

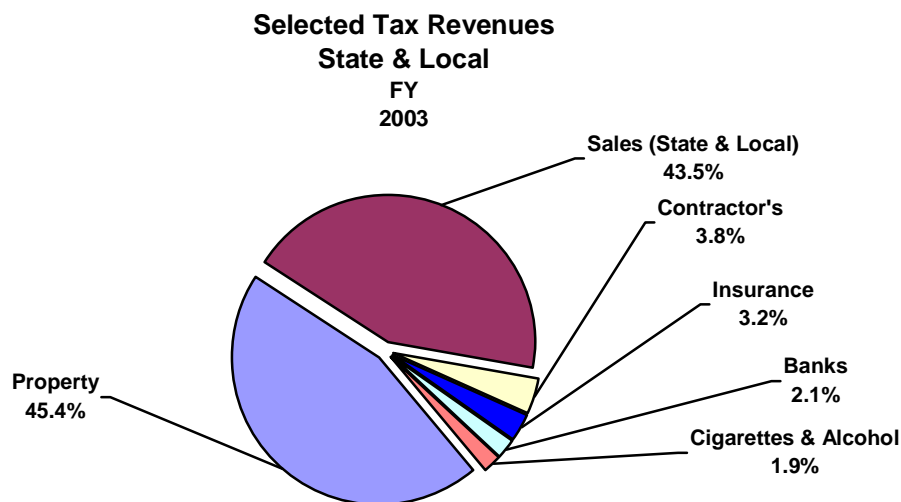
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## TAXATION

The South Dakota tax system is comprised of a mix of many of the same types of taxes and fees found in other states except for the presence of the contractors' excise tax and the absence of any personal or corporate income taxes. Although there are many nuances and exceptions in the South Dakota tax system, South Dakota's tax system is probably no more or less complicated than the tax system found in other states. Like many other states, the burden and makeup of the tax system is often discussed and debated.

This memo highlights each tax. If the reader has more interest in a certain tax, chapter citations are provided for the reader to further study the matter. It is virtually impossible to list each exemption or distinction in the South Dakota tax system without repeating a good portion of Title 10. Essentially each tax is imposed in one or two sections and the balance of the chapter or chapters is for the administration of the tax and its exemptions. In Appendix A the reader will find over 100 broad and specific exemptions to the sales and use tax.

The state and local tax revenue base is primarily the sales and use tax and property tax. A wide variety of taxes and fees are used to provide the balance of the revenue. In addition to the property and sales tax, the state taxes banks, contractors, alcohol, cigarettes and motor fuel, to name only a few. The following chart shows some of the major taxes that comprise the state and local government revenue. This chart illustrates the relationship between the taxes and the differences in revenues generated by each.



The Department of Revenue and Regulation collects over 30 different state taxes which could be subdivided into four categories:

- Sales, use, and contractors' excise taxes
- Motor fuel taxes;
- Motor vehicle taxes; and
- Special taxes.

These taxes are distributed to the states general fund, local units of government, and the state highway fund. The total amount of taxes collected by the Department of Revenue and Regulation annually exceeds a billion dollars since FY 2001.

### Property Tax

Real property, for the purposes of ad valorem taxation, includes the land and any structures which are permanently affixed to the land. Real property does not include items which pertain to the use of such structures. Property taxes are levied on all real property and in certain instances property taxes are levied on personal property. Property taxes are the primary source of funding for many local governments; however, several municipalities receive more revenue from sales and use taxes and fees from the operation of utilities.

Application	All real property, except property owned and used by certain tax exempt entities
Rate	Variable by location
Exempt Entities	Government, religious entities, public charities, benevolent organizations, nonprofit health care facilities, educational institutions
Source	SDCL chapters 10-4 to 10-38, inclusive, except those chapters that levy a gross receipts tax in lieu of property taxes and chapter 10-12A concerning tax collection agreements with Indian Tribes

Local governments administer the property tax system with assistance and oversight from the Department of Revenue and Regulation. The county is responsible for assessment and collection of property taxes on behalf of itself and the other local governments. However, like many issues, there are exceptions. The Department of Revenue and Regulation does determine the assessed value of centrally assessed property, including: air line, electrical, railroad, pipeline, and telecommunication companies.

Statute requires all real property to be assessed at eighty-five percent of its market value. The Department of Revenue and Regulation provides each county with a factor to adjust its assessment to eighty-five percent its market value to establish the taxable value of all real property. This procedure was implemented to establish a more equitable means to distribute state-aid-to-education.

There are two means of limiting local tax requests. The first is that each political subdivision has a maximum levy that may be assessed for special and general

purposes. (See Appendix B) In 1995, the Legislature enacted a second means through property tax budget limitations. This limitation requires that the amount of money from property taxes requested from one year to the next may not inflate any faster than the rate of inflation or three percent, whichever, is less. Since its inception, the growth factor has been ranged from 1.6% to 3%. Local governments are allowed to receive the additional tax dollars resulting from growth as part of their property tax request for their budgets.

Below are two tables outlining the total property taxes that were levied on each classification of property and taxes levied by each type of local unit of government.

<b>Total Property Taxes</b>		
	<b>Payable 2003</b>	<b>Share</b>
Agricultural Property	\$172,050,046	24.6%
Non-Ag Acreages	\$4,304,303	0.6%
Owner-Occupied Property	\$254,014,787	36.4%
Manufactured Homes - Not Owner Occupied	\$1,893,270	0.3%
Manufactured Homes - Owner Occupied	\$4,742,877	0.7%
Other Property	\$220,384,652	31.5%
Utilities	\$31,052,405	4.4%
Special Assessments	\$10,279,053	1.5%
<b>Total</b>	<b>\$698,721,393</b>	<b>100.0%</b>

<b>Taxes Levied by Local Units of Government - 2003</b>		
	<b>Amount Taxed</b>	<b>Percent of Total</b>
County	\$172,099,579	24.6%
Municipalities	\$87,349,215	12.5%
Schools	\$417,257,623	59.7%
Townships	\$11,735,923	1.7%
Special Assessments	\$10,279,053	1.5%
<b>Total</b>	<b>\$698,721,393</b>	<b>100.0%</b>

The 1995 Property Tax Reduction Program addressed the local property tax burden and state-aid-to-education. It also limited budget growth specifically funded by property taxes for all political subdivisions, except under certain circumstances.

The property tax relief program has centered on the education formula and property tax budget controls. The program provides the greatest relief to farmers, ranchers, and homeowners. Homeowners must, however, apply to have their homes classified as owner-occupied single-family dwellings in order to receive property tax relief.

About 20 percent of the funds used for the property tax reduction program were previously appropriated for personal property replacement dollars. Counties were permitted through the legislation to increase local property taxes to compensate for 50 percent of this lost revenue, reducing the actual property tax relief benefit. County budgets were also frozen or limited at the previous year's tax level, whether it was reflective of its usual budget request or higher or lower than normal.

Taxpayers may realize long-term tax benefits from the controls on budget growth. Property taxes may increase at the rate of inflation not to exceed three percent a year as defined in SDCL 10-13-38. The local governing board has the option of exceeding the property tax reduction limits, if supported by a two-thirds vote of the governing body. A petition signed by five percent of the registered voters within twenty days of the publication of the decision may refer the board's decision.

A taxing district may increase tax revenue above the budget limitations if there is a corresponding increase in property values resulting from improvements or changes in use of real property, annexation, minor boundary changes, to support the financing cost for new facilities that are subject to a referendum, or to pay a judgment. Otherwise, there is a limitation in the total property tax revenue that can be received by a governing body. There is no clause, however, preventing property values from increasing or decreasing from market pressures, or property values from being adjusted if they were under or over assessed. This would allow property taxes to increase on a specific piece of property but would require a corresponding decrease in other property taxes on other pieces of property within that political subdivision.

The primary focus of the property tax reduction program is to alleviate the area where the greatest property tax burden lies, in the school districts. The program places ceilings on the school district property tax levies for general fund purposes, thereby providing property tax relief and certain controls.

Uniform tax rates for school districts are applied to all property classifications as listed in the table below. Again, these rates only apply to the levy for general fund purposes and it is required that the property value either be assessed or adjusted to 85 percent of market value. School districts, however, may levy additional property taxes for special education, bond redemption, capital outlays, and retirement over and above the general fund cap limits.

## General Fund Levies for School Districts

<b>Class of Property</b>	<b>1996</b>	<b>1997</b>	<b>1998</b>	<b>1999</b>	<b>2000</b>	<b>2001</b>	<b>2002</b>	<b>2003</b>	<b>2004</b>
Nonagricultural	\$16.75	\$16.75	\$16.49	\$16.25	\$16.15	\$13.93	\$13.93	\$12.90	\$12.04
Owner-Occupied	\$10.00	\$9.20	\$9.06	\$7.61	\$7.57	\$5.36	\$6.50	\$6.02	\$5.62
Nonagricultural	--	--	--	\$6.66	\$5.70	\$4.33	\$5.04	\$4.74	\$4.49
Agricultural	\$6.25	\$5.75	\$5.66	\$4.73	\$4.70	\$3.33	\$4.04	\$3.74	\$3.49

There are also three programs that provide property tax relief for elderly and disabled persons. One program allows assessments to be frozen if the homeowner is income qualified, has owned a home for at least three years, been a resident for at least five years, and the home is assessed at less than \$100,000 (SDCL chapter 10-6A). Another program allows municipalities to reduce taxes for elderly and disabled persons, however, this program is not being offered by any municipalities at this time (SDCL chapter 10-6B). Property tax refunds are also available if the homeowner is income qualified, has owned a home for at least three years, and has been a resident for at least five years (SDCL chapter 10-18A).

The administration of property taxes involves many aspects ranging from keeping the real property lists current (i.e. ownership, new construction, rehabilitation, structure removal, etc.), conversion of land from one classification to another, payment and distribution of property taxes, collection of delinquent property taxes, sale of real property for assessments, tax deeds and scavenger laws, refunds, procedures for centrally assessing property and distributing the assessed value, etc. The portion of Title 10 dedicated to the administration of property tax system is quite extensive.

