# Comparison of Neighboring State Tax Systems

SOUTH DAKOTA LEGISLATURE
LEGISLATIVE RESEARCH COUNCIL

**ISSUE MEMORANDUM 2023-xx**

## Introduction

This issue memorandum highlights some of the nuances of states' tax systems, and how they compare to each other. Specifically, the focus of this document is comparing South Dakota to its neighboring states: Iowa, Minnesota, Nebraska, North Dakota, Montana, and Wyoming. In this investigation of several sources of state and local tax revenue, it will become apparent that some structures of South Dakota's tax system may be very similar to its neighbors, while some distinct differences of South Dakota's tax system relative to its neighbors will also be discussed.

This document uses data spanning the years 2000 to 2020, collected and published by the United States Census Bureau, and collected from an interactive data tool published by the Urban Institute.[1] The Annual Survey of State and Local Government Finances (henceforth referred to as the USCB Survey) can be found on the United States Census Bureau's website.[2] It is critical to note that all monetary values shown in the graphs of this document are attached to real 2020 dollars. This allows us to observe inflation-adjusted values for tax collections and tax burden over time, eliminating the noise from fluctuations in the price level. A similar topic was analyzed and published in Issue Memorandum 2018-07.[3]

## General Tax Revenue Collections, a Brief Introduction

In subsequent sections of this issue memorandum, specific categories of taxation are explored. First, a survey of each states' tax collections is provided, and then a summary and comparison of each state's tax burden.

As observed in Graph 1, South Dakota and Montana are the two states with consistently the lowest per capita tax burdens when combining all revenue sources, from 2000 to 2020, according to the USCB Survey. To help read the line charts of this document, South Dakota is always represented by the thicker blue line. For the most part, the per capita tax burden of states included in this analysis have been relatively smooth, with stable trends. The notable exception is North Dakota, which has undergone a somewhat significant increase in its per capita tax burden over the past 10 years.

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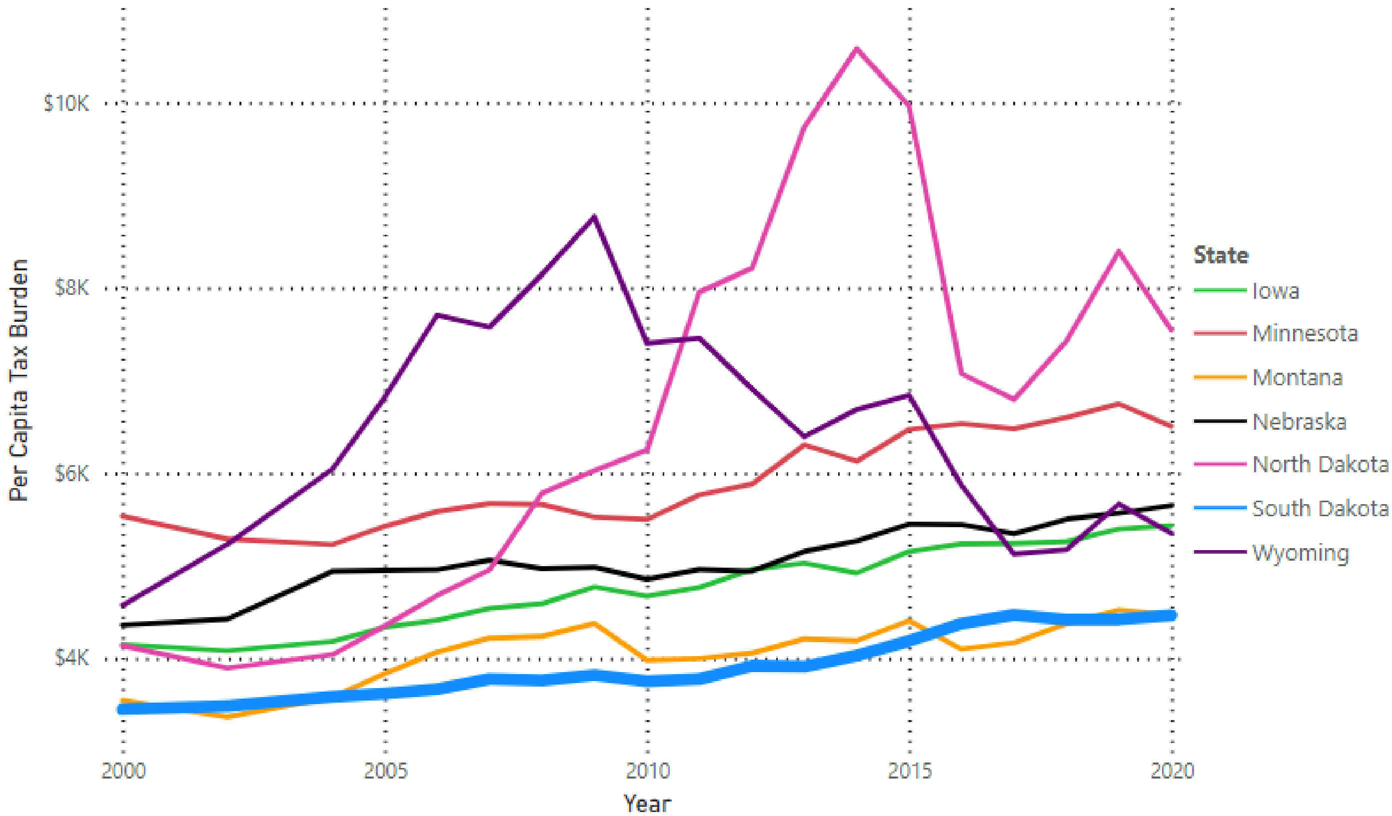
[1] Urban Institute, State and Local Finance Data, Exploring the Census of Governments

[2] United States Census Bureau, Annual Survey of State and local Government Finances

