IN THE SUPREME COURT

OF THE

STATE OF SOUTH DAKOTA

No. 30280

ELLINGSON DRAINAGE, INC.

Petitioner/Appellant,

vs.

THE SOUTH DAKOTA DEPARTMENT OF REVENUE

Respondent/Appellee.

Appeal from the Circuit Court
Sixth Judicial Circuit
Hughes County, South Dakota

The Honorable Christina Klinger, Presiding Judge

PRINCIPAL BRIEF OF APPELLANT ELLINGSON DRAINAGE, INC.

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REQUEST FOR ORAL ARGUMENT

Appellant Ellingson Drainage, Inc. respectfully requests the privilege of being heard on oral argument on all of the issues raised in this appeal.

STATEMENT REGARDING CITATION CONVENTIONS

Appellant Ellingson Drainage, Inc. adopts the following citation conventions: Citations to the settled record of the Clerk's Record Index will be denoted "R-____".

JURISDICTIONAL STATEMENT

This is an appeal from the final Order rendered by the South Dakota Circuit Court for the Sixth Judicial Circuit, affirming the Final Decision rendered by the South Dakota Department of Revenue on or about June 13, 2022. R-387. The Circuit Court's Order was entered on or about January 25, 2023, and Notice of Entry of the Order was filed on or about February 1, 2023. R-388. Ellingson's Notice of Appeal and attendant filings were filed with the Court on March 1, 2023. R-404. This Court has jurisdiction over the appeal pursuant to SDCL § 15-26A-3.

ISSUES PRESENTED

Whether imposing a $60,000 use tax on the value of equipment purchased outside of South Dakota, not originally intended for use in South Dakota but ultimately used in South Dakota for one day violates the Due Process Clause and the Interstate Commerce Clause of the Constitution of the United States.

The Circuit Court ruled that the tax as applied to Ellingson was constitutional under both the Due Process Clause and Interstate Commerce Clause.

Western Wireless Corp. v. Dep't of Revenue, 2003 S.D. 68, 665 N.W.2d 73;
Montana-Dakota Utilities Co. v. S. Dakota Dep't of Revenue, 337 N.W.2d 818 (S.D. 1983);
Complete Auto Transit, Inc. v. Brady, 430 U.S. 274 (1977);
Henneford v. Silas Mason Co., 300 U.S. 577 (1937)

SDCL §§ 10-46-2; 10-46-3; 10-45-2; ARSD 64:09:01:20;
US CONST. ART. 1, § 8, Cl. 3; U.S. CONST. AMEND. XIV.

STATEMENT OF THE CASE

The South Dakota Department of Revenue imposed a use tax on Ellingson for its use of equipment in South Dakota. R-151. Ellingson filed an administrative appeal challenging the constitutionality of applying the use tax to Ellingson. R-324. The Office of Hearing Examiners held a hearing on April 11, 2022, and the Department of Revenue rendered its Final Decision on or about June 13, 2022. R-349, R-359. The Department of Revenue held that it did not have authority to rule on the constitutionality of the challenged statutes. R-353, 354.

Ellingson appealed the matter to the South Dakota Circuit Court for the Sixth Judicial Circuit, the Honorable Judge Christina Klinger

presiding. R-356, 357. The Circuit Court affirmed the decision of the South Dakota Department of Revenue, concluding that the tax imposed under SDCL § 10-46-3 was constitutional under both the Due Process Clause of the 14th Amendment to the United States Constitution and under the Interstate Commerce Clause. R-387.

FACTS[1]

Ellingson Drainage, Inc. ("Ellingson"), is a Minnesota company with its principal place of business in West Concord, Minnesota. R-326. Ellingson specializes in installing drain tile for farming and government applications. *Id.* Ellingson performs drain tile installation throughout the United States. *Id.*

In the years 2017-2019 (the "Audit Period"), Ellingson installed drain tile in more than 20 different states. *Id.* Ellingson completed approximately 30 jobs in South Dakota during the Audit Period, ranging in price from less than $1,000 to $280,000, and the equipment taxed was used for only a single day. R-326—328. During the audit period, Ellingson purchased certain equipment outside of South Dakota. *Id.* The bulk of Ellingson's business is conducted in states other than South Dakota, and the equipment at issue was primarily

[1] All material facts at issue on this appeal were stipulated to by the parties. R-326—328.

used on jobs performed outside of South Dakota. *Id.* The pro-rata usage of the equipment in South Dakota during the audit period, compared to jobs Ellingson performed in other states, ranged from 1 to 10 percent of the equipment's' usage. *Id.*

The reasonable rental value for the equipment, if rented for use on the South Dakota jobs, would be $102,463.87. *Id.* The purchase price of the equipment at issue exceeds the gross receipts Ellingson received for the work done in South Dakota during the audit period. R-327.

The South Dakota Department of Revenue (the "Department") imposed a use tax on the following equipment owned by Ellingson because, prior to entering South Dakota, Ellingson had not paid sales or use tax on the following equipment:

1. A CAT 336EL excavator purchased on April 7, 2016 for $227,500. Ellingson used the same in South Dakota on October 28, 2019. *Id.*

2. A CAT d8K Pullcat, purchased on February 28, 2011 for $62,500. Ellingson used the same in South Dakota on September 21, 2017. *Id.*

3. A FASTRAC tractor, purchased on October 20, 2011 for $141,500. Ellingson used the same in South Dakota on October 10, 2017. *Id.*

4. A BRON 550 Plow, purchased on June 20, 2013 for $576,500. Ellingson used the same in South Dakota on October 17, 2017. *Id.*

5. Two JCB Fastrac tractors, purchased on February 21, 2013 for $148,500 each, totaling $297,000. Ellingson used one of the above tractors in South Dakota on April 19, 2017. Ellingson used the second tractor not previously used in South Dakota on May 16, 2018. *Id.*

6. A JCB Fastrac tractor purchased on March 12, 2012 for $141,000. Ellingson, used the same in South Dakota on April 23, 2018. *Id.*

7. A JCB Fastrac tractor purchased on March 12, 2012 for $153,000. Ellingson used the same in South Dakota on November 16, 2018. *Id.*

8. A BRON 585 Plow purchased on March 6, 2018 for $196,339. Ellingson used the same in South Dakota on November 18, 2018. R-327-328.

9. A JCB Fastrac tractor purchased on April 16, 2018 for $189,933. Ellingson used the same in South Dakota on April 17, 2019. R-328.

10. A JCB Fastrac tractor purchased on October 20, 2011 for $141,500. Ellingson used the same in South Dakota on September 21, 2017. *Id.*

11. Ellingson Drainage, Inc., rented an Excavator on April 30, 2019 for $120,000. And did not pay any use or sales tax on this rental. Ellingson Drainage, Inc., used the same in South Dakota on November 20, 2018 [sic]. *Id.*

As a result of the audit, the Department assessed taxes in the amount of $60,665.44 against Ellingson, plus interest in the amount of $14,862.88 for a total of $75,528.32. R-151. The issue here runs deeper than the immediate tax assessment, as the question before this Court

implicates Ellingson's, and all out-of-state companies', ability to work and use their equipment for projects in South Dakota. As explained further below, the assessment of this tax is neither reasonable nor consistent with Federal law nor the intent of the South Dakota Legislature.

STANDARD OF REVIEW

The facts in this case are undisputed, and the parties stipulated to the factual record which was before the agency and Circuit Court and which is now before this Court. "Whether a statute imposes a tax under a given factual situation is a question of law and thus no deference is given to any conclusion reached by [the] Department [of Revenue] or the circuit court." *Watertown Co-op. Elevator Ass'n v. S. Dakota Dep't of Revenue*, 2001 S.D. 56, ¶ 10, 627 N.W.2d 167, 171 (quoting *Dep't. of Revenue v. Sanborn Tel. Co–op.*, 455 N.W.2d 223, 225 (S.D.1990) (alterations in original). "The words in such statutes should be given a reasonable, natural, and practical meaning to effectuate the purpose of the statute." *Butler Mach. Co. v. S. Dakota Dep't of Revenue*, 2002 S.D. 134, ¶ 6, 653 N.W.2d 757, 759 (citations omitted). "Statutes which impose taxes are to be construed liberally in favor of the taxpayer and strictly against the taxing body." *Id.*

ARGUMENT

The Department imposed a 4.5% tax on the value of heavy equipment that was used in South Dakota for a single day. South Dakota law does not require such a tax, and, if it did, the United States Constitution would forbid its enforcement.

The Department's application of SDCL § 10-46-3 assumes that an entity using equipment in South Dakota for only a day obtains the same benefits from the state's services as one who purchases property in South Dakota or who brings property into the state intending to keep and use it here indefinitely. Should the Court uphold the Department's interpretation and application of SDCL § 10-46-3, then every individual or business who comes into South Dakota, for any length of time, no matter the duration, is subject to a 4.5% tax on everything that they have brought with them. Under this expansive view, all property that any tourist or out-of-state business brings into South Dakota without already having paid a tax on that property in their home state would be required to report and remit this tax. Such a tax scheme would be designed merely to squeeze money out of passers-through, not because South Dakota provided any particular related benefit, but as a protectionist means of increasing South Dakota's tax revenues without burdening the citizens of its State. The use tax sought to be imposed

pursuant to SDCL § 10-46-3 and ARSD 64:09:01:20 is unconstitutional both under Article 1, § 8, Cl. 3 to the United States Constitution (the "Commerce Clause") and the Fourteenth Amendment to the United States Constitution's Due Process Clause.

The Court should reverse the Circuit Court for three reasons. First, the Department's proposed tax imposition under SDCL § 10-46-3 is unconstitutional as it lacks a rational connection to the opportunities, benefits, or protections provided by the taxing state. *Montana-Dakota Utilities Co. v. S. Dakota Dep't of Revenue*, 337 N.W.2d 818, 820 (S.D. 1983). This challenge focuses on the fairness of assessing this tax against Ellingson given the circumstances of the case.

Second, the Department's interpretation of the tax scheme contemplated by SDCL § 10-46-3 is unconstitutional because it violates the Commerce Clause under the test promulgated by the United States Supreme Court in *Complete Auto Transit, Inc. v. Brady*, 430 U.S. 274, 279 (1977). This challenge focuses on how South Dakota's overall tax scheme relates to the tax schemes of other states and the compatibility of such schemes.

Finally, Ellingson will provide the Court with an interpretation of the tax contemplated by SDCL § 10-46-3 that appropriately addresses

the concerns underlying the imposition of a use tax, is consistent with the tax scheme as a whole, and comports with the Due Process and Interstate Commerce clauses of the U.S. Constitution.

I. Because Courts Have Provided No Guidance on the Interpretation of SDCL § 10-46-3, the Department Imposes A 4.5% Use Tax on Personal Property Purchased in Another State, Without the Intent to Use It in South Dakota, But Thereafter Used, Stored, Or Consumed in South Dakota, Even for a Single Day.

Interpretation of this tax scheme is an issue of first impression in South Dakota. Ellingson's research of SDCL § 10-46-3 and the use tax schemes of other states has yielded little guidance from courts of appeal as to how to interpret and apply that provision of the South Dakota use tax concerning property "not originally purchased for use, etc." in the taxing state. SDCL § 10-46-3 taxes personal property purchased in another state that is used, stored, or consumed in South Dakota.

> An excise tax is imposed on the privilege of the use, storage or consumption in this state of tangible personal property or any product transferred electronically not originally purchased for use in this state, but thereafter used, stored or consumed in this state, at the same rate of percent of the fair market value of the property at the time it is brought into this state as is imposed by § 10-45-2. The use, storage, or consumption of tangible personal property or any product transferred electronically more than seven years old at the time it is brought into the state by the person who purchased such property for use in another state is exempt from the tax imposed herein. The secretary may promulgate rules pursuant to chapter 1-26 relating to the determination of the age and value of the tangible personal

> property or the product transferred electronically brought into this state.

SDCL § 10-46-3. The rate contained in § 10-45-2 is four and one-half percent (4.5%). Pursuant to the delegation contained within § 10-46-3, the Department of Revenue established ARSD 64:09:01:20 which provides that in order to be exempt from the tax, the item must be over seven years old, as determined by its manufacture date or purchase date. If there's no proof of the item's value when it enters South Dakota, its value is assumed to be the purchase price, less 10 percent (10%) for each year of use.

