

# Comparison of the Neighboring State Tax Systems



**ISSUE  
MEMORANDUM  
2018-xx**

## Introduction

How does South Dakota's tax system compare with surrounding states?

This is an ongoing question, as tax revenues and rates are constantly changing. This issue memorandum is an attempt to compare various tax rates and revenues with surrounding states in 2015. States collect revenue from several tax categories. This memo will explore the major state taxes and provide tax revenues and rates from South Dakota and each surrounding state. A similar

comparison was done in 1995 and was recorded in Issue Memorandum 95-24.

It is important to understand the relationship of state and local government tax collections when evaluating and comparing state tax systems. The taxes collected by a state often influence the taxes collected by the state's political subdivisions. Property and sales taxes are the primary means to produce local government tax revenue in surrounding states. The balance of local government revenue is generally received from user fees and transfer payments from the federal and state government.

South Dakota ranked 50th in per capita total state tax revenue in 1993. In 2015, South Dakota ranked 46th in per capita total state tax revenue. In comparison, North Dakota ranked 2nd in per capita state tax revenue in 2015. Table 1 describes the total state tax revenue, per capita revenue, for South Dakota and each surrounding state in 2015.

**Table 1. 2015 Total State Tax Revenue and Per Capita Revenue**

2015 Total State Tax Revenue and Per Capita Revenue <sup>1</sup>			
	Total Tax Revenue (Millions)	Per Capita Revenue	Per Capita Rank
Iowa	\$9,189	\$2,942	20
Minnesota	\$24,439	\$4,452	6
Montana	\$2,843	\$2,753	24
Nebraska	\$5,087	\$2,683	27
North Dakota	\$5,740	\$7,583	2
South Dakota	\$1,674	\$1,950	46
Wyoming	\$2,356	\$4,020	7

State and local governments obtain tax income from a variety of sources, and the breakdown changes considerably from state to state. Proportions vary based on the types of taxes administered, the types of resources within the state, and the policy priorities of state and local governments. State and local governments tend to obtain the largest portion of tax revenues from property taxes and sales and gross receipts taxes. Another large source of revenue is individual income taxes.

<sup>1</sup> Federation of Tax Administrators, <https://www.taxadmin.org/>

In comparison to other states, South Dakota is largely dependent on sales tax revenue, which accounts for 40.5% of total tax collections. In comparison, sales tax only accounts for 17.3% of total tax collections in Minnesota. Individual income taxes make up a larger share of revenue for many states including Minnesota and Montana, which collect the most revenue from individual income tax rates at 31.8% and 28.3%, respectively. Below, table 2 provides an overview of where state and local governments obtained their tax revenues by percentage in 2015.

Wyoming, like South Dakota, does not have a personal or corporate income tax. Unlike South Dakota, Wyoming receives about a third of its state revenue from mineral severance taxes. This tax gives Wyoming the luxury of avoiding certain taxes while keeping other tax rates relatively low. North Dakota raised the smallest portion of tax revenue through property taxes. Like Wyoming, North Dakota generates a significant amount of revenue from severance taxes.

**Table 2. Total Percentage of State and Local Tax Collections from each Source 2015**

State and Local Tax Collections, Percentage of Total from Each Source 2015 <sup>2</sup>							
	IOWA	MINNESOTA	MONTANA	NEBRASKA	NORTH DAKOTA	SOUTH DAKOTA	WYOMING
Property Tax	33.0%	25.8%	37.3%	37.5%	13.3%	36%	36.7%
General Sales Tax	22.6%	17.3%	0.0%	22.6%	23.2%	40.5%	28%
Individual Income Tax	24.1%	31.8%	28.3%	23.4%	7.7%	0.0%	0.0%
Corporate Income Tax	3.1%	4.5%	4.0%	3.6%	2.7%	0.1%	0.0%
Other Taxes <sup>3</sup>	17.2%	20.6%	30.4%	12.9%	53.1%	23.4%	35.3%

## Tax Systems in Neighboring States

### Individual Income Tax

Forty-three states levy individual income taxes. Iowa, Minnesota, Montana, Nebraska, and North Dakota levy an individual income tax. The individual income rates vary from 2.9% to 13.3% depending on the income level and the state.<sup>4</sup> It is common to find an income tax rate higher than 6% for taxable incomes in the \$15,000 to \$20,000 range and the rates continue to escalate with increased income levels. The exemptions and definitions of taxable income vary from state to state; however, most states pattern their income definitions and exemptions after the federal government.