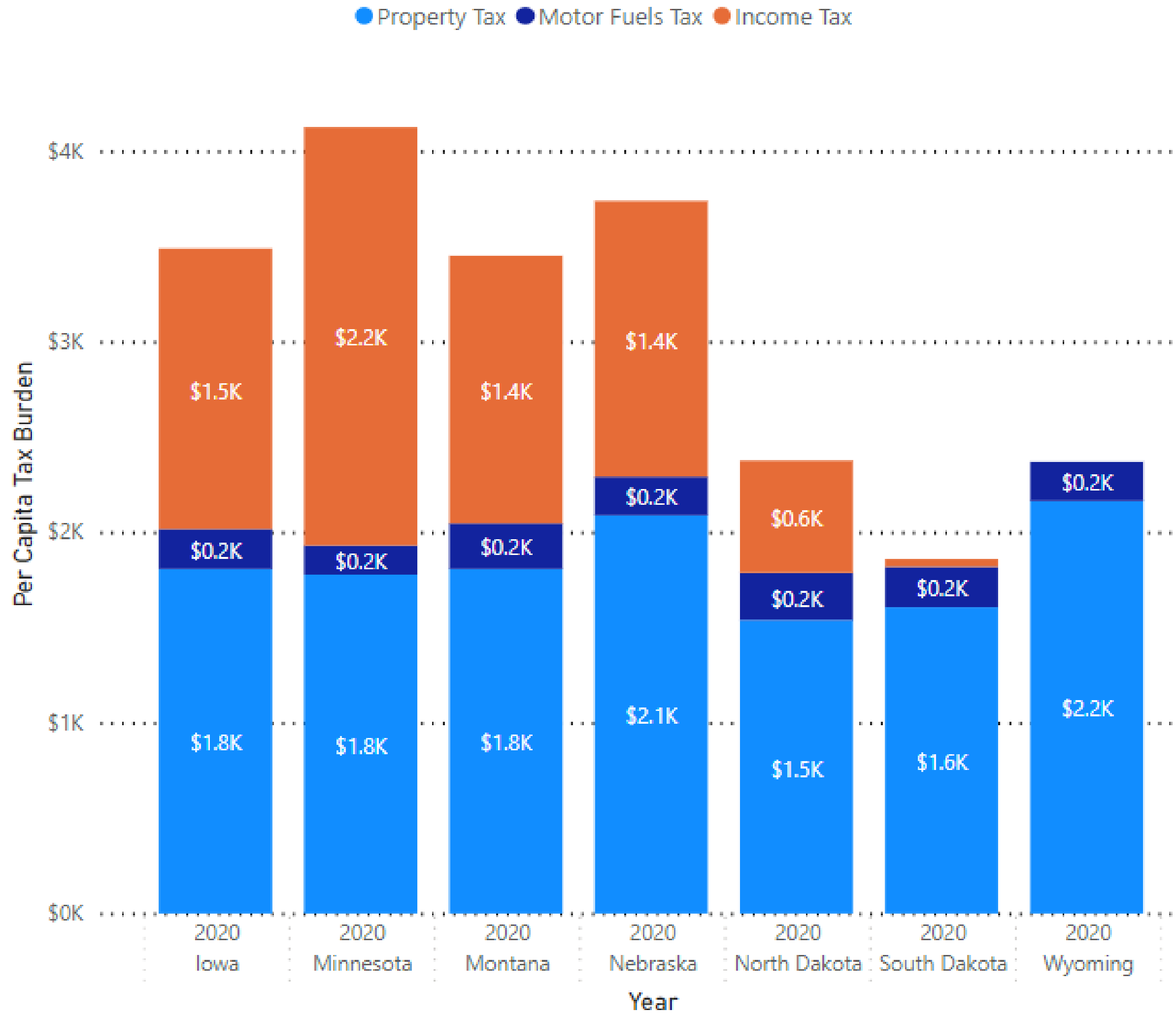
[3] Legislative Research Council, Issue Memorandum 2018-07

Graph 1: Total Tax Revenue Generated




Graph 2 shows a breakdown of each state's tax burden in 2020, with respect to three of the tax categories discussed in this document: property tax, income tax, and motor fuels tax. Notably missing are severance tax collections, which is not readily available from the USCB Survey but will be discussed at length in a later section of this document. Also very apparent is the large increase in tax burden from the imposition of an income tax at either the state level, local level, or both.

Graph 2: Per Capita Tax Burden from Difference Revenue Sources, 2020




Directly below is a breakdown of total per capita tax revenue collected in 2020, and each state's respective ranking.

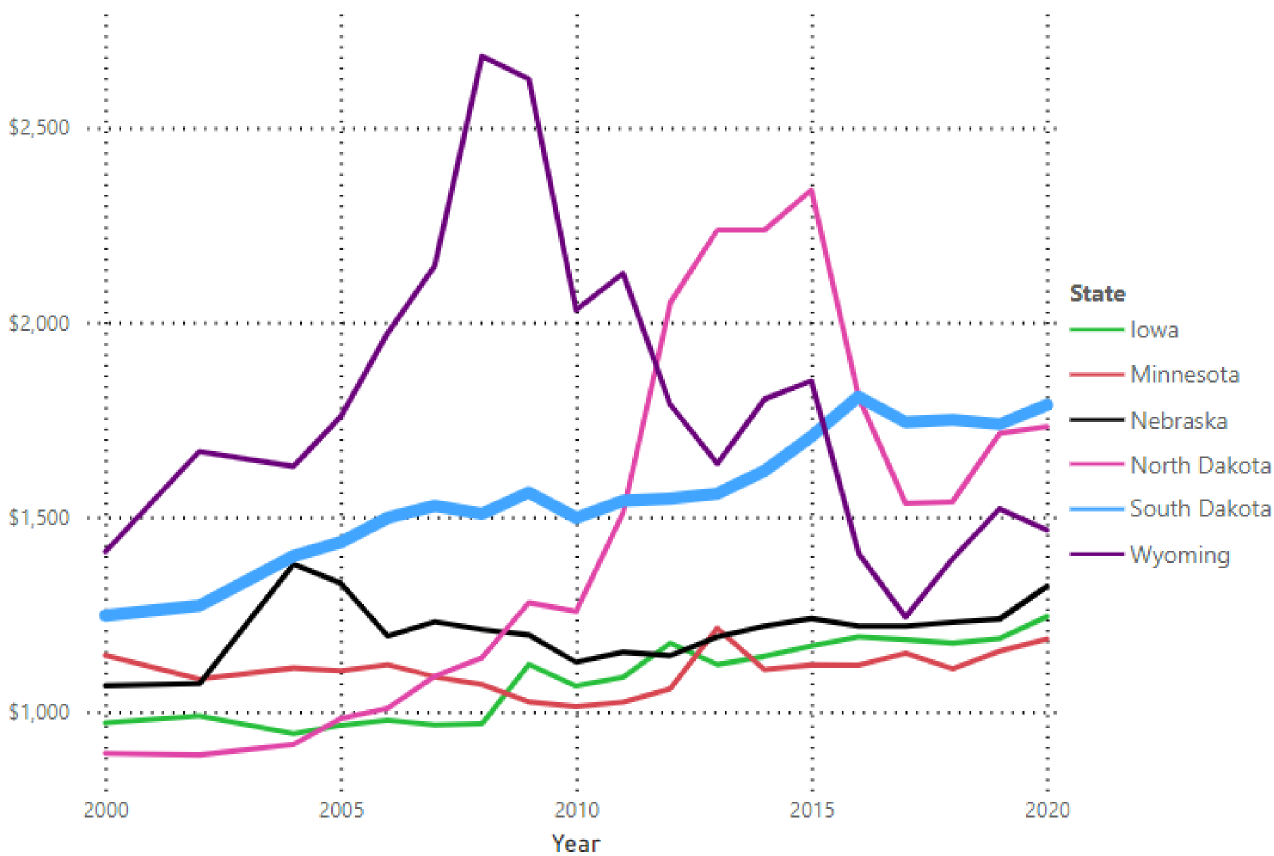
| | Total Per Capita Tax Burden, 2020 | Tax Burden Rank |
|---|---|---|
| Iowa | **$5,434** | **4** |
| Minnesota | **$6,507** | **2** |
| Montana | **$4,471** | **6** |
| Nebraska | **$5,652** | **3** |
| North Dakota | **$7,545** | **1** |
| South Dakota | **$4,466** | **7** |
| Wyoming | **$5,353** | **5** |

## Sales Tax:

Each state discussed in this document is a member-state of the Streamlined Sales and Use Tax Agreement (SSUTA), with the exception of Montana, which does not levy any sales tax at either the state or local level. The governing board of the SSUTA was first established in 2000, in an effort to reduce the burden of complying with a member-state's sales tax laws for firms without a physical presence in the state itself. The SSUTA provides uniform rules and definitions for the member-states to implement in their respective state sales tax statutes.[4]

Below are some charts comparing characteristics of state and local sales tax systems, as well as per capita sales tax collections, in real 2020 dollars. Notably, of all the states listed below, only Wyoming does not allow municipalities to impose a sales tax; however, 31% of the total state sales taxes generated in Wyoming is distributed to the counties in which the transactions took place, which is then divided amongst the county and municipalities according to population.[5] In terms of real per capita sales tax dollars collected, South Dakota has the highest per capita tax burden of all seven states discussed in this document. Graph 3 shows a steady increase in the real tax burden from sales tax in South Dakota, increasing roughly 43% from 2000 to 2020. Other states, such as Iowa and Minnesota, are observed to have consistently lower sales tax burdens over this time period.

