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**South Dakota Personal Property  
Taxation: The Final Chapter**

by

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# SOUTH DAKOTA PERSONAL PROPERTY TAXATION: THE FINAL CHAPTER

by CALVIN A. KENT\*

*At the close of the 1977-78 session the South Dakota Legislature voted to repeal all existing taxes on personal property in the state. The repeal has raised many basic issues. This article traces the history of personal property taxation as it developed across the nation and discusses South Dakota's experience. The author then focuses his attention on the legislative history of the repeal and discusses some of the solutions to the issues it has raised.*

## I. HISTORY OF PROPERTY TAXATION

### *Introduction*

More than any other group in South Dakota, farmers and ranchers have been the advocates of change in the state's tax structure. This article demonstrates that it was principally because of the concern of agrarian interests that property taxes were levied upon virtually all types of property from the beginning of statehood. Since farming as an industry involves an inordinately high ratio of property to income, taxes on property have always been of concern not only to South Dakota farmers but to agrarian interests throughout the nation. The 1978 repeal of the personal property tax marks the end of an almost twenty year campaign on the part of South Dakota agriculture interest groups, to eliminate a tax which they felt to be both unfair and excessive. While other interest groups, and the state in general, will experience some beneficial effects from this repeal, it is the agricultural groups that will be the greatest beneficiaries.

### *European Background*

Taxes on property are the most ancient of all levies. Their history can be traced back to the days of the pharaohs in ancient Egypt which levied taxes on both land, buildings, and personal property.<sup>1</sup> Seligman reported that by the 4th Century B.C. Athens levied taxes on land, houses, slaves, cattle, personal furnishings, and money, but that in most of the Greek city states the taxation of money (intangibles) gradually was phased out for administrative

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1. E. BURKHARD, *The Taxation of Business Personal Property*, PROPERTY TAXATION U.S.A. 140 (1966).

reasons.<sup>2</sup> The Roman Empire levied a property tax which rested solely on land and tangible personal property, but even with the efficiency of the Roman bureaucracy, the inability to discover personal property finally ended the usefulness of that portion of the tax.<sup>3</sup> As Benson commented, "This early in history, then, one may see the perpetual problem of the property tax—how to discover and assess the personalty and intangibles."<sup>4</sup>

Although the American property tax can trace its beginnings to the system used in England, Jensen noted, "the American general property tax, in fact, is to a large extent, indigenous."<sup>5</sup> The English had since the days of the Dangelde (a tax levied as a bribe to the Vikings not to plunder the countryside) assessed taxes on both land and "moveables" but the tax on personalty had all but been discarded by the period of colonization.<sup>6</sup> The reason for its demise was, as might be expected, the difficulty involved in locating and assessing property that was not land or permanently affixed to it.<sup>7</sup> In a summary of the experience of England, Germany, and other European states in assessing both real and personal property during the 17th and 18th centuries, Benson concluded:

[T]angible personal property is hard to locate and to assess and mobile capital is frequently even more elusive. For this reason, no nation has completely succeeded in adapting the property tax to modern circumstances; most nations have tended to substitute levies on income and consumption as their major taxes.<sup>8</sup>

### *American Experience*

The American property tax system began to develop within the traditions and practices of the colonists' European ancestors. Certain ideas such as taxation based on ability to pay as measured by income, and taxation on all forms of property were adopted from the Medieval European experience, though modified to meet colonial needs.<sup>9</sup> The situation in the colonial period has been described as follows:

Historical research . . . has established that property in the colonies was originally supplementary, as a tax base, to the poll and to an ill-defined income earning capacity of certain persons, usually called "faculty," and that this composite tax was at first often less important fiscally than other taxes. Also, property taxes were frequently imposed only upon selected types of property, the list of which was gradually extended. Often these types of property were taxed according to more or less arbitrary schedules of stat-

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2. E. SELIGMAN, *ESSAYS IN TAXATION* 34 (8th ed. 1913).

3. *Id.*

4. S. BENSON, *A History of the General Property Tax, THE AMERICAN PROPERTY TAX: ITS HISTORY, ADMINISTRATION, AND ECONOMIC IMPACT* 13 (1965).

5. J. JENSEN, *PROPERTY TAXATION IN THE UNITED STATES* 19 (1931).

6. *Id.* at 24.

7. *See id.*

8. BENSON, *supra* note 4, at 21.

9. *Id.*

utory values, and with different rates applicable to various types of property.<sup>10</sup>

In the period following the American Revolution, the Federal Government was able to exploit the tariff as its principle source of revenue. The states, on the other hand, mainly used property taxation. To a lesser degree property taxation was also relied upon by local governments, but they relied primarily upon special assessments and the poll tax for their revenue needs.<sup>11</sup> As a result, a patchwork system of state taxation developed on real and personal property, which represented as much diversity as the ethnic composition of the inhabitants of the states that imposed the levies. Despite this fact, Walcott found certain similarities in the state property tax structures: “[G]eneral agreement as to objects of taxation appeared to be present by 1796; land, farm stock, some forms of personal property, some manifestations of business or professional ability.”<sup>12</sup> But at the same time Walcott noted striking differences.

For example, some states taxed land solely on an acreage or quantity basis. Some assessed land by mode of cultivation and others by value of crop or livestock produced. A few assigned land a permanent value and some adjusted that value every three years. But a few states attempted to reach all forms of property including personal.<sup>13</sup>

Some states made an attempt, due to fiscal necessity, to expand the property tax base beyond land to include certain intangibles,<sup>14</sup> but these instances were few and neither fiscally nor historically important. During the 19th Century, however, there was a radical change: “Many states adopted constitutional ‘general property tax’ requirements that all property (realty, tangible personalty, intangibles) be taxed at a uniform rate.”<sup>15</sup>

Benson said it was not unusual, considering the dominant American philosophy of democracy, that there should arise demands for both uniformity and universality in the taxation of property.<sup>16</sup> The uniformity rule required that all taxpaying property situated in the same taxing district be treated alike and that it should be taxed in proportion to the value of that property.<sup>17</sup> The universality requirement demanded that all forms of property be taxed, partially to cure the abuses of property tax exemptions which had developed in the colonial and post-revolutionary period.<sup>18</sup> At least twenty-one states adopted such requirements in

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10. JENSEN, *supra* note 5, at 26-27.

11. *Id.* at 35.

12. O. WALCOTT, *Report on Direct Taxes: 1796*, AMERICAN STATE PAPERS, 1 FINANCE 423, 534 (1832).

13. *Id.*

14. JENSEN, *supra* note 5, at 35.

15. BENSON, *supra* note 4, at 12.

16. *Id.* at 31.

17. JENSEN, *supra* note 5, at 160.

18. BENSON, *supra* note 4, at 34-39. Benson cites the proliferation of both legal and extralegal exemptions often granted as political favors as a major source of dissatisfaction with the colonial property tax system.

the early 1800's in their constitutions and several other states enacted similar requirements through either legislative or administrative action.<sup>19</sup> As America expanded westward so did the democratic feeling and the general property tax system engulfed virtually every new state including South Dakota.<sup>20</sup>

This 19th Century idealism favoring general property taxes within the states was based upon the feeling that one should be willing to accept his obligations to pay for the expenses of the state so long as everyone else was equally willing to accept theirs.<sup>21</sup> If one accepts the concept of ability-to-pay taxation, the theoretical justification behind the general property tax movement is easy to discern. In simple economies where agriculture predominates, a tax on land is also an accurate measure of both income and wealth. But as economies become more complex and as commerce and manufacturing replace agriculture as the dominate form of enterprise, the theory breaks down. A class of wage earners arises whose income is totally independent of property ownership. Also, a class of professionals, such as lawyers, doctors, and accountants, comes into being whose income is not related to property owned. Under such conditions the justification that the property tax on land is a levy on ability-to-pay becomes foolish.<sup>22</sup>

But even as the wave of general property taxation was sweeping the western part of the country, the general property tax was being undermined on the East Coast by what has been described as the "classification movement."<sup>23</sup> The principle of a classified property tax certainly was not new. Most colonial tax systems embraced the principle. But during the late 1800's and the early part of this century,

[d]iverse measures and practices [were] designed to classify property for taxation, subjecting the various classes to taxation at different rates, or at different percentages of the true value. . . . [C]lassification may be combined with segregation. . . . [C]lassification may be general, or at least very comprehensive, effecting all property taxable . . . ; or it may be limited to specified items of property, usually intangibles . . . .<sup>24</sup>

Classification of property for taxation purposes involved one or more of the following: (1) classification of some types of property (usually religious, benevolent & educational) as exempt; (2) taxation of some property (usually monies and credits) at lower rates than other; (3) establishing a lower percentage of market value to be taxed for some property (usually agricultural land).

The reason for the failure of the general property tax was very simple. It began from the fact that personal property, particularly

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19. *Id.* at 31.

20. *Infra* note 51.

21. See BENSON, *supra* note 4, at 12.

22. JENSEN, *supra* note 5, at 22.

23. *Id.* at 173-204.

24. *Id.* at 173.

intangibles, generally was not taxed despite either constitutional or legislative requirements that it be included.<sup>25</sup> Citing statistics indicating the erosion of the personal property component of the tax base in major cities in the period between the Civil War and the turn of the century, Benson concluded:

[R]easons besides sheer hypocrisy may help explain the apparent defection of the American public from the tax ideals it had earlier espoused. Most uniformity and universality requirements were adopted during the early stages of a state's economic development. The increase in intangibles and personalty undoubtedly made the refusal to list all property easier and therefore more tempting, and the growth of cities and their mores probably made the older rural sense of personal integrity seem a little less imperative. Or perhaps tax rates were frequently so high that listing all one's property for taxation would have been financially disastrous for a man and his family. In any even widespread disregard of the constitution and the laws clearly existed.<sup>26</sup>

To induce the listing of these missing properties, the states would impose a lower rate on this property than would be applied to other forms not so easily concealed. Noting the significant lack of intangibles on most state tax roles, Benson concluded, "Many states decided that the best solution was to 'bribe' taxpayers into listing intangibles by permitting this property to be taxed at a lower rate than realty."<sup>27</sup>

Seligman summarized the feelings of the majority of the academic community around the turn of the century regarding the practical defects in the general property tax. Those objections were as follows:

1. The tax was not uniform since few states attempted to equalize property assessment.
2. The tax was not universal as most personal property was escaping taxation.
3. There was a strong incentive towards dishonesty since enforcement of the tax on personalty induced deception.
4. The tax was regressive since high income groups which were often dependent on income from intangibles had substantially exempted themselves from the tax.
5. The tax produced double taxation when mortgages and other evidences of indebtedness were taxed as well as land and the collateral for those debts under the real property tax.<sup>28</sup>

The original motivation behind the classification movement was to make the property tax an ability-to-pay levy and to reach sources of income which would otherwise be untaxed. Though sales taxes are thought to be a better method of taxing tangible

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25. BENSON, *supra* note 4, at 61.

26. *Id.* at 57.

27. *Id.* at 64.

28. E. SELIGMAN, *ESSAYS IN TAXATION* 19-31 (10th ed. rev. 1928).

personal property and income taxes superior for the taxation of monies and credits,<sup>29</sup> these taxes were not frequently employed. Despite the success of selective excise taxes in most of the states, general sales taxes were not widely accepted because of what was felt to be the United States Supreme Court's inconsistent attitude toward sales taxation of transactions involving interstate commerce.<sup>30</sup> There was also a feeling that a general sales tax might cause business to migrate into tax free states from those states which attempted to impose the levy.<sup>31</sup>

Taxation of both personal and corporate income at the federal level was not allowed until the passage of the sixteenth amendment,<sup>32</sup> and some state courts also construed their constitutions to forbid personal income taxation within their jurisdictions.<sup>33</sup> But the primary reason for the failure of the states to use individual income taxes was the administrative difficulties involved. Reaching income not directly tied to real estate was not feasible until the success of the Wisconsin tax of 1911 which included two administrative innovations, centralized administration and the use of "at-source" reporting of wages.<sup>34</sup>

In surveying the trends in personal property taxation from the turn of the century to the mid-1960's McClelland had noted two strong trends in addition to the growth of tax classification.<sup>35</sup> The first is the reduced emphasis on the use of property taxes for state government finance. McClelland cites statistics that show in 1890 72 percent of state revenue came from the property tax, but by 1957 the figure had fallen to 3.3 percent.<sup>36</sup> By 1976, only 1.7 percent of state revenue came from property taxes.<sup>37</sup> The second trend is the greater emphasis on real property taxation and the declining importance of the tax on personal property. As Netzer has noted, from the 1870's personalty declined in importance as a component of the property tax base. This decrease in importance was most pronounced in the more populated, less rural states.<sup>38</sup> By the time of the 1930's, personal property accounted for only about 19 percent

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29. See BENSON, *supra* note 4, at 73.

30. Ficklen v. Taxing District, 145 U.S. 1 (1892); Maine v. Grand Trunk Ry., 142 U.S. 217 (1891); Robbins v. Taxing District, 120 U.S. 489 (1887).

31. J. MAXWELL & J. ARONSON, FINANCING STATE AND LOCAL GOVERNMENTS 101-02 (3d ed. 1977).

32. R. BLAKEY & L. BLAKEY, THE FEDERAL INCOME TAX 1-104 (1940); II A. KELLY & W. HARBISON, THE AMERICAN CONSTITUTION, ITS ORIGINS AND DEVELOPMENT 562-73, 618-22 (3d ed. 1963). Both these works contain good histories.

33. See RESEARCH DIVISION AFL-CIO, STATE AND LOCAL TAXES 35 (1958), which lists Illinois, Washington, Pennsylvania, and Indiana as states where courts were hostile to state personal income taxes.

34. C. PENNIMAN & W. HELLER, STATE INCOME TAX ADMINISTRATION 5-6 (1959).

35. H. MCCLELLAND, *Property Tax Assessment*, THE AMERICAN PROPERTY TAX: ITS HISTORY, ADMINISTRATION, AND ECONOMIC IMPACT 82-101 (1965).

36. *Id.* at 83.

37. ADVISORY COMMISSION ON INTERGOVERNMENTAL RELATIONS, II. SIGNIFICANT FEATURES OF FISCAL FEDERALISM 28 (1977) [hereinafter cited as SIGNIFICANT FEATURES].

38. D. NETZER, ECONOMICS OF THE PROPERTY TAX 139 (1966).

of total assessments and declined moderately to about 16 percent of the tax base during the 1960's.<sup>39</sup> As shown in Table I the personal property component of the total property tax collected has declined to 13.7 percent by the mid-point of this decade.<sup>40</sup>

TABLE I  
Sources of Property Tax Revenue: 1975<sup>1</sup>

Source	Amount (millions)	Percentage distribution
<b>Nonbusiness</b>		
Nonfarm residential realty <sup>2</sup>	\$23,680	47.3
Farm realty <sup>3</sup>	1,017	2.0
Vacant lots	398	0.8
Total nonbusiness realty	\$25,095	50.1
Nonfarm personalty <sup>4</sup>	818	1.6
Farm personalty	141	0.3
Total nonbusiness personalty	958	1.9
Total nonbusiness	\$26,053	52.1
<b>Business</b>		
Farm realty <sup>5</sup>	2,315	4.6
Vacant lots	597	1.2
Other realty <sup>6</sup>	11,415	22.8
Total business realty	\$14,327	28.6
Farm personalty <sup>7</sup>	565	1.1
Other personalty <sup>8</sup>	5,336	10.7
Total business personalty	5,901	11.8
Public utilities	3,758	7.5
Total business	\$23,987	47.9
<b>Total</b>	<b>\$50,050<sup>9</sup></b>	<b>100.0</b>

<sup>1</sup> Advisory Comm'n on Intergov't Relations estimates based on 1975 collections distributed on basis of 1967 Census data, latest available statistics.

<sup>2</sup> Includes both single-family dwelling units and apartments. An estimated \$18 billion or 36% of all local property taxes was derived from single-family homes; about \$6 billion or 12% of property tax revenue came from multi-family units.

<sup>3</sup> Estimated collections from the taxation of the "residential" element of the farm.

<sup>4</sup> The collections produced through the taxation of furniture and other household effects.

<sup>5</sup> Estimated collections from the taxation of land and improvements actually used in the production of agricultural products—this is exclusive of the land and buildings used in a residential capacity by the farmer.

<sup>6</sup> Commercial and industrial real estate other than public utilities.

<sup>7</sup> The estimated collections from the taxation of livestock, tractors, etc.

<sup>8</sup> Estimated collections from the taxation of merchants' and manufacturers' inventory, tools and machinery, etc.

<sup>9</sup> This is the grand total for local property tax receipts. In addition, there are \$1.5 billion in State property taxes. The data needed for a similar distribution of State receipts is not available. However, it is estimated that approximately \$520 million of the State receipts are derived from general property taxes and could probably be distributed among the various sources of revenue in the same proportion as local receipts. The remaining \$930 million in State receipts consists mainly of State special property taxes on business personal property, but includes a substantial amount from special property taxes on motor vehicles, most of which is collected by the State of California.