### **Telecommunications Companies**

Telecommunications companies are divided into three classes for the purposes of taxation: companies which provide service by means of wired circuits and otherwise and have sales of \$50,000,000 or more; companies which provide service by means of wired circuits and otherwise and have sales of less than \$50,000,000; and wireless telecommunication services that provide two-way communication. Telecommunications companies with sales over \$50,000,000 are centrally assessed by the Department of Revenue and Regulation. Telecommunication companies with sales of less than \$50,000,000 and wireless companies are taxed based on gross receipts. The revenue from the each classification of telecommunication companies is distributed differently. The tables on the next page outline the basic elements of each telecommunications tax.

<b>Centrally Assessed – Large Telecommunications Companies</b>	
Application	Companies which provide service by means of wired circuits and otherwise and have sales of \$50,000,000 or more
Taxation	Centrally assessed by the Department of Revenue and Regulation and taxes are levied in a similar manner that other real property taxes are levied.
Rate	Variable by location
Distribution	<ul style="list-style-type: none"> <li>• Revenue from property located within city limits is distributed to all taxing entities</li> <li>• Revenue from property located outside city limits is to distributed to the county only</li> </ul>
Source	SDCL chapter 10-33

<b>Gross Receipts – Small Telecommunications Companies</b>	
Application	Companies which provide service by means of wired circuits and otherwise and have sales of less than \$50,000,000
Taxation	Based on gross receipts
Rate	Rate ranges from 2 to 4% based on either customer density or amount of gross receipts
Distribution	Revenue is distributed to schools districts
Source	SDCL chapter 10-33

<b>Gross Receipts – Wireless Telecommunications Companies</b>	
Application	Companies that provide wireless services and other certain forms of two-way communication
Taxation	Based on gross receipts
Rate	Rate is 4%
Distribution	Sixty percent deposited in Property Tax Reduction Fund Forty percent distributed to the counties
Source	SDCL chapter 10-33A

### **Rural Electric Companies**

Any rural electric company that transmits electricity principally for distribution within rural areas pay a gross receipts tax in lieu of taxes on real property as outlined in the following table.

Application	Companies that transmit electricity principally within rural areas
Taxation	Based on gross receipts
Rate	Rate is 2%
Distribution	Revenue is distributed to school districts
Source	SDCL chapter 10-36

## Mineral Severance Tax

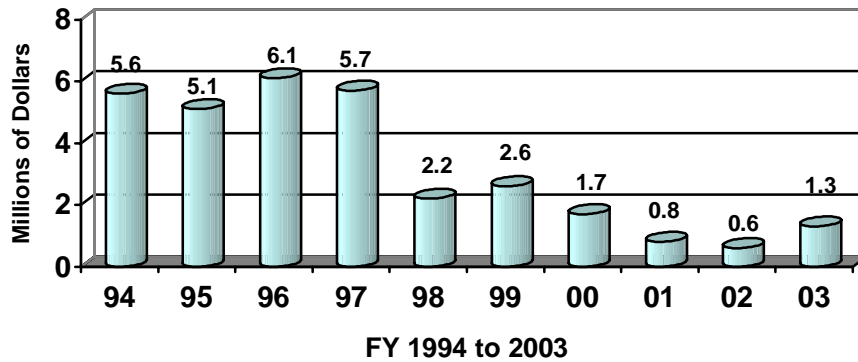
The mineral severance tax is a tax imposed on the privilege of severing precious metals, namely gold and silver. There are two taxes levied on the severance of precious metals. The first tax is a tax of four dollars per ounce of gold severed in this state. The second tax, taxes the net profits from the sale of precious metals at a rate of ten percent.

Application	Companies that sever precious metals
Taxation	Tax on amount of gold severed and net profits from the sale of precious metals severed
Rate	Four dollars per ounce of gold severed, plus Ten percent of the net profits from the sale of precious metals severed
Distribution	<ul style="list-style-type: none"><li>• General fund for companies that were operating before 1981</li><li>• Eighty percent in general fund and twenty percent in county trust fund for companies beginning operation after 1981, subject to a one million dollar cap</li></ul>
Source	SDCL chapter 10-39

There are significant differences between this income tax and the income tax on banks and financial corporations. The precious metals tax uses only income generated in South Dakota and allows only expenses incurred in South Dakota as deductions. The income tax on banks and financial corporations uses a formula that starts with a company's nationwide taxable income as defined by the Internal Revenue Code and then uses a three-factor formula to arrive at South Dakota's share of the total.

The Department of Revenue and Regulation administers the precious metals severance tax. The tax must be reported and remitted quarterly and the balance of any tax due from the previous calendar year must be paid by June of each year. Each person severing precious metals is given an exemption from the tax on the first twenty ounces of precious metals severed each year. This is intended to exempt the hobby miner from the tax. The owner of a royalty interest, an overriding royalty, or profits, or working interest in a mine must pay a tax equal to eight percent of the value received for the right to sever precious metals. This provision does not apply to royalty interests owned by the federal government, the state government, or a local government. This tax is collected by the person who severs the precious metals and pays the royalty payment to the royalty owner. The following graph illustrates the drastic swings in revenue generated by the mineral severance tax, which is related to price and production.

### Precious Metals Tax Revenue



The precious metals severance tax has undergone numerous significant changes. The tax was based on gross proceeds from its creation in 1935 until it was repealed in 1970. In 1975 the tax was reenacted at four percent of the net profits. In 1980 the rate was made variable. In 1981 the tax was completely changed into a six percent tax on gross yield. In 1984 the tax was changed to four percent on gross yield and eight percent on net profit. In 1994, the tax was changed to four dollars per ounce of gold and ten percent on net profits.

One hundred percent of the tax revenue collected from businesses doing business in this state prior to January 1, 1981, is deposited in the state general fund. The tax revenue collected from businesses that have begun business in this state since January 1, 1981, is divided between the state and the county where the precious metals are severed. The state general fund receives eighty percent, and the county of severance receives twenty percent. The county's share must be deposited in a trust fund to be used to offset social, economic or physical impacts and to diversify the county's economic base.

### Energy Minerals Severance Tax

The energy minerals severance tax is a tax imposed on the privilege of severing energy minerals in this state. The tax is imposed on the owners or operators of the energy minerals. The severed minerals are taxed at the rate of four and one-half percent of their taxable value. In addition, there is a conservation tax of two and four-tenths mills of the taxable value of any energy minerals severed and saved. The conservation tax is to compensate the state for the cost of administering the environmental protection laws related to energy mineral severance.

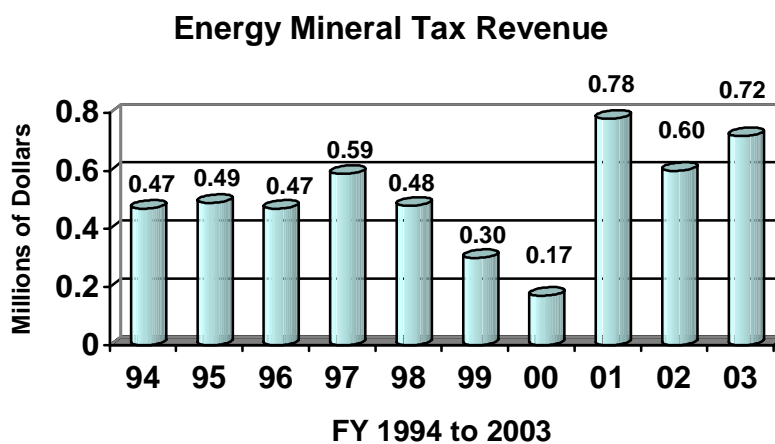
Application	Companies that sever energy minerals
Taxation	Taxable value which is the sale price or market value
Rate	Rate is 4.5% plus a .0024% administration fee
Distribution	<ul style="list-style-type: none"> <li>• One-half to the county</li> <li>• One sixth to the energy impact fund</li> <li>• One-third to the state general fund</li> </ul>
Source	SDCL chapter 10-39A & 10-39B



The severance of all mineral fuels is taxed, including coal, lignite, petroleum, oil, natural gas, uranium, and thorium and any combination of minerals used in the production of energy. The taxable value of energy minerals that are sold is the sale price less any rental or royalty payment belonging to the United States, this state, or any of its political subdivisions. The taxable value of energy minerals that have been severed and saved but not sold is the market value less any rental or royalty payment belonging to the United States, this state, or any of its political subdivisions. If an energy mineral has a posted field price at the point of production the taxable value is the posted field price. The taxable value of severed and saved uranium-bearing material is the sale price per pound of the content of triuranium octa-oxide contained in the uranium ore or processed yellow-cake concentrate.

The Department of Revenue and Regulation administers the energy minerals severance tax. The tax is imposed when an energy mineral is sold, transported from the state, or consumed, whichever occurs first. The tax must be reported and remitted on a quarterly basis. The tax revenue is distributed into three areas. One-half of the revenue is returned to the county where the energy mineral was severed. One-third of the revenue goes to the state general fund. The final one-sixth of the revenue goes to the energy development impact fund.

The following graph shows the state's portion of the revenue from the energy mineral severance tax. One-half of the revenue is returned to the county and if the energy development impact fund is at its cap the other half goes to the state.