Graph 3: Per Capita Sales Tax Revenues

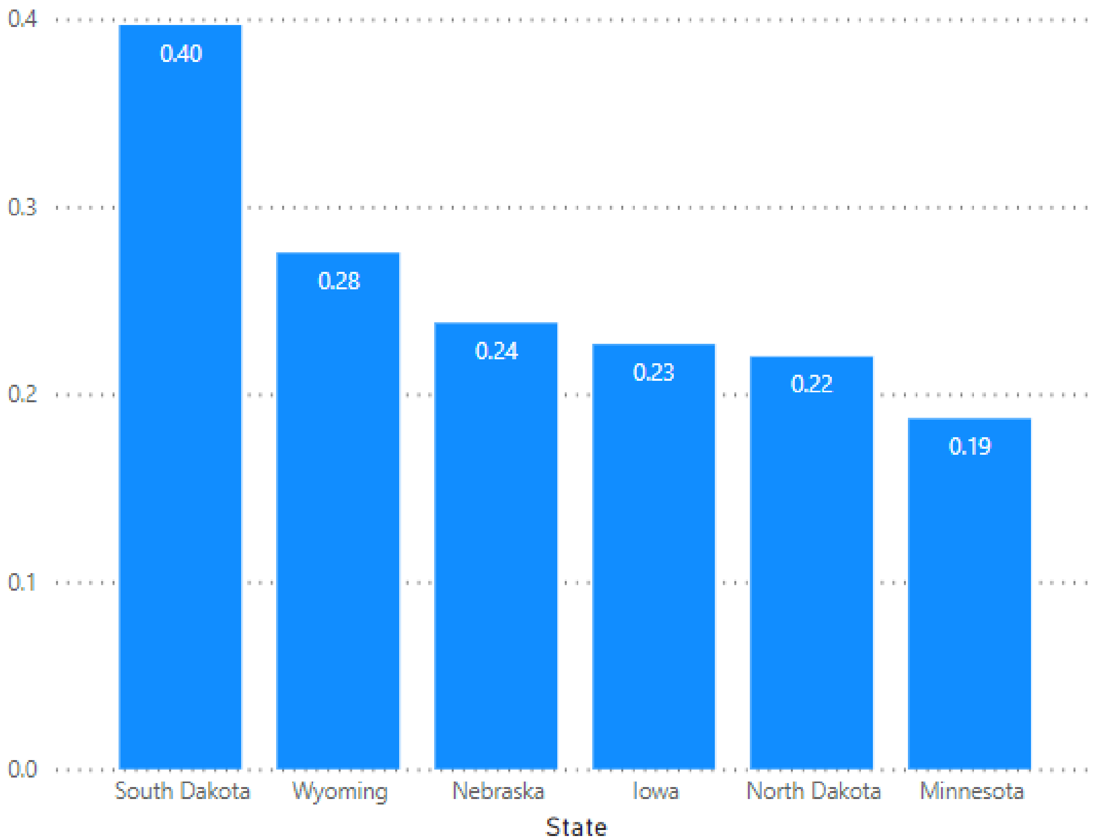



[4] Streamlined Sales Tax Governing Board, About Streamlined FAQs

[5] Wyoming Tax Facts, State Sales Tax

Also, as depicted in Graph 4, sales tax revenue makes up a significantly larger proportion of South Dakota's total (when combining state and local taxes) tax collections, compared to its neighboring states, according to the data collected by the USCB Survey.

Graph 4: Sales Tax Revenue as a Proportion of Total Tax Revenue



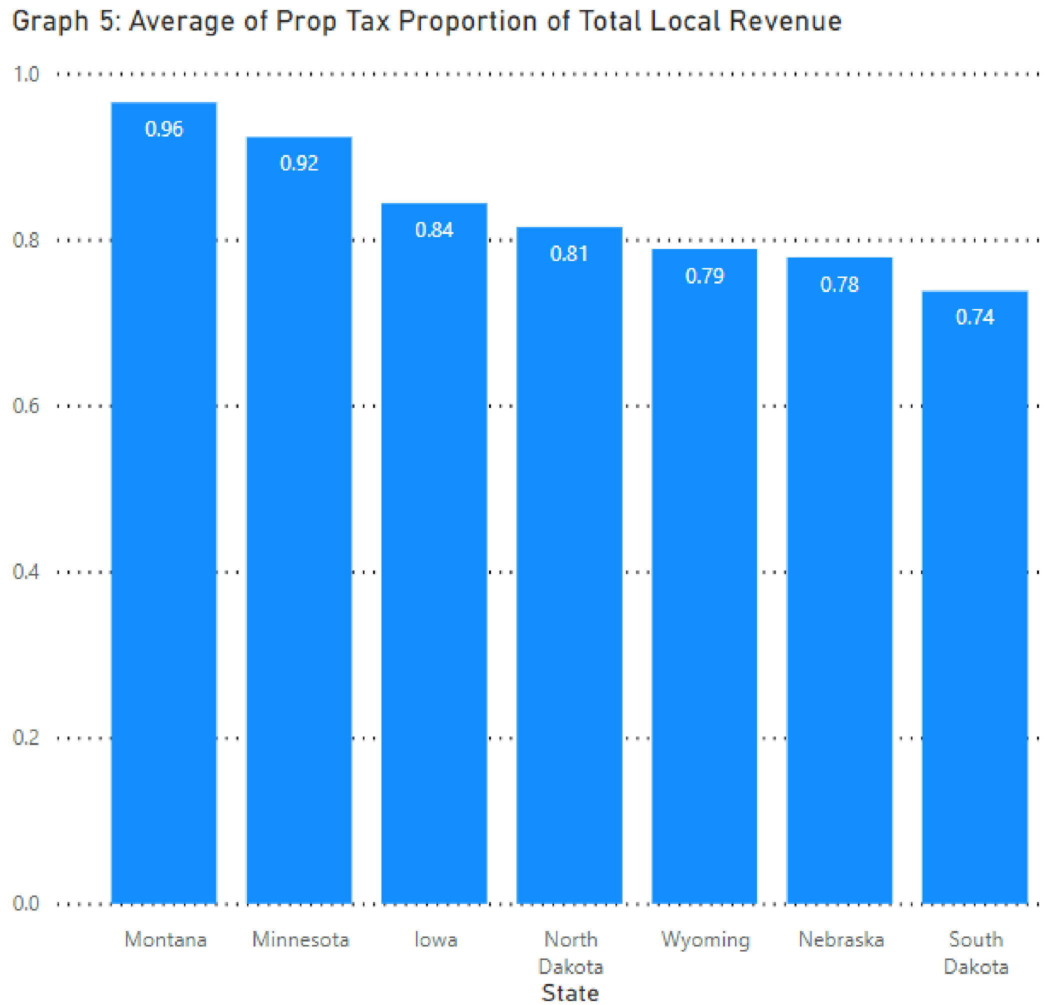

Sales tax exemptions add an additional layer of nuance when discussing state sales tax. While each state is a member of the SSUTA, with the exception of Montana, sales tax exemptions may vary significantly, changing the size of the sales tax base amongst the states. According to the conditions of the SSUTA, if a good or service is exempt from the state sales tax, it must be exempt from any local sales tax as well. In some jurisdictions where the state does not collect a sales tax on food, but local units of government are allowed, the state's rate of taxation is set at 0%, thereby following the provisions of the SSUTA. One of the largest and most common sales tax exemptions in the United States is the exemption on the sale of most food. South Dakota is the only state discussed in this document that taxes the sale of food, as defined in the SSUTA.

