. Interstate Commerce Clause.

FINDINGS OF FACT

1. Petitioner, Ellingson Drainage, Inc., is a Minnesota company with its principal place of business in West Concord, Minnesota.

2. Petitioner specializes in installing drain tile for farming and government applications. They install drain tile throughout the United States.

3. During the audit period, Petitioner installed drain tile in more than 20 different states, including South Dakota.

4. During the audit period, Petitioner completed approximately 30 jobs in South Dakota.

5. Petitioner purchased or rented equipment outside of South Dakota which was then used in South Dakota.

6. Petitioner did not pay sales tax on the purchase or rental of the equipment to any state or local jurisdiction.

7. The Department seeks to impose an excise tax on the equipment owned by Petitioner and used in

South Dakota that has not yet been subject to a sales or use tax.

8. The equipment at issue and the dates Petitioner used the equipment in South Dakota.

a. A CAT 336EL excavator purchased on April 7, 2016, for $227,500. Petitioner used the same in South Dakota on October 28, 2019.

b. A CAT d8K Pullcat, purchased on February 28, 2011, for $62,500. Petitioner used the same in South Dakota on September 21, 2017.

c. A FASTRAC tractor, purchased on October 20, 2011, for $141,500. Petitioner used the same in South Dakota on October 10, 2017.

d. A BRON 550 Plow, purchased on June 20, 2013, for $576,500. Petitioner used the same in South Dakota on October 17, 2017.

e. Two JCB Fasttrac tractors, purchased on February 21, 2013, for $148,500 each, totaling $297,000. Petitioner used one of the above tractors in South Dakota on April 19, 2017. Petitioner used the second tractor not previously used in South Dakota on May 16, 2018.

f. A JCB Fasttrac tractor purchased on March 12, 2012, for $141,000. Petitioner used the same in South Dakota on April 23, 2018.

g. A JCB Fastrac tractor purchased on March 12, 2012, for $153,000. Petitioner used the same in South Dakota on November 16, 2018.

h. A BRON 585 Plow purchased on March 6, 2018, for $196,339. Petitioner used the same in South Dakota on November 18, 2018.

i. A JCB Fastrac tractor purchased on April 16, 2018, for $189,933. Petitioner used the same in South Dakota on April 17, 2019.

j. A JCB Fastrac tractor purchased on October 20, 2011, for $141,500. Petitioner used the same in South Dakota on September 21, 2017.

k. Ellingson Drainage, Inc., rented an Excavator on April 30, 2019, for $120,000. They did not pay any use or sales tax on this rental. Ellingson Drainage, Inc., used the same in South Dakota on November 20, 2018 [sic].

9. The Department seeks to assess taxes in the amount of$60,665.44 against Petitioner, plus interest in the amount of$14,862.88, for a total of $75,528.32.

10. The Department's assessed taxes are set at the State sales tax rate of 4.5%. The equipment is taxed at the depreciated rate of the value of the equipment.

11. Equipment that is less than seven years old is depreciated and tax is charged on the depreciated value of the item. Equipment over 7 years old is exempt from the tax. SDCL 10-46-3.

12. The equipment listed above was not purchased or rented for primary use within South Dakota. It was primarily used by Petitioner for jobs outside of South Dakota.

13. The Department issued a Certificate of Assessment on July 30, 2020. Petitioner timely appealed this Assessment on September 14, 2020, pursuant to SDCL 10-59-9.

14. Any additional findings of fact included in the Reasoning section of this decision are incorporated herein by this reference.

15. To the extent any of the foregoing are improperly designated and are instead conclusions of law, they are hereby redesignated and incorporated herein as conclusions of law.

REASONING

Petitioner asks this Office to declare unconstitutional, the excise tax provisions that are the basis of the Assessment by the Department.

A certificate of assessment by the Department, is presumed prima facie correct. SDCL 10-59-8. In order to successfully challenge the certificate, a taxpayer must prove the assessment was a mistake of fact or error of law. SDCL 10-59-9.

> Although we construe statutes imposing tax liberally in favor of the taxpayer, "[s]tatutes exempting property from taxation should be construed in favor of the taxing power." *Butler Mach. Co. v. S.D. Dep't of Revenue,* 2002 S.D. 134, 6,653 N.W.2d 757, 759. Exemptions "should be given a reasonable, natural, and practical meaning to effectuate the purpose of the exemption." *K Mart Corp., Inc. v. S.D. Dep't of Revenue,* 345 N.W.2d 55, 57 (S.D. 1984). The party seeking an exemption has the burden to prove it fits into that exemption. *In re Pam Oil, Inc.,* 459 N.W.2d 251,255 (S.D. 1990).

Carsforsale.com, Inc. v. SD. Dep't of Revenue, 2019 S.D. 4, 11. In this case, Petitioner has not argued that any exemption from these excise taxes apply within

South Dakota, only that the tax, as applied pursuant to SDCL 10-46-3, is unconstitutional.

The Department imposed sales and use tax on Petitioner under the requirements of SDCL §§10-46-2, 10-46-2.2, and 10-46-3 and ARSD 64:09:01:20. These statutes and rule are listed below.

> An excise tax is hereby imposed on the privilege of the use, storage, and consumption in this state of tangible personal property purchased for use in this state at the same rate of percent of the purchase price of said property as is imposed pursuant to chapter 10-45.