The energy development impact fund was established to help offset the economic, social, and physical impacts resulting from energy development and production. The fund has a cap of one hundred thousand dollars and any money in excess of that is transferred to the state general fund. The county can use the money for school or road purposes to offset direct or indirect social, economic, or physical impacts. The majority of the severance of energy minerals in South Dakota has occurred in Harding and Fall River counties. Oil and gas are the two types of energy minerals most frequently

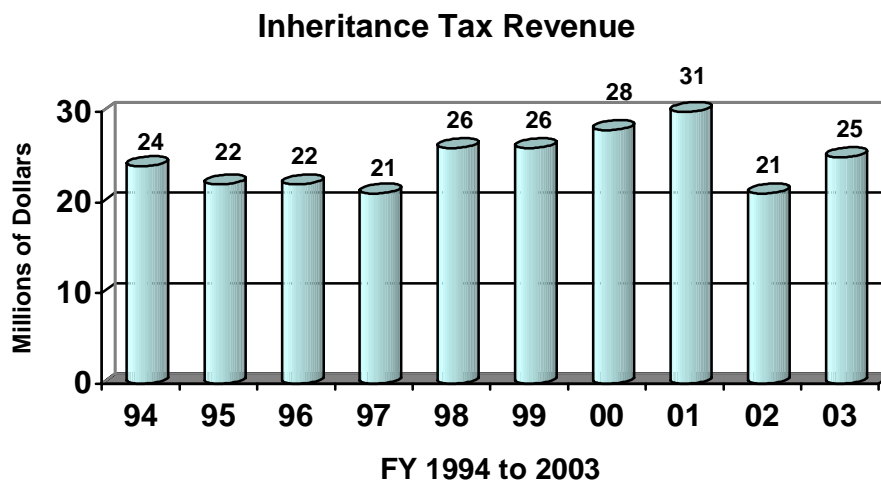
severed. Highway construction and repair is the predominant use of the energy mineral severance tax revenue kept by the counties and appropriated from the energy development impact fund.

### Inheritance Tax and Estate Taxes

The voters during the 2000 general election repealed the inheritance tax by a vote of 251,316 to 62,334. The inheritance tax was a tax on the right to receive, based on the amount of the estate going to each particular beneficiary. The state continues to impose an estate tax on the transfer of wealth at the death of an individual. The estate tax is a tax upon the net estate of the decedent based on the right to transmit property from the decedent's estate to the living.

Application	Tax on any estate subject to the federal estate tax
Taxation	Tax on the estate of each decedent who is a resident of this state
Rate	Estate tax is equal to the federal death tax credit
Distribution	<ul style="list-style-type: none"> <li>• Ninety percent to the general fund</li> <li>• Ten percent to the county from which the tax was collected</li> </ul>
Source	SDCL chapter 10-40A (Estate Tax) SDCL chapters 10-40 and 10-41 (Inheritance Tax – Repealed)

The last ten fiscal years of inheritance tax revenue for the state and counties is displayed in the following graph. The revenue from this tax will diminish to nill in the future.



The federal estate tax law provides a maximum credit that may be claimed for state death taxes that are paid. In those states that have both an inheritance tax and an estate tax, the amount of the federal credit that is not taken by the inheritance tax is taken by the estate tax. If they have only the estate tax, then it takes the entire federal credit. If a state had neither an inheritance tax nor an estate tax, there would be no state death tax credit allowed and the federal government would retain the entire amount.

In order to avail themselves of the federal credit, every state and the District of Columbia has an estate tax. The South Dakota estate tax and the estate tax in forty-four other states and the District of Columbia were enacted for the sole purpose of absorbing the credit allowed against the federal estate tax for state death taxes paid. Five states have an estate tax that imposes a tax rate on the estate based on the size of the estate. They are similar in many ways to the federal estate tax.

### Bank Franchise Tax

The bank and financial corporation tax is an income tax on the privilege of transacting business as a bank or financial corporation. The tax is measured on the bank or financial corporation's portion of net income that is assignable to South Dakota.

Application	Banks and financial corporations, does not include federal credit unions
Taxation	Tax on the net income
Rate	(See table below)
Exemptions	Federal credit unions
Distribution	<ul style="list-style-type: none"> <li>• Twenty-six and two-thirds percent to the general fund</li> <li>• Seventy-three and one-third percent to the counties</li> </ul> <p>Except revenue from certain credit card operations is apportioned as follows:</p> <ul style="list-style-type: none"> <li>• Ninety-five percent to the general fund</li> <li>• Five percent to the counties</li> </ul>
Source	SDCL chapter 10-43

The rate of taxation was changed in 2000. Net income is taxed according to the following table, and there is a minimum tax of two hundred dollars per bank location:

Net Income	Tax Rate
\$ - 400,000,000	6%
400,000,001 - 425,000,000	5%
425,000,001 - 450,000,000	4%
450,000,001 - 475,000,000	3%
475,000,001 - 500,000,000	2%
500,000,001 - 600,000,000	1%
600,000,000 - 1,200,000,000	1/2%
1,200,000,000 +	1/4%

A bank or financial institution is defined to include all state and national banks and savings and loans, all state mutual savings banks and trust companies, any person licensed under the installment repayment small loan and consumer law, any person licensed under the motor vehicle retail installment sales law, any person in the business of buying loans, notes, or other evidences of debt, and any person in the business of making installment repayment or open-end loans of more than five hundred dollars. Each branch of a bank or financial corporation is a separate taxable entity.

Net income is the taxable income defined by the Internal Revenue Code for federal income tax purposes. The state does require that certain adjustments be made to taxable income. The items that must be subtracted from the federal taxable income include interest and dividends on United States obligations, dividends paid from financial institutions taxed under this tax, taxes imposed in the tax year by the Internal Revenue Code, and certain depreciation and interest expenses. The tax is levied only on the net income that is properly apportioned to South Dakota.

### **Net Income Apportionment Formula**

$$\text{corporation's total net income} \quad \times \quad \frac{(x)+(y)+(z)}{3} = \text{corporation's S. D. net income}$$

x = the value of the corporation's property in South Dakota divided by the value of the corporation's total property.

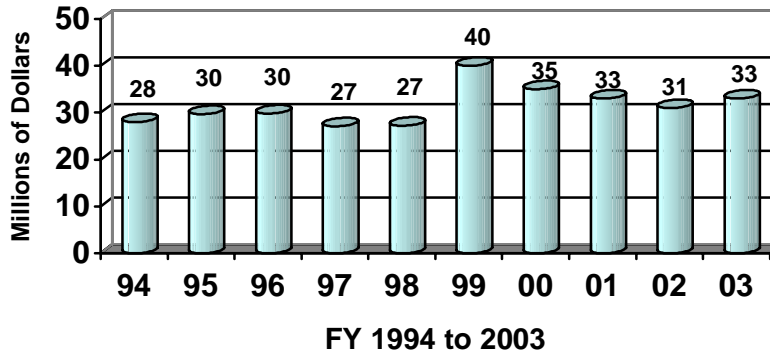
y = the corporation's payroll paid in South Dakota divided by the corporation's total payroll.

z = the corporation's receipts received in South Dakota divided by the total receipts received nationwide by the corporation.

The tax is administered by the Department of Revenue and Regulation and is reported on a yearly basis. Every quarter each bank or financial corporation must make an estimate of its yearly tax and remit it to the state. The tax revenue is shared between the state and the counties where the banks and financial corporations are located. Twenty-six and two-thirds percent of the revenue from most banks and financial corporations goes to the state and seventy-three and one-third percent to the counties. Ninety-five percent of the tax revenue from credit card operations goes to the state and five percent goes to the counties. Each county's share is based on the tax paid by the banks and financial corporations located in the county. The counties distribute this money to each subdivision within the county pursuant to the personal property tax replacement formula.

The following graph presents the bank franchise tax revenue for the last ten fiscal years. The revenue from this tax is very dependent on one company, Citibank, and this graph illustrates the impact of one company's business activity and stability of this revenue source.

### Bank Franchise Tax Revenue

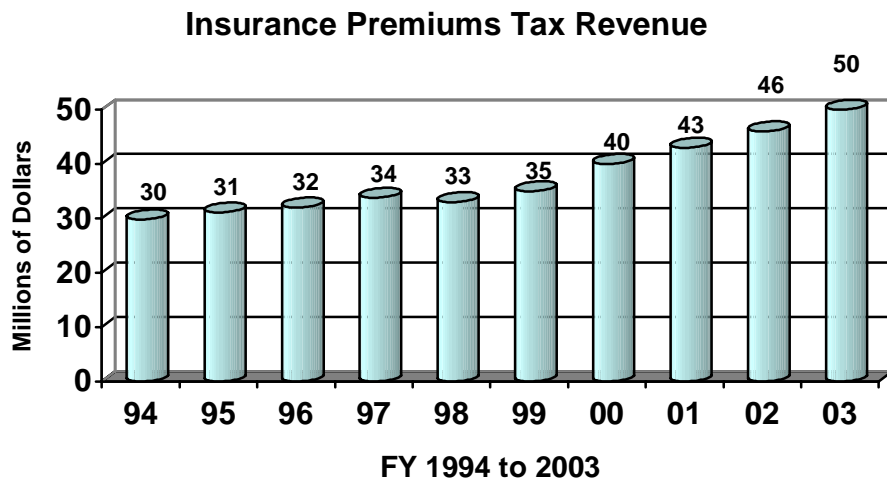


### Insurance Company Tax

The insurance company tax is a tax on any company transacting business in this state under the insurance laws of this state, as an insurer, indemnitor, or surety. The tax rate on any company and any unlicensed insurer is two and one-half percent of gross premiums and one and one-fourth percent of consideration for annuity contracts. In addition to these rates, there is an additional tax on every company doing fire insurance business in this state of one-half percent on the gross premium receipts on all fire insurance business done in the state.

Application	Insurance companies
Taxation	Tax on the premiums
Rate	<ul style="list-style-type: none"> <li>• Two and one-half percent of gross premiums</li> <li>• One and one-fourth percent of the consideration for annuity contracts</li> <li>• Plus one-half percent of gross premiums on fire insurance</li> <li>• Fourteen dollars for each policy covering worker's compensation business</li> </ul>
Exemption	<ul style="list-style-type: none"> <li>• Farm mutual insurers</li> <li>• Fraternal benefit societies</li> </ul>
Distribution	<ul style="list-style-type: none"> <li>• General fund</li> <li>• Except premium on fire insurance (first \$30,000 for training, 50% remaining goes to certified county fire departments and historically 50% is deposited in the general fund)</li> <li>• Worker's compensation fee dedicated to the Department of Labor</li> </ul>
Source	SDCL chapter 10-44

Farm mutual insurers and fraternal benefit societies are exempt from the insurance company tax. A tax credit is given to every company subject to the tax that has its principal office or a regional home office located in South Dakota. These companies are entitled to a credit of fifty percent of the tax and an amount equal to the property taxes paid on their principal or regional home office during the year preceding the tax year. The credits and deductions cannot reduce the amount of tax to less than thirty percent of the amount of tax otherwise payable without the application of the credit. A regional home office must perform for an area covering two or more states the selling, underwriting, issuing, and servicing of insurance, including actuarial, medical, and legal services and the approval or rejection of applications for insurance, the maintenance of records, advertising, public relations, and supervision and training of sales and service forces.