Below is a breakdown of important characteristics of each state's sales tax system, including whether or not a state allows for city or county sales taxes. Notably, Montana does not impose any sales tax at the state or local level. For this reason, Montana is excluded from Graph 3 and Graph 4.

| | State Tax Rate | City Tax | County Tax | Per Capita Tax Burden, 2020 | Tax Burden Rank |
|---|---|---|---|---|---|
| Iowa | **6%** | **Yes** | **No** | **$1,244** | **5** |
| Minnesota | **6.875%** | **Yes** | **Yes** | **$1,187** | **6** |
| Montana | **0%** | **No** | **No** | **$0** | **7** |
| Nebraska | **5.50%** | **Yes** | **No** | **$1,322** | **4** |
| North Dakota | **5%** | **Yes** | **Yes** | **$1,732** | **2** |
| South Dakota | **4.20%** | **Yes** | **No** | **$1,788** | **1** |
| Wyoming | **4%** | **No** | **Yes** | **$1,468** | **3** |

## Property Tax:

Unlike sales tax revenues, property tax revenues are generally considered to be more a stable source of revenue during a time of economic volatility. Property taxes are levied in every state in the country, but in some states such as South Dakota, North Dakota, Nebraska, and Iowa, property taxes are levied by local taxing entities and not by the state itself. In other states such as Montana, Wyoming, and Minnesota, property taxes are levied by both local taxing entities and the state government. Local governments, or taxing entities, that levy property taxes include counties, municipalities, townships, school districts, ambulance districts, and fire districts. For local governments, taxes make up a large majority of total tax revenue generated, as shown in Graph 5. Graph 5 shows that in South Dakota, even though property taxes make up, on average, 74% of total tax revenue generated by local governments, property tax revenue is a lower proportion than all other states examined in this document. In Montana, property taxes account for almost all tax revenue generated by local governments.

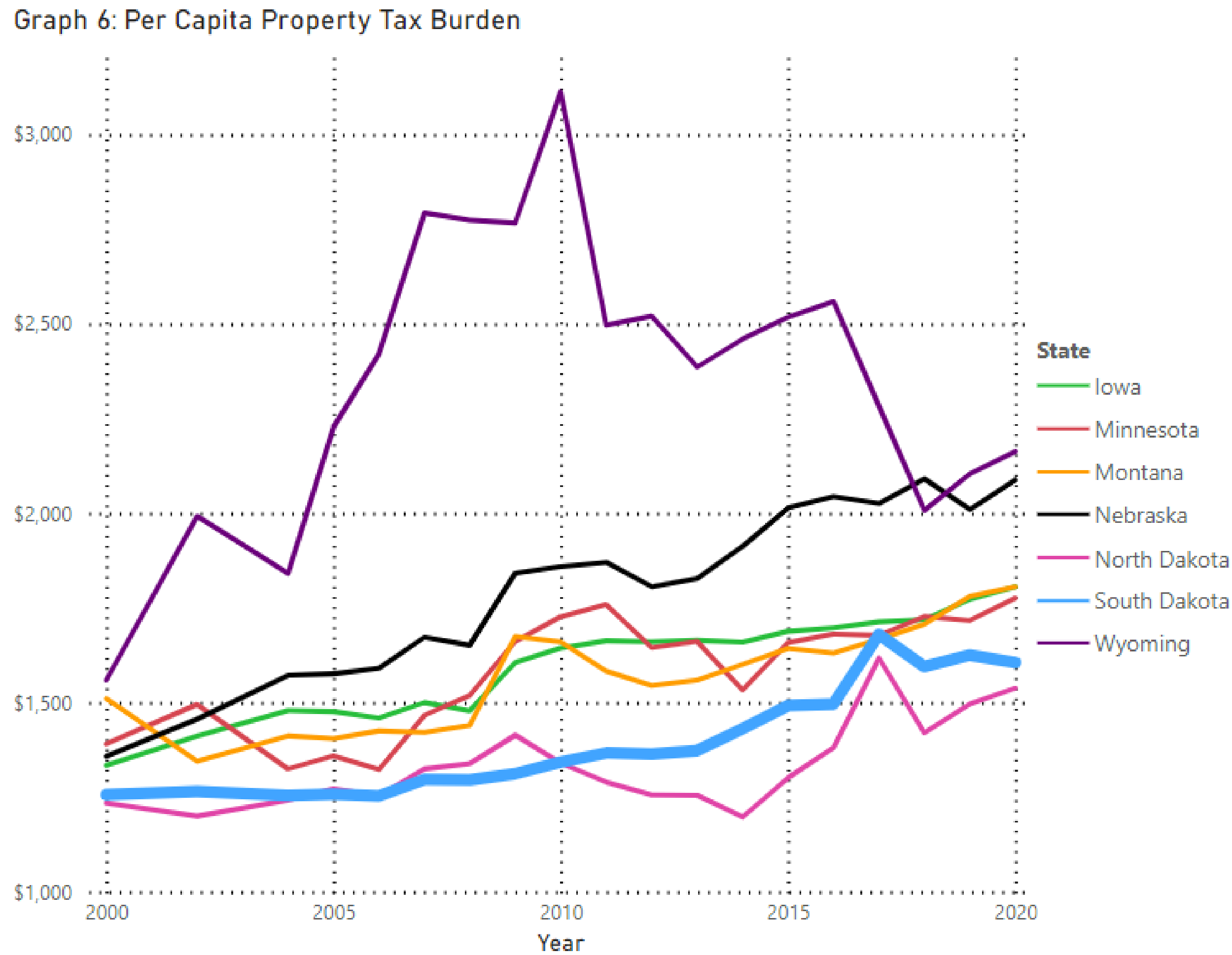



Property tax systems vary greatly from state to state. For example, North Dakota assesses property at 50% of its full and true value for purposes of taxation,[6] while South Dakota assesses property at 100% of its full and true value pursuant to SDCL 10-6-119. Montana has 18 different property classes,[7] while South Dakota only has three (residential, agricultural, and other). Despite these differences, the per capita property tax burden is relatively similar between South Dakota, North Dakota, Minnesota, and Montana, with each state having a per capita property tax burden between roughly $1,500 and $1,800 in 2020. This should demonstrate the limitation in comparing isolated parameters of a state's property tax system in a vacuum. There is much that goes into the observed tax burden of a state, and a holistic approach to comparing tax systems is incredibly important to provide context for certain parameters of any state's tax system.

As shown in Graph 6, from the years 2000 to 2020, with the exception of 2017, South Dakota has had either the lowest or second lowest per capita property tax burden of all the states discussed in this document. North Dakota joins South Dakota as the other state with consistently one of the lowest per capita property tax burdens out of all the states included in this document, over the two decades of data collected from the USCB Survey. Nebraska and Wyoming are the two states that seem to consistently have larger property tax burdens, with per capita property tax burdens exceeding $2,000.