Although the statute is mentioned by this Court in various past decisions, the Court has never interpreted or analyzed the statute with respect whether it is a proper or constitutional mechanism for taxing out-of-state persons and entities. *See, e.g., Matter of Thermoset Plastics, Inc.*, 473 N.W.2d 136, 138–39 (S.D. 1991) ("SDCL 10–46–2 is the applicable statute in this case, not SDCL 10–46–3"); *N. Border Pipeline Co. v. S. Dakota Dep't of Revenue*, 2015 S.D. 69, 868 N.W.2d 580, 583 n. 4 ("The assessment in this case was not based on [SDCL 10-46-3 or SDCL 10-46-4], and this argument was not presented below. Therefore, we express no opinion on taxability under those statutes"); *Northwestern Nat. Bank of Sioux Falls v. Gillis*, 148 N.W.2d 293, 298

(S.D. 1967) (analyzing the precursor to SDCL 10-46-3, the Court examined whether a national bank must pay a use tax on the supplies it purchases out-of-state for use in South Dakota or collect a use tax on the food it sells to patrons in its cafeteria in South Dakota); *J. D. Evans Equip. Co. v. State ex rel. Bender*, 230 N.W.2d 237, 242 (S.D. 1975) (Coler, J., dissenting) (the lone dissenter states, without explanation, that SDCL 10-46-3 would apply to a South Dakota company's leasing of equipment to contractors within South Dakota).

Ellingson believes that North Dakota is the only state with a use tax with language similar to that contained within SDCL § 10-46-3. N.D.C.C. § 57-40.2-02.1(1) provides in pertinent part:

> Except as provided in section 57-40.2-11, an excise tax is imposed on the storage, use, or consumption in this state of tangible personal property not originally purchased for storage, use, or consumption in this state at the rate of five percent of the fair market value of the property at the time it was brought into this state.

Like SDCL § 10-46-3, there is little analysis from the North Dakota Supreme Court regarding the interpretation and application of that portion of the statute which applies to tangible personal property "not originally purchased for storage, use, or consumption in this state[.]" There are four cases which mention it, but three of them, and potentially the fourth, are not concerned with the analysis or

application of the portion of the statute analogous to the one at issue in this case. *See Cladding Tech., Inc. v. State By & Through Clayburgh*, 1997 ND 84, ¶ 1, 562 N.W.2d 98, 99 (concerned only with that portion of the use tax regarding the purchase for storage use or consumption in North Dakota); *State By & Through Heitkamp v. Quill Corp.*, 470 N.W.2d 203, 205 (N.D. 1991), *rev'd sub nom. Quill Corp. v. N. Dakota By & Through Heitkamp*, 504 U.S. 298 (1992) (concerned with the use tax on property purchased for storage, use, or consumption within North Dakota and was reversed on appeal by *Quill, infra*); *Blocker Drilling Canada, Ltd. v. Conrad*, 354 N.W.2d 912 (N.D. 1984) (dealt only with whether the state could be estopped from reassessing taxes against an entity who had already paid a use tax on its drilling equipment).

The fourth case is *Boeing Co. v. Omdahl*, 169 N.W.2d 696, 698 (N.D. 1969), and it is unclear whether the court was analyzing the latter part of the North Dakota use tax statute. Boeing, who contracted with the federal government to work on Minuteman missile bases in North Dakota, disputed North Dakota's use tax on its purchases made both within and outside the state. Boeing argued it was a federal government agent and hence exempt from tax, and also claimed the

state could not impose a use tax after abolishing its sales tax. Despite these arguments, the court upheld the tax on Boeing.

It does not appear, however, that the court was analyzing the latter half of the use tax statute because it continually refers to the tax being imposed on that property which was procured by Boeing pursuant to its government contracts—i.e. procured for use in North Dakota. Additionally, the court cites to *Henneford v. Silas Mason Co., infra*, for the proposition that "[t]he use tax is not upon the operations of interstate commerce, but upon the privilege of the use *after commerce is at an end.*" 300 U.S. 577 (1937) (emphasis added). This cite to *Henneford* suggests that the court was analyzing the tax only with respect to that property which had come to rest for use, storage, and consumption in North Dakota rather than continuing to be used in interstate commerce.

A. The Use Tax as Applied to Ellingson Is an Unconstitutional Denial of Due Process Because the Tax Is Not Rationally Related to the Opportunities, Benefits, Or Protections Afforded By South Dakota.

Tax statutes are to be construed liberally in favor of the taxpayer, *Butler Mach. Co.*, ¶ 6, 653 N.W.2d at 759, and must be rationally related to the nature and extent of the taxpayer's connection with the taxing state. *Montana-Dakota Utilities Co.*, 337 N.W.2d at 820.

"Whether a state tax violates the due process clause is determined by whether the tax has relation to opportunities, benefits, or protection afforded by the taxing state." *Montana-Dakota Utilities Co.*, 337 N.W.2d at 820. As stated another way by the United States Supreme Court, the Due Process Clause "requires some definite link, some minimum connection, between a state and the person, property or transaction it seeks to tax," and that the "income attributed to the State for tax purposes must be rationally related to 'values connected with the taxing State,'" *Quill Corp.*, 504 U.S. at 306, *overruled on other grounds by South Dakota v. Wayfair, Inc.*, 138 S. Ct. 2080 (2018).

1. SDCL 10-46-3, as it has been applied to Ellingson, does not fulfill either rationale for imposing a use tax on property brought into South Dakota.

The first step in determining whether this use tax is rationally related to the benefits provided by South Dakota is to look to the rationale behind imposing use taxes in the first place. In *Western Wireless Corp. v. Dep't of Revenue*, the South Dakota Supreme Court explained:

> Use taxes accommodate two vital concerns: (1) the state may lose tax revenue if taxpayers purchase out-of-state goods or services for in-state use, and (2) local providers will lose business if taxpayers purchase out-of-state goods or services to avoid sales tax liability.

2003 S.D. 68, ¶ 7, 665 N.W.2d 73, 75; *see also Northwestern Nat. Bank of Sioux Falls*, 148 N.W.2d at 298 ("In addition to raising money it is to help the retailers in this state, who are subject to the sales tax, compete on an equal footing with out-of-state competitors"). "Use tax is complementary and supplemental to sales tax to ensure that property sold or used in the state will be taxed once for the support of state government." *Black Hills Truck & Trailer, Inc. v. S. Dakota Dep't of Revenue*, 2016 S.D. 47, ¶ 18, 881 N.W.2d 669, 674 (citing *Sioux Falls Newspapers, Inc. v. Sec'y of Revenue*, 423 N.W.2d 806, 810, n. 3 (S.D. 1988).

The tax sought to be imposed on Ellingson under SDCL § 10-46-3 fails to address either of the rationales supporting the imposition of South Dakota use tax. The two "vital concerns" set forth in *Western Wireless* are primarily assuaged by the existence of SDCL §10-46-2 which acts to prevent South Dakota residents from buying property in a state without sales tax and bringing it back to South Dakota to the disadvantage of our businesses and government's fundraising abilities. The point of the use tax is to impose a one-time tax to erase any benefit that one might receive by trying to exploit the tax schemes of various locations to the detriment of his home jurisdiction. If property, previously subject to a sales or use tax less than South Dakota's sales

or use tax, was purchased and South Dakota is intended to be its primary use location, then it is reasonable for South Dakota to tax its purchase price as though it was purchased within South Dakota. In that scenario, the tax fulfills its "complimentary" role. These are not the facts of this case.

Because the use tax sought to be imposed applies to the value of the property sought to be taxed, regardless of the degree to which it was used in South Dakota, it is not rationally related to the value being realized in South Dakota. The Department seeks to tax Ellingson's one-day equipment use at the same rate as a South Dakota resident's lifetime use of the same equipment. To further demonstrate the lack of the tax's rationality, it appears to be true that the tax would apply to a family from Luverne, Minnesota who came to the Empire Mall in Sioux Falls for an afternoon of shopping. From the clothes on their back to the tires on their vehicle, anything not previously subject to a sales or use tax would be subject to a use tax at a base rate equal to that of the South Dakota sales tax. Such a rule is wholly inconsistent with the purpose of imposing a use tax on out-of-state property and is not

rationally related to the taxable activities of Ellingson—or any others who may fall within the forgoing hypothetical.[2]

2. SDCL § 10-46-3 is a tax on interstate operations of Ellingson's business, and such tax is not rationally related to the portion of interstate business Ellingson does within South Dakota.

SDCL § 10-46-3, as applied to Ellingson, is a tax "upon the operations of interstate commerce" as opposed to being a tax imposed once the property has "come to rest in interstate commerce." *Henneford v. Silas Mason Co.*, 300 U.S. 577, 580 (1937). In *Henneford v. Silas Mason Co.*, cited favorably by this court in *Western Wireless*, the United States Supreme Court analyzed a similar use tax imposed by the State of Washington on "the privilege of using within this state any article of tangible personal property purchased subsequent to April 30, 1935, at the rate of 2 per cent. of the purchase price[.]" *Id.* This tax statute, too, was supplemented by administrative rules, one of them being the definition of "use". Use was defined as: "property is put to use by the first act after delivery is completed within the state by which the article purchased is actually used or is made available for use with intent actually to use the same within the state." *Id.* at 583. Meaning

[2] In Section II, *infra*, Ellingson proposes an interpretation of SDCL § 10-46-3 that comports with the principles set forth in *Western Wireless* and is rationally related to the values connected with South Dakota.

that in order for the tax to attach, the use of the property within the taxing state either had to be the first use[3] of that property or was procured for use in the taxing state. Both of these limitations, on what could otherwise be a broad definition of "use," are intended to limit the application of the tax to only those uses and values tied to the taxing state. Based on the Tax Commission's rule that the tax would only be applied when the first use of the property was made within the state or when the property is to become part of the "common mass of property" within the taxing state, the Court held that the tax was not "upon the operations of interstate commerce" but a tax on property which had reached its destination. *Id.* at 582.

Conversely, the manner in which SDCL § 10-46-3 is being applied to Ellingson expressly contemplates that it will be a tax on interstate operations. Relying on the language "imposed on the privilege of the use . . . in this state of tangible personal property . . . *not originally purchased for use in this state*, but thereafter used, stored or consumed

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[3] Other states have analyzed whether the property was "first used" in the taxing state as a proxy for determining whether the entity subject to the tax procured the property intending that it be used in the taxing state. *See Rowan Drilling Co. v. Bureau of Revenue*, 60 N.M. 123, 124, 288 P.2d 671, 672; *Exxon Corp. v. Wyoming State Bd. of Equalization*, 783 P.2d 685, 688 (Wyo. 1989) ("first use" rule promulgated by the Wyoming State Tax Commission)

in this state[,]" the Department seeks to impose a tax on property that was neither originally intended for use in South Dakota nor made part of the "general mass" of the property in South Dakota. SDCL § 10-46-3 (emphasis added).

In effect, South Dakota is seeking to impose a tax on property outside of its borders. Such extraterritorial extension of a state's taxing power is impermissible. Indeed, in *Norfolk & W. Ry. Co. v. Missouri State Tax Comm'n*, 390 U.S. 317 (1968), the United States Supreme Court held that a tax scheme which was calculated using a method, untethered from the subject's ownership of property or activity within the state, was illegal in that it effectively imposed the taxing state's tax power on property and activity located outside of the state. While *Norfolk & Western Railway Company* is about the assessment of property taxes to implements of interstate commerce located within the taxing state, the same Due Process analysis and rationale apply.

Norfolk & Western Railway Co. (N & W), a Virginia-based corporation with interstate rail operations, leased all of the property of appellant Wabash Railroad Company ("Wabash"). Wabash owned significant railroad tracks and rail cars and conducted substantial business in Missouri and other states. Before the lease, N & W had minimal track and rolling stock in Missouri.

Under the lease terms, N & W was obligated to pay 1965 taxes on Wabash's properties, including those in Missouri. The State Tax Commission assessed the Missouri property at $31,298,939. The Commission, utilizing a Missouri statute-authorized mileage formula, presumed that the rolling stock was evenly distributed across the entire railroad system. The formula determined that 8.2824% of all main and branch line roads owned or controlled by N & W were in Missouri. This percentage was applied to the total equalized value of N & W's rolling stock, resulting in a figure of $19,981,757. However, N & W presented evidence indicating that if the tax were assessed only on the rolling stock located within Missouri, the total tax would be approximately $7,600,000.

