## SALES TAX ON FOOD

South Dakota's tax revenue is primarily received from the sales and use tax. Sales tax applies on retailers' gross receipts from all sales and services not specifically exempted. Exemptions include, but are not limited to, sales to the state and its political subdivisions, certain agricultural products, motor vehicles, motor fuel, labor on construction, and prescription drugs. The base rate of the state sales tax is 4%. There has been some increased discussion this year of repealing the state's sales tax on food. Supporters believe that repealing the sales tax on food will boost retail sales and lower the tax burden for low income individuals. Others believe that repealing the sales tax on food would be a major hit to the state's revenue which could decrease the funding of other programs that help low income individuals. Legislation has been proposed in almost every legislative session to repeal the sales tax on food.

In fiscal year 2002, sales and use tax combined for fifty-three percent of the states total general fund revenues. A total of 198 communities (plus four reservations) also imposed local sales and use taxes in fiscal year 2002. Some local governments have several different tax rates, but the maximum local rate that can be levied in South Dakota is three percent. In fiscal year 2002, $180,686,078 was remitted to municipalities and reservations.

No two states in the country have identical tax systems. As of January 1, 2003, there were 45 states that charged a state sales tax with 29 states exempting the sale of food from the tax. Of the states that tax food, five of them do so but at a reduced rate. Six states, including South Dakota, tax food but offer credits or rebates to offset some of the taxes paid on food by qualified families and individuals. The definitions of "food" and what types of "food" can be taxed vary from state to state. However, in the Streamlined Sales Tax Project it is expected that states will have a uniform definition. The State of South Dakota currently uses the definition of food that is defined in the federal Food Stamp Act of 1977 which can be found in Appendix A. During the 2003 legislative session, legislation was proposed to add a definition of food to the state code and exempt the purchase of food from sales and use taxes when the provisions of the Streamlined Sales Tax Project were expected to become effective. The definition of food used in the 2003 proposed legislation (HB1249) is found in Appendix B.

South Dakota took a leap forward in the Streamlined Sales Tax Project with the adoption of House Bills 1001, 1002, and 1003 during the 2002 Legislature and Senate Bill 76 during the 2003 Legislature. These bills brought South Dakota into compliance with the simplification and uniformity provisions found in the Streamlined Sales Tax agreement. The legislation gives the state one sales tax rate, requires cities to have one sales tax rate per city, makes the bundle of goods and services that are taxed by the state and city the same, and changes a number of the provisions that will help retailers administer the sales tax with less expense. The Streamline Sales Tax Agreement does allow states an exception from the requirement that each state has a uniform sales tax rate. The exception allows food and drugs to be taxed at a rate that differs from the uniform base rate. Nearly forty states are currently involved in the Streamlined Sales Tax Project.

**Financial Impact**

The financial impact to the state and municipalities that would occur if the sales tax on food was repealed would be approximately $45 to $50 million dollars. The state sales tax brings in nine to ten percent of the state's sales tax receipts from the four percent levy placed on most food and grocery items. It is a bit more difficult to place a dollar figure on the impact of exempting food from sales tax imposed by municipalities because there are several different tax rates levied by the municipalities. Municipalities also vary their rates periodically as their financial needs change. Previously several cities had a sales tax, but no tax on food and two cities (Custer and Keystone) taxed food at two percent. The Department of Revenue and Regulation estimated that in FY2002 approximately $7.4 million dollars was generated by sales tax on food by the municipalities which was 9.38% of the taxable sales for the first penny of sales tax.

South Dakota's sales tax has been a stable revenue source for years even though the types and quantities of goods purchased have changed. For example in 1960, the average U.S. family spent seventeen cents of each consumption dollar on food for home consumption; by 1995 the average family spent only eight cents of each dollar on food eaten at home.

**Household Expenditures on Food**

The United States Department of Agriculture in August 2001 released a report that analyzed household food expenditures during the 1990's. They found that most U.S. households realized a modest decline in price-adjusted food expenditures, both at home and away from home, between 1990 and 1998. Per-person total food expenditures were greatest for households in the highest income quintile, for one-person households, and for households with heads between 55 and 64 years of age. Contrasted to this, households headed by a single female spent the least per capita of all households, even less than households in the poorest income quintile. However, during 1990-1998, female headed households increased their total food expenditures by about 6 percent. In addition, food expenditures in the poorest income quintile fell about 8 percent while food expenditures declined by 1 percent for the wealthiest income quintile. Note, once again that these declines in food expenditures are likely due to declines in the real inflation-adjusted price of food, although quantity adjustments can not be ruled out.

The study also showed that mid-western households spent an average of $2,045 on food in 1998 compared to $2,182 in the northeast, $2,107 in the west, and $1,894 in the south. All households spent less per person on at-home food in 1998 than in 1990 except those in the midwest, which spent the same.