[6] North Dakota Office of State Tax Commissioner, Property Tax

[7] Mont. Code Ann. chapter 15-6 Part 1




When discussing property tax, it is also important to consider personal property tax as well. Minnesota, Nebraska, Montana, and Wyoming all levy taxes on personal property in some way. Iowa does not impose any personal property tax. South Dakota does not impose any tax on personal property, with the exception of certain centrally assessed property. Similarly, North Dakota does not impose any tax on personal property tax, with the exception of certain oil and gas refineries and utilities.

Directly below is a breakdown of important characteristics of each state's property tax system, including whether or not state law allows for a tax imposed on taxable personal property, and whether or not the state levies a property tax, in addition to property taxes levied at the local level.

| | State Property Tax | Presonal Property Tax | Per Capita Tax Burden, 2020 | Tax Burden Rank |
|---|---|---|---|---|
| Iowa | **No** | **No** | **$1,806** | **T-3** |
| Minnesota | **Yes** | **Yes** | **$1,776** | **5** |
| Montana | **Yes** | **Yes** | **$1,806** | **T-3** |
| Nebraska | **No** | **Yes** | **$2,088** | **2** |
| North Dakota | **No** | **No** | **$1,538** | **7** |
| South Dakota | **No** | **No** | **$1,606** | **6** |
| Wyoming | **Yes** | **Yes** | **$2,163** | **1** |

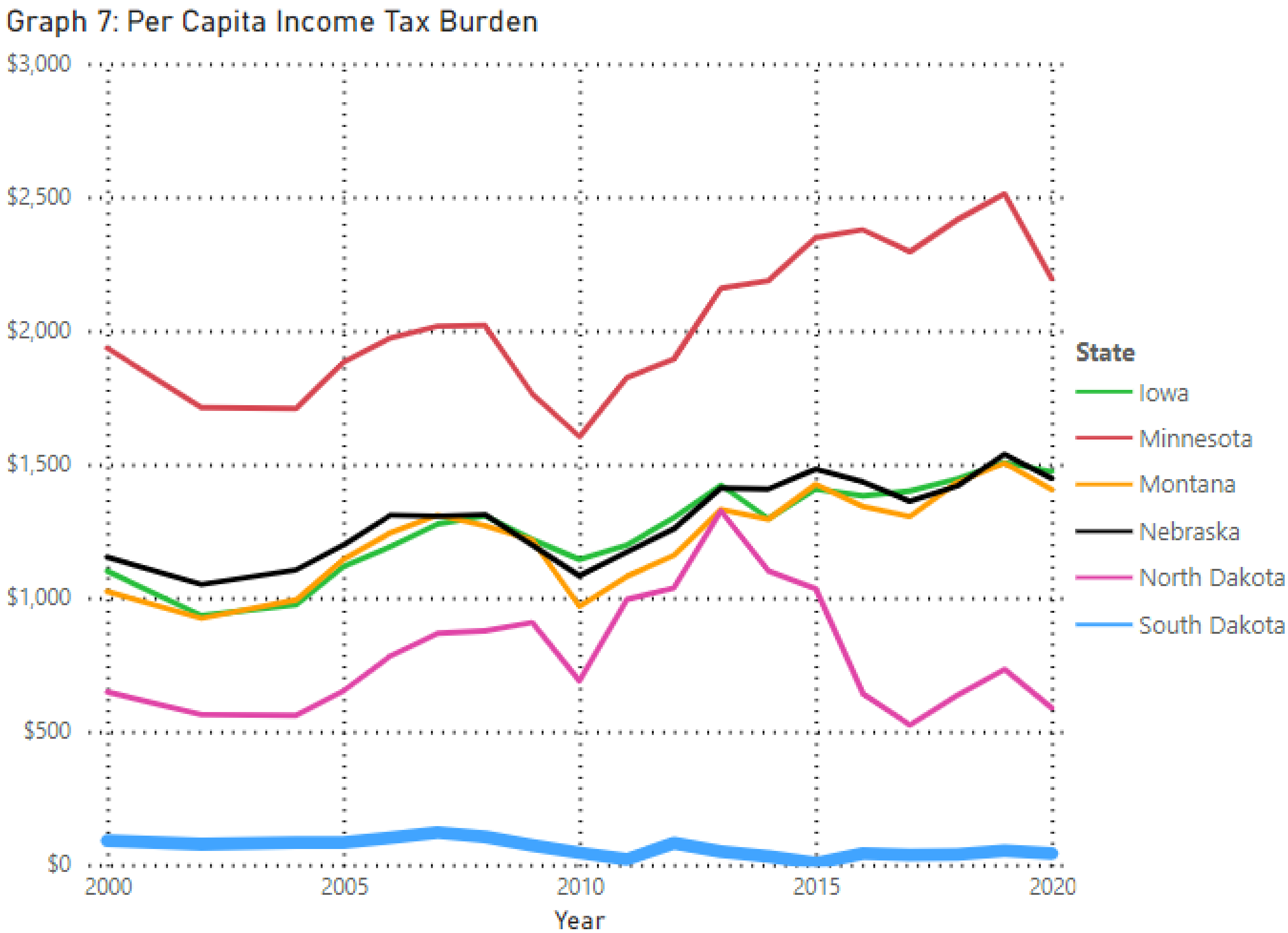
## Personal Income Tax

There are currently forty-three states that tax individual income. Of the states that are examined in this document, South Dakota and Wyoming do not impose an individual income tax. Similar to sales taxes, income tax revenues are also relatively more vulnerable to the economic fluctuations over time. There is another substantial variable that can affect state income tax revenues besides economic cycles. To varying extents, a state's income tax policy mirrors the federal tax code. When filing state income taxes, a taxpayer will start with U.S. adjusted gross income and add or subtract certain amounts to arrive at the state adjusted gross income. Changes in the federal tax code can affect a state's income tax revenues. Iowa and Minnesota, along with 14 other states, not only impose a state income tax, but also allow cities to impose an income tax as well. Across all seven states, the personal income tax is imposed in largely the same way, where roughly four to seven tax brackets are established. The lowest tax brackets start at $0, and the highest tax brackets start anywhere from $21,000 (Montana) to $183,000 (Minnesota) for single filers. The lowest tax rates are then applied to the lowest tax brackets, and the highest tax rates are applied to the highest tax brackets.