The Department of Revenue and Regulation administers this tax which is payable at the time an insurance company files its annual report. If an annual report is not required then the tax is due on March first of each year. If an insurance company paid more than five thousand dollars in insurance company taxes in the previous year then the company must pay its taxes on a quarterly basis. All of the tax revenue, except for the fire insurance tax, is deposited in the state general fund.

Each year the secretary of the Department of Revenue and Regulation is required to calculate the amount of tax revenue collected on fire insurance premiums and allocates a portion of that to the local fire departments through the Department of Public Safety. To qualify for fire insurance tax revenue a fire department must have been in existence for at least one year, be certified by the Department of Public Safety, have fifteen or more members, and have at least one fire truck with a pumper housed in a heated building. One-half of the fire insurance money is distributed to counties based on each county's share of the total state assessed valuation. The second half of the money is distributed based on each county's share of the total state population. The counties must then distribute the money to each fire department based on each fire department's service area's share of the total assessed valuation and population of all the fire department service areas in the county. The fire departments can use the money only for paying operating expenses, pension, contributions and the cost of capital improvements. The money may be accumulated from year to year.

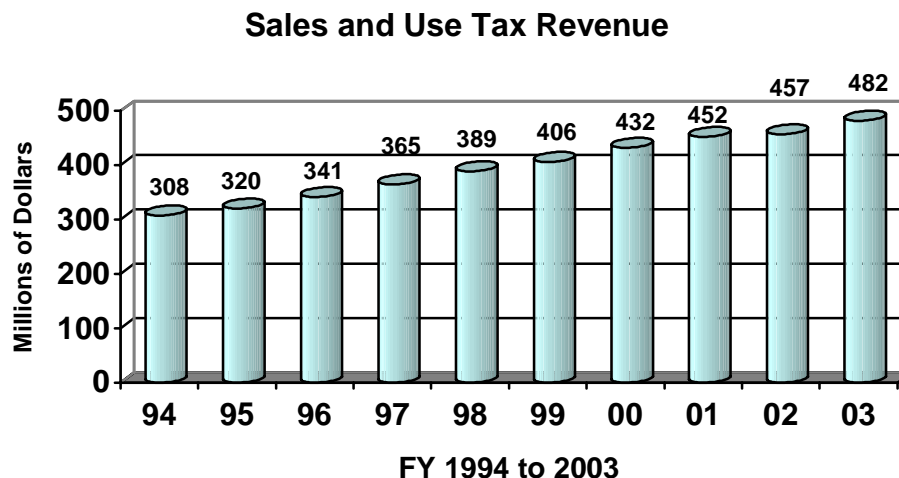
## Retail Sales and Service Tax and Special Amusement Excise Tax

The retail sales and service tax is based on the gross receipts of the retailer or service provider received from the sale of tangible personal property or from providing a service. The term, gross receipts, is defined as the total amount received in money, credits, property, or other consideration of a sale at retail or the provision of a service. A service is any activity engaged in for a fee, retainer, commission, or other monetary charge and includes activities such as are provided by an accountant, carpet cleaner, or hair stylist. If a purchase includes tangible personal property that is traded-in, the tax applies only to the trade difference. The incidence of the tax is on the retailer or service provider who is ultimately responsible for paying the tax, although the retailer or service provider may add and separately state the tax on the price of the product or service.

Application	Sales and services not specifically exempted (see Attachment A)
Rate	Rate is 4% on all goods and services beginning on January 1, 2006
Exempt Entities	Government, nonprofit hospitals, nonprofit charitable hospitals, relief agencies, nonprofit charitable relief agencies, religious and private schools, religious education institutions, nonprofit accredited/private educational institutions,
Distribution	General fund, except for the tax imposed on endoparasitocides and ectoparasitocides shall be deposited in the veterinary student tuition and animal disease research and diagnostic laboratory fund
Source	SDCL chapters 10-45, 10-46, and 10-58

After the implementation of Streamlined Sales Tax Project on January 1, 2004 and January 1, 2006, there will be only one sales tax rate for the state and a separate tax on coin-operated washers and dryers. Beginning on January 1, 2004, there will be one uniform state sales tax rate for each municipality. There is also a seasonal gross receipts tax of one percent on certain visitor-intensive businesses from June 1 through September 30, which is dedicated to the Tourism Promotion Fund.

The following graph provides the sales and use tax revenue for the last ten fiscal years. Tax collections have increased steadily in recent years.



The special amusement device tax is on the gross receipts from the operation of mechanical and electronic amusement devices, and includes a twelve dollar annual registration fee. This fee is in lieu of all municipal sales or use taxes and all other permits, licenses, permit fees, or license fees imposed by any local government on mechanical and electronic amusement devices. The revenue from this fee is collected by the state and is distributed to the municipality where the machine was located when registered.

The separate tax on coin-operated washers and dryers is an annual license fee. The fee is ten dollars in municipalities with a population of one thousand or more and eight dollars in municipalities with a population of less than one thousand. This fee is in lieu of a sales or use tax.

Sales of all tangible personal property and all services are taxable unless they are specifically exempted. Items that are exempt include sales to the United States, this, or any other state, any public or municipal corporation, any Indian tribe, and any nonprofit charitable organization which devotes its resources exclusively to the relief of the poor. In addition, health, educational, social, and most agricultural services are exempt. Most products used in agriculture are exempt and any item that is consumed in a manufacturing process and becomes an integral part of the finished product is exempt. Also exempt are motor fuel, motor vehicles, and construction services, which are subject to other taxes. Attached is a list of over 100 exemptions of goods and service that are exempted from sales and use tax. In some instances, the exemptions are enumerated by division no., major group no., group no., or industry no. pursuant to the Standard Industrial Classification Manual, 1987, as prepared by the Statistical Policy Division of the Office of Management and Budget, Office of the President. (See Appendix A)

The Department of Revenue and Regulation administers the retail sales and service tax, special amusement device tax, and use tax. Each retailer and service provider must apply and receive a license before conducting business. The tax must be reported and remitted on a bimonthly basis unless the retailer has an annual tax liability of one thousand dollars or more and then the tax must be remitted to the state monthly. Most of the penalties associated with this tax are Class 1 misdemeanors, which are punishable by one year in the county jail or a one thousand dollar fine, or both. A subsequent violation of most sales tax laws is a Class 6 felony, which is punishable by two years in the penitentiary or a two thousand dollar fine, or both.

There are two refund programs for sales and use taxes. One is for disabled person or income eligible elderly person may apply for a refund. The Legislature appropriates approximately a million dollars a year for this program and a companion program for providing a property tax refund. The Department of Revenue and Regulation determines which of the two programs provides the greatest benefit to the eligible applicant (see chapter 10-45A). The other program provides a refund of sales, use, and contractors' excise taxes paid during the construction of new agricultural processing facilities. To be eligible, the minimum project costs must exceed four million five hundred thousand dollars.



## Use Tax

The use tax is a tax on tangible personal property and services used, stored, or consumed in this state. The tax is at the same rate imposed on the tangible personal property or service by the retail sales and service tax. This tax is designed to protect in-state retailers and service providers from people purchasing items and services out-of-state and not having to pay an equivalent sales tax. Unlike the retail sales and service tax, the use tax is imposed on the person using, storing, or otherwise consuming the tangible personal property or service. Any item that is taxed in South Dakota but not taxed in the state where it was purchased, for example, clothes purchased in Minnesota, is subject to the use tax when used or consumed in South Dakota.

The use tax is based on the purchase price of any product or service used or consumed in this state. Any tangible personal property that is seven or less years old which was not originally purchased for use in this state but used, stored, or consumed in this state is taxed on its fair market value. If a person has proof that a sales or use tax was paid to another state a credit is given for such tax. If the tax rate was not as high as South Dakota's the person must pay the difference.

The use tax is very difficult to collect from the average consumer who happens to purchase food or a pair of shoes in a state that does not tax those items. A person is also liable for the use tax on every item purchased through the mail. Revenue is collected from companies that are periodically audited. Retailers pay this tax on products that they purchase tax unpaid and use in the course of their business.

## Gross Receipts Tax on Visitor Related Business

A seasonal gross receipts tax is levied on certain visitor-intensive businesses for the purpose of funding tourism promotion. The tax only applies to certain business during June, July, August, and September. The seasonal tax applies to lodging establishments, campgrounds, visitor attractions, recreational services and equipment rental, spectator events, and visitor intensive businesses. A visitor intensive business is one of several shops listed in statute that does fifty percent or more of its business during June, July, August, or September.

Application	Sales and services related to tourism
Rate	Rate is 1% during the months of June, July, August, & September
Exempt Entities	<ul style="list-style-type: none"><li>• Nonprofit organizations that own lodging or camping facilities and rented by members</li><li>• Nonprofit shooting ranges</li></ul>
Distribution	Tourism promotion fund
Source	SDCL chapters 10-45D

## Contractor's Excise Tax

The realty improvement contractor's excise tax is a tax imposed on contractors who perform realty improvement contracts. A realty improvement is any activity which

improves the value of real estate, including road construction and maintenance, housing construction or improvement, and all types of building or construction activity that improves the value of real estate or the buildings or structures located on the real estate.