N & W did not argue that the Commission failed to follow the formula contained within the statute. Instead, N & W argued that "in mechanically applying the statutory formula, the Commission here arrived at an unconscionable and unconstitutional result." *Norfolk & W. Ry. Co.*, 390 U.S. at 321. N & W further argued that the tax did not accurately represent the value of the taxable property within the state. The United States Supreme Court concurred, ruling that the assessment breached both the Due Process and Commerce Clauses.

The Court held that a company engaged in interstate commerce is subject to its fair share of taxation, as measured by "the value, appropriately ascertained, of tangible assets permanently or habitually employed in the taxing State, including a portion of the intangible, or 'going-concern,' value of the enterprise." *Id.* at 323-24. The Court went on to hold, however, that "a State is not entitled to tax tangible or intangible property that is unconnected with the state." *Id.* at 324; *see also Montana-Dakota Utilities Co.*, 337 N.W.2d at 820 ("Although the Constitution will not allow a taxpayer to avoid its domiciliary state's property tax on the full value of its assets merely because during part of the tax year a determinable fraction of its property is absent from the state, the domiciliary state may not constitutionally levy a personal property tax at full value on freight cars habitually employed on fixed routes and regular schedules in a state other than that of the owner's domicile").

A State may not impose a tax that, in application, effectively taxes property and value that lies beyond that State's borders. *See, e.g., Fargo v. Hart*, 193 U.S. 490, 499—503 (1904); *Union Tank Line Co. v. Wright*, 249 U.S. 275, 283—286 (1919); *Wallace v. Hines*, 253 U.S. 66, 69—70 (1920); *Southern R. Co. v. Commonwealth of Kentucky*, 274 U.S. 76, 81—84 (1927).

> A State will not be permitted, under the shelter of an imprecise allocation formula or by ignoring the peculiarities of a given enterprise, to 'project the taxing power of the state plainly beyond its borders.' *Nashville, C. & St. L.R. Co. v. Browning*, 310 U.S. 362, 365 (1940). Any formula used must bear a rational relationship, both on its face and in its application, to property values connected with the taxing State. *Fargo v. Hart*, 193 U.S. 490, 499—500 (1904).

Norfolk & W. Ry. Co., 390 U.S. at 324–25 (parallel citations omitted). Examining the evidence, the Court found that the tax assessed on N & W was highly exaggerated and did not reflect either N & W's presence in Missouri or any "enhanced value" gained from their connection to the Missouri railway system. The Court asserted that such a mismatch between the tax and the actual property value within the state implied that the tax impact was not limited to intrastate property. This reasoning is also applicable in the current context.

In the current case, the tax proposed against Ellingson is substantially disproportionate to Ellingson's activities within South Dakota. During the audit period, Ellingson conducted drain tile installation work in over 20 states, with the taxed equipment primarily used for jobs outside South Dakota. The taxed equipment's usage in South Dakota only represented between 1-10% of its total usage during that period, implying that it was used at least 90 percent (90%) of the

time outside the state. The record provides no evidence that any of the taxed property remained in South Dakota following its use.

Furthermore, the 4.5% tax on the property's value is an inaccurate method for taxing the use of that property within the state. Taxing the value of the property used within the taxing state is justifiable when the taxed property was either purchased for use in South Dakota or has become part of the state's overall property mass, even if not originally intended for use there. However, this is not the case here. The issue is that the Department aims to impose a tax, equivalent to the tax that would be rightfully assessed in either of the two previously mentioned scenarios, on equipment that was neither intended for use in South Dakota nor was there an intent to keep it here indefinitely. In simple terms, Ellingson is not a resident of South Dakota, never planned to be, and none of the taxed property remained in the state after its use. Despite this, South Dakota seeks to impose the full value of the sales/use tax, thereby violating Ellingson's Due Process rights. It bears repeating that this is a stunningly broad application and far outside the bounds of any rational, constitutional justification.

B. SDCL § 10-46-3 Is an Unconstitutional Burden on Interstate Commerce Because It Is Not Fairly Related to The Benefits Provided by South Dakota Nor Is It Fairly Apportioned.

A State may not impose a tax that unduly burdens interstate commerce. The Constitution grants Congress the power "[t]o regulate Commerce ... among the several States." Art. I, § 8, cl. 3. "Although the Commerce Clause is written as an affirmative grant of authority to Congress, this Court has long held that in some instances it imposes limitations on the States absent congressional action." *Wayfair, Inc.*, 138 S. Ct. at 2089.

> A [state] tax is not an unconstitutional burden on interstate commerce if the taxed activity is sufficiently connected to the state to justify the tax, the tax is fairly related to benefits provided to the taxpayer, the tax does not discriminate against interstate commerce, and the tax is fairly apportioned.

Western Wireless Corp., 2003 S.D. 68, ¶ 15, 665 N.W.2d at 78. The tax sought to be imposed under SDCL § 10-46-3 is not fairly related to the benefits that South Dakota provided to Ellingson nor is it fairly apportioned pursuant to the "internal and external consistency" analysis sent forth by the United States Supreme Court in *Goldberg v. Sweet*, 488 U.S. 582 (1989), *overruled on other grounds by Comptroller of Treasury of Maryland v. Wynne*, 575 U.S. 542, 555 (2015).

1. The tax sought to be imposed under SDCL § 10-46-3 is not fairly related to the benefits provided by South Dakota.

The proposed tax lacks a fair relation to the benefits offered by South Dakota, as Ellingson is taxed at the same rate for using equipment for a single day in South Dakota as if it had purchased the equipment in the state for use there. In *Western Wireless*, the South Dakota Supreme Court ruled that the use tax imposed on Western Wireless was "fairly related to state-provided services because Western has the right and benefit of selling its services to South Dakota residents." 2003 S.D. 68, ¶ 17, 665 N.W.2d at 78. However, in that case, Western Wireless was taxed for equipment located in South Dakota, used to record phone calls, even though the data primarily served an Illinois-based company. A use tax on the property's value in that case was fairly related to South Dakota's benefits to Western Wireless, as the property was intended for and used only in South Dakota. Furthermore, Western Wireless employed personnel to install and maintain the equipment in South Dakota, and the equipment there was integral for the interstate nature of Western Wireless's business.

The facts in the current case are distinguishable. First, there is nothing in the record to suggest that, at the time of purchase, any of the equipment was purchased with the intent that it would be used in

South Dakota. Second, none of the equipment sought to be taxed has remained in South Dakota or otherwise become part of the common mass of property within the state. Finally, the use of the equipment in South Dakota comprised, at most, ten percent (10%) of the equipment's useful life, but the tax rate imposed is the same as if the property had been purchased for use in South Dakota. The benefits offered by South Dakota to property and activities purchased and located within the state cannot equate, in terms of scale, to those provided to temporary, interstate operations. For these reasons, the 4.5% tax proposed on the transient use of equipment within the state is not fairly related to South Dakota's provided benefits, making the tax an unconstitutional burden on interstate commerce.

2. The tax imposed by SDCL § 10-46-3 is not "externally consistent" and is thus not fairly apportioned.

In order for a tax to be "fairly apportioned" it must be both internally and externally consistent. *Western Wireless*, 2003 S.D. 68, ¶ 18, 665 N.W.2d 73, 79 (citing *Goldberg*, 488 U.S. 252). "To be internally consistent, a tax must be structured so that if every State were to impose an identical tax, no multiple taxation would result." *Id.* (quoting *Goldberg*, 488 U.S. at 261). For this test, the court imagines that every state has an identical tax scheme to the one in question in order to

determine whether double taxation would result. SDCL § 10-46-3 is likely internally consistent because of the existence of SDCL § 10-46-6.1 which provides:

> The amount of any use tax imposed with respect to tangible personal property, any product transferred electronically, or services shall be reduced by the amount of any sales or use tax previously paid by the taxpayer with respect to the property on account of liability to another state or its political subdivisions. However, no credit may be given under this section where taxes paid on tangible personal property, any product transferred electronically, or services in another state or its political subdivisions of that state does not reciprocally grant a credit for taxes paid on similar tangible personal property or any product transferred electronically.

Assuming that every other state adopted this reciprocity statute, no double taxation would result. The tax, however, is not externally consistent, and thus fails the fourth prong of the *Complete Auto* test, *supra.*

"To be externally consistent under *Goldberg*, a state may tax 'only that portion of the revenues from the interstate activity which reasonably reflects the in-state component of the activity being taxed.'" *Id.* (quoting *Goldberg*, 488 U.S. at 262). In order to determine the reasonableness of the tax, the court looks to the "in-state business activity which triggers the taxable event and the practical or economic effect of the tax on that interstate activity." *Goldberg*, 488 U.S. at 262.

In *Goldberg*, the tax under scrutiny was established by the State of Illinois in response to changes in the telecommunications industry, specifically the phasing out of switchboards and telephone lines, which had previously helped states assess the extent of telecommunications conducted within their territories. Due to the growing challenge in tracing the route of modern electronic communications to their destination, Illinois implemented a 5 percent (5%) tax on the gross charge of interstate telecommunications that either started or ended in Illinois and were charged to an Illinois service address, irrespective of where the call was billed or paid. The United States Supreme Court upheld the tax as externally consistent because it "ha[d] many of the characteristics of a sales tax" and although the final purchase in Illinois "triggered simultaneous activity in several states" the tax scheme was consistent with a sales tax on calls paid for by the customer. *See also Oklahoma Tax Comm'n v. Jefferson Lines, Inc.*, 514 U.S. 175, 188 (1995) (holding that the taxable event of the sale of goods is unique and the tax need not be apportioned amongst those entities involved in the stream of commerce).

In this case, the tax under consideration does not resemble a sales tax levied upon the completion of a goods transaction within South Dakota. Nor is it intended to supplement the South Dakota sales

tax for assets purchased outside of the South Dakota for use within its borders. The tax in question aims to burden an out-of-state entity with a tax based on the value of the entity's equipment, which was only transiently utilized in South Dakota. Although *as little as* 90 percent (90%) of Ellingson's taxable activities occur outside South Dakota, the full rate of the sales/use tax was levied. Clearly, this arrangement fails to appropriately allocate the tax relative to Ellingson's in-state activities.

The fact that Ellingson has not been charged sales or use tax on its equipment in the states in which its equipment is primarily used does not render South Dakota's tax reasonable. The tax is to be imposed with respect to the value and activities located within South Dakota without respect to whether another state could be collecting a tax. Further, the reason that other states in which Ellingson primarily works have not taxed Ellingson's use of the equipment is because those states' tax statutes are more limited in application than South Dakota's. *See* M.S.A. § 297A.63 (Minnesota) ("For the privilege of using, storing, distributing, or consuming in Minnesota tangible personal property or taxable services *purchased for use, storage, distribution, or consumption in this state*") (emphasis added); I.C.A. § 423.5 § 57-40.2-02.1 (Iowa) ("The use in this state of tangible personal property as

defined in section 423.1, including aircraft subject to registration under section 328.20, purchased *for use in this state*") (emphasis added); V.T.C.A., Tax Code § 151.101 (Texas) ("A tax is imposed on the storage, use, or other consumption in this state of a taxable item purchased from a retailer *for storage, use, or other consumption in this state*") (emphasis added). Those states have tailored their statutes to the mandates of the Constitution, and South Dakota may not realize some excess benefit due to its failure to do the same. Because the tax is not externally consistent, it is an unconstitutional burden on interstate commerce.

II. SDCL § 10-46-3 Should Be Interpreted Consistent with the Principles Underlying the Use Tax Pursuant to SDCL § 10-46-2, and Should Apply Only When the Property Sought to Be Taxed Has Become Part of the Common Mass of Property in South Dakota.

A. SDCL § 10-46-3 Should Be Interpreted Such That It Applies Only When the Property, Intended to Be Taxed, Is Brought Into South Dakota With the Purpose of Being Used, Stored, Or Consumed Within the State for the Remainder of Its Useful Life.

Because this is an issue of first impression, the Court should adopt an interpretation of SDCL 10-46-3 consistent with the "vital concerns" of a use tax which are (1) the state may lose tax revenue if taxpayers purchase out-of-state goods or services for in-state use, and (2) local providers will lose business if taxpayers purchase out-of-state

goods or services to avoid sales tax liability. *Western Wireless Corp.*, 2003 S.D. 68, ¶ 7, 665 N.W.2d at 75. SDCL § 10-46-3 is a use tax complimentary to SDCL § 10-46-2, and the policy and practical reasons for the implementation of a use tax should be applied consistently among the various use tax schemes contained within the South Dakota code.