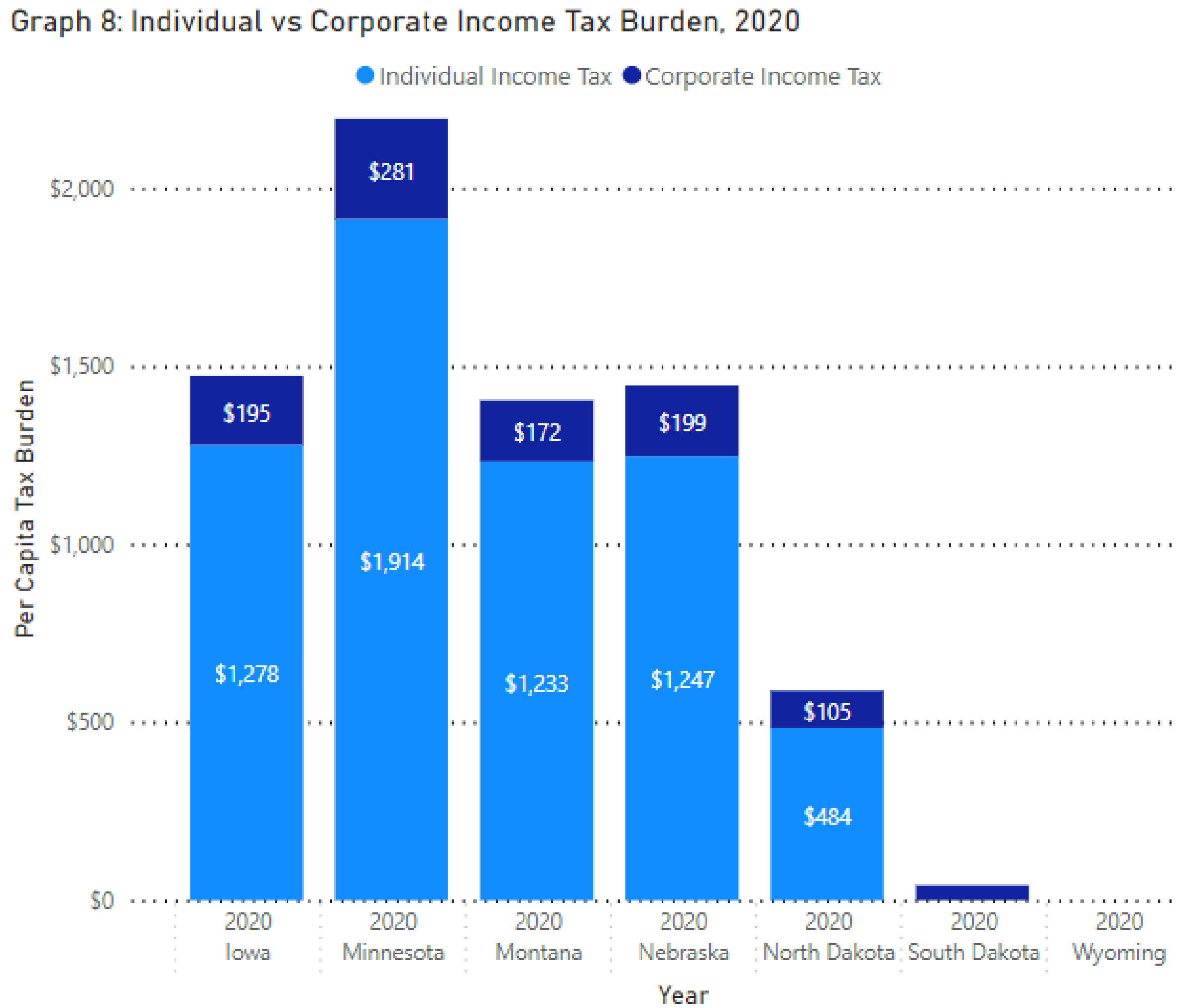
## Corporate Income Tax

Wyoming does not impose any corporate income tax, and while South Dakota may not impose a broad corporate income tax, it does impose an income tax on banks and financial institutions in SDCL chapter 10-43. Interestingly, the tax rates and tax structures between many of states' corporate tax systems vary quite substantially, including South Dakota's income tax on banks and financial institutions. For example, Montana does not establish tax brackets for its corporate income tax, and instead imposes a single tax rate of 6.75% on all net income for the tax period. Minnesota behaves similarly, imposing a single, 9.8% tax rate on all net corporate income. Nebraska, North Dakota, and Iowa have 2, 3, and 4 income brackets, respectively, where the lowest tax rates are applied to the lowest income brackets, and the highest tax rates are applied to the highest income brackets. On the other hand, South Dakota's structures its income tax on banks and financial institutions differently. South Dakota has eight income brackets, and unlike Nebraska, North Dakota, and Iowa, South Dakota applies the highest tax rate (6%) to the lowest income bracket, and applies the lowest tax rate (0.25%) to the highest income bracket.

It is observed in Graph 7 that the states' rankings with respect to income tax burden remain relatively constant over time. Wyoming is excluded altogether, and South Dakota is included insofar as its income tax on banks and financial institutions generates a low, but not zero, tax burden across the state.




Graph 8 compares income tax revenues between individual income taxes and corporate income taxes, for the year 2020. Clearly, individual income taxes far outweigh corporate income taxes, with the exception of South Dakota, whose income tax on banks and financial institutions is categorized as a corporate income tax by the USCB Survey.




Below is a breakdown of important characteristics of each state's income tax system, listing the highest and lowest tax rates on both individual income and corporate income, and each state's total per capita tax burden and relative tax burden rank. Data on income tax rates and brackets was collected from the Tax Foundation.[8] [9]

| | Personal Tax | Municipal Income Tax | Low Personal Tax Rate, 2023 | High Personal Tax Rate, 2023 | Low Corporate Tax Rate, 2023 | High Corporate Tax Rate, 2023 | Per Capita Tax Burden, 2020 | Tax Burden Rank |
|---|---|---|---|---|---|---|---|---|
| Iowa | **Yes** | **Yes** | **4.40%** | **6.00%** | **5.50%** | **8.40%** | **$1,473** | **2** |
| Minnesota | **Yes** | **Yes** | **5.35%** | **9.85%** | **9.80%** | **9.80%** | **$2,195** | **1** |
| Montana | **Yes** | **No** | **1.00%** | **6.75%** | **6.75%** | **6.75%** | **$1,404** | **4** |
| Nebraska | **Yes** | **No** | **2.46%** | **6.64%** | **5.58%** | **7.25%** | **$1,446** | **3** |
| North Dakota | **Yes** | **No** | **1.10%** | **2.90%** | **1.41%** | **4.31%** | **$588** | **5** |
| South Dakota | **No** | **No** | **-** | **-** | **0.25%*** | **6%*** | **$42** | **6** |
| Wyoming | **No** | **No** | **-** | **-** | **-** | **-** | **$0** | **7** |
| | | | | | | | | |

*This is not a corporate income tax, but rather an income tax on banks and financial institutions

[8] Tax Foundation, State Individual Income Tax Rates and Brackets for 2023

[9] Tax Foundation, State Corporate Income Tax Rates and Brackets for 2023

## Severance Tax

A severance tax is a tax levied on the value or volume of natural resources, such as coal, oil, natural gas, or metals, extracted from the ground. Naturally, since each state has a different endowment of natural resources, both in the type and in the volume of resources available, each state has a very different severance tax structure. Given that many states' severance taxes are based on the market value of the product being extracted, this revenue sources can be particularly volatile, given that geopolitical and socioeconomic factors play major roles in commodity prices.