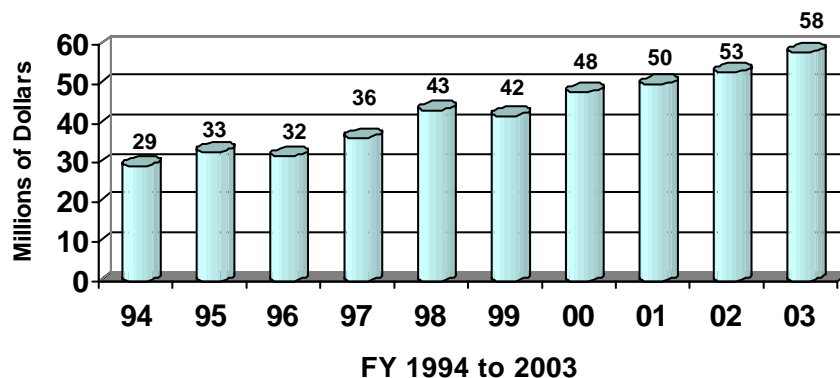
Application	Tax upon the gross receipts of all prime contractors engaged in realty improvement contracts
Rate	Rate is 2%
Exempt Entities	None (refund possible for certain agricultural facilities)
Source	SDCL chapters 10-46A and 10-46B

There are two different taxes based on the type of property being improved. Contracts to improve utility property are taxed separately from all other realty improvement contracts. All contracts are taxed at two percent of the gross receipts received directly or indirectly in money, credits, property, or other money's worth in consideration of the performance of a realty improvement contract. Gross receipts include materials furnished to the contractor by the owner or lessee of the realty improvement. The incidence of the tax, except on utility contracts, falls on the prime contractor. The prime contractor must provide the subcontractors with a certificate showing the prime contractor's tax license number to be exempt from the tax. Any subcontractor that does not receive or does not keep the certificate is liable for the tax on the contract.

Realty improvement contracts for utility companies are taxed at two percent of the gross receipts. The tax is imposed on both prime contractors and subcontractors. The tax applies to railroad, telephone, telegraph, electric, heating, water, gas, rural electric, and rural water company contracts and municipal utility contracts. The Department of Revenue and Regulation administers both taxes. The tax must be reported and remitted on a bimonthly basis unless the contractor has an annual tax liability of one thousand dollars or more and then the tax must be remitted monthly. A contractor may list the tax as a separate item on all contracts and bills, both for public and private entities.

The graph on the contractor's excise tax revenue provides an overview of the revenue generated by the contractor's excise tax. The construction industry is very susceptible to changes in the economy and the revenue from the tax can fluctuate by several percentage points in any given year although the trend has been upward.

**Contractor's Excise Tax Revenue**



## Motor Vehicle Fuel Tax

The motor fuel tax is a tax on all motor fuel sold or used in this state. The rates for motor fuel, special fuel, ethanol blends, and liquid petroleum gas was temporarily increased by three cents from May 1, 1997, to October 1, 1998. The additional revenue from this temporary tax increase was used to reimburse state and local governments for expenses incurred by the 1997 blizzards. A four cent increase was imposed on all fuels, except fuels used for aviation beginning April 1, 1999.

Any motor fuel consumer may apply for and obtain a refund of fuel taxes imposed and paid to this state, for motor fuel purchased and used by consumers in motor vehicles, recreation vehicles, and farm equipment used for nonhighway agricultural purposes or used in motor vehicles or equipment for nonhighway commercial uses. The portion of this refund attributed to nonhighway use of motor vehicles shall be calculated by multiplying the motor vehicle's average miles per gallon during the claim period times the number of nonhighway miles the vehicle was operated. The average miles per gallon and nonhighway miles shall be supported by actual individual vehicle fuel disbursement records and odometer readings. The portion of this refund attributed to nonhighway machinery and equipment shall be supported by individual vehicle fuel disbursement records. Three cents per gallon of each tax refund shall be deposited in the value added agriculture subfund created in § 1-16G-25.

Application	Fuel
Rate	<ul style="list-style-type: none"> <li>• Motor fuel (except ethanol blends, E85 and M85 blends, and aviation gasoline) - \$.22 per gallon;</li> <li>• Special fuel (except jet fuel) - \$.22 per gallon;</li> <li>• Ethanol blends - \$.20 per gallon;</li> <li>• Aviation gasoline - \$.06 per gallon;</li> <li>• Jet fuel - \$.04 per gallon;</li> <li>• E85 and M85 - \$.10 per gallon;</li> <li>• E85 and M85 used in aircraft - \$.04 per gallon;</li> <li>• Liquid petroleum gas - \$.20 per gallon;</li> <li>• Compressed natural gas - \$.10 per gallon.</li> </ul>
Exempt Entities	<ul style="list-style-type: none"> <li>• Federal government</li> <li>• Special fuel that has been dyed</li> <li>• Undyed special fuel used in a railroad locomotive, if the supplier is the railroad company</li> <li>• Motor fuel or undyed special fuel removed from a terminal and is directly used by an electrical power company</li> </ul>
Distribution	<ul style="list-style-type: none"> <li>• Motor Fuel Taxation Fund</li> <li>• Snowmobile trails' fund</li> <li>• State highway fund</li> <li>• Soil and water conservation fund</li> <li>• Parks and recreation fund</li> </ul>
Source	SDCL chapters 10-47B

The motor fuel tax is collected by the motor fuel dealer on all the motor fuel sold or used. The dealer is responsible for the tax and must pay the tax on any fuel that is not accounted for. Each person engaged in the business as a motor fuel dealer must be licensed. The motor fuel tax must be reported and remitted monthly.

Each motor fuel dealer is allowed to deduct two and one-fourth percent tax required to be paid on each gallon of fuel to this state. This deduction is to compensate the motor fuel dealer for losses in handling the fuel, for expenses incurred in preparing monthly reports, for accounting for and collecting the motor fuel tax, for the premium paid for the motor fuel dealer's bond, and for compensation for acting as an agent of the state in collecting the tax. One-third of this deduction is retained by the supplier or out-of-state supplier to help off-set the administrative expense of timely reporting and remitting of tax and the remaining two-thirds is distributed to the wholesale distributor, retail dealer, or end user who withdraws fuel from the terminal at the rack to help off-set the cost of fuel lost due to shrinkage caused by evaporation or temperature change.

Any liquid petroleum vendor who properly remits tax under this chapter may retain an amount equal to the percentage of tax remitted as follows:

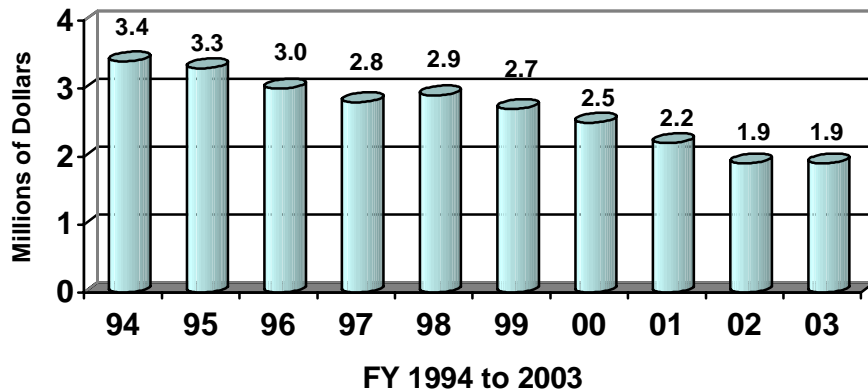
- (1) Two percent of the first twenty-five thousand gallons taxed each month;
- (2) One percent on the gallons taxed in excess of twenty-five thousand each month;  
and
- (3) The maximum amount retained each month shall be five hundred dollars.

The motor fuel dealer may also deduct the tax for all motor fuel in excess of one hundred gallons lost or destroyed by fire, flood, tornado, windstorm, explosion, or theft.

A person may receive a refund for all motor fuel bought for or used in motor vehicles, recreational vehicles, and farm equipment used for nonhighway agricultural purposes. A tax refund may also be had for motor fuel bought or used for nonhighway commercial use, except fuel that is used in recreational vehicles or recreational equipment. There is no refund available for motor fuel bought or used in aircraft, motor boats, or motorized watercraft. A refund claim must be filed within fifteen months of the date the fuel was purchased. No tax may be refunded more than fifteen months after the fuel was purchased.

The following graph displays the amount of money returned in motor fuel tax refunds. This money is basically from agricultural and construction use of motor fuel.

### Motor Fuel Tax Refunds



Motor fuel tax revenues are distributed to several recipients. The snowmobile trails fund receives an amount equal to the result of multiplying the number of licensed snowmobiles times one hundred twenty-five gallons times the motor fuel tax rate. This money is used to establish and maintain snowmobile trails. The parks and recreation fund within the Department of Game, Fish and Parks receives an amount equal to the number of licensed motorized boats times one hundred forty gallons times the motor fuel tax. This revenue is for the treatment of water, for pollution control, and for the acquisition, construction and maintenance of facilities, including landings, harbors, dams, and channels for motorboats.

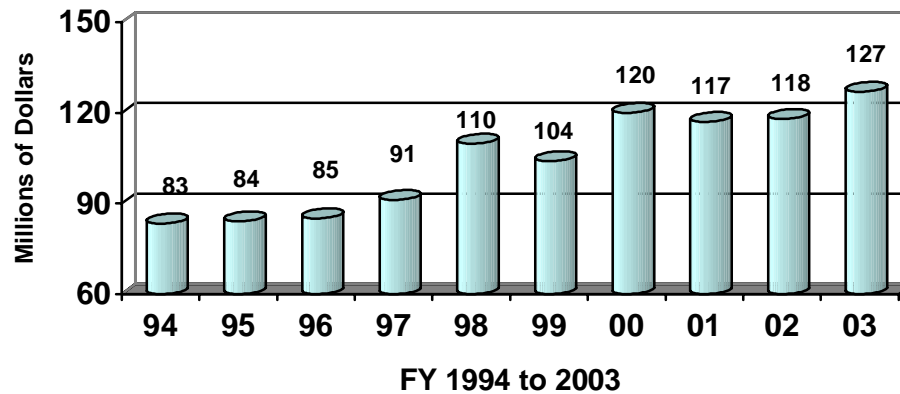
Two percent of the motor fuel tax revenue is used to cover the expenses incurred in administering the motor fuel and special fuel tax laws. All of the motor fuel tax collected on aircraft fuel is transferred to the state aeronautics fund. This revenue is transferred to individual airports based on the amount of aircraft fuel sold at each airport. The revenue not distributed to airports is distributed by the aeronautics commission for airport construction and improvement. All remaining motor fuel tax revenue is deposited in the state highway fund.

