

## **SOUTH DAKOTA**

### **Description and Scope:**

This document describes and critiques South Dakota's system of sales tax.

### **Definitions and Impositions:**

South Dakota imposes sales tax based on gross receipts received from sales of tangible personal property, products transferred electronically, and services.<sup>1</sup> South Dakota's system lists these categories, but their tax imposition does not rely on these categories as other states' sales tax systems do. Instead, South Dakota's system relies on the concept of "gross receipts."

### **Exemptions:**

South Dakota's system offers no generally applicable business-to-business exemption. There is a resale exemption within the definition of retail sale.<sup>2</sup> South Dakota law also provides an exemption for transactions among related entities or within controlled groups. South Dakota also exempts packaging and container materials used by manufacturers, processors, or fabricators.<sup>3</sup> South Dakota's system offers an exemption for wages received by an employee.<sup>4</sup>

South Dakota also exempts certain services that are subject to separate tax types.

South Dakota exempts health-care services, agricultural services other than veterinarian services, advertising services, financial services if subject to tax under chapter 10-43, "services provided by any corporation to another corporation which is centrally assessed having identical ownership and services provided by any corporation to a wholly owned subsidiary which is centrally assessed," and various other services.<sup>5</sup>

This incomplete listing highlights the heightened need for exemptions created by such a broad imposition.

### **Critique:**

#### *Clarity and ease of application:*

Under South Dakota's approach, tax imposition is clear and easy to apply. The difficulty can come with exemptions, depending on how many there are. Broader imposition can create a

---

<sup>1</sup> SDCL § 10-45-2, -2.4, and -4.

<sup>2</sup> SDCL § 10-45-1(10).

<sup>3</sup> SDCL § 10-45-14.4.

<sup>4</sup> SDCL § 10-45-4.1 (excluded from definition of "service").

<sup>5</sup> SDCL § 10-45-12.1.

need for more exemptions to build the target tax base. The exemptions can be developed to be specific, clear, and easy to apply initially, but over time this very specificity leads to obsolescence.

*Revenue generation or stability:*

South Dakota's approach is the ultimate in revenue generation and stability. The evolution of the economy and products will not erode the tax base because it is based on gross receipts rather than the specific categories and definitions of different products. However, see above for the effect on exemptions.

*Compatibility with other elements of the tax structure:*

South Dakota's system relies on the concept of gross receipts. It relies little on defined and specific categories like other states' systems do. South Dakota's approach would be difficult to implement within a typical state sales tax system with limited taxation of services. Functionally equivalent transactions might have different sales tax treatment depending upon whether or not the product was transferred electronically. To adopt South Dakota's approach might require a "conversion" to a gross receipts approach and abandonment of the categorical approach.

South Dakota is a member in good standing of the Streamlined Sales Tax system, so South Dakota's system is compatible with the Streamlined Sales Tax Agreement.

*Pyramiding of taxes:*

South Dakota's approach does not exempt business-to-business purchases. There will be pyramiding. However, the breadth of South Dakota's tax base allows a lower sales tax rate, partially reducing the effect of pyramiding.

*Other considerations:*

Sourcing

Sourcing can become complicated when the sales tax base is broad. South Dakota's tax base includes nearly all products, including those used by businesses across all their locations. This and the lack of a broad business-to-business exemption raises the issue of multiple points of use.

Exemptions

The breadth of South Dakota's general imposition language creates the need for unusual exemptions, including an existing one for wages received by an employee. Without this exemption, employees would owe sales tax on their wages.

Internet Tax Freedom Act

The breadth of South Dakota's imposition will minimize the risk of challenge under the discrimination provision of the Internet Tax Freedom Act. The breadth of the imposition means that most products are taxed and thus any offline product similar to a taxed, online, product will also likely be taxed.