Source: ADVISORY COMMISSION ON INTERGOVERNMENTAL RELATIONS, SIGNIFICANT FEATURES OF AMERICAN FEDERALISM 28 (1977).

39. *Id.*

40. SIGNIFICANT FEATURES, *supra* note 37, at 106.



## II. CURRENT STATUS OF PERSONAL PROPERTY TAXATION

The past decade has seen the trend toward exemption of all or part of personal property from state and local taxation intensify among the various states.<sup>41</sup> There are only eight states in which all personal property is completely exempted from taxation. Four of these states have granted the blanket exemption during the past decade to all items which were not previously exempted from tax. A large number of additional states tax only a few classes of personal property, for example, equipment used in farming, in construction, or in a retail trade. Only a few states still tax monies and credits or levy personal property taxes on motor and recreational vehicles.

There are no states which tax all forms of personal property. Six states employ broad based personal property tax levies which exclude one or two classes of personal property such as goods in transit, livestock, business inventories or monies in credit. In some of these states the statutory requirements for the taxation of personal property were not being followed and the enforcement of the tax was, at best, lax.<sup>42</sup>

The 1978 elections produced results that will further decrease the importance of the personal property tax. In Nevada, voters approved a constitutional amendment to phase out the business inventory tax over a five year period.<sup>43</sup> In Georgia, however, the constitutional requirement for livestock taxation was retained.<sup>44</sup> The necessary amendments to the Alabama Constitution were passed to implement the repeal of most personal property taxes in that state.<sup>45</sup> In Texas, the requirement for taxation of intangibles was removed from the state constitution and the voters directed the legislature to remove levies on household goods and personal effects.<sup>46</sup>

The repeal of personal property tax in South Dakota apparently follows the trend noted by Netzer:

One would expect neighboring states to emulate one another in the process of progressively exempting personalty, partly, of course, because legislators and governors are more aware of developments in states near by than in those at a distance. Equally significant, states within the

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41. Zellmer & Kent, *Trends in the Taxation of Personal Property*, STATE GOVERNMENT 12-19 (winter 1979) provides a complete analysis of the status of personal property taxation as of January, 1979. The discussion which follows is based on replies to a questionnaire prepared by Zellmer and Kent at the request of the South Dakota Legislative Research Council. This questionnaire was completed by state tax and legislative officials and covered the status of personal property taxation, the methods used if personal property taxes were repealed and sources of replacement revenue, if any. The questionnaires are on file with the author.

42. *Id.*

43. 1975 Nev. Ass. Joint Res. 21 (passed 1975 and 1977 referred to electorate and passed 7 November 1978).

44. 1978 Ga. Sess. Laws, Act 132.

45. 1978 Ala. Acts, Act 47.

46. 1978 Tex. Gen. Laws H.J.R. 1.

same region are typically direct competitors economically and taxpayers are likely to exert greater pressure for exemption when their nearby competitors in an adjacent state enjoy exemption.<sup>47</sup>

The repeal in total or in part of personal property taxes in states surrounding South Dakota is almost universal.<sup>48</sup>

In addition, several other states have repealed virtually all of their property taxes in the last decade. These included Alabama, California, Georgia, Illinois, Indiana, Louisiana, Maine, Missouri, New Hampshire, Ohio, Oregon, Tennessee, Washington, and Wisconsin.<sup>49</sup> Besides these states, eighteen others repealed portions

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47. NETZER, *supra* note 38, at 154.

48. Following almost a decade of agitation for repeal, North Dakota exempted all personal property except that which the Constitution required to be taxed. T. Ostenson & L. Loftsgard, *An Appraisal of Personal Property Taxes in North Dakota* 467 (1966) (North Dakota State University Ag. Experiment Station); Report of the North Dakota Personal Property Tax Commission, 41st Legislative Session (1969). See N.D. CENT. CODE § 57-02-08(25) (1972). The legislation which exempted personal property also (1) increased the sales tax to include many items previously exempted, (2) extended the business privilege tax, (3) established a replacement program for lost local revenue which contains a formula providing dollar for dollar replacement of personal property taxes levied in the base year plus a growth formula of one dollar for every seven dollars in increased real property taxes levied after the base year. 1969 N.D. Sess. Laws, ch. 528.

A personal property tax credit of up to \$10,000 assessed value of tangible personal property was passed in Iowa in 1973. IOWA CODE ANN. §§ 427A.2-6 (West Supp. 1978). The exemption for farm equipment was increased from \$300 to \$1,000 of assessed evaluation in 1975. After 1974, additional personal property tax credits were granted in each year in which the growth of the state general fund revenues adjusted for changes in rate and bases exceeded 5½%. After nine such increases all taxes on personal property will be repealed in that state. *Id.* § 427A.9-10. A replacement fund was established to reimburse local governments with money from the state general funds. *Id.* § 427A.12. The personal property tax base was established equal to the total personal property liability in 1973. The replacement base was taken times a fraction, the numerator of which is total assessed valuation of all personal property. Livestock is not to be included in any of these calculations. *Id.* §§ 427.12(5)-12(8).

Wyoming has planned a four year phase out of the personal property tax on household items and personal effects beginning in 1973, but in 1975 the legislature eliminated the phase out in favor of immediate repeal. 1975 Wyo. Sess. Laws ch. 9, § 204. The taxes on business inventories and farm supplies were previously phased out in the period 1967 to 1972 and livestock was exempted from personal property taxes in 1978 except for inspection and predator control. Letter from C. James Orr, Wyoming Legislative Council, to S. Zellmer (July 17, 1978) (on file with author). There were no special provisions made in Wyoming to replace lost revenue.

Exempt personal property in Minnesota includes farm livestock, farm machinery, furniture, inventories, and tools. MINN. STAT. ANN. § 272.02 (West 1969). Since 1959, local boards have had the option to exempt household goods from taxation. *Id.* § 272.61. The repeal of personal property tax in Minnesota was piecemeal over the period of 1967 to 1971. Letters from K. Bake, Research Dep't Minn. House of Rep., to S. Zellmer and C. Kent (August 15, 1978) (on file with author). A state sales tax was enacted in 1967 to help replace lost local revenues. 1967 Minn. Laws ch. 308.

In 1972 Nebraska began to exempt all agricultural products and equipment as well as business inventories from personal property taxation. NEB. REV. STAT. §§ 77-202.25-29 (1976). The tax is to be phased out by accumulative exemption of 12½% per year until completely eliminated. The property tax replacement fund was established with revenues gleaned from sales and income tax revenues. *Id.* § 77-202.30. The rate of the state income tax is set each year by a special commission, *id.* § 77-2715.01, which balances the budget. As a result no new taxes were needed in Nebraska to replace the losses in revenue.

49. Zellmer & Kent, *supra* note 41.

of their personal property tax.<sup>50</sup> A common characteristic in most of these instances is the absence of the replacement program for lost local revenues. Responses to a questionnaire used by Zellmer & Kent indicated that most of the tax loss in these states to local government is recouped by higher rates on other property, particularly residential and business realty, which remained on the tax rolls.

### III. HISTORY OF SOUTH DAKOTA TAX ON PERSONAL PROPERTY

#### *The Early Development*

In light of the historical trends traced earlier in this article, it is not surprising to find that when South Dakota was admitted to the Union in 1889, the state constitution adopted the general rather than the classified form of the property tax: "All taxes to be raised in this state shall be uniform on all real and personal property according to its value in money."<sup>51</sup> Whitlow, in his history of the South Dakota property tax, indicates three reasons for adopting the general rather than the classified form of property taxation:

The first is that at that time the general property tax had little more than passed the zenith of its popularity in the United States; the second is that the economic relationships in the middlewest were then relatively simple, making a setting in which the "uniform rule" in property taxation operated most satisfactorily; and the third is that the general property tax had been the chief source of revenue for the territorial government prior to the state's admission to the Union.<sup>52</sup>

Similar universality and uniformity requirements were included in the constitutions of the other four states admitted to the Union in that year.<sup>53</sup> Benson noted that South Dakota reinforced her 1889 constitution with provisions that all monies, credits, bank notes and bills were to be taxed currently with real and other personal property.<sup>54</sup>

The first serious attempt to alter the uniformity provisions of the state Constitution occurred in 1907 when the State legislature first proposed the classification of all property for tax purposes. This amendment was defeated at the general election. In its 1913-14 Report, the Tax Commission recommended classification for the purpose of taxation of monies and credits at a lower rate, saying that the rate would be fairer and the state would "profit by an increased revenue from this source."<sup>55</sup> In 1916 the recommended constitutional amendment again failed to receive the approval of

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50. *Id.*

51. S.D. CONST. art. XI, § 2 (as originally adopted on October 1, 1889).

52. C. WHITLOW, *THE PROPERTY TAX IN SOUTH DAKOTA*, printed in XXI SOUTH DAKOTA HISTORICAL COLLECTION 4 (1942).

53. MONT. CONST. art. XII, § 1; N.D. CONST. art. XI, § 176; WASH. CONST. art. VII, § 2; WYO. CONST. art. XV, § 11.

54. BENSON, *supra* note 4, at 41.

55. S.D. TAX COMMISSION, *FIRST BIENNIAL REPORT* 137 (1913-1914).

the voters; in 1918, however, a third attempt met with success.<sup>56</sup> The grant of power to the legislature was broad:

To the end that the burden of taxation may be equitable upon all property, and in order that no property which is made subject to taxation shall escape, the Legislature is empowered to divide all property including moneys and credits as well as physical property into classes and to determine what class or classes of property shall be subject to taxation and what property, if any, shall not be subject to taxation. Taxes shall be uniform on all property of the same class, and shall be levied and collected for public purposes only. Taxes may be imposed upon any and all property including privileges, franchises and licenses to do business in the state. Gross earnings and net incomes may be considered in taxing any and all property, and the valuation of property for taxation purposes shall never exceed the actual value therefore. The Legislature is empowered to impose taxes upon incomes and occupations, and taxes upon incomes may be graduated and progressive and reasonable exemptions may be provided.<sup>57</sup>

The South Dakota Legislature extended the classification to monies and credits the following year and passed a tax on the recording of mortgages which was to be paid by lenders in lieu of a personal property tax on mortgages.<sup>58</sup>

In 1923, however, the legislature repealed the mortgage recording tax<sup>59</sup> and redefined money and credits to include mortgages on real property located within the state and increased the levy on monies and credits to four mills.<sup>60</sup> Bank stock, which had been taxed at the rate imposed upon property in general,<sup>61</sup> was brought under the rate applicable to other monies and credits in another 1923 act.<sup>62</sup> The reason for this action was to bring the South Dakota law into compliance with a new federal statute<sup>63</sup> which required that shares of stocks in national banks could be taxed at a rate no higher than that imposed upon other money capital.<sup>64</sup> This method of taxing monies and credits and bank stock persisted until 1939 when the Legislature, in an attempt to improve the taxation of financial institutions, eliminated all personal property taxes on them and subjected them to a 3 percent net income tax in-lieu.<sup>65</sup>

There is contradictory evidence on whether the exemption of monies and credits succeeded in achieving the goal of inducing more listing of intangible property and creating higher revenues for the state. Benson thought that the evidence showed the suc-

56. WHITLOW, *supra* note 52, at 129.

57. 1917 S.D. Sess. Laws ch. 161, amending S.D. CONST. art. XI, § 2.

58. JENSEN, *supra* note 5, at 195.

59. 1923 S.D. Sess. Laws ch. 110.

60. *Id.* at ch. 108.

61. WHITLOW, *supra* note 52, at 131.

62. 1923 S.D. Sess. Laws ch. 103.

63. Act of March 4, 1923, ch. 267, 42 Stat. 1499 (1923) (current version at 12 U.S.C. § 548 (1976)).

64. WHITLOW, *supra* note 52, at 132.

65. 1939 S.D. Sess. Laws ch. 263.

cess of the special provisions, since tax revenues rose from \$196,000 to \$332,000 and the number of persons listing intangibles rose from 9,500 to 68,600 from 1918 to 1919.<sup>66</sup> On the other hand, Whitlow estimated the amount of revenue that would have been received by the State if intangibles had not been specially classified and compared that to the revenue from intangibles the State actually received in the years 1919 to 1936, and concluded,

[T]he striking fact that with the exception of two years (1919 and 1933), the levy actually imposed each year upon money and credits is less than half the amount that it is reasonable to assume would have been levied against the same intangibles if the policy of classification had never been adopted!<sup>67</sup>

During the Depression of the 1930's, among the more significant property tax developments in South Dakota was the recognition that, due to declining property values, both the State and its local subdivisions could no longer rely upon the property tax as their most important source of revenue. The legislature decided to reserve virtually all the general property tax for local government use and other sources of revenue would be used to supply state government needs.<sup>68</sup> As a result in 1933 the South Dakota legislature enacted a gross income tax as an emergency measure which was to endure for only two years. In 1935 the legislature replaced the gross income tax with the net income levy, which remained in effect until 1943 when it was repealed.<sup>69</sup>

### *Legislative Activities During the 1950's and 1960's*

During the 1950's the principle concern of the legislature appears not to have been with repeal of the personal property tax but with improvement in its administration. In 1955 the legislature relieved the local assessor from the responsibility of personally listing all items of personal property and provided for a self-assessment system<sup>70</sup> which prevailed until the repeal in 1978. In addition, legislation in both 1957 and 1959 exempted checking accounts and certain other funds from assessment under the monies and credits tax and doubled the exemption limit for the remaining taxable monies and credits. "It was hoped that these measures would encourage more accurate self-listing of taxable assets" and thus expand the revenue base for local governments.<sup>71</sup> Ten years later, the Legislative Research Council's 1967 report notes that the

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66. BENSON, *supra* note 4, at 64.

67. WHITLOW, *supra* note 52, at 146.

68. S.D. Legislative Research Council, Feasibility of Repealing the Personal Property and Moneys and Credits Taxes and Methods for the Replacement and Distribution of Revenues 34 (July 10, 1967) (located at I.D. Weeks Library, Univ. of S.D.) [hereinafter cited as Feasibility of Repeal].

69. 1935 S.D. Sess. Laws ch. 205, § 5 (codified at S.D.C. § 57.2801 (1939)); repealed, 1943 S.D. Sess. Laws ch. 295.

70. S.D. Legislative Research Council, Reports of the Committee on Assessment and Taxation 3 (September 1954) (located at I.D. Weeks Library, Univ. of S.D.).

71. Feasibility of Repeal, *supra* note 68, at 2.

self-assessment experience could not be considered successful,<sup>72</sup> a conclusion that was historically unsurprising. England turned to a self-listing system for assessment of a personal property tax in the late middle ages, leading Francis Bacon to remark in 1620, "The Englishman was most master of his own valuation, and the least bitten in purse of any other nation in Europe."<sup>73</sup>

Two reports prepared during the 1950's mentioned the possibility of repeal of all or part of the personal property tax.<sup>74</sup> Although the Herseth Committee, appointed by the Governor in 1958, gave little consideration to abolishing the personal property tax, it did recommend reduction in the reliance upon the property taxes in general with additional revenue to come from increased use of sales taxes or by adoption of corporate and personal income taxation, or diversion of highway funds.<sup>75</sup>

Responding to increased agitation for repeal of the personal property tax primarily from agricultural groups during the 1960's, the Legislative Research Council studied the issue in 1964<sup>76</sup> and recommended repeal with replacement revenues either to come from expanded sales tax, corporate income taxes, business transactions, or privilege taxes.<sup>77</sup> But perhaps the most comprehensive study of taxation in South Dakota was the one prepared in 1968 by Papke.<sup>78</sup> While the report concentrated on the possible revenue yields from personal and corporate income taxation, it did note that many states had eliminated all or part of their personal property taxes and that a phaseout of this levy might be possible in South Dakota.<sup>79</sup>

### *The Initiated Tax Proposal*

Following the failure of the South Dakota legislature to enact a repeal of the personal property tax in 1967, the South Dakota Farmer's Union and several other allied agricultural groups placed a bill on the 1970 ballot through the initiative process.<sup>80</sup> The basic thrust of this bill was to repeal the tax on personal property and to reduce the real property tax on certain homesteads using substitute revenues from a state income tax levied on federal income tax liability. The personal property tax was to be phased out over three years and replaced by revenues from the income tax by use

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72. *See id.*

73. S. DOWELL, A HISTORY OF TAXES AND TAXATION IN ENGLAND 80-81 (1884).

74. Thompson & Myers, Taxation in South Dakota 99 (December 1954) (Pamphlet 58, South Dakota State College); Griffen, Property Tax in South Dakota 15 (1958) (Gov't Res. Bureau, Univ. of S.D.).

75. Report of South Dakota Citizens Tax Study Committee 167 (December 1959) (located in I.D. Weeks Library, Univ. of S.D.).

76. *See* Feasibility of Repeal, *supra* note 68.

77. *Id.* at 15-41.