The Conservation Commission Grant Fund receives thirty-five percent of the claimed motor fuel tax refunds in the preceding month not to exceed \$1,500,000 in any fiscal year. The revenue in this fund is used by the Conservation Commission to provide grants for cropland, grassland, and water quality improvement projects identified through community resource/hydrolic unit plans.

In addition to the motor fuel tax exemption for ethanol blends, the state has created an ethyl alcohol producer payment program. Each person producing ethyl alcohol from cereal grain is eligible for a producer payment of twenty cents per gallon of ethyl alcohol.

The motor and special fuel tax collected in the last ten fiscal years is displayed in the following graph. The graph illustrates the temporary increase in the motor fuel tax of three cents per gallon from May 1, 1997, to October 1, 1998, and the increase of four cents per gallon beginning on April 1, 1999.

### Motor & Special Fuel Tax Revenue



Special fuel is compressed natural gas used to propel a motor vehicle, all other combustible gases and liquids except fuels subject to the motor fuel tax, and natural gas that is not compressed natural gas. All special fuel sold or used in this state is taxed at twenty-two cents per gallon, except special fuel sold for use in aircraft or airplanes, which is taxed at four cents per gallon. Liquefied petroleum gases are taxed at twenty cents per gallon.

There are uses of special fuel, which are exempt from the tax. All special fuel purchased for nonhighway use is exempt if the purchaser does not own a special fuel powered vehicle. All special fuel used for nonhighway commercial or agricultural purposes purchased by a licensed bulk fuel purchaser is exempt. All special fuel used by the state, counties, municipalities, townships, or Indian tribes for use in their vehicles and used for highway or street construction, reconstruction, or maintenance is exempt from the tax.

A licensed special fuel distributor may sell tax-unpaid special fuel to any purchaser who stipulates that the purchaser does not own or operate any special fuel powered motor vehicle on a public highway. The purchaser must consume all of the special fuel and may not sell any and must verify that none of the special fuel will be put into the supply tank of a motor vehicle. Also, a person may purchase the special fuel tax-unpaid if all of the special fuel will be used exclusively for the generation of electricity.

A person may obtain a bulk purchaser license if purchasing special fuel in quantities of twenty gallons or more. The fuel must be predominately used for nonhighway commercial or agricultural purposes or must be stored for interstate or intrastate motor carriers or for use by a contractor in any highway or nonhighway construction. A licensed bulk purchaser may purchase special fuel tax-unpaid. The bulk purchaser must

pay the special fuel tax on any special fuel delivered in the supply tank of a motor vehicle owned or operated by the bulk purchaser on a public highway.

Special fuel dealers must be licensed and may not purchase, sell, or deliver tax-unpaid special fuel. A special fuel dealer may deduct losses of special fuel in excess of one hundred gallons resulting from a single incident of loss or destruction caused by fire, flood, tornado, windstorm, or explosion. A special fuel dealer may also deduct any theft loss in excess of five hundred gallons if the theft was discovered by some means other than bookkeeping or accounting records and if the theft was reported to local law enforcement.

A special fuels distributor must be licensed and must collect and remit all special fuel taxes except on special fuel sold to another licensed distributor, the federal government, an aviation fuel dealer, a bulk purchaser, or a person purchasing special fuel for nonhighway uses. All special fuel distributors and aviation fuel distributors must report and remit the special fuels tax monthly. A distributor may deduct the special fuel tax on two percent of the first twenty-five thousand gallons taxed each month and one percent on all taxed gallons in excess of twenty-five thousand. The maximum deduction allowed is five hundred dollars per month. The deduction is to compensate the distributor for acting as an agent of the state. All of the special fuel tax revenue is deposited in the state highway fund except the amount collected on special fuel sold or used in aircraft or airplanes, which is deposited in the aeronautics fund.

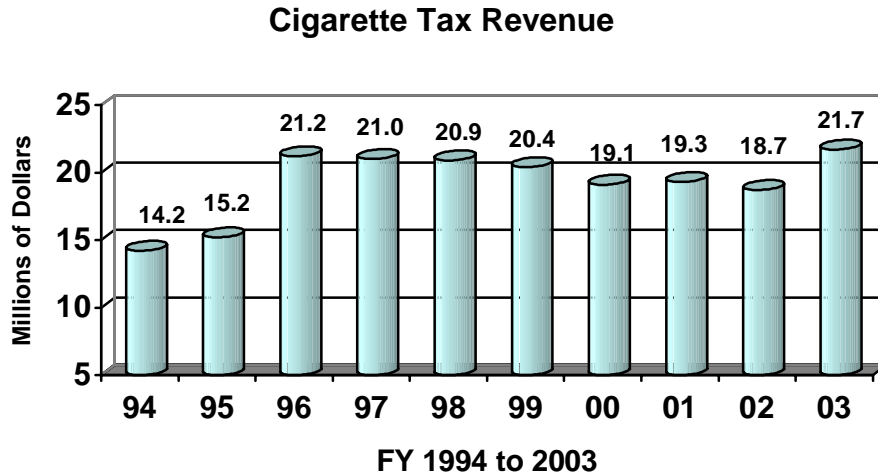
### **Cigarette Tax**

The cigarette tax is a tax imposed on all cigarettes held in this state for sale by any person. The tax rate on cigarettes is fifty-three cents per pack of twenty cigarettes. The tax rate was increased by twenty cents per pack on March 18, 2003. In addition, all tobacco products are taxed at the rate of 10% of the wholesale purchase price.

Application	Cigarettes and other tobacco products
Rate	Fifty-three cents per pack of cigarettes Ten percent of the wholesale purchase price for tobacco products
Distribution	General fund
Source	SDCL chapters 10-50

Each person selling cigarettes, except a retailer, must be licensed. The license fee is one hundred fifty dollars annually. Affixing stamps or the impression of an imprint evidences the payment of the cigarette tax. The stamps are sold to licensed distributors at a discount of three and one-half percent of their face value.

The following graph shows the cigarette tax revenue for the last ten years. The graph illustrates the increase in cigarette tax revenue due to legislation passed in 1995 that increased the tax ten cents per pack and imposed a ten percent wholesale tax.



### Municipal Sales and Use Tax

Each municipality beginning on January 1, 2004, may impose a sales and use tax that will mirror the tax the state imposes on goods and services with the same exemptions. Previously, the state exempted certain goods and services from municipal sales and use tax and only permitted the taxation of food up to a maximum of one percent by a municipality. There were exceptions, however, two municipalities taxed food at two percent and several municipalities did not tax food at all. The restrictions on how municipalities may spend the second penny of sales tax revenue have been lifted. There are 205 cities that impose a municipal sales and use tax.

Application	Sales and use tax on goods and services taxed pursuant to chapters 10-45 and 10-46
Rate	Rate is 0 to 2 % of gross receipts
Exempt Entities	Same entities as permitted for the state sales and use tax
Distribution	General fund of the municipality
Source	SDCL chapters 10-52

### Municipal Gross Receipts Tax

The municipal gross receipts tax provided in chapter 10-52A replaces the tax formerly known as the bed, board, and booze tax. Each municipality beginning on July 1, 2002, may impose a gross receipts tax on any combination of the following lodging and camping; alcoholic beverages; prepared foods; or ticket sales for certain events. There are, however, certain restrictions on how the revenue from this tax may be expended by



the each municipality. The revenue may only be used for the purpose of land acquisition, architectural fees, construction costs, payments for civic center, auditorium, or athletic facility buildings, including the maintenance, staffing, and operations of such facilities and the promotion and advertising of the city, its facilities, attractions, and activities.

Application	Gross receipts tax on: <ul style="list-style-type: none"> <li>• Lodging and camping</li> <li>• Alcoholic beverages</li> <li>• Prepared food for immediate consumption</li> <li>• Ticket sales for certain events</li> </ul>
Rate	Rate is 1% of certain gross receipts
Distribution	Revenue may only be used for purposes describe above
Source	SDCL chapters 10-52A

### Alcoholic Beverage Taxes

The alcoholic beverage taxes are occupational taxes levied on manufacturers and wholesalers of alcoholic beverages. The tax applies to all alcoholic beverages purchased, received, or imported from a distiller, manufacturer, or foreign wholesaler for sale to a retail dealer. The rate of taxation varies with the type of alcoholic beverage.