**Tax Relief**

The Food Stamp Program helps low income families get the food they need to be healthy by increasing their food purchasing power. In South Dakota, more than $39 million in benefits were distributed to low income families in 2002. Almost 20,000 families participate in the program each month, with 51.7% of participants under the age of 18. Overall, 70% of South Dakota participants are under age of 18, elderly, or disabled, with 40.5% of food stamp households having earned income and 29% of food stamp families residing on reservation or tribal lands. A family of four with no countable income would receive $465 a month under the Food Stamp Program in South Dakota. Food purchased with food stamps is non taxable.

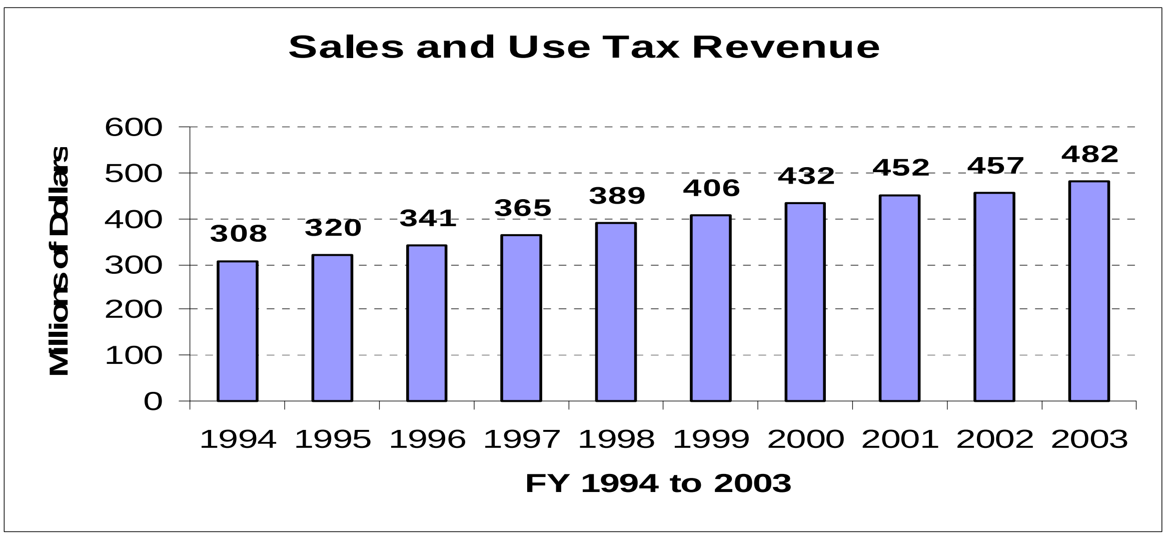
One alternative would be to provide additional tax relief by increasing funding and eligibility requirements in the Sales and Service Tax Refund Program administered by the Department of Revenue and Regulation. Currently, this program only applies to the low income elderly and disabled. The program allows any person sixty-five years of age and older prior to January first in the year for which a claim for the refund is made or any disabled person as defined in subdivision 10-45A-1(2), who is a resident of this state for the entire calendar year to receive a refund for retail sales and service taxes paid. The income requirements needed to receive this refund depend on whether the claimant is in a single or multiple member household. Currently, a single member household whose income is less than $3,500 is entitled to a $250 refund. If their income is $3,501 and not more than $9,750 then the claimant is entitled to a refund of the sum of $46 plus 3/4 percent of the difference between $9,750 and the income of the claimant. If the claimant's income is more than $9,750 then no refund is given. The refund schedule for multiple-member households is as follows. If the household income is $6,250 or less, the claimant is refunded the sum of $581. If the household income is $6,251 and not more than $12,750, a sum of $74 plus 7/8 percent of the difference between $12,750 and the total household income is refunded. If the household income is more than $12,750 then no refund is given.

Another alternative that was discussed during the 2003 legislative session was to exempt certain low income individuals from sales tax on food by use of an exemption card. The legislation proposed that the gross receipts resulting from the authorized purchases of food by a low income household would be exempted from the provisions of chapter 10-45. For purposes of determining a low income household, the legislation stated that the Department of Social services would use the federal poverty level established in 67 Fed. Reg. 6,931 as of January 1, 2003, and multiply that figure by two hundred percent. The federal poverty level amounts can be seen in Appendix C. If the household income was below that level, the department would issue an exemption card to the household indicating that the purchaser is exempt from taxation on food. Any food purchased by a member of an eligible low income household would be for consumption by that household only. The exemption card would have an identification number that is recorded by the seller and records would be kept on the dollar amount of food purchases by each exemption card holder. The Legislature could adjust the income eligibility levels to a point that fits the amount of subsidy that could be allocated through the budgeting process.

**Replacement Revenue**

A few suggestions of possible replacement revenue are:

- Increase the State Sales Tax rate
- Personal and Corporate Income Tax
- Increase other tax rates- cigarette, alcohol, telecommunications, etc.
- Growth in sales tax receipts due to the Streamlined Sales Tax Project, however, Congressional or court action is necessary for this income to be realized.
- Historical growth of sales tax over a period of time may replace the revenue lost if the food tax is reduced then repealed.