78. Papke, Tax Policy Alternatives for the State of South Dakota (September 1968) (unpublished thesis located in I.D. Weeks Library, Univ. of S.D.).

79. *Id.* at 51.

80. 1968 S.D. Sess. Laws.

of a ratio.<sup>81</sup> Among the criticisms levied against the proposal was that the new revenue to be obtained from the income tax would not fund the loss in revenue from personal property tax relief,<sup>82</sup> and that the bill substituted a stable source of revenue for an unstable one.<sup>83</sup> The bill was rejected by the electorate by a 2 to 1 majority in the 1970 General Election.

### *The Council For Tax Decision*

Following the 1971 Legislative Session, Governor Richard Kniep reconvened his Council for Tax Decision which had been established during the winter of 1970. Its stated goal was "to propose a tax system which constitutes real and meaningful tax reform; to relieve the burden where it is excessive, to place the burden where it can be more equitably carried, and to create a system of taxation which will be durable in the years ahead."<sup>84</sup> The Council made several recommendations.<sup>85</sup> The Council considered but did not recommend the repeal of the personal property tax. A minority report, however, called for that action.<sup>86</sup> Bills embodying the Council's proposals were introduced in the legislature in both 1972<sup>87</sup> and in 1973,<sup>88</sup> but neither of these proposals was accepted.<sup>89</sup>

### *The 1973 Interim Study*

During the summer of 1973, the Interim Committee on Taxa-

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81. The ratio compared the amounts raised in personal property taxes in the three years preceding the passage of the initiated bill to the amounts raised by real property taxation. If in the three years preceding repeal the county raised \$2.75 in real property taxes for each \$1.00 it raised in personal property taxes, then for each \$2.75 in real property taxes raised in future years the state would supply an additional \$1.00 in personal property tax replacement revenues. Each local jurisdiction was to receive an allotment using the same distribution principle.

82. Kent, *The Initiated Tax Proposal: An Economic Appraisal*, S.D. BUS. REV. SUPP. 10 (August 1970).

83. Kent, *supra* note 82, at 3.

84. Council for Tax Decision, *A Modern Tax System for South Dakota: Report of the 1* (November 1971) [hereinafter Council for Tax Decision].

85. These recommendations are: (1) an individual income tax with graduated rates from 3 to 5%; (2) a diminishing cost of living sales tax credit ranging downward from \$20.00 per exemption; (3) corporate income tax at a rate of 5%; (4) full funding of the minimum foundation program for aid to public schools; (5) the adoption of a circuit breaker to relieve property taxes for low income individuals; and (6) improved administration of the property tax to be brought about by: (a) lowering the level of taxable value from 60 to 40%, (b) by requiring appointed county directors of equalization from those who had passed a state administered examination, (c) required reappraisal of property every 10 years, and (d) adopting a conference board approach to assessment administration. *Id.* at 4-11.

86. *Id.* at 17-18.

87. 1972 S.D. Sess., S.B. 266.

88. 1973 S.D. Sess., H.B. 549.

89. The 1972 bill, after severe and repeated amendments, managed to pass both houses but in different forms. The conference committee report was rejected. See 1972 SOUTH DAKOTA HOUSE JOURNAL. The 1973 proposal passed the House and the Senate Tax Committee but was killed on the Senate floor. See 1973 SOUTH DAKOTA SENATE JOURNAL.

tion made an extensive study on the question of personal property taxation.<sup>90</sup> The deliberations of the Interim Committee and the reports prepared for it are reviewed here in some detail as these conclusions and studies formed the basis for all repeal proposals during the subsequent legislative sessions. The Interim Committee recommended to the 1974 legislative session that the tax on personal property be repealed and replaced with a tax on business profits. In reaching this conclusion, the Interim Committee gave consideration to the administrative difficulties inherent in the administration of the personal property tax.

The Committee focused upon the personal property tax as it corresponded with either the benefits received or the ability-to-pay principles of taxation.<sup>91</sup> It has been well documented for over a century that the personal property tax fails to correspond to either of these two principles.<sup>92</sup> Property value is a poor proxy for the benefits received either from local governments or schools. Due to the exemptions and the separation of income from property ownership, it does not reflect the ability of the taxpayer to carry the costs of governmental services.<sup>93</sup> Both because of these failures to correspond with the principles of equity in taxation, and also on administrative grounds, the Committee agreed with the Advisory Commission on Intergovernmental Relations: "There is substantial reason for abolishing the tax on tangible personal property in any state which can possibly raise revenue in any other way."<sup>94</sup>

#### A. *Economic Effects of Personal Property Taxation*

In its deliberations, the Committee examined the economic effects relating to the repeal of personal property taxes.<sup>95</sup> The evidence presented to the Committee supported the following conclusions:

1. The general level of property taxation and the existence or absence of a tax on personal property did not appear to be a major factor in determination of the location of industry.<sup>96</sup>

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90. South Dakota Public Finance Project, Replacement of South Dakota's Personal Property Tax with a Business Privilege Tax (January 4, 1974) (summary of findings) [hereinafter cited as Public Finance Project].

91. *Id.* at 3-4.

92. A. LYNN, PROPERTY TAX: PROBLEMS AND POTENTIALS 323 (Tax Inst. Am. 1967).

93. JENSEN, *supra* note 5, at 78-83.

94. ADVISORY COMMISSION ON INTERGOVERNMENTAL RELATIONS, STATE LEGISLATIVE PROGRAM: 1968 159 (1967).

95. C. Kent, Economic Factors Relating to the Repeal of Personal Property Taxes in South Dakota (August 17, 1973) (prepared for committee use).

96. J. FLOYD, AFFECTS OF TAXATION ON INDUSTRIAL LOCATION (1952); A. BUELER, *Report of the Committee on Intergovernmental Fiscal Relations*, PROCEEDINGS OF THE 58TH ANNUAL CONFERENCE ON TAXATION 396ff (1965); Due, *Studies on State and Local Tax Influence on Location of Industry*, XIV NAT'L TAX J. 163-73 (1961); Campbell, *Taxes and Industrial Location in New York Metropolitan Region*, I NAT'L TAX J. 209ff (1948); Ojala & Rizza, *Route 128: A Study of Industrial Location Factors*, ATLANTA ECON. REV. 39ff (October 1970); Ross, *Louisiana Industrial Tax Exemption Program*, LA. BUS. BULL. 47 (March



2. Property taxes which are significantly higher in one state may cause industry to locate in other nearby states with a more favorable property tax environment.<sup>97</sup>
3. Repeal of the personal property tax on business inventories would have a positive effect in attracting new industry to the state.<sup>98</sup>

After making a statistical comparison in the growth rates of states which had repealed their personal property taxes in the period of 1962 to 1972 and those which had not, a committee report concluded that there was no significant statistical difference in these growth rates which could be attributed to the repeal of personal property taxes.<sup>99</sup> Using a methodology developed for North Dakota,<sup>100</sup> it was determined by this author that there would be an increase in net farm income if the personal property tax was repealed. The extent of this increase depended upon what taxes were to be used to replace the lost revenue.<sup>101</sup>

The Interim Committee's attention was also directed to the effect of personal property taxes on the competitive position of South Dakota businesses.<sup>102</sup> In the analysis, it was indicated that the personal property tax on inventory could either be shifted forward to consumers in the form of higher prices or would have to be absorbed by firms either in the form of lost markets or lower profits.<sup>103</sup> Data was presented which indicated that when a comparison was made between states which had no taxes on business inventories and those which taxed business inventories, there was no significant difference in per capita retail sales as a percentage of state income.<sup>104</sup> On the other hand, the report to the Interim Com-

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1953); Business Executives Research Committee, *Factors Effecting Industrial Location in the Southwest* (1970) (Bur. of Bus. Research, Univ. of Okla.); Office of Domestic Commerce, United States Dep't of Commerce, *Basic Industrial Location Factors* (1947); Hanning, *How North Dakota Taxes Industry* (1947) (N.D. Econ. Found.); Chapman & Wells, *Factors in Industrial Location in Atlanta: 1946 to 1955* (1948) (Atlanta Bur. of Bus. & Econ. Research, Ga. St. C.); California Senate Committee on Revenue & Taxation, *Analysis and Evaluation of Proposals Relating to the Ad Valorem Taxation of Business Inventories in California* (March 1968).

97. Advisory Commission on Intergovernmental Relations, *State and Local Taxation and Industrial Location* 78 (April 1967).

98. "Deemphasizing the personal property tax, especially on business inventories, is perhaps the most significant step a state can make to improve . . . their business tax climate. . . ." *Id.*; accord, J. FLOYD, *supra* note 96; Sommers, *Taxation of Property in California* 151 (December 1965) (Assembly Interim Committee on Revenue and Taxation).

99. Kent, *Economic Factors Relating to the Repeal of Personal Property Taxes in South Dakota* 10-15 (1973) (Interim Committee on Taxation) [hereinafter cited as *Economic Factors*].

100. Libera, *Analysis of North Dakota Taxes* (December 1970) (Bur. of Bus. & Econ. Research, Univ. of N.D.).

101. *Economic Factors*, *supra* note 99, at 10.

102. *Id.* at 16-21.

103. *Id.* at 16; accord, T. POGUE & L. GONTZ, *GOVERNMENT AND ECONOMIC CHOICE* 316-19 (1978).

104. *Id.* at 17. This conclusion was consistent with a Wisconsin survey which indicated that most small firms facing competitive pressures absorb the inventory tax in lower profits rather than surrendering their markets. Univer-

mittee indicated that South Dakota cattle feeders were at a competitive disadvantage with those in Iowa, Nebraska, Minnesota, and North Dakota, which gave more favorable personal property tax treatment to livestock than did this state.<sup>105</sup>

The committee considered arguments that the South Dakota tax on inventories led to severe adjustments in inventories around assessment time in order to avoid the tax. The committee analysis indicated that inventory adjustments did take place in South Dakota for goods which had high value relative to size and weight, were easily transportable, quickly replaceable, and experienced a high sales turnover.<sup>106</sup> A study prepared for the California Senate found that stock depletion for tax avoidance existed for heating and air conditioning dealers, lighting fixture dealers, paint dealers, and swimming pool contractors.<sup>107</sup> A Minnesota study, completed before that state's personal property tax on inventories was repealed, found hardware, drug, furniture, appliance, and fuel oil dealers likely to practice tax depletion.<sup>108</sup> The South Dakota study found the property tax on inventories does play favorites. Some firms were able to avoid the tax by drawing down inventories before the assessment date, but other firms were not able to do so. Examples of the adversely affected firms were hardware stores, jewelry stores, shoe stores, and farm equipment dealers. Those firms less likely to be affected include auto dealers, restaurants, and grocery stores.<sup>109</sup> The results of a Minnesota study also found that certain types of livestock operations were able to adjust the number of cattle on feed to avoid the tax.<sup>110</sup> Breeding and dairy farm operations were not able to practice tax avoidance and were therefore more adversely affected by the personal property tax on livestock than other livestock operators.<sup>111</sup>

### B. *Sources of Replacement Revenue*

The Interim Committee studied methods of replacing the lost revenue from personal property taxes.<sup>112</sup> These discussions and studies were later used by the legislature during the 1978 session and the summer study committee as they reviewed possible ways

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sity of Wisconsin Tax Study Committee, Wisconsin State and Local Tax Burden 4 (1959). The data was inconsistent with an Indiana study which reached exactly the opposite conclusion. Bonzer, *Business Taxation in Indiana* 70 (1966) (Commission on State Tax and Financing Policy).

105. *Id.* at 18-19.

106. *Id.* at 22-24.

107. Senate Committee on Revenue and Taxation, Cal. An Analysis and Evaluation of Proposals Relating to the Ad Valorem Taxation of Business Inventories in California 14 (March 1968).

108. Hady, *The Incidence of Personal Property Tax*, XV NAT'L TAX. J. 368-84 (1962).

109. Economic Factors, *supra* note 99, at 23.

110. GOVERNORS MINNESOTA TAX STUDY COMMITTEE, THE IMPACT OF THE PERSONAL PROPERTY TAX UPON AGRICULTURE ch. VI (1956).

111. Economic Factors, *supra* note 99, at 24-25.

112. Kent, *Alternatives to Personal Property Taxation in South Dakota* (September 19, 1973) (Interim Committee on Taxation) [hereinafter cited as *Alternatives*].

to fund the repeal. Five alternatives were considered: (1) increases in local real property taxes, (2) adoption of a comprehensive corporate and personal income tax, (3) increasing or expanding the state sales tax, (4) levy of a gross receipts tax, and (5) establishment of a business privilege tax based on profits of incorporated and unincorporated businesses

The first alternative of increased real estate taxes was found lacking for a number of reasons. These were that the tax on real estate in South Dakota was already among the highest in the nation, and that there would be a major increase in the property tax burden carried by homeowners in South Dakota since residential property constituted 45 percent of the total real property tax base.<sup>113</sup> Requiring that local taxes on real property pick up the loss from the repeal of personal property taxes would also have generated hardship on many local units of government. Ninety percent of the school districts would not have been able to make their operating budgets within the mill levy limitations prescribed by the state code and twenty of the twenty-seven largest cities would have had to reduce their budgets due to mill levy limitations. Even if mill levies could have been increased, the impact would have been uneven, requiring real property increases of between 16 percent in some counties and up to 48 percent in others, with the sparsely populated and less wealthy counties being most seriously impacted.<sup>114</sup> The counties most affected by this suggestion were those most dependent on farming as their economic base. Increasing taxes on farm land while reducing taxes on farm equipment appears to be of little benefit. Such a result would in fact be capricious, because the property tax burden on "dry" farms, which have comparatively high land and low capital requirements, would rise while property taxes on "wet" farms with less land and higher capital requirements would expand. For these reasons, the Interim Committee rejected increased real property taxes as a replacement even though this was the solution that had been followed in most of the other states which had eliminated taxes on personal property.<sup>115</sup>

The second substitute source of revenue discussed by the Interim Taxation Committee was a comprehensive state income tax on both personal and corporate income.<sup>116</sup> This idea was also rejected, principally because of the lack of enthusiasm which the legislature had demonstrated over the past several years<sup>117</sup> for income tax proposals and the rejection of the initiated bill<sup>118</sup> which many legislators considered to be a mandate against a comprehensive tax on income. A further objection to an income tax was that

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113. *Id.* at 6-8. See D. NETZER, *supra* note 38, at 156, for support of the contention that repeal of personal property taxes raises taxes on residences.

114. *Id.* at 7.

115. See note 41 *supra*.

116. *Id.* at 13-15.

117. *Id.*

118. *Id.*

50 to 60 percent of any corporate and personal income taxes would be paid by wage earners, while 75 to 90 percent of the tax relief occasioned by the repeal of personal property taxes would benefit only farmers and merchants.<sup>119</sup>

A third alternative was to increase the state sales tax or to expand the sales tax base.<sup>120</sup> The sales tax has met as little resistance in South Dakota as it has in other states.<sup>121</sup> An increase in its rate could not be avoided by taxpayers except by saving, and it would be paid in small amounts spread over a large time period.<sup>122</sup> There were, of course, objections to increasing the sales tax rate. The sales tax in South Dakota was at that time among the nation's highest, with only eight states taxing retail sales at an amount greater than 4 percent.<sup>123</sup> In most of those states, food and prescription drugs were exempted, but this was *not* the case in South Dakota.<sup>124</sup> In addition, many of the other higher sales tax states did not permit the addition of municipal sales levies, piggybacked onto that of the state.<sup>125</sup> An additional argument against an increase of the South Dakota sales tax rate was that it would create problems with bordering states who tax retail sales at a lesser percentage.<sup>126</sup> The contention was that a sales tax differential would severely penalize retailers in South Dakota communities bordering lower tax states.<sup>127</sup> These arguments appear to have had an impact on the Governor's staff in 1978 when they rejected a sales tax increase as a replacement source.

Consideration was also given by the Interim Committee to a gross income tax to be levied upon the proceeds of all businesses, both farm and non-farm in the state. Such an approach had been briefly tried in South Dakota.<sup>128</sup> The only state which had successfully used a gross receipts tax was Indiana from the years 1933 to

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119. *Id.* at 15.

120. *Id.* at 15-17.

121. ADVISORY COMMISSION ON INTERGOVERNMENTAL RELATIONS, CHANGING PUBLIC ATTITUDES ON GOVERNMENTS AND TAXES 8-9 (1978).

122. *Pogue & Gontz, supra* note 103, at 287.

123. Alternatives, *supra* note 112, at 16.

124. *Id.* Prescription drugs were exempted from the South Dakota sales tax in 1974.

125. *Id.*

126. *Id.* at 16-17.