The interpretation and implementation of SDCL § 10-46-3 sought to be instituted by the Department is unconstitutional because it is not rationally related to the opportunities and benefits provided by South Dakota to Ellingson, it discriminates against interstate commerce, and it does not serve the purposes of the use tax as set forth by this Court in *Western Wireless Corp., supra*. The interpretation urged by the Department provides that South Dakota can impose a one-time use tax on any non-taxed property brought into the state for use by any person or entity, irrespective of its intended use in South Dakota or the duration and extent of its use. As stated above, such interpretation would seem to permit agents of the Department to scour the parking lots of the Empire Mall, Corn Palace, or Mount Rushmore, or otherwise locate one of our 10,000,000 annual visitors and assess them a 4.5% tax on all of their property incidentally now in South Dakota and not previously taxed. Out-of-staters would be subject to and liable for a use

tax on their personal belongings that they brought from home and never would have purchased from a South Dakota retailer—even though they were subject to their home state's tax schemes and potential taxes that South Dakota does not have (i.e., state income tax). That interpretation, however, would be wholly divorced from the purpose of use taxes which is to prevent local businesses from being disadvantaged by consumers gaming different jurisdictions' tax schemes, and to ensure that the State of South Dakota receives its due for the benefits and services provided during the use and consumption of property within South Dakota. *Western Wireless Corp.*, 2003 S.D. 68, ¶ 7, 665 N.W.2d at 75.

The notion that the sales and use tax are complimentary only makes sense in the context of discouraging and, if necessary, rectifying any disadvantage to South Dakota that accrues as the result of a purchaser going to a jurisdiction with a different tax scheme. There is a "one-time" tax to erase the benefit and detriment to the purchaser and state, respectively. SDCL 10-46-3, should be applied according to the same principles. It should be applied only when someone from out-of-state—who had no intention at the time of purchase to use the purchased property in South Dakota—relocates to South Dakota such that the remaining useful life of his property will be used, stored, and

consumed in South Dakota. Such application of the rule comports with the reasoning in *Western Wireless* for implementing a use tax. There is no disadvantage to South Dakota or its retailers that individuals or companies from out-of-state—who never considered purchasing the property in question in or for use in South Dakota—bring property into South Dakota incident to their presence here.

Further, the interpretation of SDCL §10-46-3 by the Department and the Circuit Court appears to conflict with or render meaningless other pertinent rules or regulations. Consider, for instance, the principle prohibiting double taxation in sales/use tax cases. The Department urges an interpretation of SDCL § 10-46-3 such that any utilization of the state's services and infrastructure, subjects one to the full extent of the use tax. But if that is the rule, why should a rule against double taxation apply? Why should Texas, Nebraska, or Iowa not be entitled to tax Ellingson with respect to its use of equipment in those states following Ellingson's projects in South Dakota? The bar on double taxation makes sense in the context of a "one-time" tax intended to level the playing field for retailers in different jurisdictions; it makes little sense if the point of the tax is to ensure that a state receives its cut for the taxpayer's utilization and enjoyment of that which is offered by the state.

Additionally, interpreting SDCL § 10-46-3 consistent with the principles of *Western Wireless* is the only way to make sense of ARSD 64:09:01:20's depreciation schedule based on the age of the property to be taxed. The step-down calculation for evaluating the value of the property to be taxed makes sense only if the intent is to try to determine the property's useful life and how long it will continue to be used, stored, or consumed in South Dakota. If SDCL § 10-46-3 is to be interpreted as the Department urges, what would be the rationale for adjusting the tax obligation based on the age of the property? What impact would the age of the property have on the temporary use of the property in South Dakota so as to justify a reduction in tax basis? Such reduction would seem wholly arbitrary unless it was intended to be a rough estimation at how much longer the property will continue to be used, stored, or consumed in South Dakota and continue to benefit from the laws, services, and infrastructure of the state once it has come to rest in South Dakota.

There is another policy consideration in applying SDCL § 10-46-3 and ARSD 64:09:01:20 to out-of-state businesses as the Department urges. Should these statutes apply in the manner argued by the Department, then going forward, out-of-state companies will only bring that equipment which is greater than seven years old. So, not only will

South Dakota residents be served by outdated equipment, but companies will still find a way to avoid the use tax. Again, SDCL § 10-46-3 and its seven-year depreciation schedule make sense only if it is to apply to individuals who are not intentionally exploiting different tax schemes—otherwise it is simply another tax scheme to exploit.

SDCL § 10-46-3 should not apply to Ellingson in this case, and should be applied exclusively when an out-of-state individual or company—who had no initial intention of using the purchased property in South Dakota—relocates property to South Dakota, and the remaining useful life of their property will be used, stored, and consumed within the state. This application aligns with the *Western Wireless* decision and meets the policy objectives of implementing a use tax. It also would be rationally related to the values connected with South Dakota, and would have no effect on interstate commerce because it would apply only to that property which has come to rest in the taxing state and has become part of the common mass of property therein.

B. Should the Court Find That SDCL § 10-46-3 Applies to Ellingson, the Court Should Adopt a Calculation That Is Rationally Related to Ellingson's Presence and Activity in South Dakota.

The Department is misinterpreting SDCL § 10-46-3, and it should not apply to Ellingson at all. If this Court is to uphold SDCL § 10-46-3's application to Ellingson, it should adopt a more accurate and constitutional method of calculating the tax, reflecting Ellingson's actual operations in South Dakota. An example would be something akin to taxing the rental value of the property for its duration in the state. The reasonable rental value for the equipment at issue in this case, if rented for use in South Dakota, would amount to $102,463.87. R-326. Taxing this value would provide a more accurate depiction of Ellingson's activities within South Dakota. While this might be an argument better reserved for the legislature, the Department's current interpretation of SDCL §10-46-3 is patently unfair.[4]

With respect to Ellingson's proposed valuation of its connection to the taxing state, the Circuit Court's opinion states that:

[4] As it did in *Carsforsale.com v. South Dakota Dep't. of Revenue*, 2019 S.D. 4, ¶ 19, 922 N.W.2d 276, 282, this Court should recommend that the legislature revisit and clarify the scope and application of SDCL § 10-46-3 to businesses with equipment only temporarily used, stored, or consumed in South Dakota.

> Essentially, Ellingson is asking the Department to turn a one-time tax on property used in South Dakota not previously subject to sales or use tax, into a personalize, use-based ration tax calculated on a business-by-business basis by examining how frequently each business subjected to the tax uses each piece of equipment in the taxed state. Ellingson's proposition seems implausible.

R-386. Despite its purported implausibility, it's the only constitutional and reasonable way to enforce SDCL § 10-46-3 as applied to Ellingson or others in like situations. As stated by the United States Supreme Court, "[t]he facts of life do not neatly lend themselves to the niceties of constitutionalism; but *neither does the Constitution tolerate any result, however distorted*, just because it is the product of a convenient mathematical formula which, in most situations, may produce a tolerable product." *Norfolk & W. Ry. Co.*, 390 U.S. at 327 (emphasis added). If the Court is to apply SDCL § 10-46-3 to Ellingson, this Court should interpret and calculate the tax contemplated by SDCL § 10-46-3 in a manner that accurately reflects Ellingson's activities in South Dakota, potentially adopting a model based on the reasonable rental value of the property within the state, as it's the only viable and constitutional approach to applying SDCL § 10-46-3 to Ellingson under these circumstances.

CONCLUSION

For the reasons set forth in this Brief, this Court should reverse the Circuit court's Order and enter an Order declaring that SDCL § 10-46-3 is unconstitutional as it has been applied to Ellingson.

Dated this 18th day of May, 2023.

CADWELL SANFORD DEIBERT & GARRY LLP

By: /s/ Andrew S. Hurd

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200 E. 10th Street, Suite 200
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Attorneys for Appellant

CERTIFICATE OF COMPLIANCE

I hereby certify that Ellingson's Principal Brief complies with the Type-Volume requirements of SDCL 15-26A-66 in the following manner: The Brief was prepared using Microsoft Word and uses proportionally spaced font [Century] in 13-point type. Based on the word-count feature of the MS Word processing system, the Brief contains 8,509 words.

/s/ Andrew S. Hurd
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Telecopier: (605) 336-6036
Attorneys for Appellant

CERTIFICATE OF SERVICE

The undersigned attorney hereby certifies that a true and correct copy of the Principal Brief of Appellant Ellingson Drainage, Inc., with attached Appendix, was electronically filed and served through Odyssey File and Serve System to:

Shirley Jameson-Fergel
South Dakota Supreme Court Clerk
scclerkbriefs@ujs.state.sd.us

Joseph Thronson
South Dakota Department of Revenue
j*oe.thronson@state.sd.us*

and the original of the Principal Brief of Appellant Ellingson Drainage, Inc., with attached Appendix, was mailed, by U.S. mail, postage prepaid, to:

Shirley Jameson-Fergel
Clerk of the Supreme Court
500 East Capitol Avenue
Pierre SD 57501-5070

all on May 18, 2023.

/s/ Andrew S. Hurd
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Attorneys for Appellant

APPENDIX INDEX

S.D. Department of Revenue
Audit Division
445 East Capitol Avenue
Pierre, S.D. 57501-3185
Phone: (605) 773-3311

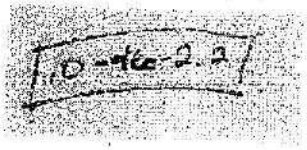
CERTIFICATE OF ASSESSMENT 0002

Taxpayer Name: ELLINGSON DRAINAGE
Mail Address: PO BOX 68
City/State/Zip: WEST CONCORD, MN 55985

Commencement Date: 05/18/2020 End Date: 07/30/2020

Pursuant to South Dakota Law you are hereby notified that the Secretary of Revenue has made an assessment of tax, penalty and/or interest in the amount of $ 75,528.32 for the stated period. Penalty and interest are assessed pursuant to SDCL 10-59-6. THIS ASSESSMENT IS DUE UPON RECEIPT OF THE CERTIFICATE. The major reasons for the assessment are stated below.

SD A.R 64:09:01:20. Determination of age and value of tangible personal property.
SDCL 10-46-3Tax on tangible personal property and electronically transferred products not originally purchased for use in state--Property more than seven years old.
SDCL 10-46-2.1. Tax imposed on use of services.



DBA Name	ELLINGSON COMPANIES
Record Number	1012-9851-ET
Begin Period	03/2017
End Period	01/2020
Tax	$60,665.44
Interest	$14,862.88
Penalty	$0.00
State	$75,528.32
City / IFTA / Tank Inspection	$0.00
Total	$75,528.32
Remitted	$0.00

JAN 19 2022

You have sixty days from the date of this certificate to request a hearing pursuant to SDCL 10-59. A request for hearing must be submitted in writing to the Secretary of Revenue, and contain a statement indicating the portion of the assessment being contested and the mistake of fact or error of law you believe resulted in an invalid assessment.

COMBINED AUDIT ASSESSMENT	
Net Due	$75,528.32
Amount Remitted	$0.00
Balance Due or Credit**	$75,528.32
**Credit balance will be applied to:	

Jim Terwilliger, Secretary of Revenue

Date of Certificate: July 30, 2020 By:

STATE OF SOUTH DAKOTA
OFFICE OF HEARING EXAMINERS

ELLINGSON DRAINAGE INC., d/b/a ELLINGSON COMPANIES **v.** **SOUTH DAKOTA DEPARTMENT OF REVENUE**	**DOR 20-14** **STIPULATED FACTS**

Ellingson Drainage Inc, by and through its attorney, Shawn Nichols, and the South Dakota Department of Revenue, by and through its attorneys, Joe Thronson and Anita Fuoss, do stipulate to the following facts:

1. Ellingson Drainage, Inc., is a Minnesota company with its principal place of business in West Concord, Minnesota.

2. Ellingson Drainage, Inc., specializes in installing drain tile for farming and government applications.

3. Ellingson Drainage, Inc., does drain tile installation throughout the United States. During the audit period, Ellingson Drainage, Inc., did drain tile installation work in more than 20 different states.

4. During the Audit Period, Ellingson Drainage, Inc., completed approximately 30 jobs in South Dakota, ranging in price from less than $1,000 to $280,000.

5. During the audit period, Ellingson Drainage, Inc., purchased certain equipment outside of South Dakota. The equipment at issue was primarily used on jobs performed outside of South Dakota. The pro-rata usage of the equipment in South Dakota during the audit period, compared to jobs Ellingson Drainage, Inc., performed in other states ranged from 1 to 10 percent.

