South Dakota Legislative Research Council

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COMPARISON OF THE NEIGHBORING STATE TAX SYSTEMS

Introduction

It is important to understand the relationship of state and local government tax collections when evaluating and comparing state tax systems. The taxes collected by a state often influence the taxes collected by its political subdivisions. The primary means to produce local government tax revenue are property and sales taxes. The balance of local government revenue is generally received from user fees and transfer payments from the federal and state government. A few local governments possess the capability of levying an income tax.

General sales taxes and personal income taxes are the two primary sources for state tax collections and comprise about 65 percent of the total tax revenue for all states. Corporate income and motor fuels taxes and license fees produce slightly more than 20 percent of state tax revenue. The proportional share received from each source, however, varies greatly from one state to another.

South Dakota ranked 50th in total state tax revenue and 50th in per capita tax revenue in 1993. When local government tax collections were included with state tax collections, South Dakota ranked 49th in total tax revenue and 46th in per capita tax revenue.

Tax systems are usually classified as regressive or progressive, and classifications are somewhat dependent on the assumptions made and outcomes desired. Several states which have high per capita taxes are also classified as having progressive tax systems. For instance, Minnesota has the fifth highest per capita state tax burden but is also considered as having a progressive tax system.

Although Minnesota does not collect sales taxes on food or clothes, it does have higher sales tax collections per capita than all the neighboring states. Minnesota ranked seventh in per capita state and local government revenue in the nation in 1993. This may be attributed to its high sales tax rate and high base rates for personal and corporate income taxes.

Wyoming, like South Dakota, does not have a personal or corporate income tax. Unlike South Dakota, Wyoming receives about a third of its state revenue from mineral severance taxes. This tax gives Wyoming the luxury of avoiding certain taxes while keeping other tax rates relatively low.

Montana also collects a significant amount of revenue through severance taxes and does not have a sales tax. Montana does levy a personal and corporate income tax, and its levy for motor fuels tax is the fifth highest in the nation. The motor fuel tax rate may reflect to the number of highway miles that must be maintained in relation to the population supporting it.

The chart below reflects per capita and total tax revenue collected by neighboring states and their local governments in 1992:

	SOUTH DAKOTA	IOWA	MINNESOTA	MONTANA	NEBRASKA	NORTH DAKOTA	WYOMING
Per Capita Revenue	$1,562.99	$2,028.02	$2,476.79	$1,768.14	$2,016.90	$1,760.53	$2,340.03
Per Capita Rank	46	23	7	37	26	38	9
Total Tax Revenue (Millions)	1,108	5,695	11,081	1,455	3,235	1,118	1,085

Tax Systems in Neighboring States

Personal Income Tax

Iowa, Minnesota, Montana, Nebraska, and North Dakota levy a personal income tax. The personal income rates vary from 0.4% to 12.0% depending on the income level and the particular state. It is common to find an income tax rate higher than 6% for taxable incomes in the $15,000 to $20,000 range and the rates continue to escalate with increased income levels. The exemptions and definitions of taxable income vary from state to state; however, most states pattern their income definitions and exemptions after the federal and government. North Dakota possesses a moderate tax schedule and closely correlates its tax schedule and definitions after the federal income tax program.

Seven states, including South Dakota and Wyoming, have not implemented of a personal income tax. Nebraska was the last neighboring state to adopt a personal income tax in 1967 and North Dakota was the first to adopt in 1919. The other neighboring states adopted a personal income tax in the 1930s. Tax definitions and exemptions have been altered frequently along with the tax rate schedules since each state has enacted a personal income tax. A few states like Iowa also allow local governments to levy an income tax in certain instances.

Minnesota is commonly considered a high income tax state. It does have a relatively high personal income tax rate; however, Iowa, North Dakota, and Montana have higher rates when taxable incomes exceed $47,701, $50,000 and $62,701, respectively. The table below outlines tax rates and per capita revenue from each source.