127. The literature on the effect of sales tax differentials between states is generally supportive of this contention. See CALIFORNIA STATE INTERIM COMMITTEE ON STATE AND LOCAL TAXATION, STATE AND LOCAL SALES AND USE TAXES IN CALIFORNIA 34 (1953); McAllister, *The Border Tax Problem in Washington*, XIII NAT'L TAX J. 374 (1961); Hamovitch, *Sales Taxation: An Analysis of the Effects of Rate Increases and Two Contrasting Cases*, XIX NAT'L TAX J. 420 (1966); Mikesell, *Sales Taxation and the Border County Problem*, XI Q. REV. ECON. & BUS. 29 (1971); *Central Cities and Sales Tax Differentials*, XXIII NAT'L TAX J. 206, 206-13 (1970). *But see* CITY AND COUNTY OF DENVER, FINANCING MUNICIPAL GOVERNMENT IN DENVER 111 (1955); Johnson & Kent, *Municipal Sales Taxes and the Border Tax Problem: Contrary Evidence* (S.D. Finance Project, Working Papers) (1973). These last two works indicate that whatever effect sales tax differentials may have is quickly dissipated with the passage of time.

128. See text accompanying notes 68-69 *supra*.

1963.<sup>129</sup> Evidence was presented to the Committee which indicated that the incidence of a gross receipt tax would be very close to that of the tax on personal property and would be carried primarily by farms and retail business.<sup>130</sup>

Some of the states which have repealed their taxes on personal property have replaced the revenues by adopting special taxes on business. These are usually classified as "Business Privilege Taxes" with the tax being levied on the privilege of being allowed to do business in the state.<sup>131</sup> The value of the privilege is measured by the net earnings of the firm. These business privilege taxes are in essence two taxes: a corporate income tax and a tax on the profits of unincorporated businesses. Partially by the process of elimination and partially because the "Business Profits Tax" is paid only by firms which are enjoying profits, this is the alternative which was recommended by the Interim Committee to the South Dakota Legislature.

After considering several different methods of replacing local government and school district revenues,<sup>132</sup> the Committee recommended a formula under which each local government would receive replacement monies each year in the same amount as it collected from personal property taxes on the average for 1972-1974. This base allotment would be supplemented by a 5 percent annual increase over the previous year's amount to allow for expansion of local government budgets.<sup>133</sup> The recommendations of the Interim Committee<sup>134</sup> failed, however, to survive the scrutiny of the Senate Taxation Committee.<sup>135</sup>

### *Developments During 1975-77*

During the period 1975-77 the most significant piece of personal property tax legislation would have changed livestock taxation to a per-head/per-day basis, rather than the ad valorem levy. This came about because of the steep rise in cattle prices during late

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129. See Commission on State Tax and Financing Policy, *Business Taxation in Indiana* ch 4. (December 1966). The tax was abolished in that state for the following reasons: (1) The tax was difficult to administer because firms with high gross receipts were always seeking ways of making those receipts appear to have been incurred out-of-state. This was particularly true for out-of-state chain stores, and in-state stores felt that they were at a disadvantage since their potential for avoidance of the tax was less. (2) The tax was felt to be unfair because of the failure to relate gross receipts to profits. Many occupations, particularly farming and retail establishments had high gross receipts but operated on very narrow profit margins. Gross receipt taxation would tax them more heavily even though their profits might be lower than other firms.

130. Alternatives, *supra* note 112, at 18.

131. *Id.* at 8-12. States using such taxes are Idaho, New Hampshire, New Jersey, and North Dakota.

132. C. Kent, *Alternative Formulas for the Replacement of the Personal Property Tax Revenues* (October 1973) (INTERIM COMMITTEE ON TAXATION) [hereinafter cited as *Replacement*].

133. Public Finance Project, *supra* note 91, at 19-20.

134. 1974 S.D. Sess., S.B. 9.

135. S.D. LEGISLATIVE RESEARCH COUNCIL, *DISPOSITION OF BILLS AND RESOLUTIONS* 69 (1974).

1973 and early 1974 and their equally steep decline during 1975.<sup>136</sup> A 1975 bill to this effect, patterned after California legislation,<sup>137</sup> was passed, but the effective date was delayed until 1976.<sup>138</sup> The 1976 Legislature again delayed the implementation of the per-head/per-day tax and set statutory values to be used for livestock taxation in 1976.<sup>139</sup> The 1977 Legislature then repealed the per-head/per-day tax entirely,<sup>140</sup> and instead continued with statutory rates for livestock taxation.

The year 1976 saw the introduction of several income tax bills designed to replace personal property taxes or to reduce property taxes for school purposes.<sup>141</sup> That same year a bill was proposed to levy a gross receipts tax on business firms in-lieu of the personal property tax.<sup>142</sup> In addition, a bill was introduced to expand the personal property tax by placing a levy on the value of certain educational certificates such as degrees and licenses.<sup>143</sup> This idea harkens back to the old concept of the "faculty tax" which was widely used in the colonial period of this nation's history.<sup>144</sup>

Several bills dealing with the question of personal property taxation again appeared in the 1977 Session.<sup>145</sup> One bill would have repealed the tax on monies and credits.<sup>146</sup> A Senate bill would have instituted a system of "zero based taxation" requiring the periodic re-enactment of each tax including the levy on personal property.<sup>147</sup> Another Senate proposal called for a "Farmer's Franchise Tax" patterned after the financial institutions franchise tax which would have been based upon the net income of farms and in-lieu of the taxes on agricultural personalty.<sup>148</sup>

#### IV. THE 1978 REPEAL OF PERSONAL PROPERTY TAX

Two weeks before the commencement of the 53rd Legislative Assembly, Governor Richard Kneip, through the Bureau of Finance and Management, sent his proposals to the South Dakota

136. See S. ZELLMER, PER-HEAD PER-DAY TAX ON CATTLE, SHEEP & BUFFALO IN SOUTH DAKOTA, S.D. LEGISLATIVE RESEARCH COUNCIL (1978) (provides a detailed summary) [hereinafter cited as PER-HEAD PER-DAY].

137. CAL. REV. & TAX. CODE §§ 5521-22 (West 1970).

138. 1975 S.D. Sess. Laws ch. 99.

139. 1976 S.D. Sess. Laws ch. 91.

140. 1977 S.D. Sess. Laws ch. 89.

141. S.D. LEGISLATIVE RESEARCH COUNCIL, DISPOSITION OF BILLS AND RESOLUTIONS 63-67 (1976).

142. 1976 S.D. Sess., S.B. 48.

143. 1976 S.D. Sess., H.B. 648.

144. The faculty tax was levied on members of certain professions during the colonial period. Its purpose was to reach those whose income depended on ability and skills rather than property. The idea was to equalize tax burdens between farmers and those in professions such as law, medicine, and trade. The tax was a clumsy attempt to tax the average income of these professionals by capitalizing that income into an estimate of wealth. BENSON, *supra* note 4, at 26-29.

145. S.D. LEGISLATIVE RESEARCH COUNCIL, DISPOSITION OF BILLS AND RESOLUTIONS 81-86 (1977).

146. 1977 S.D. Sess., H.B. 788.

147. *Id.* at S.B. 10.

148. *Id.* at S.B. 29.

Legislature.<sup>149</sup> The Governor's package included four recommended pieces of legislation: (1) a bill to repeal the tax on all personal property;<sup>150</sup> (2) a bill to appropriate 35 million dollars to local governments during fiscal year 1979 to replace the lost personal property tax revenues;<sup>151</sup> (3) a bill to expand the sales tax to include all services except health, education, and social services, and to increase the sales tax on farm machinery from 2 percent to 3 percent;<sup>152</sup> (4) a bill to increase the cigarette tax from 12 cents per pack to 16 cents per pack.<sup>153</sup> The legislative path of the Governor's tax recommendations was long and torturous and opposed by multiple amendments and revisions. A detailing of this legislative history would serve no purpose in this article. What finally resulted was a total redrafting of the legislation that was passed almost unanimously by both Houses,<sup>154</sup> though on the final legislative day additional legislation<sup>155</sup> had to be passed to correct mistakes and clarify the intent of the original. The enacted bill provides for the following:

1. The personal property tax on household goods, personal effects, home appliances, and sporting goods was repealed immediately on an emergency basis.<sup>156</sup> This freed taxpayers from the responsibility of paying taxes on those items in 1979.
2. The remainder of local assessed personal property, monies and credits, plus the property taxes on feed, seed, honey bees, and the poll tax were also repealed, to be made effective January 1, 1979.<sup>157</sup>
3. Buildings on lease sites were reclassified from personal to real property thus making them subject to ad valorem taxation.<sup>158</sup>
4. Centrally assessed property (utilities, railroad companies, telegraph companies, airline companies, etc.) would continue to be taxed on a "unit" basis with no reduction in property taxation, but the taxable percentage of the centrally assessed personal property would not rise more than 125 percent above the 1977 taxable percentage.<sup>159</sup>
5. An appropriation of 6 million dollars was included to replace the tax on household goods, personal effects, home

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149. R. Garry, Memorandum to South Dakota Legislators (December 13, 1977).

150. 1978 S.D. Sess., H.B. 1039 & S.B. 39.

151. *Id.* at H.B. 1040 & S.B. 40.

152. *Id.* at H.B. 1041 & S.B. 41.

153. *Id.* at H.B. 1042 & S.B. 42.

154. 1978 S.D. Sess. Laws ch. 72. *See also* 1978 Sess. Laws ch. 71, § 2 (codified at S.D.C.L. § 10-4-13.1 (Supp. 1978)), which dropped dwellings and garages on farm land from a \$10,000 exemption. It also seems to provide that such buildings will not be considered farm property for tax purposes.

155. *Id.* at ch. 73.

156. *Id.* at ch. 72, § 1.

157. *Id.* at § 3 (codified at S.D.C.L. § 10-4-6 (Supp. 1978)).

158. *Id.* at § 4 (codified at S.D.C.L. § 10-4-2.1 (Supp. 1978)).

159. *Id.* at §§ 2 & 14 (codified at S.D.C.L. §§ 10-4-6.1 & -34.1 (Supp. 1978)).

- appliances, and sporting goods that would be lost immediately and was to be paid to the counties in May of 1979.<sup>160</sup>
6. Nine million dollars of surplus revenue were placed in the tax allocation fund to be held as replacement revenue to be distributed in 1980.<sup>161</sup>
  7. An apportionment formula was established for the distribution of future revenues that would be appropriated to replace personal property tax revenue lost to local governments and school districts.<sup>162</sup> Under this formula, each county's annual entitlement was to be the result of multiplying the average ratio of personal property taxes to real property taxes assessed in 1972 through 1976 times the real property taxes assessed in the current year. No county could receive less than 95% of the amount of personal property taxes assessed in 1977 to be paid in 1978.<sup>163</sup> If funds were insufficient to fully fund all entitlements, entitlement would be prorated on an equal percentage basis among all local governmental entities.<sup>164</sup>
  8. A Task Force was set up to study the replacement revenue issue, with a report on the most equitable manner to raise replacement revenues due by November 15, 1978.<sup>165</sup>
  9. The State sales and use taxes on feed, seed, and fertilizer were raised by one cent along with the tax on vending machines, and the tax on agricultural machinery was raised to 3 percent. These increases were to take effect on July 1, 1979,<sup>166</sup> though the increase in the sales tax rate was to be effective only if the 1979 Legislative Session was unable to produce alternative methods of raising the necessary sums for replacement.

## V. ANALYSIS OF REPEAL

The Governor's proposal and the legislation passed during the 1978 session raised some substantive legal and economic issues which are discussed below. The sources of new revenue suggested by the government are summarized in Table II, and the amounts of revenue being raised from personal property taxation and the amounts of personal property tax valuation are given in Table III.

### *Legal Issues*

#### A. *Constitutional Debt Limitations*

It was suggested that elimination of personal property from

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160. *Id.* at §§ 16 & 17 (not codified).

161. *Id.*

162. *Id.* at §§ 32-36 (codified at S.D.C.L. §§ 10-13A-2 to -4 (Supp. 1978)).

163. *Id.* at § 33 (codified at S.D.C.L. § 10-13A-3 (Supp. 1978)).

164. *Id.* at § 34 (codified at S.D.C.L. § 10-13A-4 (Supp. 1978)).

165. *Id.* at §§ 43 & 44 (not codified).

166. *Id.* at §§ 37-42 (codified at S.D.C.L. §§ 32-5-31 & 10-45-2, -3, -3.1, -8.1, -23 (Supp. 1978)).



TABLE II

Official\* Revenue Estimate From The Broadening Of The Sales Tax To Include All Services\*\* And Other Revenue Sources

	Governor's Office	Legislative Research Council
<b>I. SALES TAX BROADENING</b>		
AGRICULTURE AND FORESTRY SERVICES		
Agriculture Services	\$ 2,188,000	
Veterinary Services	156,000	\$ 1,005,000
Forestry Services	110,000	
MINING AND OIL AND GAS EXPLORATION SERVICES		
	NA	NA
CONSTRUCTION SERVICES		
	9,211,000	13,500,000
TRANSPORTATION OR FREIGHT SERVICES		
Transportation Services	2,521,345	2,700,000
Arrangement of Transportation Services	NA	NA
WATER AND SANITARY SERVICES		
Water Services	531,550	780,000
Sewerage, Refuse and Garbage Services	136,350	
CREDIT AGENCIES		
Banking Services		
Savings and Loan Assoc. Services	426,000	554,000
Loan Brokers Services		
STOCK AND COMMODITY BROKERS SERVICES		
	124,000	124,000
REAL ESTATE AGENTS SERVICES		
	733,000	1,200,000
PERSONAL SERVICES		
Funeral Services and Crematories	104,000	272,000
Coin-Operated Laundries & Dry Cleaning	268,000	
BUSINESS SERVICES		
Advertising Services	1,466,000	1,900,000
Consumer Credit Agencies		
Commercial Art & Graphics Services		
News Syndicate Services		
Personnel Supply Services		
Management, Consulting & Consulting Services		
Detective Agencies Services		
Trading Stamp Services		
CUSTOM AUTOMOTIVE AND PAINT SERVICES AND GARAGES		
	NA	NA
MOTION PICTURE RENTAL SERVICES		
	NA	NA
AMUSEMENT AND RECREATION SERVICES		
	NA	NA
RENTAL OF TANGIBLE PERSONAL PROPERTY FOR MORE THAN 28 DAYS (SDCL 10-45-5)		
	1,200,000	1,200,000
RECEIPTS FROM STATE AND COUNTY FAIRS (SDCL 10-45-13)		
	23,000	23,000
NEWSPAPER SALES AND SUBSCRIPTIONS		
	317,000	317,000
INSURANCE COMPANY TAX INCREASE		
	1,377,000	1,377,000
SUB-TOTAL	<u>\$20,892,245</u>	<u>\$24,952,000</u>
<b>II. OTHER REVENUE SOURCES</b>		
CIGARETTE TAX INCREASE	\$ 3,000,000	\$ 2,300,000
FARM EQUIPMENT (INCREASE FROM 2% TO 3%)	1,400,000	1,750,000
EXISTING SALES TAX REVENUE	16,000,000	16,000,000
GRAND TOTAL	<u>\$41,292,245</u>	<u>\$45,002,000</u>

These are the estimates of revenue available in FY 1979 to be used to return \$40 million to local governments to replace lost personal property tax revenue.

\*As of January 19, 1978.

\*\*Except medical, educational, and social services.

TABLE III  
 Amounts of Property Valuations and  
 Taxes Payable in South Dakota: 1960-78

Year	Total Valuation	Personalty Valuation	Personalty as % of Total	Total Property Txs.	Personal Property Txs.	Personal as % of Total
1977/78	4,636,346	1,012,773	21.84%	233,096	39,152	16.80%
1976/77	4,218,760	1,141,995	27.07%	218,355	45,640	20.90%
1975/76	3,875,335	1,044,999	26.97%	205,352	43,173	21.02%
1974/75	3,747,738	1,143,156	30.50%	190,735	45,729	23.98%
1973/74	3,426,082	986,128	28.78%	170,758	39,248	22.98%
1972/73	3,211,921	871,243	27.13%	164,216	36,201	22.04%
1971/72	3,059,470	790,047	25.82%	157,588	33,498	21.26%
1970/71	3,003,431	788,867	26.27%	150,902	32,385	21.46%
1969/70	2,725,383	730,924	26.82%	143,595	29,722	20.70%
1968/69	2,562,379	690,914	26.96%	121,271	27,260	22.48%
1967/68	2,392,328	677,500	28.32%	111,438	26,629	23.90%
1966/67	2,353,161	675,915	28.72%	105,093	27,326	26.00%
1965/66	2,253,078	624,379	27.72%	100,357	25,243	25.15%
1964/65	2,318,166	614,698	26.52%	NA	NA	NA
1963/64	2,261,577	600,785	26.56%	NA	NA	NA
1962/63	2,191,651	563,257	25.70%	NA	NA	NA
1961/62	2,174,115	577,930	26.58%	NA	NA	NA
1960/61	2,117,323	546,111	25.79%	NA	NA	NA

the property tax base might reduce the bonding capacity of all local governments including cities, counties, townships, and school districts.<sup>167</sup> The South Dakota Constitution provides<sup>168</sup> that the debt of any city, county, or township shall not be in excess of 5 percent of the assessed valuation of that jurisdiction. If the town's population is above 8,000, the limitation rises to 8 percent. The limit may go as high as 10 percent if the debt is to be incurred for providing water, sewage, or irrigation. The 10 percent limitation is also applied to school districts. The question is whether or not these constitutional debt restrictions impair the ability of local government and school districts to borrow for capital expenditures in the future with personal property taxes removed from the base. Existing debt would probably not be affected since it was incurred before the date that the personal property tax was repealed.<sup>169</sup> As is indicated in Table IV, in some local jurisdictions bonding capacity may be reduced by as much as 30-40 percent with the removal of personal property from the bonding base. This specific issue has not been directly addressed by the courts in South Dakota. The courts have clearly established the invalidity of debt in excess of the constitutionally mandated percentages.<sup>170</sup> The court has attempted to define what is and is not to be included as debt, but the amount of assessed valuation against which debt was to be applied

167. Kent & Zellmer, Senate House Taxation Committee Document, Number 1 (January 2, 1978).

168. S.D. CONST. art. XIII, § 4.

169. *Freemont, E. & M.V.R. v. Pennington County*, 22 S.D. 202, 116 N.W. 75 (1908).