SDCL 10-46-2.

> An excise tax is imposed upon the privilege of the use ofrented tangible personal property and any product transferred electronically in this state at the rate of four and one-half percent of the rental payments upon the property.

SDCL 10-46-2.2.

> An excise tax is imposed on the privilege of the use, storage or consumption in this state of tangible personal property or any product transferred electronically not originally purchased for use in this state, but thereafter used, stored or consumed in this state, at the same rate of percent of the fair market value of the property at the time it is brought into this state as is imposed by §10-45-2. The use, storage, or consumption of tangible personal property or any product transferred electronically more than seven years old at the time it is brought into the state by the person who purchased such property for use in another state is exempt from the tax imposed herein.

> The secretary may promulgate rules pursuant to chapter 1-26 relating to the determination of the age and value of the tangible personal property or the product transferred electronically brought into this state.

SDCL 10-46-3.

> For the purposes of the exemption in SDCL 10-46-3, tangible personal property or any product transferred electronically must be more than seven years old as determined by its date of manufacture, if documented, or by the date of the purchase by the person bringing the property into this state. In the absence of independent documentary proof of the value of the tangible personal property or any product transferred electronically at the time it is brought into South Dakota, the value of the property is presumed to be the purchase price reduced by ten percent for each year of use of the property by the person bringing the property into this state. Statements, opinions, or depreciation schedules of the owner of the property are not independent documentary proof of the value of the property.

ARSD 64:09:01:20.

Each of the pieces of equipment purchased or rented by Petitioner were used in South Dakota. Not all the equipment was new at the time the tax was imposed. If less than 7 years old, the equipment values were depreciated based upon the Rule set out above. The 4.5% tax was imposed upon the depreciated values. The values set by the Department and the calculations of the 4.5% tax are not in dispute by Petitioner. The amount of tax set by the Department is not disputed by Petitioner, only the existence of the tax.

Pursuant to the above statutes, the Petitioner owes excise tax on the purchase or rental of the equipment as it was used within South Dakota and no sales or use tax had been paid upon the purchase or rental price of the equipment by Petitioner. See also *Thermoset Plastics, Inc. v. Department of Revenue,* 473 N.W.2d 136 (S.D. 1991); *Western Wireless Corp. v. SD Dept. of Revenue,* 665 N.W.2d 73 (S.D. 2003).

The constitutional question brought forward by Petitioner is outside the jurisdiction of this Office and the Department. As determined by the Eighth Circuit, United States Court of Appeals, and in other state jurisdictions, an executive branch agency is required to treat a duly adopted law as constitutionally valid unless a judicial determination has ordered otherwise. The separation of powers doctrine requires that the executive branch not declare legislation to be unconstitutional, that power is left to the judicial branch. See *Colonial Pipeline Company v. Morgan et al,* 263, S.W.3d 827, 841-844 (2008) (citing *Alleghany Corp v. Pomeroy,* 698 F. Supp. 809, 813-814 (D.N.D. 1990), rev'd on other grounds, 898 F.2d 1314 (8th Cir. 1990) (agency without power to adjudicate constitutional issues); *Belco Petroleum Corp v. State Bd of Equalization,* 587 P.2 204,208 (Wyo. 1978) (Agency does not determine facial constitutionally of statute or constitutionality of its application); 73 C.J.S. *Public Administrative Law and Procedure* §65 at 536; 1 Am.Jur2d *Administrative Law* §185 at 989-90).

Therefore, the constitutionality of the excise tax, as imposed by the Department in this case is presumed and will not be analyzed further. For this Office and the Department to the further question the constitutionality would be a violation of the separation of powers. It is my Proposed Decision that the Certificate

of Assessment made upon Petitioners be upheld in its entirety.

CONCLUSIONS OF LAW

1. The Department of Revenue has jurisdiction over the parties and subject matter of this case.

2. The Office of Hearing Examiners has authority to conduct the hearing and issue a Proposed Decision pursuant to SDCL l-26D-4.

3. Following the requirements of SDCL §§10-46-2, 10-46-2.2, and 10-46-3, the Department imposed a 4.5% excise tax upon equipment purchased or rented by Petitioner and used within South Dakota.

4. The taxes imposed by SDCL 10-46-2, 10-46-2.2, and 10-46-3 are constitutional as there are no judicial determinations by a presiding court that have held the statutes to be unconstitutional.

5. The Department's Certificate of Assessment should be upheld in its entirety.

6. Any additional conclusions of law included in the Reasoning section of this decision are incorporated herein by this reference.

7. To the extent any of the foregoing are improperly designated and are instead findings of fact, they are hereby redesignated and incorporated herein as findings of fact.

Based on the above Findings of Fact, Reasoning and Conclusions of Law, the Hearing Examiner enters the following:

PROPOSED ORDER

It is the Proposed Order of this Office of Hearing Examiners to the Department of Revenue, that the Certificate of Assessment issued by the Department on July 30, 2020, in the amount of $75,528.32, for the period of March 2017 to January 2020, be affirmed in all respects.

Dated this 13th day of May 2022.

/s/ Catherine S. Williamson
Catherine S. Williamson
Chief Hearing Examiner
Office of Hearing Examiners
Pierre, South Dakota 57501