6. The reasonable rental value for the equipment, if rented for use on the South Dakota jobs reflected in Exhibit A would be $102,463.87.

7. The purchase price of the equipment at issue exceeds the gross receipts Ellingson Drainage, Inc., received for the work done in South Dakota during the audit period.

8. Ellingson Drainage, Inc., purchased a CAT 336EL excavator on April 7, 2016 for $227,500 and did not pay any use or sales tax on this purchase. Ellingson Drainage, Inc., used the same in South Dakota on October 28, 2019.

9. Ellingson Drainage, Inc. purchased a CAT d8K Pullcat on February 28, 2011 for $62,500 and did not pay any use or sales tax on this purchase. Ellingson Drainage, Inc. used the same in South Dakota on September 21, 2017.

10. Ellingson Drainage, Inc., purchased a FASTRAC tractor for $141,500 on October 20, 2011 and did not pay any use or sales tax on this purchase. Ellingson Drainage, Inc., used the same in South Dakota on October 17, 2017.

11. Ellingson Drainage, Inc., purchased a BRON 550 Plow for $576,500 on June 20, 2013 and did not pay any use or sales tax on this purchase. Ellingson Drainage, Inc., used the same in South Dakota on October 17, 2017.

12. Ellingson Drainage, Inc., purchased two JCB Fasttrac tractors for $148,500 each, totaling $297,000 on February 21, 2013 and did not pay any use or sales tax on this purchase. Ellingson Drainage, Inc., used one of the above tractors in South Dakota on April 19, 2017. Ellingson Drainage, Inc., used the second tractor not previously used in South Dakota on May 16, 2018.

13. Ellingson Drainage, Inc., purchased a JCB Fasttrac tractor for $141,000 on March 12, 2012 and did not pay any use or sales tax on this purchase. Ellingson Drainage, Inc., used the same in South Dakota on April 23, 2018.

14. Ellingson Drainage, Inc., purchased a JCB Fastrac tractor for $153,000 on March 12, 2012 and did not pay any use or sales tax on this purchase. Ellingson Drainage, Inc., used the same in South Dakota on November 16, 2018.

15. Ellingson Drainage, Inc., purchased a BRON 585 Plow for $196,339 on March 6, 2018 and did not pay any use or sales tax on this

purchase. Ellingson Drainage, Inc., used the same in South Dakota on November 18, 2018.

16. Ellingson Drainage, Inc., purchased a JCB Fastrac tractor for $189,933 on April 16, 2018 and did not pay any use or sales tax on this purchase. Ellingson Drainage, Inc., used the same in South Dakota on April 17, 2019.

17. Ellingson Drainage, Inc., purchased a JCB Fastrac tractor for $141,500, on October 20, 2011 and did pay any use or sales tax on this purchase. Ellingson Drainage, Inc., used the same in South Dakota on September 21, 2017..

18. Ellingson Drainage, Inc., rented an Excavator on April 30, 2019 for $120,000. And did not pay any use or sales tax on this rental. Ellingson Drainage, Inc., used the same in South Dakota on November 20, 2018.

Dated this 22nd day of ~~March~~ October, 2021.

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Shawn Nichols
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CIRCUIT COURT OF SOUTH DAKOTA
SIXTH JUDICIAL CIRCUIT

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Circuit Judges (Pierre):
Honorable Bobbi J. Rank
Honorable M. Bridget Mayer
Honorable Margo D. Northrup

Magistrate Judge (Ft. Pierre):
Honorable Tara L. Adamski

Circuit Administrator (Pierre):
Heather E. Covey

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January 25, 2023

RE: 32CIV22-122; Ellingson Drainage Inc. v. South Dakota Department of Revenue

MEMORANDUM OPINION

Ellingson Drainage, Inc. (Ellingson) appeals from a decision of the South Dakota Department of Revenue (Department) adopting a proposed decision by the Office of Hearing Examiners (OHE). The OHE concluded that neither it nor the Department had jurisdiction to consider the issue of whether the taxes imposed are constitutional as an executive branch agency is prohibited by the separation of powers doctrine from declaring a duly adopted law as unconstitutional unless a judicial determination has ordered otherwise, which had not been done in this case. As a result, the tax imposed was presumed constitutional and the OHE went on to conclude that pursuant to SDCL 10-46-2, 10-46-2.2 and 10-46-3 the Certificate of Assessment made on Ellingson should be upheld in its entirety. The Court heard oral argument on January 9, 2023. After reviewing the administrative record and considering the arguments of the parties, the Court now issues this Memorandum Opinion affirming the Department's decision.

FACTS

Ellingson Drainage, Inc. (Ellingson), is a Minnesota company with its principal place of business in West Concord, MN. Ellingson provides drainage services to farmers by installing drain tile for farming and government applications. Ellingson operates its business across the United States, and the company has maintained a South Dakota excise tax license since September 2, 2008. On March 10, 2020, the Department provided Ellingson with a Notice of Intent to Audit for the recording periods of March 2017 through January, 2020. The Department conducted its audit as a "desk audit" meaning all communication between the Department's auditor and Ellingson's Representative was conducted via email. Specific to the use tax audit, the auditor examined job cost reports for each of the company's South Dakota jobs in addition to invoices for equipment used in South Dakota.

In total, the Department found twelve separate instances in which it deemed Ellingson failed to pay use tax.[1] The Department found eleven instances in which use tax was due on equipment used in South Dakota without sale or use tax paid. The Department assessed the taxable amount based on the equipment value at the time it was used in South Dakota. A full breakdown of these eleven instances are as follows:

(1) April 19, 2017 SD use of a 2013 Fastrac 3230 purchased from Windridge Implement, LLC (IA) for $148,500 taxable amount $86,625;
(2) September 21, 2017 SD use of a CAT Pullcat D8K purchased from Western Finance & Lease, Inc. (ND) for $62,500 taxable amount $21,354.17;
(3) September 21, 2017 SD use of a 2011 Fastrac 3230 purchased from Windridge Implement, LLC (IA), for $141,500 taxable amount $57,779.17;
(4) October 10, 2017 SD use of 2011 Fastrac 3230 purchased from Windridge Implement, LLC (IA) for $141,500 taxable amount $56,600;
(5) October 17, 2017 SD use of a 2013 Bron 550 Tile Plow purchased from RWF Industries (MN) for $576,500 taxable amount $326,683.33;
(6) April 23, 2018 SD use of a 2011 Fastrac 3230 purchased from Windridge Implement, LLC (IA) for $141,500 taxable amount $55,420.83;
(7) May 16, 2018 SD use of a 2013 Fastrac 3230 purchased from Windridge Implement, LLC (IA), for 148,500 taxable amount $70,537.50;
(8) November 16, 2018 SD use of a 2011 Fastrac 3230 purchased from Windridge Implement LLC (IA) for $153,000, taxable amount $51,000;
(9) November 18, 2018 SD use of a 2017 Bron 585 purchased from RWF Bron (MN) for $196,399, taxable amount $183,305.73;
(10) April 17, 2019 SD use of a 2018 Fastrac H220 purchased from Windridge Implement, LLC (IA) for $189,933 taxable amount $170,939.70; and
(11) October 28, 2019 SD use of a CAT 336EL purchased from Agassiz Excavating, Inc. (ND) for $227,500, taxable amount $147,875.

On July 30, 2020, the Department issued a Certificate of Assessment against Ellingson for the reporting periods of March 2017 to January 2020 alleging unpaid tax and interest totaling

[1] The Department found one instance in which use tax was due on rental equipment used in South Dakota without sale or use tax paid—a November 20, 2018 equipment rental of an Excavator from Northland Capital Equipment Finance for $120,000, taxable amount $120,000. During the audit, there was a disagreement between the auditor and Ellingson's representative regarding the fair market value used to calculate the taxable amount of the equipment—Ellingson believed the Department overstated the fair market value of the equipment, stating "the value of that equipment depreciates much faster than 10% per year."

$75,528.32. The Certificate of Assessment alleged that Ellingson owed the Department of Revenue $60,665.44 in unpaid use taxes pursuant to SDAR 64:09:01:20, SDCL 10-46-3, and SDCL 10-46-2.1.[2] The Department calculated this number based on a taxable amount of $1,348,120.43 at a tax rate of 4.5%. The certificate also alleged that Ellingson owned $14,862.88 in interest assessed through July 31, 2020 pursuant to SDCL 10-59-6.[3]

On September 15, 2020, Ellingson submitted a timely request to the Department for hearing before the Secretary of Revenue pursuant to SDCL 10-59-9, disputing the certificate of assessment. A hearing was conducted by the OHE pursuant to SDCL chapter 1-26 and 1-26D. Ellingson objected to the equipment value determination, asserting that it was incorrect and excessive. Ellingson's position to the OHE was that the value of the equipment for purposes of SDCL 10-46-3 and other statutes and regulations should be proportionate to the value of the company's use of that equipment in South Dakota. Ellingson classified its use in South Dakota as "nominal." Ellingson argued alternatively that to the extent that SDCL 10-46-3 is applied to tax the full value of equipment "nominally used in South Dakota," the statute violates the Full Faith and Credit Clause established by Article IV, Section I of the United States Constitution and the Dormant Commerce Clause established by Article I of the United States Constitution.

The parties entered into a Stipulation as to the facts of the case presented to the OHE on October 22, 2021. Accordingly, the parties agree that during the audit period, Ellingson did drain tile installation work in more than twenty different states. During the audit period Ellingson completed about thirty jobs in South Dakota ranging in price from less than $1,000 to $280,000. The equipment at issue was primarily used on jobs performed outside of South Dakota, and the pro-rata usage of the equipment in South Dakota during the audit period ranged from one to ten percent. Additionally, the purchase price of the equipment at issue exceeds the gross receipts Ellingson received for the company's work done in South Dakota during the audit period. Ellingson did not dispute that the company failed to pay use taxes for each of the twelve instances outlined as part of the audit.

The parties had a virtual hearing with the OHE on April 11, 2022. The parties made arguments, but all evidence was received through the stipulated facts and stipulated exhibits for the OHE's consideration. The OHE entered a Proposed Decision on May 13, 2022, affirming the Department's Certificate of Assessment in its entirety. The OHE concluded that pursuant to the separation of powers doctrine it was outside of its jurisdiction to determine duly adopted laws as unconstitutional and it was therefore required to treat SDCL 10-46-2, 10-46-2.2, and 10-46-3 as constitutionally valid since there had not been a judicial determination otherwise.[4] The OHE went

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[2] A full breakdown of dates and amounts owed in tax by Ellingson as outlined in the Department's Total Assessment Worksheet and Summary are as follows: $3,898.13 due April 2017; $3,561.00 due September 2017; $17,247.75 due October 2017; $2,493.94 due April 2018; $3,174.19 due May 2018; $15,943.76 due November 2018; $7,692.29 due April, 2019; and $6,654.38 due October, 2019.

[3] Under SDCL 10-59-6, interest charges for unpaid taxes are assessed and determined as follows: "Any person subject to tax under the chapters set out in 10-59-1 who fails to pay the tax within the time prescribed is subject to an interest charge for each month or part thereof for which the payment is late, which interest shall be one percent or five dollars whichever is greater for the first month, and one percent per month thereafter. If the failure to pay tax was with the intent to intentionally avoid or delay the payment of tax, the person who fails to pay the tax within the time prescribed is subject to an interest charge for each month or part thereof for which the payment is late, which interest shall be one and one-half percent or five dollars, whichever is greater."

[4] The OHE cited cases from Tennessee, North Dakota, and Wyoming: *Colonial Pipeline Co. v. Morgan et al*, 263 S.W.3d 827, 841-44(Tenn. 2008) (citing *Alleghany Corp. v. Pomeroy*, 698 F.Supp. 809, 813-14 (D.ND. 1990), rev'd on other grounds, 898 F.2d 1314 (8th Cir. 1990) (stating that an agency is without power to adjudicate constitutional issues); *Belco Petroleum Corp. v. State Bd. of Equalization*, 587 P.2 204, 208 (Wyo. 1978) (holding an agency does not determine facial constitutionality of statute or constitutionality of its application). The OHE also cited 73 C.J.S. *Public Administrative Law and Procedure* 65 at 536 and 1 Am.Jur2d *Administrative Law* 185 at 989-90.

on to conclude that based upon statutes above and the facts presented, the Department's Certificate of Assessment should be upheld in its entirety. The Department adopted the OHE's proposed decision in its entirety and ordered that Ellingson's request for hearing be dismissed with prejudice on June 13, 2022. Ellingson appealed the Department's final decision to this Court on July 1, 2022 pursuant to SDCL 1-26-31. Ellingson challenges the constitutionality of SDCL 10-46-3 as applied to the circumstances of the case.[5] Ellingson challenges SDCL 10-46-3 first under the Due Process Clause of the Fourteenth Amendment, and second under the Commerce Clause. Specific to the Due Process claim, Ellingson asserts SDCL 10-46-3 is not rationally related to the opportunities, benefits, or protections afforded to Ellingson by the State. Specific to the Commerce Clause claim, Ellingson asserts SDCL 10-46-3 is not fairly related to the benefits provided to Ellingson by the State and is not fairly apportioned.