170. *State v. Board of Comm'rs*, 36 S.D. 606, 156 N.W. 96 (1916); *Dring v. St. Lawrence Tp.* 23 S.D. 624, 122 N.W. 664 (1909).

was not an issue.<sup>171</sup>

TABLE IV  
Average Real and Personal Property Tax Collections  
for South Dakota Counties 1973-77

County	1973-1977 5-Year Average Personal Property Collections <sup>1</sup>	Personal Property 5-Year % of Total Taxes <sup>2</sup>	Real Property 5-Year % of Total Taxes <sup>3</sup>
Aurora	\$ 339,417	30.6	69.4
Beadle	1,280,379	24.2	75.8
Bennett	262,005	26.6	73.4
Bon Homme	538,432	25.4	74.6
Brookings	1,252,336	23.3	76.7
Brown	2,450,589	23.2	76.8
Brule	528,817	31.3	68.7
Buffalo	116,980	32.5	67.5
Butte	478,339	24.0	76.0
Campbell	303,669	30.3	69.7
Charles Mix	811,254	30.7	69.3
Clark	534,025	31.7	68.3
Clay	522,407	17.3	82.7
Codington	1,105,309	22.7	77.3
Corson	380,187	30.4	69.6
Custer	264,008	21.6	78.4
Davison	972,704	22.3	77.7
Day	623,363	26.0	74.0
Deuel	525,612	30.9	69.1
Dewey	220,741	30.4	69.6
Douglas	420,249	34.3	65.7
Edmunds	486,352	27.4	72.6
Fall River	440,280	27.9	72.1
Shannon	115,378	40.1	59.9
Faulk	396,613	30.3	69.7
Grant	602,131	27.6	72.4
Gregory	547,246	30.8	69.2
Haaken	286,042	27.4	72.6
Hamlin	416,644	28.7	71.3
Hand	705,490	32.1	67.9
Hansen	339,324	28.7	71.3
Harding	255,995	34.5	65.5
Hughes	652,208	18.7	81.3
Hutchinson	735,937	25.7	74.3
Hyde	243,176	29.4	70.6
Jackson	141,418	30.3	69.7
" Washabaugh Unorg.	99,353	37.3	62.7
Jerauld	365,364	32.9	67.1

171. *Ridgeland School Dist. v. Biesmann*, 71 S.D. 82, 21 N.W.2d 324 (1946); *Farrar v. Britton School Dist.*, 72 S.D. 226, 32 N.W.2d 627 (1948); *City of Tyndall v. Schuurmans*, 74 S.D. 566, 56 N.W.2d 693 (1953).

Jones	206,719	27.1	72.9
Kingsbury	630,975	29.8	70.2
Lake	631,776	22.4	77.6
Lawrence	693,872	16.1	83.9
Lincoln	682,254	21.1	78.9
Lymann	392,607	27.8	72.2
McCook	556,059	28.3	71.7
McPherson	508,786	30.6	69.4
Marshall	462,314	25.7	74.3
Meade	620,960	22.7	77.3
Mellette	213,390	33.1	66.9
Miner	346,535	28.1	71.9
Minnehaha	3,948,104	16.0	84.0
Moody	550,851	26.4	73.6
Pennington	1,940,200	13.6	86.4
Perkins	565,674	31.1	68.9
Potter	391,405	26.8	73.2
Roberts	778,003	28.6	71.4
Sanborn	330,911	31.3	68.7
Spink	868,142	27.9	72.1
Stanley	171,465	21.7	78.3
Sully	258,399	21.9	78.1
Tripp	648,602	26.3	73.7
Todd	196,794	34.8	65.2
Turner	655,413	26.8	73.2
Union	604,935	20.9	79.1
Walworth	483,948	24.4	75.6
Yankton	726,323	16.6	83.4
Ziebach	176,272	28.7	71.3
	\$40,061,946	23.1	

- 1 Total personal property taxes minus buildings on leased sites plus monies and credits.
- 2 Total personal property taxes minus buildings on leased sites plus monies and credits.
- 3 Total real taxes.

The full significance of this issue is difficult to understand without some historical background. Prior to 1955, there was only one value placed on property by assessors and used by county auditors. That was assessed value and was to be full and true value as determined in the market. Over the years, due to poor assessing practices and failure to keep the tax rolls current with changing property valuations, the assessed value fell considerably below the market value for most properties.<sup>172</sup> Bowing to the reality of the underassessment of property, the South Dakota Legislature in 1957 established that all property should be assessed at its full and true value but only 60 percent of that value would be taken as taxable valuation.<sup>173</sup> From 1957 until 1977, the figures certified by county auditors for bonding purposes were not the assessed valua-

172. Report of Committee on Assessment and Taxation, *supra* note 71, at 3.

173. 1957 S.D. Sess. Laws ch. 459. This was modified in 1977 to provide that *not more* than 60% of full and true value would be used as taxable valuation, S.D.C.L. § 10-6-33 (Supp. 1978).

tion at full and true value, but rather the taxable valuation in those counties. In fact, prior to 1977 many counties did not maintain figures on assessed valuations at all.<sup>174</sup> Therefore, for bonding purposes, the term "assessed valuation" became synonymous with "taxable valuation" in this state.<sup>175</sup>

In 1977, the Department of Revenue issued a declaratory ruling<sup>176</sup> which asserted that assessed valuation as mentioned in Article 13 of the Constitution meant "full and true value" rather than "taxable value" and required that all assessors and auditors list property at its assessed or full and true value.<sup>177</sup> The effect of this ruling was to expand the debt-carrying capacity of most local units of government since they had been using taxable values rather than assessed values as their base for bonding purposes.<sup>178</sup> Information presented to the taxation committee indicated the effects of this change.<sup>179</sup> This data compared 1976 taxable valuations in all South Dakota counties with 1977 assessed valuations. That report demonstrated that even if personal property valuations were subtracted from the 1977 assessed values, the 1977 bonding base would be greater in all counties than the 1976 base using taxable valuation. The report thus concluded that due to the declaratory ruling, removal of personal property valuation would not impair the debt carrying capacity of local government.<sup>180</sup>

Private opinions of bond attorneys doing business in South Dakota show disagreement as to the impact of personal property repeal on debt limitations. One attorney agreed with the interpretation of the Revenue Department and indicated that some \$2,250,000 of general obligation water bonds for the city of Sturgis had been issued which would not have been permissible if taxable valuation rather than assessed valuation had been used to determine bonding capacity.<sup>181</sup> On the other hand, another attorney doubts the validity of the ruling and has written that "Coupled with the exemption of personal property, [the repeal of personal property taxes] would probably have a significant adverse effect on local debt limits, until, and unless, the Supreme Court approved the principle of ignoring the taxable value for Constitutional debt limit purposes."<sup>182</sup> Coming down to the bottom line, however, these debt restrictions have been found to be of little value in protecting the solvency of local governments.<sup>183</sup> It thus appears that

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174. Information supplied by S. Zellmer, Secretary, S.D. Dep't of Revenue.

175. Cf. [1977] S.D. ATT'Y GEN. OP. 77-48.

176. S.D. Dep't of Rev., Declaratory Ruling 77-12 (May 9, 1977).

177. S.D. Dep't of Rev., Declaratory Opinion 76-4 (1976).

178. Garry & Coler, Memorandum to House and Senate Taxation Committee 2 (January 5, 1978).

179. S.D. STATE PLANNING BUREAU, ANALYSIS OF THE EFFECT OF THE REPEAL OF PERSONAL PROPERTY TAX ON LOCAL GOVERNMENT DEBT (January 1978).

180. Garry & Coler, *supra* note 178, at 3.

181. See letter from W. Jones to D. Bertsh (January 4, 1978) (on file with author).

182. See letter from A. Whitney to the author (January 16, 1978) (on file with author).

183. A. HINES, CONSTITUTIONAL RESTRICTIONS AGAINST STATE DEBT ch. 3

the repeal of the personal property tax will not create a constitutional barrier to the issuance of debt by most South Dakota local government entities.

### B. *Irrepealability of Taxes*

The South Dakota Constitution poses a potential problem concerning the ability of the legislature to repeal the tax. The constitution provides:

Any city, county, town, school district or any other subdivision incurring indebtedness shall, at or before the time of so doing, provide for the collection of an annual tax sufficient to pay the interest and also the principal thereof when due and all laws or ordinances providing for the payment of the interest or principal of any debt shall be irrepealable until such debt be paid.<sup>184</sup>

Several legislators raised the question as to whether or not this provision meant the personal property tax was irrepealable, since the tax was currently being used to fund repayments of bond interest and principal. The South Dakota Supreme Court has already ruled that the Legislature has no power to abrogate any levy which provides for payment of interest or principal or to pass legislation which would prevent a local government from being able to discharge its debt obligations.<sup>185</sup>

The Attorney General has stated that the personal property tax can be repealed and the legislature is not bound by the irrepealability language in the constitution.<sup>186</sup> History strongly supports the decision of the Attorney General, for the personal property tax base has been changed several times without raising significant constitutional questions.<sup>187</sup> For instance, the legislature has previously classified monies and credits separately and granted a \$15,000 monies and credits exemption. To construe the constitution to limit the state's ability to legislate entirely would stifle any tax change or *any* reduction in a tax base which is used by a local government to discharge debt obligation. The result would be to perpetually freeze the tax base and prevent any future modification. The Court would probably have cause to rule the repeal invalid only if it rendered the local governments unable to meet their debt responsibilities.

### C. *Taxation of Transportation and Advertising.*

There are additional legal issues which must be considered if the sales tax is to be expanded to sale of transportation and advertising services. The Revenue Department found only eleven states

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(1963); A.C.I.R. STATE CONSTITUTION AND STATUTORY RESTRICTIONS ON LOCAL GOVERNMENT DEBT 39ff (1961).

184. S.D. CONST. art. XIII, § 5.

185. *Freemont v. Pennington County*, 22 S.D. 202, 116 N.W. 75 (1908).

186. [1971-1972] S.D. ATTY GEN. BIENNIAL REP. 71-28, at 109.

187. FEASIBILITY OF REPEAL, *supra* note 68.

attempting to tax transportation.<sup>188</sup> States are generally prohibited from taxing transportation services in interstate commerce.<sup>189</sup> This would mean a person buying a plane ticket from Sioux Falls to Denver would not be subject to the tax, but a person buying a place ticket from Sioux Falls to Pierre would be. Similarly, a person contracting to have cattle hauled to the Sioux City stock market would not be liable to the tax but a person contracting to have livestock hauled to the Sioux Falls market would pay. This results in what at least one commentator calls "serious distortion and inequity."<sup>190</sup> The United States Supreme Court likewise has prohibited the taxation of advertising in many instances,<sup>191</sup> though it recently has loosened its restrictions on the taxation of businesses in interstate commerce if a sufficient local business nexus can be found.<sup>192</sup> The current direction of the Supreme Court seems to be that a state's tax on interstate business does not violate the commerce clause (1) when it is applied to an interstate activity with substantial nexus within the taxing state, (2) is fairly apportioned, (3) does not discriminate against interstate commerce, and (4) is fairly related to the service provided within the state.<sup>193</sup> Even so, judicial standards would have to be substantially relaxed for transportation and advertising to become fully taxable.

#### D. *Taxation of Utility Property*

Another major issue raised by the passage of the personal property tax repeal involved the status of utility and other centrally assessed property. The repeal did not remove the tax from personal property owned by those utilities and transportation companies that is centrally assessed by the state,<sup>194</sup> though the tax on all non-operating personal property of these utilities, which is locally assessed, was repealed. Even though the operating property of such companies includes both real and personal property, and the Department of Revenue requires that the annual reports of these companies segregate their personal and real property, the distinction between the two types of property has in fact been ignored under the unit rule of taxation.<sup>195</sup> By agreement, 55 percent

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188. S.D. DEP'T OF REV., SALES/USE TAXATION OF SERVICES (June 1978) [hereinafter cited as SALES/USE TAXATION OF SERVICES].

189. W. BEAMAN, PAYING TAXES TO OTHER STATES ch. 11 & 12 (1963); see *Spector Motor Serv. v. O'Connor*, 340 U.S. 602 (1951); *J.D. Adams Mfg. Co., v. Storen*, 304 U.S. 307 (1938). For a full discussion see Barrett, *State Taxation of Interstate Commerce—Direct Burdens, Multiple Burdens, or What Have You?* 4 VAND. L. REV. 496 (1951).

190. J. DUE, STATE AND LOCAL SALES TAXATION 83 (1971).

191. *Nat'l Bellas Hess, Inc. v. Dep't of Revenue*, 386 U.S. 753 (1967); *Fisher's Blend Station, Inc. v. Tax Comm'n*, 297 U.S. 650 (1936).

192. *Nat'l Geographic Soc'y v. California*, 430 U.S. 551 (1977); *Western Live Stock v. Bureau of Revenue*, 303 U.S. 250 (1938).

193. *Complete Auto Transit, Inc. v. Brady*, 430 U.S. 274 (1977); *Gen. Motors Corp. v. Washington*, 377 U.S. 436 (1964); *Scripto v. Carson*, 362 U.S. 207 (1960); *Northwestern Cement Co. v. Minnesota*, 358 U.S. 450 (1959); *Memphis Gas Co. v. Stone*, 335 U.S. 80 (1948); *Wisconsin v. J.C. Penney*, 311 U.S. 435 (1940).

194. 1978 S.D. Sess. Laws ch. 72 § 14.

195. The unit rule of property taxation as applied to utilities and transporta-

of utility operating property has been considered as personal property and 45 percent as real property.<sup>196</sup> By not extending relief to centrally assessed utilities, the personal property component of their property tax continues. As Due has pointed out, "[p]roperty taxes on utility services are merely passed forward to the consumer in the form of higher prices, as these are allowable costs under rate regulation schemes."<sup>197</sup> There seems to be no reason for repealing the personal property tax on other businesses and continuing it on centrally assessed utilities.

Previous to the repeal of the personal property tax, that percentage of utility property which was deemed to be personal was taxed at 60 percent of its value as was all other personal property. That portion which was deemed to be real property was taxed at whatever the annual *South Dakota Sales Ratio Study* indicated was the taxable percentage being used for other real property within the county. A 1977 act which allowed property to be assessed at any percentage determined by the County Board of Equalization so long as the taxable valuation did not exceed 60 percent of market value, also specifically classified utility property as a separate class for tax purposes.<sup>198</sup> On this basis some counties set higher percentages of taxable valuation on utility property than for other types of real property. In order to restrict the growth of property taxes on utilities, the 1978 legislation provided that the county board of equalization could not raise by more than 25 percent the taxable percentage levied against the personal property components of utility property.

Centrally assessed property is hereby classified for purposes of ad valorem taxation and shall be assessed and equalized as real and personal property in the same proportion as was established in the respective taxing districts in the year 1977. Centrally assessed personal property shall be equalized at a percentage which is not greater than one hundred twenty-five of the percentage at which centrally assessed personal property is equalized in the respective taxing districts in 1977, but not to exceed the maximum percentage provided in paragraph 10-6-33. Centrally assessed real property shall be assessed and

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tion companies involves a determination of the value of the entire firm without respect to where the property of the firm is located. There are three methods used and compared to establish unit value: (1) value of assets under replacement or reproduction cost less depreciation, (2) the market value of outstanding capital stock and debt or (3) capitalized earnings. The unit value of the firms is then allocated by each state for property tax purposes on the same basis such as sales, ton miles, passenger miles, etc. See *Selected Papers Delivered at the 1971 Workshop on the Valuation of Public Utilities for Ad Valorem Tax Purposes*, NAT'L TAX J., 231-330 (June 1972).

196. J. Murphy letter to J. Dewell, W. May, A. Sommervold and G. Fisher (April 21, 1976) settled the lawsuit brought by the City of Sioux Falls (*Sioux Falls v. State Board of Equalization, Stipulation and Judgment*, September 1974). The settlement established the "55-45 rule," which has been used to divide personal from real property in the state ever since.