North Dakota possesses a moderate tax schedule and closely correlates its tax schedule and definitions after the federal income tax program. In 2015, North Dakota reduced income tax rates from 1.22%-3.22% to 1.10%-2.90%, respectively. Currently, North Dakota has the lowest maximum rate among states levying an individual income tax, at 2.9%.

Seven states, including South Dakota and Wyoming, have not imposed an individual income tax. Nebraska was the last neighboring state to adopt an individual income tax in 1967 and North Dakota was the first to adopt in 1919. The other neighboring states adopted an individual income tax in the 1930s. Tax definitions and exemptions have been altered frequently along with the tax rate schedules since each state has enacted an individual income tax. A comparison of state individual income total revenue in 2015 is in table 3 below.

<sup>2</sup> Tax Foundation, <https://taxfoundation.org/>

<sup>3</sup> Other taxes include excise taxes, severance taxes, etc.

<sup>4</sup> Tax Foundation <https://taxfoundation.org/state-individual-income-tax-rates-brackets-2018/>



**Table 3. Individual Income Tax in 2015**

Individual Income Tax in 2015							
	Iowa	Minnesota	Montana	Nebraska	North Dakota	South Dakota	Wyoming
Total Revenue (Millions) <sup>5</sup>	\$3,576	\$10,370	\$1,180	\$2,240	\$537	N/A	N/A
Per Capita <sup>6</sup>	\$1,145	\$1,900	\$1,143	\$1,181	\$709	N/A	N/A
Per Capita Rank (Nationally)	21	6	22	17	37	N/A	N/A
Minimum Tax Rates	0.36%	5.35%	1%	2.46%	1.10%	N/A	N/A
Maximum Tax Rate	8.98%	9.85%	6.90%	6.84%	2.90%	N/A	N/A

### Corporate Income Tax

Corporate income taxes are levied in 44 states, but account for a relatively small share of state revenue – 5.2% of state tax collections and just over 2% of all state revenue.<sup>7</sup> South Dakota and Wyoming are two states that do not levy a corporate income tax.

All of the surrounding states imposing a corporate income tax use a graduated scale except Minnesota and Montana, which tax all corporate income at 9.8% and 6.75%, respectively. The volatility of corporate income tax revenue, as well as its narrowing base, has contributed to many states deciding to reduce reliance on this revenue source over time. North Dakota has one of the lowest maximum rates at 4.53%, compared to the previous maximum rate of 10.50% in 1993. Iowa levies the highest top statutory corporate tax rate, at 12%. Of the surrounding states, Montana was the first to adopt a corporate income tax in 1917, while Nebraska was the last in 1967.

**Table 4. State and Local Corporate Income Tax Collections in 2015**

State and Local Corporate Income Tax Collections in 2015							
	Iowa	Minnesota	Montana	Nebraska	North Dakota	South Dakota	Wyoming
Per Capita	\$148	\$269	\$163	\$182	\$246	N/A	N/A
Total Revenue <sup>8</sup> (Millions)	\$463	\$1,477	\$168	\$344	\$186	N/A	N/A
Minimum <sup>9</sup> Tax Rates	6%	9.80%	6.75%	5.58%	1.48%	N/A	N/A
Maximum Tax Rates	12%	9.80%	6.75%	7.81%	4.53%	N/A	N/A

<sup>5</sup> Tax Policy Center, <https://www.taxpolicycenter.org/statistics/state-and-local-general-revenue/>

<sup>6</sup> Tax Foundation, <https://taxfoundation.org/>

<sup>7</sup> Tax Foundation, <https://taxfoundation.org/>

<sup>8</sup> Tax Policy Center, <https://www.taxpolicycenter.org/statistics/state-and-local-general-revenue/>

<sup>9</sup> Tax Foundation, <https://taxfoundation.org/state-corporate-income-tax-rates-brackets-2017/>



**Sales Tax**

Forty-five states collect statewide sales taxes and 38 states collect local sales taxes. Five states in the United States, including Montana, do not levy a sales tax. Minnesota, Iowa, Nebraska, and North Dakota have a higher sales tax rate than South Dakota. Wyoming has the lowest rate at 4%.

Sales tax rates differ by state, but sales tax bases also impact how much revenue is collected from a tax and how the tax affects the economy. Unlike surrounding states, South Dakota has a broad base that includes many goods and services. Minnesota, which has a limited interpretation of taxable purchases including no taxes on food and clothes, ranks near the top as the sixth highest sales tax rate in the United States at 6.875%.