ISSUES

I. WHETHER THE DEPARTMENT ERRED IN FINDING THE STATE'S USE TAX UNDER SDCL 10-46-3 AS APPLIED TO ELLINGSON DRAINAGE, INC. IS CONSTITUTIONAL?

LEGAL STANDARD

This Court's review of a decision from an administrative agency is governed by SDCL 1-26-36.

> The court shall give great weight to the findings made and inferences drawn by an agency on questions of fact. The court may affirm the decision of the agency or remand the case for further proceedings. The court may reverse or modify the decision if substantial rights of the appellant have been prejudiced because the administrative findings, inferences, conclusions, or decisions are:
>
> > (1) In violation of constitutional or statutory provisions;
> >
> > (2) In excess of the statutory authority of the agency;
> >
> > (3) Made upon unlawful procedure;
> >
> > (4) Affected by other error of law;
> >
> > (5) Clearly erroneous in light of the entire evidence in the record; or

[5] Ellingson acknowledges that the Certificate of Assessment stated that a tax was being imposed under SDCL 10-46-2.1 which imposes a use tax on services, though the Department contends the tax was intended to be imposed under 10-46-2.2 which imposes a use tax on rented personal property; Ellingson does not challenge the application of SDCL 10-46-2.2 to the facts of the case regarding the singular instance of use tax on rental property audited by the Department.

> (6) Arbitrary or capricious or characterized by abuse of discretion or clearly unwarranted exercise of discretion.
>
> A court shall enter its own findings of fact and conclusions of law or may affirm the findings and conclusions entered by the agency as part of its judgment.

SDCL 1-26-36. "We give great weight to the findings made and inferences drawn by an agency on questions of fact. We reverse only when those findings are clearly erroneous in light of the entire record. We review de novo issues of statutory and constitutional interpretation." *Jans v. Dep't of Public Safety*, 2021 S.D. 51, ¶ 10, 964 N.W.2d 749, 754 (citations omitted). When an agency's factual determinations are made on the basis of documentary evidence, however, the Court reviews the matter de novo, unhampered by the clearly erroneous rule. *Darling v. W. River Masonry, Inc.*, 2010 S.D. 4 ¶10, 777 N.W.2d 363, 366. Because Ellingson challenges the constitutionality of SDCL 10-46-3 and all facts were based on the parties' written stipulation and documentary evidence, the Court reviews the Department's decision de novo.

The South Dakota Supreme Court has acknowledged that "deciding the constitutionality of a legislative enactment is a solemn and momentous occasion" that the Court does not take lightly. *Metropolitan Life Ins. Co. v. Kinsman*, 2008 S.D. 24 ¶9, 747 N.W.2d 653, 658. Following the Supreme Court's guidance, this Court also acknowledges the serious nature associated with ruling on a statute's constitutionality and refrains from "hasty ventures into constitutional analysis until after any preliminary obstacles have been surmounted and judgment is unavoidable." *Id.* The matter at hand is properly before the Court because Ellingson has timely exhausted all administrative remedies within the Department while simultaneously preserving its constitutional challenge. Though the Department and the OHE reasoned that the constitutional question was beyond their jurisdiction, the Department's conclusion of law is that the taxes imposed by SDCL 10-46-2, 10-46-2.2, and 10-46-3 "***are constitutional*** as there are no judicial determinations by a presiding court that have held the statutes to be unconstitutional." Therefore, because the Department's conclusion is that the statutes are constitutional, the question of constitutionality is properly before this Court.

ANALYSIS

I. WHETHER THE DEPARTMENT ERRED IN FINDING THE STATE'S USE TAX UNDER SDCL 10-46-3 AS APPLIED TO ELLINGSON IS CONSTITUTIONAL.

"Our function is not to decide if a legislative act is unwise, unsound, or unnecessary, but rather, to decide only whether it is unconstitutional." *Kinsman*, 2008 S.D. 24 ¶18 at 661 (citations omitted). "There is a strong presumption that the laws enacted by the legislature are constitutional and the presumption is rebutted only when it *clearly, palpably and plainly appears* that the statute violates a provision of the constitution." *State v. Hague*, 1996 S.D. 48 ¶4, 547 N.W.2d 173, 175 (citations omitted) (emphasis added). Statutes are presumed constitutional "unless shown otherwise beyond a reasonable doubt." *Kinsman*, 2008 S.D. 24 ¶18 at 661 (citations omitted). Thus, it is Ellingson's burden to prove beyond a reasonable doubt "that there is no reasonable basis for the Legislature's decision" to impose a one-time use tax on

property purchased outside of the state, not previously subject to sales or use tax in any other jurisdiction, and brought into South Dakota for use. *See id.*

The language of SDCL 10-46-3 imposes an excise tax on the use of tangible personal property brought into the state after being purchased outside of the state. The statute exempts any property previously subjected to sales or use tax in other states from being taxed in South Dakota. SDCL 10-46-3 reads in its entirety:

> An excise tax is imposed on the privilege of the use, storage or consumption in this state of tangible personal property or any product transferred electronically not originally purchased for use in this state, but thereafter used, stored or consumed in this state, at the same rate of percent of the fair market value of the property at the time it is brought into this state as is imposed by § 10-45-2. The use, storage, or consumption of tangible personal property or any product transferred electronically more than seven years old at the time it is brought into the state by the person who purchased such property for use in another state is exempt from the tax imposed herein. The secretary may promulgate rules pursuant to chapter 1-26 relating to the determination of the age and value of the tangible personal property or the product transferred electronically brought into this state.

SDCL 10-46-3. The statute's reference to SDCL 10-45-2 sets the tax rate at four and one-half percent (4.5%) based on the gross receipts of all sales of tangible personal property later brought into South Dakota for use. SDCL 10-45-2.[6]

ARSD 64:09:01:20 provides exemptions to the use tax and a basis for calculating use tax for property with depreciated value. It reads:

> For the purposes of the exemption in SDCL 10-46-3, tangible personal property or any product transferred electronically must be more than seven years old as determined by its date of manufacture, if documented, or by the date of the purchase by the person bringing the property into this state. In the absence of independent documentary proof of the value of the tangible personal property or any product transferred electronically at the time it is brought into South Dakota, ***the value of the property is presumed to be the purchase price reduced by ten percent for each year of use of the property by the person bringing the property into this state.*** Statements, opinions, or depreciation schedules of the owner of the property are not independent documentary proof of the value of the property.

ARSD 64:09:01:20 (emphasis added).

Ellingson challenges the constitutionality of SDCL 10-46-3 as applied to the circumstances of the case, specifically under the Due Process Clause of the Fourteenth Amendment and the Commerce Clause. "The Commerce Clause and the Due Process clause impose distinct but parallel

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[6] SDCL 10-45-2, which sets the property sales tax, states: "There is hereby imposed a tax upon the privilege of engaging in business as a retailer, a tax of four and one-half percent upon the gross receipts of all sales of tangible personal property consisting of goods, wares, or merchandise, except as otherwise provided in this chapter, sold at retail in the State of South Dakota to consumers or users."

limitations on a State's power to tax out-of-state activities." *MeadWestvaco Corp. ex rel Mead Corp. v. Illinois Dept. of Revenue*, 553 U.S. 16, 24 (2008) (citations omitted). Thus, the Court reviews each inquiry separately. However, "the broad inquiry subsumed in both constitutional requirements is 'whether the taxing power exerted by the state bears fiscal relation to protection, opportunities and benefits given by the state'—that is, 'whether the state has given anything for which it can ask return.'" *Id.* at 24-25 (citations omitted).

Ellingson first argues that the statute is not rationally related to the opportunities, benefits, or protections afforded to Ellingson by the State of South Dakota under the Due Process Clause of the Fourteenth Amendment.

a. *As applied to Ellingson, SDCL 10-46-3 is constitutional under the Due Process Clause of the Fourteenth Amendment.*

"Whether a state tax violates the due process clause is determined by whether the tax has relation to opportunities, benefits, or protection afforded by the taxing state." *Montana-Dakota Utilities Co. v. S. Dakota Dep't of Revenue*, 337 N.W.2d 818, 820 (S.D. 1983) (citations omitted).

The United States Supreme Court has articulated two requirements a tax must meet to satisfy the Due Process Clause of the Fourteenth Amendment: (1) there must be "some definite link, some minimum connection, between the state and the person, property or transaction seeks to tax," and (2) the "income attributed to the State for tax purposes must be rationally related to values connected with the taxing state." *Quill Corp. v. N. Dakota By and Through Heitkamp*, 504 U.S. 298, 306 (1992), overruled on other grounds by *South Dakota v. Wayfair, Inc.*, 138 S. Ct. 2080 (2018) (overruling the "physical presence" rule for the imposition of state sales tax).

i. <u>There is a minimum connection between the tax sought to be imposed by SDCL 10-46-3 and Ellingson's presence within the State.</u>

To satisfy the first requirement, there must be "some definite link, some minimum connection," between Ellingson and the State of South Dakota. The United States Supreme Court has stated that this inquiry is "flexible" and "focuses on the reasonableness of the government's action." *Id.* at 307. Ellingson concedes that there is some connection between South Dakota and Ellingson sufficient to satisfy this requirement under *Quill* because it conducts business within the State. The Court agrees that there is a minimum connection between the tax sought to be imposed by SDCL 10-46-3 and Ellingson's presence within the State sufficient to satisfy the first requirement under *Quill* because Ellingson has voluntarily entered into and conducted business within the state and has maintained a South Dakota excise tax license since 2008.

ii. <u>The tax income sought to be imposed is rationally related to "values connected with the taxing state."</u>

To satisfy the second requirement, SDCL 10-46-3 must be "rationally related to values connected with [the State of South Dakota]." *Quill*, 504 U.S. 298 at 306. The South Dakota Supreme Court expressed the values associated with the use tax in *Western Wireless Corp. v. Dep't of Revenue* when it stated: "Use taxes accommodate two vital concerns: (1) the state may lose tax revenue if taxpayers purchase out-of-state goods or services for in-state use, and (2) local providers will lose business if taxpayers purchase out-of-state goods or services to avoid sales tax liability."

Western Wireless Corp. v. Dep't of Revenue, 2003 S.D. 68 ¶7, 665 N.W.2d 73, 75. The South Dakota Supreme Court also described use tax as "complementary and supplemental" to the state's sales tax, ensuring the state government is supported by a single tax for any property sold or used in the state. *Black Hills Truck & Trailer, Inc. v. S. Dakota Dep't of Revenue*, 2016 S.D. 47 ¶18, 881 N.W.2d 669, 674 (citations omitted).

Ellingson argues SDCL 10-46-3, as it applies to Ellingson, is not rationally related to the values articulated by the South Dakota Supreme Court in *Western Wireless* because SDCL 10-46-2 exists to dull and remedy the sales tax fairness concerns outlined in *Western Wireless*, making 10-46-3 unnecessary. SDCL 10-46-2—which imposes a tax on tangible personal property purchased *for use in South Dakota*—exists to prevent South Dakota residents, or companies with a business presence in the state, from purchasing property elsewhere to avoid sales tax with the intent to use the property in South Dakota. SDCL 10-46-2, as opposed to 10-46-3, Ellingson argues, acts in complementary fashion with the state's sales tax statutes and is rationally related to the state's values for imposing the tax.

Ellingson's ultimate conclusion under its Due Process challenge becomes: because SDCL 10-46-2 exists, SDCL 10-46-3 serves no purpose in the statutory scheme. Ellingson's argument fails because SDCL 10-46-3 serves a separate and distinct role in the statutory scheme, aside from the role SDCL 10-46-2 accomplishes. SDCL 10-46-3's role is rationally related to the values associated with the use tax articulated by the South Dakota Supreme Court in *Western Wireless* and *Black Hills Truck and Trailer*. While 10-46-2 taxes property purchased specifically for use in South Dakota, 10-46-3 taxes any property that was not purchased specifically for use in South Dakota but was used in South Dakota. This in itself works to further the South Dakota Supreme Court's desire for complementary and supplemental statutes that ensure the state government is supported by a single tax on property used or sold within the state. SDCL 10-46-3 optimizes the state's ability to tax property used within the state in a way that SDCL 10-46-2 does not.