197. DUE, *supra* note 190, at 82.

198. 1977 S.D. Sess. Laws ch. 86, § 1 (codified at S.D.C.L. § 10-6-33 (Supp. 1978)).



equalized at the same percentage as other real property in the county.<sup>199</sup>

Two things are significant about this section. The first is that it locks in the 55/45 percent allocation between utility personal and real property. The second is the provision that the personal component may be taxed as high as 60 percent while the real component of utility property may not be assessed at a higher percentage than other real property is assessed within the county. The logic for this type of tax treatment of centrally assessed utilities is difficult to fathom.

Another issue which has been raised concerning the omission of utility personal property taxes from repeal concerns the effect of the Railroad Revitalization and Regulatory Act of 1976.<sup>200</sup> That act prohibits states from placing taxes on railroad property, ad valorem or otherwise, that are higher or figured differently than the general rate of assessment on other commercial and industrial property. The position of the Kneip administration was that since railroads are assessed on a unit basis, they are being assessed in the same way as other commercial and industrial property and, "[t]he restriction in the Railroad Revitalization and Regulatory Reform Act goes to the rate of taxation and not the elements which go to make up that taxable valuation."<sup>201</sup>

#### A. *Economic Issues*

##### *Sales Taxation of Personal Services*

A major economic issue concerned the desirability and feasibility of expanding the base of the South Dakota sales tax to include services not currently taxable. This expansion was the major source of replacement revenue for lost personal property tax dollars under the Governor's proposal. South Dakota's sales tax is already one of the broadest in the nation, with only Washington, West Virginia, Hawaii, and New Mexico having broader bases.<sup>202</sup> The majority of the states currently do not tax services or if they do limit their taxation of services to only a few items. Twenty-eight states either tax no services or only a relatively small number.<sup>203</sup> Only Iowa, of the states surrounding South Dakota, has expanded its sales tax base to include most of the services envisioned by the Governor's original proposal.<sup>204</sup>

There is a strong economic case made in the literature for the taxation of personal services. First, expenditures on personal services are consumer expenditures exactly as are the purchase of goods. In terms of consumer satisfaction, there is no logical reason

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199. 1978 S.D. Sess. Laws ch. 72, § 14.

200. 45 U.S.C. §§ 801-54 (1976).

201. Garry & Coler, *supra* note 178, at 4.

202. DUE, *supra* note 190, at 88.

203. SALES/USE TAXATION OF SERVICES, *supra* note 188 reviews the practice in 42 of the 50 states.

204. DUE, *supra* note 190, at 86-92.

for distinguishing between types of consumer purchases. Extending the tax to include personal service would reduce the distortion of household choice between consumption categories.<sup>205</sup>

Second, expansion of the state sales tax to include personal services can bring in greater revenue without having to raise the sales tax rate. The extension of the Iowa tax increased its yield by 12 percent.<sup>206</sup> California estimated that taxation of utilities, rentals, and non-professional services would raise the yield in that state by 20 percent.<sup>207</sup> Evidence from New Mexico and Hawaii indicates that taxation of services there added about 30 percent to the yield of the tax.<sup>208</sup> In light of the already broad coverage of the South Dakota tax, however, no such spectacular increases should be expected.

Third, extension of the sales tax to personal services allegedly lessens the regressivity of the tax as high income groups are thought to typically spend a larger fraction of their income on personal services than do lower income groups. One study indicated that elimination of consumer services from the West Virginia sales tax base would make that tax considerably more regressive than it was at that time.<sup>209</sup> Another study suggested the opposite: (1) the taxation of retail services would make the sales tax, if food was left in the base, slightly more progressive; (2) The taxation of utilities services and medical care, would make the tax more regressive as would application of the sales tax to housing services; (3) taxation of insurance services would increase the progressivity, more than taxation of any other single service.<sup>210</sup> The general conclusion was that the inclusion of services in the sales tax would make little improvement in its progressivity.<sup>211</sup>

Fourth, taxation of services would in many instances, facilitate the administration of the sales tax. Several vendors now provide both goods and services and must distinguish between the two in making their sales tax payments.<sup>212</sup> On the basis of the experience of other states, administrative simplicity is achieved when services are included in the tax base.<sup>213</sup> As a result of this, the failure to tax personal services has been listed as a major defect of retail sales taxation in most states.<sup>214</sup>

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205. J. Mikesell, *The Economic Effect of West Virginia's Consumption Taxes*, 64 (September 1970) (Staff Paper #2, West Virginia University, Legislative Fiscal Studies).

206. DUE, *supra* note 190, at 86.

207. Schoeplein, *Some Perspectives on Sales Taxation of Services*, PROCEEDINGS NAT'L TAX ASS'N 168 (1969).

208. DUE, *supra* note 190, at 87.

209. Mikesell, *supra* note 205, at 65.

210. Davies, *The Significance of Taxation of Services for the Pattern of Distribution of Tax Burden by Income Class*, PROCEEDINGS NAT'L TAX ASS'N 138-46 (1969).

211. *Id.* at 146.

212. Schoeplein, *supra* note 207, at 167.

213. DUE, *supra* note 190, at 87-89.

214. D. MORGAN, *RETAIL SALES TAX* 16 (1964).

### B. *Sales Taxation of Business Services*

The taxation of business services does not receive the accolades that taxation of personal services does from economists and students of taxation. In the states which tax personal services, services provided to business firms have been generally excluded from the tax on the grounds that these services are input and included in the price of the final product which is subject to the sales tax when purchased by the ultimate consumer.<sup>215</sup> In discussing the services rendered primarily to business firms, such as legal, accounting, advertising, architectural, and janitorial services, one commentator notes that the taxation of these services would

[e]ncourage firms to provide the services with their own employees, instead of obtaining them from separate firms. . . . Larger firms would be in a better position to provide their own services than smaller firms and the efficient organization of business would be impaired. Taxation of freight transportation would give strong incentive for firms to use their own trucks instead of public carriers and would create serious interstate distortion.<sup>216</sup>

### C. *Taxation of Construction*

A significant portion, 8 million dollars, of the additional sales tax revenue to be raised under the Governor's proposal was to come from the taxation of construction services. This amount was to be derived from expanding the base to include labor services in construction contracts which are not now taxable. Building materials used in construction contracts are taxable under current South Dakota law unless they are sold to an exempt organization,<sup>217</sup> and the Governor's proposal would continue to exempt purchases of materials by governmental entities.

One authority comments, "Neither real property nor the labor services used to construct real property is taxable under the usual rule."<sup>218</sup> In only eleven of the forty-two sales tax states surveyed did contractors pay the tax on either materials or labor services.<sup>219</sup> The issue is summarized in this fashion, "The question of whether real property contracts should be fully taxable is largely a matter of equity. A large portion of contract work is for housing on which as a matter of social policy, many states prefer not to place the full impact of the tax."<sup>220</sup> In addition, the taxation of labor services to local and state governments can be predicted to either increase taxes or lower the quantity and/or quality of state and local services provided.

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215. Schoepflein, *supra* note 207, at 168.

216. DUE, *supra* note 190, at 89.

217. S.D.C.L. § 10-45-10 & -13 (1967).

218. DUE, *supra* note 190, at 94.

219. SALES/USE TAXATION OF SERVICES, *supra* note 188, at 58.

220. DUE, *supra* note 190, at 95.

#### D. *Cigarette Taxation*

The Governor's proposal also provided for an increase in the cigarette tax from 12 cents to 16 cents a pack, which was expected to result in a three million dollar increase in revenue, assuming that sales would not decline. The 16 cents tax would only be slightly less than the 18 cents Minnesota tax which is the highest in the nation. Iowa and Nebraska tax cigarettes at 13 cents, North Dakota at 11 cents, Montana at 12 cents, and Wyoming at 8 cents a pack.<sup>221</sup> The assumption that there would be no decline in cigarette sales has been seriously questioned by legislative staff.<sup>222</sup> It has been estimated in several studies that increases in the price of cigarettes reduces their consumption,<sup>223</sup> and one must consider the bootlegging problem, which has become epidemic in this country.<sup>224</sup> Because of the ease and profitability of cigarette bootlegging, this has become a major source of financing for organized crime, particularly in the eastern part of the nation.<sup>225</sup> The Advisory Commission on Intergovernmental Relations has estimated that the bootlegging effect is approximately 1.5 times as great as the decrease in consumption associated with the higher taxes.<sup>226</sup> On this basis it was estimated there would be an approximate 6.8 percent loss in sales of cigarettes in South Dakota and the new revenue would be only 2.3 million dollars.<sup>227</sup>

#### *Effects on School Aid Program*

Another problem is the effect that this change will have on the minimum foundation program used to supply some 31 million dollars in state aid to elementary and secondary schools.<sup>228</sup> Under the minimum foundation formula the entitlement of the school district for state aid is calculated by applying 13 mills and 18 mills respectively to the agricultural and non-agricultural property within the school district to determine local revenue raising abil-

221. ADVISORY COMMISSION ON INTERGOVERNMENTAL RELATIONS, CIGARETTE BOOTLEGGING (May 1977) [hereinafter cited as CIGARETTE BOOTLEGGING].

222. Kent, Johnson, & Brown, Senate/House Taxation Committee Document No. 3 (January 12, 1978).

223. STATE OF NEW YORK COMMISSION OF INVESTIGATION, REPORT OF AN INVESTIGATION CONCERNING THE ILLEGAL IMPORTATION AND DISTRIBUTION OF CIGARETTES IN NEW YORK STATE (1972); A. Wiseman, *The Demand for Cigarettes in the U.S. (January 1968)* (doctoral dissertation, Univ. of Wash.); Manchester, *An Econometric Analysis of State Cigarette Taxes, Prices and Demand, with Estimates of Tax Induced Interstate Bootlegging* (August 1973) (thesis submitted to the Univ. of Minn.); *Interstate Cigarette Smuggling*, PUBLIC FINANCE Q. (April 1976). Data presented to the legislature indicated that when South Dakota last raised its tax on cigarettes from 8¢ to 12¢ a pack, sales declined by 9%. See Legislative Handout from D. Reidel, S.D. Cigarette and Candy Association (on file with author).

224. CIGARETTE BOOTLEGGING, *supra* note 221, indicates that bootlegging is a serious problem in 14 states and a moderate problem in 8 others.

225. CIGARETTE BOOTLEGGING, *supra* note 221, at 21-25.

226. *Id.* at 84-89.

227. Kent, Johnson, & Brown, *supra* note 222, Committee Document No. 3, at 2.

228. S.D.C.L. ch. 13-13 (1975).

ity. This figure along with other income is subtracted from the total costs allocated on a per classroom unit to determine a district's eligibility for state aid.<sup>229</sup>

Removing personal property from the tax base will have the effect of lowering the amount of school district revenue which can be raised by the 13 and 18 qualifying mill levies. The greater the percentage of taxable valuation in the school district represented by personal property, the greater the amount of lost revenue which will result. The effect will be greater in rural districts than in urban. Thus, the revenue received from replacement of the personal property tax has to be taken into consideration when the eligibility for state aid is calculated or there will be a severe distortion in the payment of state school aid. Accordingly, the decision was made to include 50 percent of the personal property tax replacement revenue received by a school district as local effort in the calculation of state aid distribution.<sup>230</sup>

## VI. REPORT OF THE PERSONAL PROPERTY TAX REPLACEMENT TASK FORCE

During the summer of 1978, the Personal Property Tax Replacement Task Force met and conducted extensive hearings to carry out their charge from the legislature.<sup>231</sup> The final report of the Task Force, with findings and recommendations in thirteen problem areas, was released on October 25, 1978.<sup>232</sup> Its conclusions are reviewed below.

### *Emergency Funding*

The first of these problem areas involved the funding of the immediate repeal of the tax on personal effects, household furnishings, household pets, home appliances, sporting hobby goods, grain and seed, honey and sugar beets, and the poll tax. During the 1978 legislature, it had been estimated that replacement of these levies alone would require some 6 million dollars.<sup>233</sup> Yet, legislation passed later in the same session added the dog poll, feed, seed, and grain taxes as items subject to immediate repeal.<sup>234</sup> In addition, the estimates used by the Governor's staff and the Legislative Research Council for the other items of personal property proved to be low and the actual amount of the revenue needed was some 1 million dollars more.<sup>235</sup> A sufficient supplemental appropriation was recommended.

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229. S.D.C.L. § 13-13-32 (Supp. 1978).

230. 1978 S.D. Sess. Laws ch. 72, § 15.

231. 1978 S.D. Sess. Laws ch. 72, § 44.

232. State Legislative Research Council, Final Report of the Personal Property Tax Replacement Task Force, (October 25, 1978) [hereinafter cited as Final Report].

233. 1978 S.D. Sess. Laws ch. 72, § 16.

234. 1978 S.D. Sess. Laws ch. 73, §§ 1 & 2.

235. Final Report, *supra* note 232, at 11.

### *Replacement Formula*

The second problem area concerned the formula that should be used to return replacement funds to the counties and other local subdivisions of government (including school districts) in 1980 and subsequent years. The Committee noted that in 1978, some 37.1 million dollars was needed to be returned to the counties in personal property tax replacement revenues.<sup>236</sup> The Committee also took note that personal property taxes had been as high as 47 million in 1975 and 1977 and as low as 36 million in 1972 as shown in Table III. The decline in personal property tax collections in 1978 can be attributed to two factors. The first factor was the "sell down" of cattle herds. This resulted from both the drought and declining cattle prices in 1977.<sup>237</sup> The second factor was the decrease in the percentage of assessed valuation used as taxable value. Prior to 1978, personal property had been taxed at 60 percent of value. The passage of the bill allowing counties to use any percentage up to 60 percent as taxable value led most counties to reduce the taxable percentage for personalty from 60 percent to equal the lower level that was applied to real property.<sup>238</sup>

Under the terms of the original 1978 bill each county was entitled to replacement revenue in an amount equal to the product of multiplying the five year average ratio of personal to real taxes from 1972 to 1976 times the real property taxes being levied in that year.<sup>239</sup> For the 1972 to 1976 period, personal property taxes averaged 30 percent of real property taxes. Had that ratio been used, the counties and other local subdivisions would have been entitled to 55.4 million dollars in replacement revenues due to an expansion of the real property tax base to over 184 million dollars.<sup>240</sup> This amount was more than 18 million dollars in excess of the 37 million which was estimated to be raised in 1978 from personal property and monies and credits taxation. Because of this shift of the tax burden from personal to real property due to the decline in personal property valuations, the actual ratio of personal to real property taxes payable in 1978 was 20.14 percent and not 30 percent as anticipated by the original legislation.<sup>241</sup>

The formula to be used for distribution of replacement reve-

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236. The estimate is calculated as follows: Total personal property tax payable in 1978, \$37,691,251; less: taxes on buildings or leased site, \$1,569,219; plus: monies and credits tax, \$1,569,219; equals \$37,195,399.

237. PER-HEAD PER-DAY TAX, *supra* note 136, at 14-16.

238. The Task Force Report indicated that between 1977 and 1978, taxes on agricultural land went up 18.4% and city lots increased 12%. At the same time agricultural personalty decreased 13.2% and non-agricultural personal property decreased in valuation 15.4%. The result of this was a shift from personal to real property in most county tax bases. See S. Zellmer, Personal Property Tax Replacement Task Force Document 4A (June 20, 1978).

239. 1978 S.D. Sess. Laws ch. 72, §§ 31-36.

240. Final Report, *supra* note 232, at 24-26.

241. This is calculated as follows: Property taxes on realty plus buildings or leased sites, \$184,663,107; Personal Property plus monies and credits taxes, \$37,195,457; Ratio, 20.14%.

nues was one of the more controversial issues discussed by the Task Force<sup>242</sup> with nine different options being discussed.<sup>243</sup> The final recommendation of the Task Force was "that the Legislature return to each county in 1979 the higher of personal property taxes assessed in 1977 and payable in 1978 or 95% of the average personal property taxes assessed from 1972 to 1976 and payable from 1973 to 1977."<sup>244</sup> The total amount of the replacement funding under that suggestion would be \$40,744,168, which exceeds the actual collections in 1978 but is below the average for the preceding five years.

The Task Force further recommended that the entitlements received by the counties to be passed through to the local subdivisions should be determined in the following manner:

By multiplying the current real property taxes levied by the subdivision times the ratio of personal property taxes to real property taxes levied by that subdivision in 1977 and payable in 1978, or the ratio of personal property taxes to real property taxes levied from 1972-1976 and payable from 1973 to 1977, *at the discretion of the board of county commissioners.*<sup>245</sup>

That last provision must be viewed as mischievous. The county governments are entitled to receive the higher of the two replacement amounts, but the local subdivisions and school districts will have their entitlement determined by the county commissioners which may or may not select to reimburse them with the greatest possible replacement funding. There has been considerable controversy in South Dakota over the past decade between cities, school boards, and county commissioners over the control which the latter have exercised over the levels of taxable valuation and, as a result, the budgets of the former.<sup>246</sup> The recommendation of the Task Force further diminishes the financial autonomy of other local levels of government and strengthens the hand of the county commissioners. There is nothing in the proposed legislation which assures that even if the higher amount of replacement revenue is selected in one year for distribution to the cities and schools, a lesser amount of replacement revenue would not be imposed in years to come.