In addition to state-level sales taxes, consumers may pay a local sales tax depending on the state. These rates can be substantial, so a state with a moderate statewide sales tax rate could actually have a very high combined state-local rate compared to other states. Table 5 shows the state tax rate for each state as well as the maximum local government tax rate in each state. Table 5 also shows state and local government per capita and total revenues in each state in 2015. Most states allow incorporated municipalities and in some instances counties to levy a general sales tax, or a lodging and entertainment tax, like Montana, which allows designated tourist areas to levy a sales tax.

**Table 5. State and Local Sales Tax in 2015**

State and Local Sales Tax in 2015 <sup>10</sup>							
	IOWA	MINNESOTA	MONTANA	NEBRASKA	NORTH DAKOTA	SOUTH DAKOTA	WYOMING
Per Capita Revenue	\$1,075	\$1,026	N/A	\$1,139	\$2,129	\$1,553	\$1,791
Total Revenue <sup>11</sup> (Millions)	\$3,358	\$5,635	N/A	\$2,160	\$1,611	\$1,334	\$1,050
State Tax Rate <sup>12</sup>	6.00%	6.875%	N/A	5.50%	5.00%	4.00% <sup>13</sup>	4.00%
Maximum Local Govt. Tax Rate	1.00%	1.00%	N/A	2.00%	3.00%	2.00%	2.00%
Maximum Total Rate	7.00%	7.875%	N/A	7.50%	8.00%	6.00%	6.00%

**Property Tax**

Taxpayers in all fifty states pay property taxes, but the tax is primarily levied by local governments. Property taxes may vary by property classification, and different types of property may be taxed or excluded. Some states, such as Wyoming, use the property tax to tax mineral wealth, while states like North Dakota levy separate severance

<sup>10</sup> Tax Foundation, <https://taxfoundation.org/>

<sup>11</sup> Tax Policy Center, <https://www.taxpolicycenter.org/statistics/state-and-local-general-revenue>

<sup>12</sup> Tax Foundation, <https://taxfoundation.org/>

<sup>13</sup> Effective June 1, 2016 the South Dakota state sales and use tax increased from 4.0% to 4.5%



taxes. Property tax collection is a critical source of revenue for local governments, accounting for 72% of local tax collections nationwide in 2015.<sup>14</sup>

Property taxes are one of the primary sources of revenue for local governments. Property taxes provide a reliable and dependable source of revenue for local governments to provide services like schools, law enforcement, courts, roads, other infrastructure, and basic services provided by these local units of government. In 1992, South Dakota ranked 28th in the nation on per capita state and local government property tax revenue and 6th in the seven-state region.

In 2015, South Dakota ranked 27th in the nation in per capita state and local government property tax revenue, and remains 6th in the seven-state region.<sup>15</sup> Table 6 shows the per capita and total revenue from property taxes in each surrounding state in 2015. This ranking does not compare the total property tax burden on property of equivalent value from one state to another.

**Table 6. Per Capita and Total Revenue from Property Taxes in 2015**

Per Capita and Total Revenue from Property Taxes in 2015							
	IOWA	MINNESOTA	MONTANA	NEBRASKA	NORTH DAKOTA	SOUTH DAKOTA	WYOMING
Per Capita Revenue <sup>16</sup>	\$1,569	\$1,534	\$1,509	\$1,895	\$1,222	\$1,381	\$2,347
Total Revenue <sup>17</sup> (Millions)	\$4,902	\$8,418	\$1,558	\$3,594	\$925	\$1,185	\$1,376

**Severance Taxes**

Thirty-five states levy severance taxes, which are taxes on the extraction of natural resources. Severance taxes are often imposed on the extraction of nonrenewable resources such as crude oil, natural gas, and coal. Mineral severance taxes from oil, natural gas, and coal production, along with associated federal mineral royalties, are the primary revenue sources for Wyoming.

Even though severance taxes make up a small percentage of tax revenues across the nation, it is an extremely important revenue source for Wyoming. Wyoming receives over a third of its revenue through severance tax, which is equivalent to revenue typically generated by an income tax or sales tax for many states. In 2015, South Dakota collected \$5,396,624 in mineral severance taxes.<sup>18</sup> In comparison, Wyoming collected \$786,942,685.<sup>19</sup> Like Wyoming, North Dakota collects significant severance tax. Due to the new oil production since 2006, severance tax revenues have enabled North Dakota to reduce other taxes, such as income and property. North Dakota levies two state production taxes: the oil extraction tax, and the oil and gas gross production tax. In 2015, North Dakota collected \$2,800,985,013 in total net collections<sup>20</sup>. Severance taxes can be exceedingly volatile, and in recent years state revenues have seen periodic dips depending on production levels and oil prices.