North Dakota, a state rich in oil, gas, and coal, imposes an ad valorem tax of 5% on the gross value of oil extracted in the state. This rate automatically increases to 6% if the average spot price of crude oil in a month is over $90. For natural gas, North Dakota imposes a severance tax rate that can, and does, fluctuate quite substantially according to a certain price index.[10] Regarding the severance tax on coal, outlined in chapter 57-61 of North Dakota state statute, North Dakota imposes a tax on the volume of the resource extracted, not the market value of the resource, and this tax liability changes depending on the type of facility at which the coal is used to produce energy.[11] In 2021, North Dakota collected $1.66 billion from severance taxes, according to data collected by the United States Census Bureau's Annual Survey of State Government Tax Collections.[12]

Wyoming, another state that relies heavily on revenue generated from natural resources such as coal, crude oil, and natural gas, imposes ad valorem taxes on surface coal at 6.5%,[13] underground coal at 3.75%,[14] crude oil at 6%,[15] and natural gas at 6%.[16] A notable difference between Wyoming and North Dakota is the relative simplicity of Wyoming's severance tax, which is a schedule of fixed ad valorem taxes, compared to North Dakota's assortment of taxes with fluctuating rates based on the value, volume, or use of the natural resources. In 2021, Wyoming collected $435 million from severance taxes, according to data collected by the U.S. Census Bureau's Annual Survey of State Government Tax Collections.[17]

Montana is the third state included in this comparative analysis that relies more on severance tax revenues relative to the other states included in this issue memorandum. It imposes an ad valorem tax on surface coal of 10% to 15% and on underground coal of 3% to 4%.[18] The exact tax rate is determined by the quality of coal in terms of the coal's heating quality. It also imposes an ad valorem tax on oil and natural gas at a rate that varies between 0.5% to 14.8%, according to the type of well used in production, and for how long the well has been operating.[19] Generally speaking, the tax rate on extracting oil and natural gas is much lower for the first 12 - 18 months that a well is operating. Severance tax rates are generally higher for owners with a nonoperating working interest in the well. In 2021, Montana collected $130 million from severance taxes, according to data collected by the United States Census Bureau's Annual Survey of State Government Tax Collections.[20]

Minnesota does not have a severance tax, strictly speaking, but it does have a rather straight-forward tax on the net proceeds of mining, at the rate of 2%;[21] in addition, there is an additional "occupation tax" at the rate of 2.45% on an amount equal to the taxable income of the operation.[22] These taxes apply to the mining, production, processing, smelting, and refining of metal or mineral products. In 2021, Minnesota collected $64 million from

[10] North Dakota Office of State Tax Commissioner, Oil and Gas Tax
[11] North Dakota Office of State Tax Commissioner, Coal Tax
[12] St. Louis FRED, Severance Taxes in North Dakota
[13] Wyo. Stat. Ann. § 39-14-104
[14] Wyo. Stat. Ann. § 39-14-104
[15] Wyo. Stat. Ann. § 39-14-204
[16] Wyo. Stat. Ann. § 39-14-204
[17] St. Louis FRED, Severance Taxes in Wyoming
[18] Mont. Code Ann. § 15-35-103
[19] Mont. Code Ann. § 15-36-304
[20] St. Louis FRED, Severance Taxes in Montana
[21] Minn. Stat. § 298.015
[22] Minn. Stat. § 298.01

these "severance taxes", according to data collected by the United States Census Bureau's Annual Survey of State Government Tax Collections.[23]

Neither Nebraska nor Iowa generates a significant amount of revenue from severance taxes or any similar tax. Similar to Minnesota, Nebraska imposes a simple severance tax of 3% on the value of oil and natural gas, which decreases to 2% on oil from properties producing stripper oil.[24] Nebraska only collects roughly $2.5 million from these severance taxes.[25]

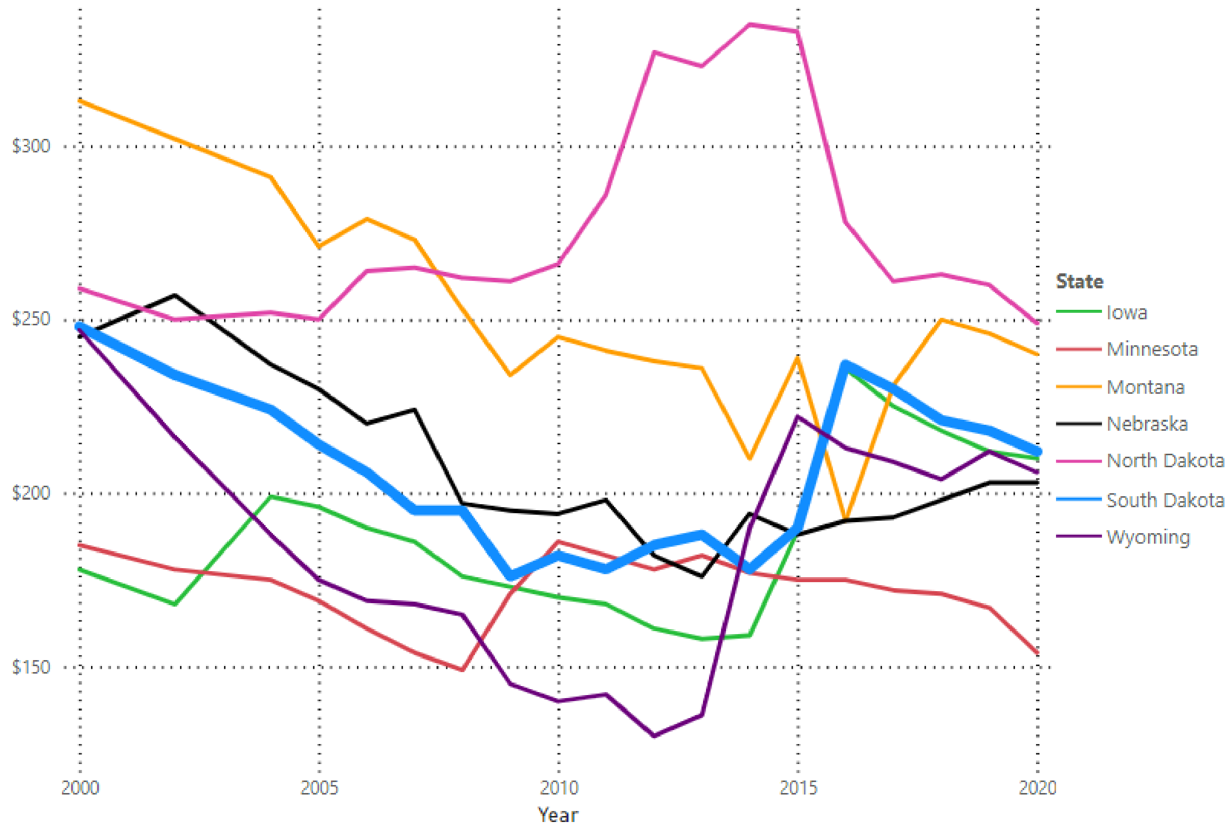
South Dakota imposes an "energy mineral" severance tax in SDCL chapter 10-39A, which imposes a 4.5% tax on the market value of minerals such as oil, natural gas, and coal severed from the ground. South Dakota also imposes a "conservation tax" in SDCL chapter 10-39B, which imposes a tax at the rate of 2.4 mills on the taxable value of minerals such as oil, natural gas and coal severed from the ground. Additionally, SDCL chapter 10-39 imposes a severance on the mining of gold and silver, at the rate of 10% of net profits. In 2021, South Dakota collected $9.8 million from severance taxes, according to data collected by the United States Census Bureau's Annual Survey of State Government Tax Collections.[26]

## Motor Fuel Tax

Motor fuels taxes are imposed on gasoline, diesel, and ethanol blends. This tax is generally not an ad valorem tax based on the value of the product, but rather an excise tax levied at a fixed amount per-gallon of product. Graph 9 demonstrates that there is a noticeable clumping amongst South Dakota, Nebraska, Wyoming, and Iowa, with respect to the per capita tax burden in recent years. It also appears that the trend lines shown in Graph 9, depicting the per capita tax burden from states' motor fuels taxes, are much less stable over time compared to the trend lines shown in previous line charts.