### *Growth of Replacement Revenues*

The third problem area addressed by the Task Force concerned an issue which was not considered by the original legislation.<sup>247</sup> This was whether the Task Force should recommend that there be automatic increases in the replacement revenues desig-

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242. Minutes of Personal Property Placement Task Force (September 21-22, 1978).

243. Final Report, *supra* note 232, at appendix 2.

244. *Id.* at 13.

245. *Id.* (emphasis added).

246. See Resolution of State Board of Education to Interim Taxation Committee (September 15, 1977).

247. 1978 S.D. Sess. Laws ch. 72, § 33.





nies to 1% (excluding annuity contracts from the increase), by extending the insurance premiums tax to fraternal companies at 1%, by raising the sales tax on farm machinery and irrigation equipment to 3%, by imposing a 3% sales tax on the gross receipts of laundermats, by raising the financial institution's franchise tax to 6½% from the current 5½%, by increasing financial broker's licensing fees to \$150 and agent's to \$125 and by raising the cigarette tax by 2¢ from 12¢ to 14¢ per pack. It is estimated that this will raise from \$26.3 to \$28.2 million which, along with the expected continuing revenue from the existing sources will provide sufficient money to fully fund the replacement.<sup>254</sup>

Several members of the Task Force expressed the opinion, however, that additional taxes would not be needed and replacement funding should come from existing sources and fiscal belt-tightening.<sup>255</sup> The replacement amounts that are to come from each of the services to be taxed, as estimated by the Governor and the Legislative Research Council, are given in Table II.

Certain services were exempted from the expansion of the sales tax base. The Task Force explains the exemption on agricultural services on the grounds of an anticipated difficulty in collecting the tax from transient custom combine operators and farm operators who work for each other. Forestry services were excluded because of the number of small loggers and operators who work across state lines.<sup>256</sup> While these arguments may be true, there is no reason to assume that they are any more valid for these occupations than for other types of services which the Task Force did not recommend exemption.

Financial institution services were exempted, but the Task Force recommended an increase in the franchise tax from 5½ percent to 6½ percent.<sup>257</sup> The Committee attributed difficulties in defining exactly what constitutes a financial service as the reason for the exemption. At least one author disagrees, finding no such administrative difficulties, and feels that the financial services of banks are appropriate for sales taxation.<sup>258</sup> Financial brokers were excluded from the tax and their license fees increased instead, from 125 to 150 dollars. The Task Force felt that because a tax on broker services could be avoided by consumers by phoning out-of-state brokers with toll free numbers, a tax would discriminate against South Dakota brokers.<sup>259</sup>

Trading stamps were exempted on the grounds that when trading stamps were redeemed, those purchases are already taxable. Motion picture rentals were exempted for the same reason, because the admission price to movie houses is subject to the sales

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254. Final Report, *supra* note 232, at 28.

255. *Id.* at appendix 5 & 6.

256. *Id.* at 31-33.

257. S.D.C.L. § 10-43-4 (Supp. 1978).

258. DUE, *supra* note 190, at 99.

259. Final Report, *supra* note 232, at 32.

tax.<sup>260</sup> The sale of newspaper and magazine subscriptions was also exempted, the Task Force here fearing that a tax would be an interference with free speech. There is little reason to believe that subscriptions could not be taxed in South Dakota as they are in other states.<sup>261</sup> But there are some constitutional prohibitions against the taxation of advertising services when they flow across state lines.<sup>262</sup> It might be pointed out that the Task Force's concern for the United States Constitution was somewhat inconsistent, however, since it did not also recommend an exemption for advertising services on constitutional grounds.

Travel agents were to be exempted because their services were consumed by the airlines and not the airline passengers. The travel agent receives a commission from the airline for selling the ticket, and an airline ticket purchased from a travel agent costs the same as one purchased from the airline itself.<sup>263</sup> It could also be contended that levying the sales tax on the travel agent's commission would amount to discrimination against travel agents. Interstate transportation including airline services may not be subject to state taxation under the constitutional prohibitions discussed previously in this article, although intrastate travel by airlines would be.<sup>264</sup> While there appears to be no case law dealing specifically with sales taxation of travel agents, it is reasonable to assume that a taxable nexus could be more easily established and the service isolated from interstate commerce when tickets are handled by a travel agent than directly by the carrier. The grounds on which the exemption is granted appear to be weak. Users of travel agents generally do so for convenience and because the travel agent can provide a wider range of services than provided by the airline ticket office. In essence the traveler receives these services without fee as the carriers, hotels, and tours pay the agent. It is doubtful that a sales tax on the value of those services would result in detrimental effects to their business.

### *Definition of Personal Property*

Another problem that received brief consideration from the Task Force was whether there needed to be an improved statutory definition of what constituted personal property. The current statutory definition of personal property is as follows:

Personal property, for the purpose of taxation includes all goods, chattels, money, credits, and effects, wheresoever

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260. *Id.* at 32.

261. SALES/USE TAXATION, *supra* note 188, at 42, lists 6 states taxing subscriptions.

262. *See* notes 42 & 43 *supra*.

263. Final Report, *supra* note 232, at 33.

264. *See* notes 200 & 201 *supra*. While there appears to be no case law dealing specifically with sales taxation of travel agents, it is reasonable to assume that a taxable nexus could be more easily established and the service isolated from interstate commerce when tickets are handled by a travel agent than directly by the carrier.

they may be; all ships, boats, and vessels, belonging to the inhabitants of this state, whether at home or abroad, and all capital invested therein; all money and interests, whether within or without this state, due the person to be taxed, and all other debts due such person; all public stocks and securities; the capital stock of all insurance companies organized under the laws of this state; all stock in turnpikes, railroads, canals and other corporations, except national banks out of the state, owned by the inhabitants of this state; all personal property of monied corporations, where the owners thereof reside in or out of the state; the income of any annuity, unless the capital of such annuity is taxed within the state; and all shares of stock in any bank organized, or that may be organized, under the law of the United States or of this state.<sup>265</sup>

The Task Force staff and the Department of Revenue pointed out that items considered real property in some counties had been taxed as personal property in other counties.<sup>266</sup> This problem was particularly acute with fixtures and machinery.

In the past there had been a positive incentive on the part of the taxpayer to have fixtures and machinery classified as real property since real property was assessed at a taxable value less than 60 percent while personal property was carried on the tax rolls at 60 percent.<sup>267</sup> The personal property tax repeal reversed that situation and created a positive incentive for fixtures and machinery to be classified as personal property and thereby exempted from the tax. The Secretary of Revenue told the Task Force the definition of real property was well established, but defining personal property as anything that isn't real property amounted to "no definition at all."<sup>268</sup> It is not uncommon, however, to find the definition of personal property to be stated as any property which is not real property<sup>269</sup> and for the courts to support such a definition.<sup>270</sup> The response of the Task Force was to recommend,

That no new definition of real and personal property be proposed. The classification of property is a local decision and previous misclassification of property at the local level cannot be solved by legislation. Problems in classification should be solved at the local level or through existing appeal procedures. Existing definitions and case laws should give adequate guidelines.<sup>271</sup>

The principle controversy which will arise along these lines in South Dakota concerns the definition of fixtures. The staff attor-

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265. S.D.C.L. § 10-4-6 (Supp. 1978).

266. Minutes of Personal Property Task Force 3-4 (April 10, 1978).

267. See text accompanying notes 197 & 198 *supra*.

268. Statement by Coler, Secretary of the Dep't of Revenue, Minutes of Personal Property Placement Task Force 4 (April 10, 1978).

269. *In re Berman's Estate*, 39 Ill. App. 2d 175, —, 187 N.E.2d 541, 544 (1963); *In re Althause's Estate*, 63 App. Div. 252, —, 71 N.Y.S. 445, 447 (1901).

270. *In re Kruger's Estate*, 55 Cal. App. 2d 619, —, 131 P.2d 619, 621 (1942); *McDougal v. McDougal*, 279 S.W.2d 731, 738 (Mo. App. 1955); *Travis v. Dickey*, 96 Okla. 256, —, 222 P.2d 527, 528 (1924); *In re McBlathery's Estate*, 311 Pa. 351, —, 166 A. 886, 887 (1933).

271. Final Report, *supra* note 232, at 42.

ney for the Task Force indicated that South Dakota law clearly states that all fixtures are to be considered real property.<sup>272</sup> The South Dakota Code has established the taxability of fixtures as real property and specifically enumerates some of them such as heating, lighting, and plumbing systems.<sup>273</sup> The major problem concerns the determination of when items, which might otherwise be considered personal property, have become "fixed" to real property and thus still subject to taxation in South Dakota.<sup>274</sup> It has been pointed out that fixtures are a special type of property lying along the dividing line between real and personal property.<sup>275</sup>

In determining whether a particular item has changed from personal property to a status of a fixture, three tests are generally applied. These are the tests of annexation, adaptation, and intention.<sup>276</sup> Intention, regardless of the method of annexation, has become the dominant factor in South Dakota in classifying particular objects as fixtures.<sup>277</sup>

Since intention is the major criteria for distinguishing between chattels and fixtures, special problems are presented with machinery and trade fixtures. This is particularly true when the equipment or fixtures are leased by one person,<sup>278</sup> or when a tenant is occupying a building even though that building was specifically constructed for the equipment.<sup>279</sup>

Under the intention test, machinery introduced upon the realty as a permanent accession in order to carry on the business for which the realty is used becomes a fixture and part of the realty upon being installed. In this connection, many courts take the position that when such an intention is shown, the fact that the machines are easily removable and may be used with equal facility elsewhere is immaterial. . . .

On the other hand, machinery may be held personalty where no intent appears that it should become a part of the realty, and it was not specially designed for the build-

272. R. Bezpalatz, Task Force Memoranda No. 2 (April 25, 1978).

273. S.D.C.L. § 10-4-2 (Supp. 1978).

274. *Id.* A fixture is defined in these words:

A thing is deemed to be affixed to land when it is attached to it by roots, as in the case of trees, vines, or shrubs; or inbedded in it, as in the case of walls; or permanently resting upon it, as in the case of buildings; or permanently attached to what is thus permanent as by means of cement, plaster, nails, bolts, or screws.

S.D.C.L. § 43-33-1 (1967).

275. *Frost v. Schinkel*, 121 Neb. 784, —, 238 N.W. 659, 663 (1931).

276. *See, e.g.*, *Knell v. Morris*, 39 Cal. 2d 450, —, 247 P.2d 352, 355 (1952); *Sword v. Low*, 122 Ill. 487, —, 13 N.E. 826, 827 (1886); *First State Bank v. Crap Orchard Banking Co.*, 255 Ky. 800, —, 75 S.W.2d 517, 518 (1934).

277. *See Killian v. Hubbard*, 69 S.D. 289, 9 N.W.2d 700 (1943); *Metropolitan Life Ins. Co. v. Jensen*, 69 S.D. 225, 9 N.W.2d 140 (1943). *See also Arlt v. Langley*, 56 S.D. 79, 227 N.W. 469 (1929).

278. The South Dakota Supreme Court has held that parties to a contract may agree whether fixtures are realty or personalty. *See Home Owners' Loan Corp. v. Gotwals*, 67 S.D. 579, —, 297 N.W. 36, 36 (1941); *Curran v. Curran*, 67 S.D. 119, —, 289 N.W. 418, 420 (1939). *See also Glenn v. W.C. Mitchell Co.*, 9 F.2d 599 (8th Cir. 1925); *Earle v. Kelly*, 21 Cal. App. 480, —, 132 P. 262, 263-64 (1913); *Olympia Lodge No. 1, F. & A.M., v. Keller*, 142 Wash. 93, —, 252 P. 121, 123 (1927).

279. *Meena v. Drousiotis*, 146 Fla. 168, 200 So. 362 (1941).

ing, but is of a common lot and description, especially where it is capable of removal without material injury to it or to the building and may be used elsewhere.<sup>280</sup>

On the other hand, the "integrated industrial plant doctrine," as interpreted in other states, indicates that machinery necessary to the proper operation of a plant is a fixture, irrespective of the way in which it is attached to the plant and even though it may not be attached at all.<sup>281</sup>

Another issue has been raised concerning the status of certain household appliances and other articles. The wording of the new statutory language seems to clearly exempt all of these from taxation: "Personal effects, household furnishings, home appliances and sporting and hobby goods are hereby classified and exempt from ad valorem taxation."<sup>282</sup> In the past, household appliances like ranges, ovens, venthoods, and trash compactors have been considered as real property when they are built into the structure.<sup>283</sup> As such, these have been listed on the real property cards as "add-ons." When these same items have not been built in, they have been treated as personal property and subject to separate listing on the personal property tax blank. It appears appropriate and consistent to treat all appliances alike. If this is not done, discrimination will exist between groups of taxpayers if some appliances are exempt and other are not. Of course, consistently treating all appliances as personalty would result in a loss of revenue to local governments which was not calculated or considered by the Task Force.

In light of these problems, the decision of the Task Force to leave the determination of what is real and what is personal property to local, and perhaps conflicting, determination appears unwise. When statutory provisions govern the determination of whether a particular object is or is not a fixture the other tests and criteria are generally held immaterial.<sup>284</sup> Considerable confusion would be eliminated by statutory definition.

### *Other Determinations*

The Task Force reached a number of other conclusions, including a decision to state the sales tax broadening legislation in general terms rather than to attempt to list all services which are taxable.<sup>285</sup> The suggested legislation contains a representative list of services that would be taxable and a general presumption that a service is taxable unless specifically exempted.<sup>286</sup> This approach

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280. 35 AM. JUR. 2d *Fixtures* § 101 (footnotes omitted).

281. See *First Nat. Bank v. Nativi*, 115 Vt. 15, 49 A.2d 760 (1946); *Snuffer v. Spangler*, 79 W. Va. 628, 92 S.E. 106 (1917).

282. 1978 S.D. Sess. Laws ch. 72, § 1.

283. S.D. DEPARTMENT OF REVENUE, APPRAISAL MANUAL: URBAN PROPERTY 1c-3c (1971).

284. See *Gar Wood Indus., Inc. v. Colonial Homes, Inc.*, 305 Mass. 41, 24 N.E.2d 767 (1940).

285. Final Report, *supra* note 232, at 34.

286. *Id.* at Bill No. 3.

is consistent with the practice in New Mexico and Hawaii and considered to be superior to the specific enumeration method.<sup>287</sup>

Despite the problems which have been noted in the taxation of utility personal property,<sup>288</sup> the Task Force recommended that no change be made in that provision of the new law.<sup>289</sup> In addition, the Task Force concluded that problems associated with sales to Indians and Tribal sales taxes, which are currently administered by the Department of Revenue, were not relevant to Task Force goals and should be addressed by the full legislature.<sup>290</sup>

The Task Force also considered the problem of the livestock predator control tax. In the past this tax had been levied on the number of animals listed on the personal property tax form in those counties which had chosen to use the tax as a method of raising funds for predator control. The abolition of the personal property tax destroyed the list upon which the tax was levied. The Task Force recommended that legislation be adopted which would allow county commissioners to conduct a livestock census within a predator control district.<sup>291</sup>

## VI. CONCLUSION

Having made the decision to repeal the personal property tax and replace it with alternate sources of funding, inquiry can be made as to the impact of this change in tax policy on the economy of the State and the welfare of its taxpayers. When a tax structure is changed, the question always arises as to who will benefit and who will lose. The repeal of the personal property tax is not designed to increase the overall tax burden of the state, but rather to shift the tax burden from one group of taxpayers to another.

The current burden of the personal property tax is given in Table V. As that Table shows, it is the agriculture sector of the State's economy which will receive the most immediate relief from the personal property tax repeal. In 1978 farm operators paid 52 percent of the total personal property taxes levied in this state. It must be recalled that 1978 was a year in which personal property taxes on the farm community were less than usual because of the decline in the value of cattle subject to taxation.<sup>292</sup>

There is no doubt that South Dakota agriculture could use a stimulus. From 1973 to 1977 net farm income in the state declined by 87 percent which in real terms is comparable to the level during the depression of the 1930's.<sup>293</sup> Most of the surrounding states have either totally or partially repealed their farm personal prop-

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287. *DUE*, *supra* note 190, at 89-90.

288. *See* text accompanying notes 192-99 *supra*.

289. Final Report, *supra* note 232, at 38-40.

290. *Id.* at 37.