Application	Alcoholic beverages
Rate	<ul style="list-style-type: none"> <li>• Occupational tax (see information below)</li> <li>• Rate is 2% of the wholesale price, except beer</li> </ul>
Exemptions	<ul style="list-style-type: none"> <li>• Alcohol sold to dispenser licensees</li> <li>• Sacramental wine</li> <li>• Alcoholic and malt beverages sold by distillers and manufacturers for transportation in interstate commerce</li> </ul>
Distribution	<ul style="list-style-type: none"> <li>• Occupational tax – Twenty-five percent to municipalities – seventy-five percent to the state general fund</li> <li>• Wholesale tax revenue deposited in the state general fund</li> </ul>
Source	SDCL chapters 35-5

### Alcoholic Beverage Tax Rates

- \$8.50 p/barrel -- malt beverages
- \$ .93 p/gallon -- light wine and diluted beverages containing between 3.2 and 14% alcohol by weight
- \$1.45 p/gallon -- wine and diluted beverages containing between 14 and 20% alcohol by weight
- \$2.07 p/gallon -- wine and diluted beverages containing between 20 and 24% alcohol by weight and all sparkling wines
- \$3.93 p/gallon -- all other alcoholic beverages

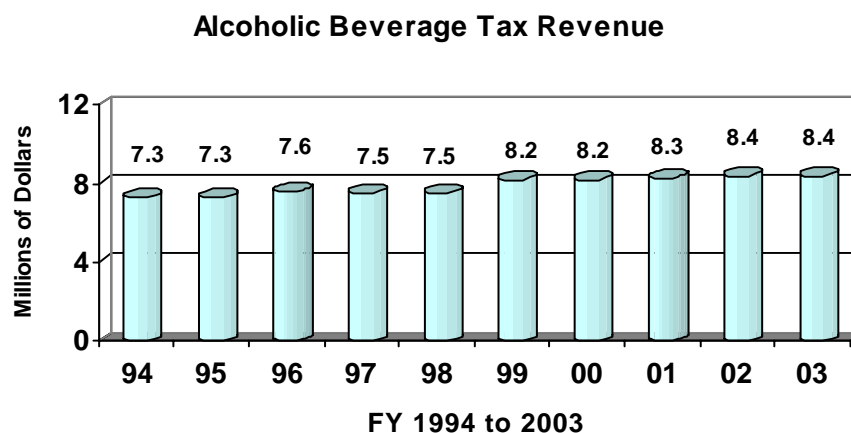
There is an additional tax of two percent on the wholesale price of all alcoholic beverages except beer. This extra tax is imposed on the purchase of alcoholic beverages, except beer, by a wholesaler from a distiller, manufacturer, or supplier.

The Department of Revenue and Regulation administers all of the alcoholic beverage taxes. The revenue from the two percent wholesale tax is deposited in the state general fund. The tax revenue from all the remaining types of alcoholic beverages is deposited in the alcohol beverage fund. Twenty-five percent of the revenue in the alcohol beverage fund is distributed to the state's municipalities. Each municipality's share is determined by the ratio the population each municipality has to the total population of all municipalities sharing in the revenue from the tax. The remainder of the revenue in the alcohol beverage fund is deposited in the state general fund.

The state and local governments heavily regulate alcoholic beverages and the licenses to sell alcoholic beverages. The fees for the different licenses vary greatly. The fee for the on-sale license, which is typically a bar or lounge, is based on the size of the municipality. In municipalities of the first class the fee is not less than one dollar for each person living within the municipality. In municipalities of the third class the fee is not more than nine hundred dollars. There are licenses for distillers, wholesalers, and on-sale dealers at publicly operated airports, among others.

The licenses for bars and liquor stores are issued by municipalities in conjunction with the Department of Revenue and Regulation or by counties when located outside the municipal corporate limits. The number of on-sale licenses permitted in a municipality or county is limited by state law and is based on a municipality's or county's population. The number of new malt beverage licenses is not regulated by state law and is not dependent on the population of the municipality or county. Municipalities and counties can have three on-sale licenses for the first one thousand in population and one for each fifteen hundred additional people and any fraction thereof. However, a county's population does not include anybody living within an incorporated municipality. The municipality or county issuing the license retains the fees for on-sale and off-sale liquor licenses.

The total revenue received by the state from all alcoholic beverage taxes is presented in the following graph.



## Motor Vehicle Excise Tax

The motor vehicle excise tax is a tax of three percent on the purchase price of any motor vehicle purchased or acquired for use on the streets and highways of this state. The purchase price of a new or used motor vehicle sold by a licensed motor vehicle dealer is the total consideration whether received in money or otherwise. If a motor vehicle is taken in trade the value of the trade-in is deducted from the value of the motor vehicle sold to arrive at a taxable value.

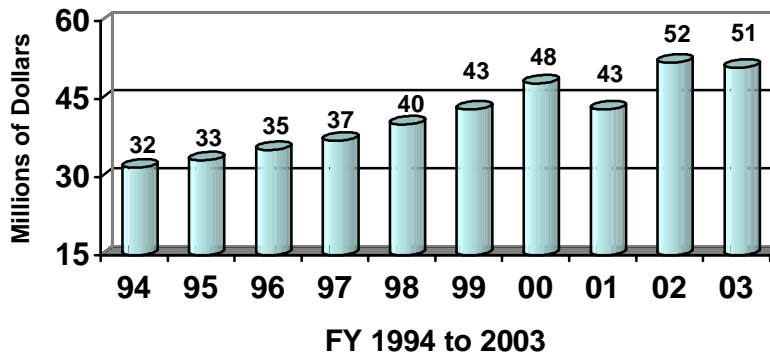
Application	Tax on purchase price of motor vehicle less any trade-in value
Rate	Rate is 3% of the purchase price less any trade-in value
Exemptions	<ul style="list-style-type: none"><li>• Any vehicle that is eleven or more years old and worth less than one thousand five hundred dollars</li><li>• Acquired by inheritance</li><li>• Transferred between a subsidiary corporation and the parent corporation</li><li>• Native Americans living within the bounds of a reservation</li></ul>
Distribution	State highway fund
Source	SDCL 32-5B – Motor vehicles SDCL 32-3A – Boats SDCL 32-5 – Snowmobiles SDCL 32-5 – Mobile homes

The purchase price of a used vehicle sold by a person other than a licensed motor vehicle dealer is the retail value as stated in a nationally recognized dealers' guide approved by the Department of Revenue and Regulation. The value of a trade-in is deducted from the value of the vehicle sold. The purchase price for a used or new vehicle acquired for no or nominal consideration is the manufacturers' suggested dealer list price for new vehicles or the retail value listed in a recognized dealers' guide for used vehicles.

Certain motor vehicle transfers are exempt from the tax. Any motor vehicle that is eleven or more years old and worth less than one thousand five hundred dollars before trade-in is exempt. Any motor vehicle acquired by inheritance or transferred from a subsidiary corporation to its parent corporation for no or nominal consideration is exempt. Also, any motor vehicle transferred without consideration between spouses, parent and child, or between siblings or any motor vehicle transferred between licensed motor vehicle dealers is exempt from the tax. Native Americans living within the bounds of a Reservation are also exempt from the tax.

The tax is paid to the county treasurer in the county of the new owner's residence. The county transfers the money to the state and it is deposited in the state highway fund. The tax on motor vehicles used in interstate commerce is prorated according to the number of miles driven in South Dakota as compared to the total number of miles driven.

## Motor Vehicle Excise Tax Revenue



### ***The Lottery***

The state's gambling development occurred in 1986 when the Legislature adopted House Joint Resolution 1001. This measure proposed a constitutional amendment that would authorize the Legislature to create "a state lottery that is regulated, controlled, owned, and operated by the state of South Dakota." This measure was placed on the 1986 general election ballot and was approved with a 59.7% majority (Article III, section 25 of the S. D. Constitution).

In 1987 the Legislature enacted the enabling legislation for the lottery. This legislation created a lottery commission of seven people appointed by the Governor to oversee the operation of the lottery agency. This legislation also created the South Dakota Lottery, a quasi-independent executive agency to operate the lottery games.

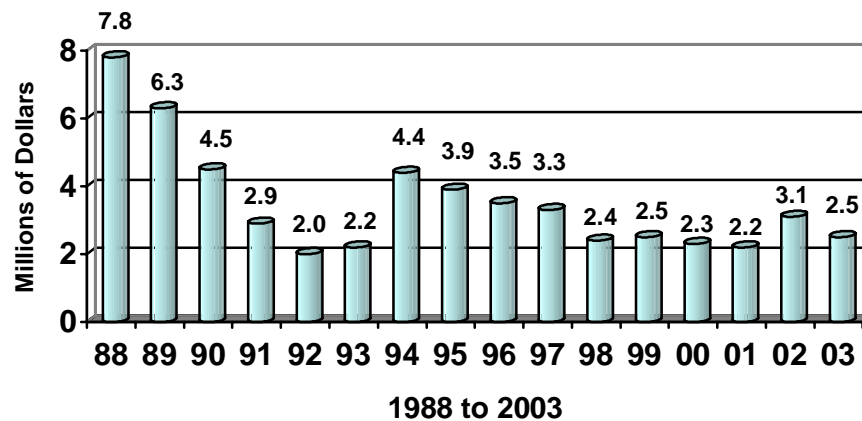
### ***Instant Tickets***

There were several competing interests in the process of enacting the lottery enabling legislation, and the competition resulted in the South Dakota Lottery having the authority to conduct only an instant ticket lottery game.

Initially, a minimum of forty-five percent of instant ticket sales was devoted to prizes. To counter declining sales this was increased to a minimum of fifty percent and currently fifty-seven percent is devoted to prizes. The lottery retailer pays small prizes. The large prizes must be presented to one of the three South Dakota Lottery offices for payment. The instant ticket retailers in the state receive a five percent commission on the sale of instant tickets and one percent of the redemptions.

The net revenue from the sale of instant tickets is deposited in the state general fund. As with most instant ticket lotteries there were large ticket sales in the first and second years of operation and then declining sales. The following graph provides the annual instant ticket revenue to the state.

## Instant Ticket Revenue



## Video Lottery

The next stage in the lottery's growth occurred in 1989 when the Legislature authorized lottery games that utilized video terminals. The video lottery, as it is now known, was first introduced in 1988 by an interim legislative study committee. The video lottery legislation was defeated in 1988, but was enacted in 1989 when the Governor sponsored the legislation.

The video lottery became operational in October of 1989. The video lottery was discontinued on August 12, 1994, after the Supreme Court determined that it was not a lottery within the scope of meaning of the state constitution. A special session of the sixty-ninth legislative assembly proposed a constitutional amendment that was approved on November 8, 1994, that rewrote Article III, section 25, of the constitution that authorized video lottery games. When video lottery became operational there were approximately two hundred terminals in place. By FY 2002, the number of terminals averaged 8,108 located across the state in 1,401 licensed establishments.

Video lottery terminals are not owned by the South Dakota Lottery but are owned by private citizens who are licensed by the state for that purpose. These 8,108 terminals in the state are owned by 176 operators. These terminals are located in licensed establishments that are required by law to possess an on-sale alcoholic beverage license.