## Conclusion

It is estimated that the repeal of the tax on food could cost the state general fund $45-$50 million dollars and the municipalities another seven to nine million dollars. This revenue funds programs and projects that help South Dakota's citizens. Either alternative tax revenue initiatives must be imposed or programs and projects will be cut if the tax on food is repealed or reduced. Tough decisions lie ahead for the Legislature and the people of South Dakota.

**This issue memorandum was written by Aaron Olson, Fiscal 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.**

"Food" means

**(1)**

any food or food product for home consumption except alcoholic beverages, tobacco, and hot foods or hot food products ready for immediate consumption other than those authorized pursuant to clauses (3), (4), (5), (7), (8), and (9) of this subsection,

**(2)**

seeds and plants for use in gardens to produce food for the personal consumption of the eligible household,

**(3)**

in the case of those persons who are sixty years of age or over or who receive supplemental security income benefits or disability or blindness payments under title I, II, X, XIV, or XVI of the Social Security Act (42 U.S.C. 301 et seq., 401 et seq., 1201 et seq., 1351 et seq., 1381 et seq.), and their spouses, meals prepared by and served in senior citizens' centers, apartment buildings occupied primarily by such persons, public or private nonprofit establishments (eating or otherwise) that feed such persons, private establishments that contract with the appropriate agency of the State to offer meals for such persons at concessional prices, and meals prepared for and served to residents of federally subsidized housing for the elderly,

**(4)**

in the case of persons sixty years of age or over and persons who are physically or mentally handicapped or otherwise so disabled that they are unable adequately to prepare all of their meals, meals prepared for and delivered to them (and their spouses) at their home by a public or private nonprofit organization or by a private establishment that contracts with the appropriate State agency to perform such services at concessional prices,

**(5)**

in the case of narcotics addicts or alcoholics, and their children, served by drug addiction or alcoholic treatment and rehabilitation programs, meals prepared and served under such programs,

**(6)**

in the case of certain eligible households living in Alaska, equipment for procuring food by hunting and fishing, such as nets, hooks, rods, harpoons, and knives (but not equipment for purposes of transportation, clothing, or shelter, and not firearms, ammunition, and explosives) if the Secretary determines that such households are located in an area of the State where it is extremely difficult to reach stores selling food and that such households depend to a substantial extent upon hunting and fishing for subsistence,

**(7)**

in the case of disabled or blind recipients of benefits under title I, II, X, XIV, or XVI of the Social Security Act (42 U.S.C. 301 et seq., 401 et seq., 1201 et seq., 1351 et seq., 1381 et seq.), or are [1] individuals described in paragraphs (2) through (7) of subsection (r) of this section, who are residents in a public or private nonprofit group living arrangement that serves no more than sixteen residents and is certified by the appropriate State agency or agencies under regulations issued under section 1616(e) of the Social Security Act (42 U.S.C. 1382e(e)) or under standards determined by the Secretary to be comparable to standards implemented by appropriate State agencies under such section, meals prepared and served under such arrangement,

**(8)**

in the case of women and children temporarily residing in public or private nonprofit shelters for battered women and children, meals prepared and served, by such shelters, and

**(9)**

in the case of households that do not reside in permanent dwellings and households that have no fixed mailing addresses, meals prepared for and served by a public or private nonprofit establishment (approved by an appropriate State or local agency) that feeds such individuals and by private establishments that contract with the appropriate agency of the State to offer meals for such individuals at concessional prices.

**Appendix B—HB 1249 2003 Legislative Session**

"Food," and "food ingredient," any substance, whether in liquid, concentrated, solid, frozen, dried, or dehydrated form, that is sold for ingestion or chewing by humans and is consumed for its taste or nutritional value. The term, food, does not include alcoholic beverages, tobacco, soft drinks, candy, or prepared food.

"Soft drinks," any nonalcoholic beverages that contain natural or artificial sweeteners. The term, soft drinks, does not include any beverage that contains milk products, soy, rice, or similar milk substitutes, or greater than fifty percent of vegetable or fruit juice by volume.

"Candy" any a preparation of sugar, honey, or other natural or artificial sweeteners in combination with chocolate, fruits, nuts or other ingredients or flavorings in the form of bars, drops, or pieces. The term, candy, does not include any preparation containing flour and does not require refrigeration.

"Prepared food" any:

(a) Food sold in a heated state or heated by the seller;

(b) Two or more food ingredients mixed or combined by the seller for sale as a single item. The term, prepared food, in this subsection does not include food that is only cut, repackaged, or pasteurized by the seller, and eggs, fish, meat, poultry, and foods containing these raw animal foods requiring cooking by the consumer as recommended by the Food and Drug Administration in chapter 3, part 401.11 of its Food Code as of January 1, 2003, so as to prevent food borne illnesses; or

(c) Food sold with eating utensils provided by the seller, including plates, knives, forks, spoons, glasses, cups, napkins, or straws. A plate does not include a container or packaging used to transport the food.