291. S.D.C.L. ch. 40-37 (1967).

292. Final Report, *supra* note 232, at Bill #10.

TABLE V  
Tax Dollars to be Collected From Personal  
Property in 1978

Item	Dollars Collected	Percent of Collection
Household Furnishings	\$ 5,708,616	15.8
Livestock	8,239,513	22.8
Ag. Machinery & Tools	10,556,792	29.2
Fixtures & Equipment	3,769,954	10.4
Business Inventory	6,410,681	17.7
Industrial & Road Machinery	1,214,475	3.4
Other	222,099	.1
Total	\$36,122,130	

erty taxes. By doing likewise, the competitive position of the South Dakota farmer should be improved since agricultural prices are still determined from basically free markets.<sup>294</sup> The result should be an expanded profit margin for South Dakota farmers as opposed to lower prices to be received from agricultural products. Of course, due to the extension of the sales tax to veterinary services and farm machinery plus the increase of the farm machinery tax from 2 percent to 3 percent, farmers can anticipate paying up to 2.2 million more dollars in sales tax than they had previously.<sup>295</sup> At the same time, some 18.9 million dollars in personal property tax relief is being granted them. Clearly South Dakota agriculture is the big "winner" from the repeal of the personal property tax.

The second group that should benefit by the repeal of the personal property tax is the retail businessmen who in 1978 paid over 38 percent of the total personal property taxes in assessments on their inventories, fixtures, and equipment. Retailers in the state have claimed that the personal property tax repeal will improve their competitive position and will lower prices to their customers.<sup>296</sup> The extent to which their argument is true depends on how much of the replacement revenues must come from increased sales taxes which will either have to be passed on to ultimate consumers or swallowed in the form of reduced profits. It is impossible to separate out what portion of the increased sales taxes on business and transportation services will be paid by retail firms. Together these two items total some 7 million dollars.<sup>297</sup> Since Table V shows a reduction in personal property taxes on business inventory and fixtures of over 10 million dollars, it is reasonable to assume that the retail industry in the state will be a net gainer, but

293. PER-HEAD PER-DAY TAX, *supra* note 136, at 15-16.

294. Kent, *Implications of Personal Property Tax Repeal*, 11 S.D. MUNICIPALITIES 14 (1978).

295. J. DOLL, J. RHODES, & J. WEST, *ECONOMICS OF AGRICULTURE PRODUCTION, MARKETS AND POLICY* (1968). Part 3 contains a comprehensive discussion of the conditions determining agricultural prices.

296. See Table II.

297. Economic Factors, *supra* note 99, at 16-21.

the benefit will be considerably less than that achieved by agriculture.

Perhaps the clearest losers from the personal property tax repeal are the customers of the centrally assessed utilities. Since the repeal gave no benefit to these utilities, their consumers will be forced to bear the burden of continued personal property taxation.<sup>298</sup> It is difficult to determine how the "average" taxpayer in the state will benefit. If a penny increase in the sales tax remains in the code, most South Dakotans will have their annual sales tax payments increased by approximately 45 dollars per family. This increase in the sales tax will be offset by the repeal of personal property taxes on household goods, an average decline of 50 to 75 dollars per family.<sup>299</sup>

Among the big gainers must be included the tax administrators at the county level who no longer will have to endure listing, assessment, and enforcement of the personal property levies. The studies on the administrative difficulties associated with the personal property tax are legion and do not need to be reviewed here. This summary is sufficient:

In administration . . . personalty presents the greatest problems. Intangible property is easy to assess, but extremely difficult to locate. Assessing it on the same basis as other property is completely unenforceable. Household personalty is both difficult to locate and to assess accurately . . . an arbitrary assessment date inevitably hits some industries with peaks and other with low inventory and thus complicates equitable inventory assessment. Alleviation of this problem through averaging involves considerably administrative and compliance costs. Business and, to some extent, agriculture personalty is easy to find, but complex and highly specialized machinery and equipment is difficult to value accurately.<sup>300</sup>

Property tax administration should in fact improve significantly with the elimination of the personal property tax because the assessor should have more time to improve their real estate assessment practices.<sup>301</sup> The Advisory Commission on Intergovernmental Relations, in speaking of the personal property tax, has concluded, "The tax provisions that are impossible to administer as written, whose honest administration would be economically intolerable, which force administrators to condone evasion, which makes taxpayer dishonesty a routine procedure, should be repealed."<sup>302</sup> It has been noted that many experts feel repeal is justified on administrative grounds alone. If the resources freed from

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298. See Table II.

299. Kent, *supra* note 294, at 15.

300. McCLELLAND, *supra* note 35, at 87.

301. *Id.*

302. ADVISORY COMMISSION ON INTERGOVERNMENTAL RELATIONS, I THE ROLE OF THE STATES IN STRENGTHENING THE PROPERTY TAX 32-33 (1963). *Contra*, BURKHARDT, PROPERTY TAXATION U.S.A. 103-25 (R. Lindholm ed., 1967); C. SAUNDERS, *A Defense of Personal Property Taxation*, printed in THE PROPERTY TAX 331-50 (1967).



personal property taxation are used to improve the quality of real property taxation in the state, then a significant advance in tax administration will have been achieved.

Another question that needs to be asked is: Has the equity of the South Dakota tax structure been improved by the repeal? It is generally held that equity in taxation is enhanced by the replacement of regressive taxes with those which demonstrate more progressive characteristics.<sup>303</sup> Peckman and Okner have found, "personal property taxes and motor vehicle licenses are regressive at the lower income scale and proportionate or slightly progressive in the higher classes."<sup>304</sup> On the other hand, that portion of the personal property tax which is collected on monies and credits is progressive because financial assets are concentrated in the hands of more wealthy individuals.<sup>305</sup> As has been established previously in this article, taxes on farm personalty and business inventories bear no relationship to ability-to-pay.<sup>306</sup>

Before a final verdict can be rendered regarding the equity of personal property tax repeal, the equity of the replacement sources of revenue must be considered. Sales taxes as a whole are generally regressive. Peckman and Okner found them to be more so than personal property levies.<sup>307</sup> If replacement is funded by a 1 cent increase in the sales tax, it is doubtful that any improvement in tax equity will have been achieved. In fact, it is likely that the state's tax structure would move in the opposite direction. The progressivity, or lack of it, of extending the sales tax to services has been discussed previously.<sup>308</sup> The extension of the sales tax to utility services must be viewed as strongly negative on equity grounds. The bulk of the evidence regarding sales tax equity seems to support the conclusion that, while not as bad an alternative as a 1 percent increase in the general sales tax rate, the replacement of personal property tax revenues by sales taxes levied on services is not likely to improve the overall equity of the state's tax structure significantly.

The overall economy of the state can expect to benefit, particularly the agricultural and retail sectors. The absence of a property tax on business inventories and fixtures has been previously cited as a factor in attracting new industry,<sup>309</sup> although the importance of inventory tax repeal may be overemphasized. A study of inventory taxes in California concluded: "The economic effects of the present taxation of inventories are not serious enough to warrant

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303. R. MUSGRAVE & P. MUSGRAVE, *PUBLIC FINANCE IN THEORY AND PRACTICE* 210-12, 220-24 (2d ed. 1976).

304. J. PECKMAN & B. OKNER, *WHO BEARS THE TAX BURDEN?* 46 (1974).

305. H. AARON, *WHO PAYS THE PROPERTY TAX?* 46 (1975).

306. See text accompanying note 93 *supra*.

307. PECKMAN & OKNER, *supra* note 304, at 58.

308. See text accompanying notes 209-11 *supra*.

309. See text accompanying note 98 *supra*.

their elimination just for that reason."<sup>310</sup> If South Dakota is successful in repealing its personal property tax without the passage of a state income tax on either individual or corporate income, it is likely that the tax structure of the state will be touted by state officials as an even greater enticement to the movement of new firms and businesses across its borders. The impact of repeal on local governments is at best cloudy. The issue of their bonding capacity may not be settled. If bonding capacity has been limited, then the capacity of local government to provide the necessary sewer, water, roads, and public buildings may have been crippled and additional reliance upon the state for money may be necessary. Since labor services in construction contracts to government entities will now be taxable, there will probably be some moderate pressure on local government costs and taxes, particularly those used for capital improvements.

It appears likely that the state government will provide sufficient revenues to fully replace the lost personal property taxes to local governments for the first year or two. But the failure to provide in legislation a growth formula for replacement revenue presents the possibility of a shift in tax burden to real property, particularly homesteads and commercial buildings, in the years to come as has been the case in other states.<sup>311</sup> The philosophical question of whether state government can participate to a greater extent in the financing of local services without exerting increased control over local decisions has yet to be answered.

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310. Inventory Taxation, Hearings Before California Senate Committee on Revenue and Taxation 28 (October 23, 1968) (Statement of G. Break).

311. See text accompanying note 113 *supra*.

## ADDENDUM

Since the above article was completed, the 54th Session of the South Dakota Legislature concluded work on the implementation of the personal property tax repeal. The produce of their deliberations was a package of seven bills designed to raise the revenues necessary to replace those lost from levies on personal property and to establish formulas for distributing the replacement monies to the local subdivisions of government.

### *broadening of the sales tax base*

The first piece of legislation<sup>1</sup> repealed the one percent increase in the sales tax that was scheduled to go into effect January 1, 1980 and broadened the sales and use tax base to include previously exempted services effective July 1, 1979. By reference to those services enumerated in the Standard Industrial Classification Manual,<sup>2</sup> certain services are to be subject to taxation.<sup>3</sup> These include metal mining services, anthracite mining services, bituminous coal and lignite mining services, oil and gas field services, non-metallic mineral services, service industries for the printing trades, coding, engraving and allied services, communications, electric and gas services, hotels, motels and tourist courts, rooming and boarding houses, camps and trailer parks, personal services, business services, automotive repair services and garages, miscellaneous repair services, amusement and recreation services, legal services, engineering, architectural and surveying services, accounting, auditing and bookkeeping services.<sup>4</sup> In addition to those services taxed by reference to the Standard Industrial Classification Manual, other services are also to become taxable, including those provided by abstractors, collection agents, real estate agents, appraisers, and loan brokers.<sup>5</sup>

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1. 1979 S.D. Sess., H.B. 1039 [hereinafter cited as H.B. 1039].

2. Division of Office and Management and Budget, Office of the President, *Standard Industrial Classification Manual*, 1972. The Standard Industrial Classification system was not established for purposes of delineating taxable and non-taxable activities or as an aid in tax administration or collection. The Standard Industrial Classification Codes are used by the federal government in economic analysis as an aid in determining both the volume and type of economic activity throughout the nation and within a specific region. When gathering data on the level and types of economic activity, the federal government places firms in certain standard industrial classifications on the basis of their predominant economic activity. Those firms which perform more than one type of service or produce more than one type of good are classified on the basis of which good or service dominates in their product mix. This classification system and the placing of firms within it is arbitrary. The question can be raised as to whether or not reference to the *Standard Industrial Classification Manual* adds any additional clarification or precision to the South Dakota law. It is entirely possible that a firm may be classified by the Federal government for statistical analysis purposes under one of the headings designated as exempt and not be so designated by the State.

3. H.B. 1039, *supra* note 1, § 10.

4. *Id.*

5. *Id.*

This bill also enumerates certain services that are to be exempt:

The following services enumerated in the Standard Industrial Classification Manual, 1972, as prepared by the statistical policy division of the office of management and budget, office of the President are exempt from the provisions of this chapter; health services (major group 80); educational services (major group 82); social services (major group 83); agricultural services (major group 07); and forestry services (group no. 085). The following are also hereby specifically exempt from the provisions of this chapter: financial services including loan origination fees, late payment charges, non-sufficient fund check charges, stop payment charges, safe deposit box rent, exchange charges, commission on travelers checks, and charges for administration of trusts; interest charges, and "points" charged on loans; commissions earned or service fees paid by an insurance company to an agent or representative for the sale of a policy; stock and commodity brokers services; travel agents' service; the sale of trading stamps; water services except for irrigation; sanitary services; veterinarians services; construction services (division C); transportation services; rentals of tangible personal property leased under a single contract for more than twenty-eight days; advertising services; services provided by any corporation to another corporation which is centrally assessed having identical ownership and services provided by any corporation to a wholly-owned subsidiary which is centrally assessed; newspaper sales and subscriptions and motion picture rentals.<sup>6</sup>

Contractors making improvements either to or on real estate are subject to a four percent gross receipts tax<sup>7</sup> with the provision that materials upon which a sales tax had previously been paid can be used as a credit against the gross receipts tax due from the contractor, if an exemption certificate from the Department of Revenue has been obtained.<sup>8</sup> In an attempt to close a possible loophole, this legislation provides that if real estate is improved without a contract for the improvement being issued, the gross receipts from the sale of the improvement but not the land, shall be subject to the excise tax unless the improvement was made four years prior to the sale of the property.<sup>9</sup>

The act also gives a statutory definition of taxable nexus for services subject to the use tax provisions of the code: "For the purpose of proper administration of this chapter and to prevent evasion of the tax, evidence that a service is used in the state shall be prima facie evidence that the service was performed in the state and that the service is subject to tax."<sup>10</sup> Whether this definition would withstand the scrutiny of the Federal courts as being an ad-

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6. *Id.*, § 11.  
 7. *Id.*, § 12B.  
 8. *Id.*, § 12C.  
 9. *Id.*, § 12L.  
 10. *Id.*, § 6E.

equate standard for taxable nexus will probably be settled by litigation.<sup>11</sup>

### *Additional Sources of Revenue*

The license fees for security agents were increased from \$15 to \$125 and security brokers' fees were raised from \$100 to \$150 with their services being exempted from the sales and use tax.<sup>12</sup> The financial institutions franchise tax was raised from five and one-half to six percent of their net income. The services provided by financial institutions were exempted from the tax. The proceeds of this additional one-half percent of the tax will accrue entirely to the state general fund and not be distributed among the counties.<sup>13</sup> The cigarette tax was raised two cents per pack<sup>14</sup> and the insurance premium tax on domestic companies was raised from one-half to three-quarters of one percent.<sup>15</sup>

### *Tax Replacement Funds for New Taxing Entities*

Part of the legislative package included a provision that the new governmental entities formed after January 1, 1979 will be entitled to replacement revenues "in proportion to percentage of the tax base withdrawn from the parent taxing entity."<sup>16</sup> Only newly formed counties, townships, municipalities and school districts will be subject to any replacement entitlements under the provisions of this act.

### *Formula for Allocation of Additional Replacement Revenues*

Formulas were established within the legislative package for distribution of any additional revenues appropriated by the legislature for replacement of personal property tax funds above the 1980 base distribution.<sup>17</sup> The distribution to each county is to be based on a three-factor formula consisting of the ratio of real property taxes assessed in the county to total real property taxes assessed in the state, times the ratio of personal property taxes assessed from 1972-1976 and payable from 1973-1977 in the county compared to the ratio of personal property taxes assessed throughout the state compared to the real property taxes assessed throughout the

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11. 1979 S.D. Sess., H.B. 1040. The tests employed by the federal courts as to whether a use tax applied to out-of-state vendors is in violation of the interstate commerce clause of the Federal Constitution are whether the out-of-state business receives a benefit or protection from the state, *Wisconsin v. J.C. Penney*, 311 U.S. 435, 444 (1940) and *Nelson v. Sears Roebuck*, 312 U.S. 359, 364 (1941) or whether there is "some definite link, some minimum connection, between a state and the person, property or transaction it seeks to tax." *Miller Bros. v. Md.*, 347 U.S. 340, 344-345 (1954); *see also National Bellas Hess v. Ill.*, 386 U.S. 753 (1967).

12. *Id.*

13. 1979 S.D. Sess., H.B. 1042.

14. 1979 S.D. Sess., H.B. 1044.

15. 1979 S.D. Sess., H.B. 1045.

16. 1979 S.D. Sess., H.B. 1043.

17. 1979 S.D. Sess., S.B. 66.

state over the same time period, times the additional funds made available by legislative appropriation.

Any additional funds allocated to a county in one year shall be part of its base allocation used in future years.<sup>18</sup> Prior to 1981, each county shall be entitled to an allocation equal to the higher of personal property taxes assessed in 1977 and payable in 1978, or ninety-five percent of the average property taxes assessed between 1972 and 1976.<sup>19</sup>

For the distribution of funds within the counties to the local taxing subdivisions, entitlements are calculated as follows:

The entitlement of each subdivision is determined by multiplying the current real property taxes levied by that subdivision times the ratio of personal property taxes to real property taxes levied by that subdivision in 1977 and payable in 1978 or the ratio of personal property taxes to real property taxes levied from 1972 to 1976 and payable from 1973 to 1977 at the discretion of the Board of County Commissioners.<sup>20</sup>

The apportionments to the counties and the entitlements to the local subdivisions are both subject to pro-ration if insufficient funds are available to make full payment.

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18. H.B. 1039, *supra* note 1, § 3.

19. *Id.*, § 2.

20. *Id.*, § 5. This means that if a city is levying \$1 million in property taxes and its ratio of personal property taxes to real property taxes levied during the year 1977 was 20%, the city would be entitled to \$200,000 of replacement revenues under the formula.