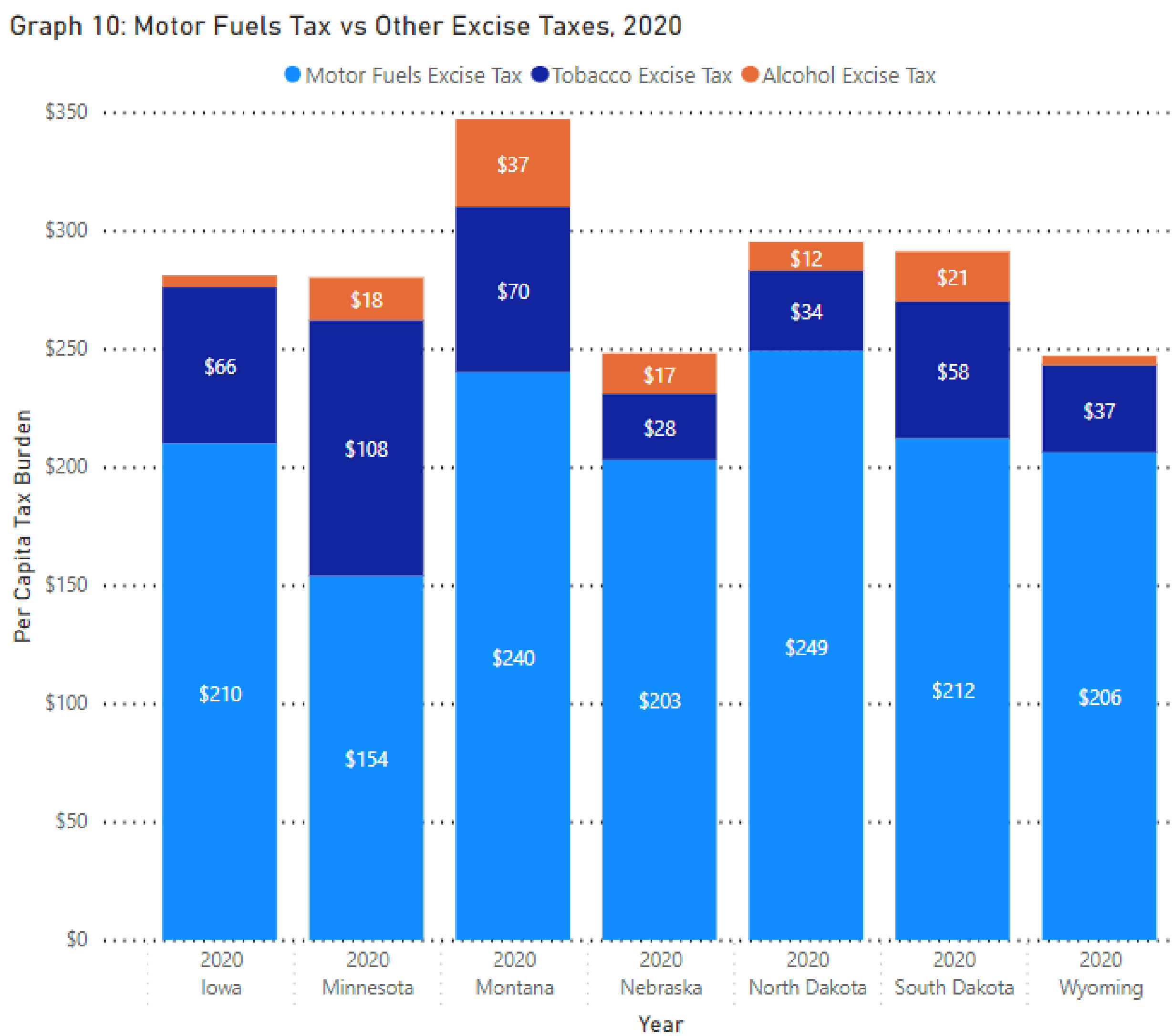
[23] St. Louis FRED, Severance Taxes in Minnesota
[24] Neb. Rev. Stat. § 57-703
[25] St. Louis FRED, Severance Taxes in Nebraska
[26] St. Louis FRED, Severance Taxes in South Dakota

Graph 9: Per Capita Motor Fuel Tax Burden




Interestingly, there seems to be somewhat of a loose, negative correlation between the per capita tax burden from motor fuels tax, and the degree of urbanization of a state. For example, the three states that consistently rank very low on various measures of urbanization, North Dakota, South Dakota, and Montana, rank highest on per capita tax burden from motor fuels tax shown in the table below. The two states in this study that tend to rank much higher on various measures of urbanization, Nebraska, and Minnesota, rank the lowest on per capita tax burden from motor fuels tax in the table below. It is important to keep in mind that the tax rates of each state are different, affecting the overall tax burden observed in the state, but even with different motor fuel tax rates, a loose relationship does appear to exist between the urbanization of the state and the state's tax burden from this particular tax category.

Graph 10 provides information on the motor fuels tax burden compared to the tax burden on other common excise taxes, namely, taxes imposed on alcohol and tobacco. Unsurprisingly, the tax burden of the motor fuels excise tax significantly outpaces that of alcohol and tobacco taxes. Also worthy of note, according to the USCB Survey, the tax burden placed on tobacco is consistently larger that the tax burden placed on alcohol.




Directly below is a breakdown of each state's tax rates on motor fuels, and the resulting tax burden and rank. Data for this chart was collected from the American Petroleum Institute, for the year 2022.[27] [28]

| | Gasoline Tax Per Gallon, 2022 | Diesel Tax Per Gallon, 2022 | Per Capita Tax Burden, 2020 | Tax Burden Rank |
|---|---|---|---|---|
| Iowa | **$0.300** | **$0.325** | **$210.00** | **4** |
| Minnesota | **$0.285** | **$0.285** | **$154.00** | **7** |
| Montana | **$0.325** | **$0.296** | **$240.00** | **2** |
| Nebraska | **$0.248** | **$0.248** | **$203.00** | **6** |
| North Dakota | **$0.230** | **$0.230** | **$249.00** | **1** |
| South Dakota | **$0.280** | **$0.280** | **$212.00** | **3** |
| Wyoming | **$0.230** | **$0.230** | **$206.00** | **5** |

[27] American Petroleum Institute, Gasoline Tax Map

[28] American Petroleum Institute, Diesel Tax Map

## Conclusion

A tax structure, and subsequent tax revenues generated therefrom, can vary greatly from state to state, even when comparing neighboring states that seemingly share many similar characteristics in terms of their economy, demographics, climates, and geographies. Rarely can a thorough examination of any one revenue source be done without consideration of other revenue sources. Generally, there is a substitutional relationship amongst revenue sources available to state and local governments. South Dakota, for example, has not imposed an individual income tax, and as a result, the tax burden from other revenue sources, such as sales tax, increases. Similarly, Wyoming does not impose a personal income tax, and replaces that foregone revenue with a mineral severance tax, which generates very high levels of annual revenue for the state.

The economic and political conditions both on a national level and on a state level are unquestionably complex, and the many parameters of a state's tax system with which these economic and political conditions interact are similarly complex. Rarely can a single parameter or program of a state's tax structure be viewed as if in a vacuum; instead, comparing the differences in states' tax structures should be done with due consideration to states' economies, and to the network of trade-offs that must be made to construct a cohesive, effective, and fair system of taxes to fund the budgets of state and local governments.

This document has shown that there exist many similarities between South Dakota's tax system and the tax system of its neighboring states; at the same time, the document clearly highlights some relatively unique characteristics in South Dakota's tax structure that have measurable effects on the tax burden placed on South Dakota residents.

This issue memorandum was written by Will Steward, Research Analyst, on August 7, 2023, 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.