It is important to note that a number of conditions must occur before the State can impose a tax under 10-46-3. SDCL 10-46-3 ***only*** acts to impose a use tax on property not previously subject to taxation in a different state. If a company or business purchases property in a different state and pays sales tax, South Dakota will not and cannot impose a tax under 10-46-3. If a company purchases property in a different state and does not pay sales tax but is later taxed for using that property in an entirely different state, South Dakota will not and cannot impose a tax under 10-46-3. One may think of SDCL 10-46-3 as a rarely used, "final option" for the state to recover use tax for property used within the state from a company that derives benefits from the state's infrastructure by conducting business therein. Thus, the tax is rationally related to values connected with the taxing state.

Finally, Ellingson attempts to distinguish the equipment its company used in South Dakota as "merely incidental" to the company's interstate operations because Ellingson is a Minnesota company that operates across the United States. This argument fails to address why SDCL 10-46-3 is not rationally related to the state's values in imposing a use tax and is more fairly situated as an argument relating to the tax's apportionment, which will be addressed below.

There is a minimum connection between the tax sought to be imposed by SDCL 10-46-3 and Ellingson's presence within the State and the tax income sought to be imposed is rationally related to "values connected with the taxing state." Therefore, SDCL 10-46-3 is constitutional under the Due Process Clause of the Fourteenth Amendment.

b. As applied to Ellingson, SDCL 10-46-3 is constitutional under the Commerce Clause.

Ellingson argues next under the Commerce Clause, asserting that the statute is not fairly related to the benefits provided to Ellingson by the State and is not fairly apportioned. In *Western Wireless v. Dept. of Rev*, the South Dakota Supreme Court looked to the United States Supreme Court's holding in *Complete Auto Transit, Inc. v. Brady* for the test to determine whether South Dakota's imposition of a use tax for telephone billing services was constitutional under the commerce clause. *Western Wireless, Corp. v. Dept. of Revenue*, 2003 S.D. 68, ¶15, 665 N.W.2d 73, 78 (citing *Complete Auto Transit, Inc. v. Brady*, 97 S.Ct. 1076, 1083 (1977). The Court stated, "a tax is not an unconstitutional burden on interstate commerce if the taxed activity is sufficiently connected to the state to justify the tax, the tax is fairly related to the benefits provided to the taxpayer, the tax does not discriminate against interstate commerce, and the tax is fairly apportioned." *Id.* Ellingson argues under the second and fourth prongs of the test—that the SDCL 10-46-3 is not fairly related to the benefits provided by South Dakota and that the tax is not fairly apportioned.

i. There is a sufficient connection between the taxed activity and the State of South Dakota.

In *Western Wireless*, the South Dakota Supreme Court reasoned that there was a "substantial nexus" between South Dakota and the taxed activity because Western Wireless provided cellular service to South Dakota subscribers, owned communications equipment in South Dakota, conducted business in South Dakota, and employed personnel in South Dakota to install and maintain the equipment. See *Western Wireless Corp*, 2003 S.D. 68. Ellingson concedes that there is a sufficient connection between South Dakota and Ellingson sufficient to satisfy the first requirement under *Western Wireless* because Ellingson conducts business within the State. The Court agrees that there is a minimum connection between the tax sought to be imposed by SDCL 10-46-3 and Ellingson's presence within the State sufficient to satisfy the first requirement under *Western Wireless* because Ellingson has voluntarily entered into and conducted business within the state and has maintained a South Dakota excise tax license since 2008.

ii. The statute, as applied to Ellingson, is fairly related to the benefits and services provided by South Dakota.

A tax must be fairly related to the benefits and services provided to the taxpayer to satisfy the second requirement for constitutionality under *Western* Wireless. In *Western Wireless*, the South Dakota Supreme Court reasoned that the use tax on services imposed on Western Wireless was fairly related to state-provided services because South Dakota's use tax on services applies only when the primary benefit of the service is used or consumed in South Dakota and at the time of purchase, no sales tax was imposed. Specific to the company, Western Wireless had the right and benefit of selling its services to South Dakota residents.

Ellingson argues that the tax sought to be imposed is not fairly related to the benefits provided by South Dakota because the rate at which the Appellant is taxed for using equipment for one day in South Dakota is the same as if it had purchased the equipment in South Dakota for use therein. Ellingson's argument under the second prong misses the mark regarding the actual test used by the South Dakota Supreme Court in *Western Wireless*. In *Western Wireless*, the South Dakota Supreme Court's analysis shows that the standard is: if a company has the right and benefit

to sell its services to South Dakota residents, those services may be taxed under the one-time use tax. Though a distinction may be made between the use tax imposed for services in *Western Wireless* and the use tax imposed on the use of tangible personal property in the present case, the Court's standard applies because Ellingson still receives benefits from South Dakota by using its property in the State. As the Department argues, Ellingson performed approximately thirty jobs within the state during the audit period, and during those jobs, Ellingson had the benefit of accessing all public services available to South Dakota residents supported by taxes including: use of roads and bridges, police protection, and use of the State's courts. As in *Western Wireless*, Ellingson has the right and benefit of operating its business in South Dakota, which involves operating the taxed property in South Dakota. Though Ellingson opposes the state's use tax because it believes the tax should not apply to equipment used minimally in the state, Ellingson may continue to receive the state's benefits indefinitely once the use tax has been paid. As such, the taxing statute and the one-time use tax imposed on Ellingson by SDCL 10-46-3 is fairly related to the benefits and services Ellingson receives from South Dakota when it uses its property within the state.

iii. As applied to Ellingson, SDCL does not discriminate against interstate commerce.

The South Dakota Supreme Court acknowledged the constitutionality of the State's use tax in *Western Wireless* by stating: "Because use taxes are paired with complementary sales taxes, the United States Supreme Court has upheld them: in the context of the overall tax structure, such statutes may properly impose on the out-of-state purchase of goods and equivalent burden to that imposed on an in-state purchase." *Western Wireless Corp. v. Dept. of Revenue*, 2003 S.D. 68, ¶7, 665 N.W.2d 73, 76 (citations omitted). Further, "equal treatment for in-state and out-of-state transactions similarly situated is a prerequisite to a valid use tax on goods and services imported from out-of-state." *Id.* (citations omitted).

As the Department argues, South Dakota's use tax ensures that out-of-state businesses are not able to undercut local merchants who are subject to state sales tax. If South Dakota did not have a use tax but maintained a sales tax, individuals and businesses alike would seek to do business from out-of-state merchants to avoid taxation altogether. This would ultimately result in an unfortunate increase in consumer purchase prices within South Dakota. The Department correctly reasons that if out-of-state businesses could avoid taxation but maintain business in South Dakota, demands for infrastructure and services would remain the same, but the flow of tax revenue to support the demands would diminish. By maintaining complementary sales and use tax statutes, South Dakota properly imposes an equal burden on property used in South Dakota, regardless of where the initial purchase of the property occurred. The tax imposed by SDCL 10-46-3 does not discriminate against interstate commerce and satisfies the third prong of the *Western Wireless* test.

iv. As applied to Ellingson, SDCL 10-46 3 is fairly apportioned.

The South Dakota Supreme Court in *Western Wireless* acknowledged the United States Supreme Court's holding in *Goldberg v. Sweet* that a tax is apportioned if it is both internally and externally consistent. *Western Wireless Corp. v. Dept. of Revenue*, 2003 S.D. 68 ¶18-19, 665 N.W.2d 73, 78-79 (citing *Goldberg v. Sweet*, 488 U.S. 252 (1989)).

1. As applied to Ellingson, SDCL 10-46-3 is internally consistent.

"To be internally consistent, a tax must be structured so that if every State were to impose an identical tax, no multiple taxation would result." *Id.*, 2003 S.D. 68 ¶18 at 79. Ellingson concedes that SDCL 10-46-3 is internally consistent because SDCL 10-46-6.1[7] exists to grant a tax credit for property previously taxed in another state upon purchase or first use.[8] The Court agrees that SDCL 10-46-3 is internally consistent as applied to Ellingson because, as reasoned by the South Dakota Supreme Court in *Western Wireless*, the credit provision in SDCL 10-46-6.1 "avoids actual multiple taxation, and thus, the tax does not threaten interstate commerce" under *Goldberg*. *Id.*, 2003 S.D. 68 ¶18 at 79.

2. *As applied to Ellingson, SDCL 10-46-3 is externally consistent.*

Though SDCL 10-46-3 is internally consistent as applied to Ellingson, it must also be externally consistent. "To be externally consistent under *Goldberg*, a state may tax 'only that portion of the revenues from the interstate activity which reasonably reflects the in-state component of the activity being taxed." *Id.* In *Goldberg*, the United States Supreme Court explained the external consistency test by stating "we thus examine the in-state business activity which triggers the taxable event and the practical or economic effect of the tax on that interstate activity." *Goldberg v. Sweet*, 488 U.S. 252, 262 (1989). The external consistency test is "essentially a practical inquiry." *Id.* at 264. Finally, "apportionment does not require [a] State to adopt a tax which would 'pose genuine administrative burdens.'" *Id.* at 265 citing *American Trucking Associations, Inc. v. Scheiner*, 483 U.S. 296 (1987).

Ellingson argues that the tax imposed under SDCL 10-46-3 seeks to impose a tax on the value of an out-of-state entity's equipment it "temporarily used" in South Dakota at a rate equivalent to the rate it would have been charged if it purchased that equipment in the state, or if it purchased the equipment with the specific intent to use the equipment in South Dakota. Ellingson argues that because only approximately ten percent of the company's "taxable activity" occurred in South Dakota throughout the audited period, the scheme fails to apportion the tax to Appellant's in-state activities. Ellingson also argues that the fact that Ellingson has not been charged sales or use tax on the equipment in the equipment's primary states of use does not render South Dakota's

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[7] SDCL 10-46-6.1 states:

> The amount of any use tax imposed with respect to tangible personal property, any product transferred electronically, or services shall be reduced by the amount of any sales or use tax previously paid by the taxpayer with respect to the property on account of liability to another state or its political subdivisions. However, no credit may be given under this section where taxes paid on tangible personal property, any product transferred electronically, or services in another state or its political subdivisions of that state does not reciprocally grant a credit for taxes paid on similar tangible personal property or any product transferred electronically.

[8] In *Western Wireless*, the South Dakota Supreme Court recognized that SDCL 10-46-6.1's conditional reciprocity "could present a problem in the future because it is critical that the statutory 'credit provisions create a national system under which the first state of purchase or use imposes the tax.'" *Western Wireless Corp. v. Dept. of Revenue*, 2003 S.D. 68 ¶19, 665 N.W.2d 73, 79 (citations omitted). The South Dakota Supreme Court stated that because Western Wireless did not argue that any sales or use taxes had been paid on all or part of the services taxed in any other state and because Western did not seek any credit for payment of taxes, the point is moot. The same is true for Ellingson. Ellingson concedes that the tax is "likely internally consistent" as applied, and the company agrees it has not previously paid sales or use tax on the equipment in question. Thus, the issue is moot in this matter.

tax reasonable because the tax should be imposed with respect to the value and activities located within South Dakota, without respect to whether another state could be collecting a tax.

Essentially, Ellingson is asking the Department to turn a one-time use tax on property used in South Dakota not previously subject to sales or use tax, into a personalized, use-based ratio tax calculated on a business-by-business basis by examining how frequently each business subjected to the tax uses each piece of equipment taxed in the state. Ellingson's proposition seems implausible. The taxation scheme as it currently exists works to impose *one* tax on property used in the state of South Dakota not previously subject to tax. Once the tax on that property is paid, the business or individual using that property in South Dakota never has to pay South Dakota taxes on the property again. If the Legislature were to adopt Ellingson's proposed scheme, the Department would be subjected to a never-ending cycle of calculating and re-calculating how frequently a business is using a piece of property in South Dakota to ensure they are appropriately taxed for the property's use. It is clear that Ellingson's proposed replacement taxation scheme for SDCL 10-46-3 would "pose genuine administrative burdens" for the South Dakota Department of Revenue as deemed unnecessary by the United States Supreme Court in *Goldberg*.