	SOUTH DAKOTA	IOWA	MINNESOTA	MONTANA	NEBRASKA	NORTH DAKOTA	WYOMING
Per Capita Revenue	NA	$520.04	$734.30	$424.48	$424.72	$197.31	NA
Total Revenue (Millions)	NA	1,467	3,322	357	685	126	NA
Minimum Tax Rate	NA	0.40%	6.00%	2.00%	2.62%	2.67%	NA
Maximum Tax Rate	NA	9.98%	8.50%	11.00%	6.99%	12.00%	NA

Corporate Income Tax

South Dakota and Wyoming are among five states that do not levy a corporate income tax. South Dakota's bank franchise tax, however, is regarded as an income tax on a business sector by several reporting services. Corporate income taxes only provide 6.6% of the operating revenue produced by states in 1993. Minnesota is often perceived as having high corporate income tax rates, but North Dakota and Iowa again have higher rates when the income exceeds $50,000 and $250,000, respectively. All the surrounding states use a graduated scale except Minnesota, which taxes all corporate income at 9.8%.

Oddly enough, Minnesota, which is regarded as having a progressive tax system, taxes low income entities higher than any other neighboring state. Minnesota ranks in the middle of the neighboring states on how it taxes the upper income categories reflecting its relatively high flat tax.

A few states, including Iowa, allow corporate incentives or rebates for jobs created by new corporations.

	SOUTH DAKOTA	IOWA	MINNESOTA	MONTANA	NEBRASKA	NORTH DAKOTA	WYOMING
Per Capita Revenue	$39.30	$59.22	$112.63	$101.13	$63.70	$85.05	NA
Total Revenue (Millions)	28	167	510	85	103	54	NA
Minimum Tax Rate	1.00%	6.00%	9.80%	6.75%	5.58%	3.00%	NA
Maximum Tax Rate	6.00%	12.00%	9.80%	7.25%	7.81%	10.50%	NA

Sales Tax

Six states, including Minnesota, do not levy a sales tax. Minnesota, Iowa, and Nebraska have a higher sales tax rate than South Dakota. North Dakota's is the same and Wyoming recently returned to the three percent level. South Dakota is recognized as having a liberal interpretation of taxable purchases, i.e., a broad base, yet remains low in per capita sales taxes collected. Minnesota which has a limited interpretation of taxable purchases including no taxes on food and clothes, however, ranks near the top in per capita sales taxes collected.

According to a 1990 consumer expenditure survey completed by the Bureau of Labor Statistics, consumers typically expend less than 15 to 20% of their total expenditures for food at home, apparel, and other services throughout all income strata. This may partially explain why Minnesota's exemptions for food and clothing do not substantially diminish its tax base or impact its return allowing Minnesota to yield a high per capita sales tax revenue.

South Dakota does have a high percentage of local governments who have exercised their option to levy a local sales tax. Most states allow incorporated municipalities and some instances counties to levy a general sales tax or a lodging and entertainment tax and Montana allows designated tourist areas to levy a sales tax. High sales tax rates are often found in out-of-state communities frequented by business travelers or tourists and these rates are often higher than South Dakota's.

	SOUTH DAKOTA	**IOWA**	**MINNESOTA**	**MONTANA**	**NEBRASKA**	**NORTH DAKOTA**	**WYOMING**
Per Capita Revenue	$427.73	$443.78	$524.80	NA	$430.80	$453.31	$414.59
Total Revenue (Millions)	306	1,252	2,374	NA	695	289	195
State Tax Rate	4.00%	5.00%	6.00%	NA	5.00%	4.00%	3.00%
# Local Govt.	Cities-170	Counties-0 Cities-265	All Counties Cities-5	NA	Cities-35	City-35	Counties-21
Local Govt. Tax Rate	1 to 2%	None	.5% 0 to 10%	NA	.5 to 1.5%	1 to 3%	.5 to 1%

# Local Govt.	State Cities-27	Counties-2 Cities-4	Cities-5	Resort Areas	Counties-42	Cities-30	Counties-15 Cities-10
Subject	Lodging Entertainment Tourism	Lodging	Lodging Entertainment Admissions	Lodging Entertainment	Lodging	Lodging Restaurant	Lodging
Range	1.00%	0 to 7%	0 to 10%	0 to 3%	1 to 4%	1 to 3%	1 to 4 %

Property Tax

Forty-two states assess a property tax to provide revenue for the state budget; however, property taxes provide about two percent of state government tax revenue for all fifty states. Montana and Wyoming are the only two states in this region that levy a significant state property tax raising approximately ten and fourteen percent of their tax revenue, respectively.