<sup>14</sup> Tax Foundation, <https://taxfoundation.org/>

<sup>15</sup> Tax Foundation, <https://taxfoundation.org/>

<sup>16</sup> Tax Foundation, <https://taxfoundation.org/>

<sup>17</sup> Tax Policy Center, <https://www.taxpolicycenter.org/statistics/state-and-local-general-revenue>

<sup>18</sup> South Dakota Bureau of Finance and Management, <https://bfm.sd.gov/budget/>

<sup>19</sup> Wyoming Economic Analysis Division, <http://eadiv.state.wy.us/>

<sup>20</sup> North Dakota Office of State Tax Commissioner, <https://www.nd.gov/tax/>



**Motor Fuel Excise Taxes**

All states levy a motor fuel excise tax. However, states vary in how they impose motor fuel taxes. Generally, motor fuel taxes are used to fund transportation infrastructure and projects. Currently, South Dakota ranks 23rd in total state taxes and fees per gallon on gasoline.<sup>21</sup> South Dakota's total fuel tax revenue in 2015 amounted to \$169,843,878.<sup>22</sup> The total state tax and fee per gallon is \$0.30 (\$0.28 gasoline tax and \$0.02 tank inspection fee) in South Dakota. Regionally, motor fuel taxes had changed recently, as Iowa, Nebraska, South Dakota and Wyoming all increased motor fuel taxes since 2013. The table below outlines total state tax and fee rates from motor fuel taxes in 2015.

**Table 7. Total State Tax and Fees Per Gallon in 2015**

Total State Tax and Fees (Cents Per Gallon) <sup>23</sup>		US Rank
IOWA	32.00¢	19
MINNESOTA	28.60¢	24
MONTANA	27.75¢	26
NEBRASKA	27.00¢	27
NORTH DAKOTA	23.00¢	35
SOUTH DAKOTA	30.00¢	23
WYOMING	24.00¢	32

**Recent Tax Reform**

From 1980 to today, South Dakota has experienced several property tax freezes, temporary and permanent sales tax increases, and property tax relief programs. There had been referendums on property and income taxes as well as the lottery, which is a substantial revenue generator for the state.

In recent years, South Dakota, like many other states, has experienced a slowdown in sales tax revenue growth, due in part to more consumers shopping online. On June 21, 2018, the United States Supreme Court handed down a landmark decision in *South Dakota v. Wayfair, Inc.*, expanding states’ authority to require out-of-state businesses (primarily online retailers) to collect and remit sales taxes on transactions involving in-state residents. In its decision, the Supreme Court overturned longstanding legal precedent that previously limited states’ online sales tax collection authority to sellers with property or employees (physical presence) in a given state. The long-term outcome of this decision is yet to be seen, but states now have an opportunity to stabilize their sales tax revenue streams, as more sales transactions continue to shift from brick and mortar to electronic.

**Conclusion**

No two states have the same tax or administer taxes in the same way. The reliance on certain taxes can have important implications for both revenue stability and economic growth, and the many variations across states are indicative of the different ways that states consider opposing policy goals. The combination of taxes and fees used by a particular jurisdiction is dependent upon many factors, including revenue needs, the tax base of the local government, the fiscal relationship between the state and local governments, constitutional limitations in some states, and the level of government services demanded by residents.

<sup>21</sup> Tax Foundation, <https://taxfoundation.org/>

<sup>22</sup> Department of Revenue, [http://dor.sd.gov/Publications/Annual\\_Reports/](http://dor.sd.gov/Publications/Annual_Reports/)

<sup>23</sup> Tax Foundation, <https://taxfoundation.org/>



Based on these differences, it can be difficult to draw comparisons between states. Iowa and Nebraska continue to have agriculture-based economies and are the closest matches to draw comparisons with South Dakota's existing and potential tax revenues. Wyoming, Montana, and North Dakota have significant deposits of oil, minerals and coal, allowing these states to shift the tax burden to these sectors. Minnesota is regarded as a high tax state, with a highly urbanized, major metropolitan area, and especially high costs of delivering social programs, and it is the most difficult to draw comparisons with South Dakota.

South Dakota's and neighboring states' tax rates have decreased in some areas and increased in others, but the tax systems in these states remain comparable to the tax systems of 1995. Changes in fiscal policies and economic conditions over the past twenty years have had a measurable impact on the distribution of government taxes and spending. Going forward, states will continue to consider and debate tax reform and the methods used to generate revenue.

DRAFT

This issue memorandum was written by Amanda Jacobs, Senior Research Analyst, on November 9, 2018, for the Legislative Research Council. It is designed to provide background information on the subject and is not a policy statement made by the Legislative Research Council.