Licensed establishments can own their own terminals but must also be licensed as an operator. Terminals can only be purchased from licensed distributors and manufacturers, and there are currently two manufacturers and one distributor licensed. Manufacturers and distributors are prohibited from being licensed as operators and cannot own, manage, or control a licensed establishment.

Video lottery terminals are required to pay back at least eighty percent in prizes, and the current credit win percentage in 2002 was 90.82%. The minimum bet is five cents and the maximum bet is two dollars. The maximum prize is one thousand dollars. The

terminals do not pay out in cash. The terminal issues a receipt that must be given to a person in the licensed establishment for actual payment. The licensed establishment must pay all prizes.

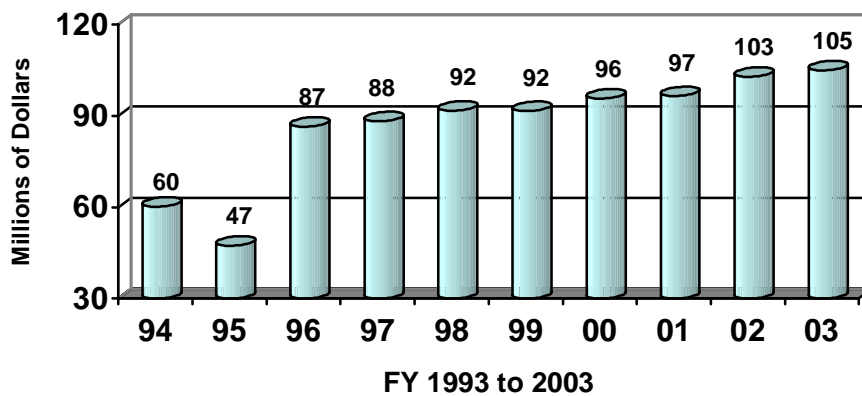
The tax revenue the state receives from video lottery is calculated as a percentage of the net terminal income, which is cash in the terminal minus the credits paid out in cash. The average net terminal income changes with the number of terminals and the amount of play. Average net terminal income has been decreasing as more terminals are put in place.

Up until 1993 the state's share of net terminal income was set by administrative rule by the South Dakota Lottery Commission. They had the authority to set the state's share from fifteen to thirty-five percent of net terminal income. Initially the South Dakota Lottery Commission set the state's share at 22.5% and beginning in 1993 the Legislature increased the state's share as shown in the following table.

Body Establishing the State's Share	Date the State's Share was Increased	State's Share of Net Income
Lottery Commission	October, 1989	22.5%
Lottery Commission	January, 1991	25%
Lottery Commission	January, 1992	35%
Legislature	July, 1993	36%
Legislature	July, 1994	37%
Legislature	July, 1995	50%

The state's share of net terminal income totaled \$102.9 million in FY 2002. The machine owner retains the remainder of net terminal income. Beginning in Fiscal Year 1997, the state's share of net terminal income is deposited in the state property tax reduction fund. The following graph provides the annual state revenue from the video lottery.

**Video Lottery Revenue**

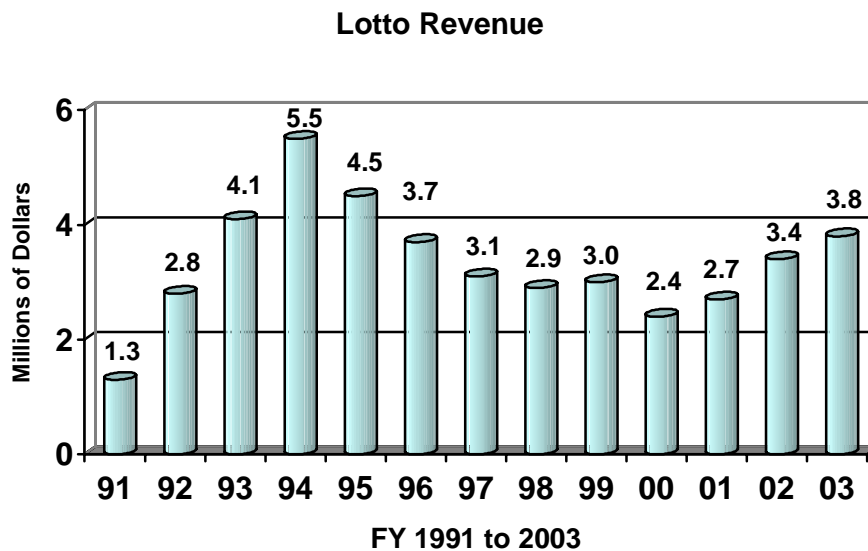


In addition to the state's share of net terminal income, the state receives revenue from license fees. Licenses are required for manufacturers, operators, distributors, establishments, and video terminals. Video lottery license fees are deposited in the video lottery operating fund that is used for the operation of the video lottery. In addition, one-half percent of the net terminal income that the state receives is also deposited in the video lottery operating fund and used for the cost of video lottery administration.

## Lotto

The third stage in the evolution of the lottery was the introduction of the on-line lotto game. The legislation for this was enacted in 1990 and sales began in November of 1990. The lotto legislation was enacted with the general understanding that South Dakota's population was not large enough to support a lotto game and that the South Dakota Lottery would join with other states. The lottery is a member of the Multi-State Lottery Association.

There are approximately 350 lotto terminals located across the state. Beginning on January 1, 2003, the profits from lotto are distributed as follows: first \$1.4 million to the general fund and the remainder to the capital construction fund. The capital construction funds proceeds are divided as follows: 71.8% to the water and environment fund; 25.6% to ethanol fuel fund; and 2.6% to public and special transportation fund. The following graph illustrates the annual state revenue from lotto.



## Deadwood

Another stage in the growth in gambling in South Dakota began in 1986 when a group of Deadwood residents formed an organization known as "Deadwood You Bet." This organization's purpose was to gather support for limited gambling within the city limits of Deadwood with the revenue from gambling used for the historic restoration and preservation of Deadwood.

They approached the Legislature in 1987 with House Joint Resolution 1002, which proposed placing a measure on the 1988 general election ballot to amend the constitution to permit limited gambling in Deadwood. The House of Representatives rejected this proposal. The members of "Deadwood You Bet" then spent several months collecting signatures to use the initiative process to place the constitutional amendment on the 1988 ballot. The voters approved the constitutional change with a 64.3% majority.

In 1989 the Legislature enacted the enabling legislation for limited gambling in Deadwood. The measure was then submitted to the residents of Deadwood for their approval and, as required by the amended constitution, more than 60% approved the measure. The enabling legislation created the five-member South Dakota Commission on Gaming whose responsibility it is to oversee the regulation of gambling within Deadwood. The commission employs an executive secretary who oversees the daily operation of the administrative agency created to regulate gambling in Deadwood. There are eighteen full-time employees of the Commission of Gaming.

The constitution requires that gambling in Deadwood be limited. Gambling is limited in Deadwood in four ways. First, no person may place a bet that exceeds one hundred dollars. This applies to the first bet and to any subsequent bet. Second, the types of games are limited. The constitution permits "limited card games and slot machines." And the Legislature has defined "card games" to mean poker and blackjack. The Commission on Gaming is required to define the rules of blackjack and poker, and in that process they have defined fifteen different varieties of poker games.

Third, the specific geographical area where gambling is permitted is limited. The constitution limits gambling to "within the city limits of Deadwood." The Legislature has defined the city limits of Deadwood to be the city boundary as it existed on January 1, 1989. Fourth, the number of gaming devices is limited. No establishment can have more than thirty card games or slot machines. The establishments in Deadwood can also have video lottery terminals and they are not counted in the gaming device limit for Deadwood.

The Commission on Gaming issues a variety of licenses. The types of licenses include those for gaming establishments, gaming employees, key employees, operators, gaming devices, and slot machine manufacturers.

The tax revenue from limited gambling in Deadwood consists of an eight percent gaming tax and various fees, including a \$2000 annual per machine fee. The revenue is divided among the Commission on Gaming, the city of Deadwood, the state, and Lawrence County. All of the revenue received by the Commission on Gaming, including the gaming tax and all fees, is deposited in the Gaming Commission Fund and then distributed. The state tourism promotion fund receives forty percent of the gaming tax and Lawrence County receives ten percent. The balance remains in the Commission Fund. All of the fee revenue remains in the Commission Fund.



The Gaming Commission uses the Commission Fund to pay the expenses of regulating gambling in Deadwood as well as horse and dog racing. All revenue in the Commission Fund after the cost of administration and the tax revenue dedicated to the state and Lawrence County is distributed to the city of Deadwood. The bulk of the tax and fee revenue from gambling in Deadwood goes to the city of Deadwood.

### **Constitutional Limitations**

Article XI of the South Dakota Constitution grants certain authority to impose taxes, it also exempts certain entities and facilities from certain taxation and limits the imposition of others. Article III, section 25 of the South Dakota Constitution permits gambling which certain taxes and fees are assessed against. These constitutional provisions establish certain parameters for the South Dakota tax structure, which include:

- Revenue from taxes on motor vehicles and fuel shall be used for highways and bridges;
- Property tax exemptions;
- Taxation of banks;
- No tax on any inheritance; and
- The requirements for imposing and increasing taxes
  - The right of initiative or
  - Two-thirds supermajority of the Legislature to impose a new tax or increase the rate of an existing tax

### **Conclusion**

This memo highlights the general application, rate schedules, exemptions, exceptions, and distribution of the major taxes imposed by the state of South Dakota and its political subdivisions. However, some minor taxes like the bingo tax were not discussed nor were some fees which may be viewed by some individuals as a tax. There are numerous nuances and exceptions enacted into the law, such as the various systems used to distribute the revenue. This may be viewed as special legislation, changes necessary to make the tax work, or compromises needed to enact legislation. In addition, several distinctions and exemptions are provided and granted in the constitution. The discussion and debate of taxes have been around for decades in South Dakota and centuries for the rest of the world. It is expected that the discussion and debate will continue.

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**This issue memorandum was written by Fred Baatz, Principal 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.**

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