Property taxes are one of the primary sources for local governments to provide revenue for operations and capital improvements. In 1992, South Dakota ranked 28th in the nation on per capita state and local government property tax revenue and sixth in the seven-state region. This ranking does not compare the total property tax burden on property of equivalent value from one state to another.

	SOUTH DAKOTA	IOWA	MINNESOTA	MONTANA	NEBRASKA	NORTH DAKOTA	WYOMING
Per Capita Revenue	$611.29	$706.61	$776.82	$706.61	$727.41	$532.39	$993.68
Total Revenue (Millions)	443	1,998	3,475	582	1,167	338	461
State Revenue (Millions)	NA	NA	8	98	0	2	87

Severance Taxes

Even though severance taxes make up a small percentage of the national tax revenue, it is an extremely important revenue source for Wyoming. Wyoming receives approximately a third of its revenue through severance tax, which is equivalent to revenue typically generated by an income tax or sales tax for many states. Because of this unique circumstance, Wyoming is able to maintain an attractive tax climate without burdening its citizens or businesses.

Severance taxes generate more than 10 percent of the tax revenue for Montana and North Dakota. The ability to generate this revenue is unique to each state. North Dakota, for instance, generates 10 times as much revenue from this source as South Dakota. This income reflects North Dakota's greater coal and oil resources.

Motor Fuel Sales Taxes and Motor Vehicle and Operator's License Tax

All the states levy motor fuel sales taxes and collect motor vehicle and operator's licence fees. South Dakota has a comparable motor fuel taxes rate, but its annual motor vehicle and operator's license fees are among the lowest in the region. It should be noted that Minnesota, Iowa, Wyoming, and North Dakota, respectively, rank second, third, fifth, and sixth in the nation in 1993.

	SOUTH DAKOTA	IOWA	MINNESOTA	MONTANA	NEBRASKA	NORTH DAKOTA	WYOMING
Per Capita Revenue (Fuel)	$116.27	$119.80	$103.73	$138.28	$137.87	$123.14	$78.19
Total Revenue (Millions)	83	338	469	116	222	78	37
Cents Per Gallon	18	20	20	24	24.4	18	9
Per Capita Revenue (Vehicles)	$39.15	$89.49	$99.54	$55.74	$39.07	$73.26	$79.75
Total Revenue (Millions)	$28	$252	$450	$47	$63	$47	$37

Tax Reform

In recent years, South Dakota has experienced several property tax freezes, temporary sales tax increases and most recently property tax relief programs. There have been referendums on property and income taxes as well as the lottery, which is a substantial revenue generator for the state.

These circumstances are common among states as cost of services and mandates escalate while revenues fluctuate with the national and local economies. Many of the surrounding states have also faced referendums, held special sessions and increased rates on existing taxes to compensate for decreasing revenues caused by economic downturns. Now many of these states are looking for ways to lower taxes in reaction to voter demands. South Dakota has not faced the issue of declining tax revenues caused by an economic downtown as some of the other states which are dependent on income taxes.

Theory suggests caution on dependence or reliance on a one particular tax which could be influenced by national and international economic downturns. Many states suffered budget deficits and took various measures to address them in the 1980s and early 1990s. Now states are looking for means to reduce costs and lower or shift the tax burden. The remedies will vary from state to state.

Conclusion

North Dakota, Iowa, and Nebraska have agricultural-based economies and are the closest matches to draw comparisons with South Dakota’s existing and potential tax avenues. Wyoming and Montana have significant deposits of minerals and coal, allowing these states to shift the tax burden to this sector. Minnesota is regarded as a high tax state with especially high maintenance costs of delivering social programs and it is difficult to draw comparisons with South Dakota.

Discussions on the methods used to generate revenue and then how to appropriate these funds have been taking place since the state was accepted into the Union and will continue in the future. The discussions over the years have been similar: too much government spending, too many taxes, and too much red tape.

This issue memorandum was written by Fred Baatz, Research Analyst for the Legislative Research Council. It is designed to supply background information on the subject and is not a policy statement made by the Legislative Research Council.