Ultimately, Ellingson's argument fails because the United States Supreme Court in *Henneford v. Silas Mason* held that a similar Washington state use tax—which imposed a two percent use tax on property brought into the state—was constitutional, stating:

> Equality is the theme that runs through all the sections of the statute. There shall be a tax upon the use, but subject to an offset if another use or sales tax has been paid for the same thing. This is true where the offsetting tax became payable to Washington by reason of purchase or use within the state. It is true in exactly the same measure where the offsetting tax has been paid to another state by reason or use or purchase there. No one who uses property in Washington after buying it at retail is to be exempt from a tax upon the privilege of enjoyment except to the extent that he has paid a use or sales tax somewhere. Every one who has paid a use or sales tax anywhere or, more accurately, in any state, is to that extent to be exempt from the payment of another tax in Washington.

Henneford v. Silas Mason, Co., 300 U.S. 577, 583-84 (1937). As in *Silas Mason*, SDCL 10-46-3 may be applied to the entire value of Ellingson's equipment because South Dakota provides a credit towards taxes paid in other states. Ellingson has not presented a valid reason as to why South Dakota should be barred from assessing a one-time use tax for Ellingson's first use of a piece of equipment within the state. Ellingson sought contracts for business in South Dakota, completed a large number of jobs in the state, and competed with South Dakota businesses for those jobs. Ellingson shall accordingly be subjected to the state's applicable taxes.

CONCLUSION

Ellingson Drainage has challenged the constitutionality of SDCL 10-46-3 under the Due Process Clause of the Fourteenth Amendment and the Commerce Clause. The language of SDCL 10-46-3 imposes an excise tax on the use of tangible personal property brought into the state after being purchased outside of the state. The statute exempts any property previously subjected to sales or use tax in other states from being taxed in South Dakota. Statutes are presumed constitutional unless proven beyond a reasonable doubt that there is no reasonable basis for the Legislature's

decision in enacting the statute. Ellingson has failed to meet its burden. As applied to Ellingson, SDCL 10-46-3 is constitutional under the Due Process Clause of the Fourteenth Amendment because there is a minimum connection between Ellingson and South Dakota and because the statute is rationally related to the values of the taxing state. As applied to Ellingson, SDCL 10-46-3 is constitutional under the Commerce Clause because there is a sufficient connection between the taxed activity and the state, the statute is fairly related to the benefits and services provided to Ellingson by South Dakota, the statute does not discriminate against interstate commerce, and finally the statute is fairly apportioned. Accordingly, the Final Decision and Order is affirmed. A corresponding Order shall be entered accordingly.

Dated this 25th day of January 2023.

BY THE COURT

Christina Klinger

Christina Klinger
Circuit Court Judge

STATE OF SOUTH DAKOTA	)	IN CIRCUIT COURT
	) SS	
COUNTY OF HUGHES	)	SIXTH JUDICIAL CIRCUIT

ELLINGSON DRAINAGE, INC	)	
	)	32CIV22-122
Petitioner/Appellant,	)	
v.	)	
	)	**ORDER**
SOUTH DAKOTA DEPARTMENT OF REVENUE	)	
Respondent/Appellee.	)	

WHEREAS, the Court having entered its Memorandum Decision on January 25, 2023, and having expressly incorporated the same herein, it is hereby

ORDERED, ADJUDGED, AND DECREED:

The South Dakota Department of Revenue's decision concluding that the State's use tax under SDCL 10-46-3 as applied to Ellingson Drainage is constitutional is AFFIRMED.

Pursuant to SDCL 1-26-32.1 and SDCL 15-6-52(a), the Court's Memorandum Decision shall act as the Court's findings of fact and conclusions of law as permitted by SDCL 1-26-36.

Dated this 25th day of January 2023.

BY THE COURT:

Christina Klinger

The Honorable Christina L. Klinger
Circuit Court Judge
Sixth Judicial Circuit

Attest:
Deuter-Cross, TaraJo
Clerk/Deputy

South Dakota Codified Laws
Title 10. Taxation (Refs & Annos)

10-46-2. Tax on tangible personal property purchased for use in state--Rate based on purchase price
SD ST § 10-46-2 South Dakota Codified Laws Title 10. Taxation *(Approx. 2 pages)*

SDCL § 10-46-2

10-46-2. Tax on tangible personal property purchased for use in state--Rate based on purchase price

Currentness

An excise tax is hereby imposed on the privilege of the use, storage, and consumption in this state of tangible personal property purchased for use in this state at the same rate of percent of the purchase price of said property as is imposed pursuant to chapter 10-45.

Credits

Source: SL 1939, ch 276, § 3; SL 1953, ch 471, § 1; SDC Supp 1960, § 57.4303 (1); SL 2001, ch 56, § 7.

Relevant Notes of Decisions (1)

View all 35

Notes of Decisions listed below contain your search terms.

Use in state

Taxpayer's purchase of used forklift was not exempt from use tax, though forklift was more than seven years old and purchased from out-of-state dealer who did not originally purchase it for use in South Dakota, in that taxpayer purchased forklift for use in South Dakota. SDCL 10-46-2, 10-46-3. Matter of Thermoset Plastics, Inc., 1991, 473 N.W.2d 136.

S D C L § 10-46-2, SD ST § 10-46-2
Current through the 2023 Regular Session and Supreme Court Rule 23-15

End of Document

NOTES OF DECISIONS (35)

NOTES OF DECISIONS (2)

Age of property
Review

South Dakota Codified Laws
Title 10. Taxation (Refs & Annos)

10-46-3. Tax on tangible personal property and electronically transferred products not originally purchased for use in state--Proper...
SD ST § 10-46-3 South Dakota Codified Laws Title 10. Taxation *(Approx. 2 pages)*

SDCL § 10-46-3

10-46-3. Tax on tangible personal property and electronically transferred products not originally purchased for use in state—Property more than seven years old

Currentness

An excise tax is imposed on the privilege of the use, storage or consumption in this state of tangible personal property or any product transferred electronically not originally purchased for use in this state, but thereafter used, stored or consumed in this state, at the same rate of percent of the fair market value of the property at the time it is brought into this state as is imposed by § 10-45-2. The use, storage, or consumption of tangible personal property or any product transferred electronically more than seven years old at the time it is brought into the state by the person who purchased such property for use in another state is exempt from the tax imposed herein. The secretary may promulgate rules pursuant to chapter 1-26 relating to the determination of the age and value of the tangible personal property or the product transferred electronically brought into this state.

Credits

Source: SL 1953, ch 471, § 1; SDC Supp 1960, § 57.4303 (2); SL 1984, ch 90; SL 1991, ch 106; SL 2008, ch 51, § 40.

Notes of Decisions (2)

S D C L § 10-46-3, SD ST § 10-46-3
Current through the 2023 Regular Session and Supreme Court Rule 23-15

End of Document

Administrative Rules of South Dakota
Department of Revenue (Articles 64:01 to 64:80)

64:09:01:20. Determination of age and value of tangible personal property.
SD ADC 64:09:01:20 South Dakota Administrative Code *(Approx. 3 pages)*

ARSD 64:09:01:20

64:09:01:20. Determination of age and value of tangible personal property.

Currentness

For the purposes of the exemption in **SDCL 10-46-3**, tangible personal property or any product transferred electronically must be more than seven years old as determined by its date of manufacture, if documented, or by the date of the purchase by the person bringing the property into this state. In the absence of independent documentary proof of the value of the tangible personal property or any product transferred electronically at the time it is brought into South Dakota, the value of the property is presumed to be the purchase price reduced by ten percent for each year of use of the property by the person bringing the property into this state. Statements, opinions, or depreciation schedules of the owner of the property are not independent documentary proof of the value of the property.

Credits

Source: 18 SDR 3, effective July 14, 1991; 21 SDR 219, effective July 1, 1995; 35 SDR 48, effective September 8, 2008.

General Authority: SDCL 10-46-35.1.
Law Implemented: SDCL 10-46-3.

Current through rules published in the South Dakota register dated April 24, 2023. Some sections may be more current, see credits for details.

S.D. Admin. R. 64:09:01:20, SD ADC 64:09:01:20

End of Document

IN THE SUPREME COURT
STATE OF SOUTH DAKOTA

APPEAL NO. 30280

ELLINGSON DRAINAGE, INC.

Plaintiff and Appellant,

v.

SOUTH DAKOTA DEPARTMENT OF REVENUE,

Respondent and Appellee.

APPEAL FROM THE CIRCUIT COURT
SIXTH JUDICIAL CIRCUIT
HUGHES COUNTY, SOUTH DAKOTA

THE HONORABLE CHRISTINA KLINGER
Circuit Court Judge

BRIEF OF APPELLEE
SOUTH DAKOTA DEPARTMENT OF REVENUE

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Notice of Appeal Filed March 1, 2023

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IN THE SUPREME COURT
STATE OF SOUTH DAKOTA

APPEAL NO. 30280

ELLINGSON DRAINAGE, INC.

Plaintiff and Appellant,

v.

SOUTH DAKOTA DEPARTMENT OF REVENUE,

Respondent and Appellee.

PRELIMINARY STATEMENT

For the convenience of the Court, the Appellee, the South Dakota Department of Revenue will be referred to as "Department." The Appellant, Ellingson Drainage, Inc., will be referred to as "Ellingson." The Administrative Record will be cited as "R __." The Appellant's Brief, filed and served on May 18, 2023, will be cited as "AB __."

JURISDICTIONAL STATEMENT

On May 13, 2022, the Office of Hearing Examiners entered a Proposed Decision affirming the Department's July 30, 2020, Certificate of Assessment issued to Ellingson. R 348- 353. On June 13, 2022, the Department's Deputy Secretary issued the Final Decision affirming the Hearing Examiner's Proposed Decision. R 4. A Notice of Entry of the Department's Final Order was issued on June 15, 2022. R 5-6. On July 1, 2022, Ellingson filed a notice of appeal of the Department's Final Order with the Circuit Court. R 1-2. On January 25, 2023, the

Honorable Christina Klinger, Sixth Judicial Circuit, issued a Memorandum Opinion and Order affirming the Department's Final Order. R 374- 387. On February 1, 2023, the Department served the Notice of Entry of the Circuit Court's Order on Ellingson. R 388-389. On March 1, 2023, Ellingson filed the Notice of Appeal with this Court and served that notice on the Department. R 404-405.

STATEMENT OF LEGAL ISSUE AND AUTHORITIES

WHETHER SDCL 10-46-3 AS APPLIED TO ELLINGSON IS CONSTITUTIONAL?

The Circuit Court found that the SDCL 10-46-3, as applied to Ellingson, did not violate the Commerce Clause of the United States Constitution. R 374.

Complete Auto Transit, Inc. v. Brady, 430 U.S. 274 (1977).

Western Wireless Corp. v. Department of Revenue, 2003 S.D. 68, 665 N.W.2d 73.

Oklahoma Tax Comm'n v. Jefferson Lines, Inc., 514 U.S. 175 (1995).

South Dakota v. Wayfair, Inc., 138 S.Ct. 2080 (2018).

SDCL 10-46-3

SDCL 10- 46-6.1

ARSD 64:09:01:20

STATEMENT OF CASE AND FACTS

Ellingson is a Minnesota-based company that does drainage tile work throughout the United States. R 325. Between April 7, 2016, and April 30, 2019, Ellingson completed approximately thirty construction

jobs within South Dakota. R 325-327. To complete these jobs, Ellingson brought into South Dakota equipment purchased outside of the state. *Id.* Ellingson also rented an excavator for use in South Dakota on April 30, 2019.[1] Ellingson acknowledged that it did not pay any sales tax or use tax in any state on the purchase of the equipment at issue prior to bringing the equipment into South Dakota for commercial use. *Id.*

South Dakota imposes a tax of four and one-half percent[2] on "the privilege of the use, storage or consumption in this state of tangible personal property[.]" SDCL 10-46-3.[3] The use tax due pursuant to SDCL 10-46-3 is calculated based on the value of the item at the time of its first use in South Dakota. SDCL 10-46-3. Absent independent documentary evidence, the value of an item is presumed to be the purchase price reduced by ten percent for each year of use. ARSD 64:09:01:20. Any property older than seven years is exempt from use tax. SDCL 10-46-3. After a party pays use tax on a piece of equipment once, it is free to use that property indefinitely within the state without further taxation. Importantly, South Dakota grants a credit to any sales or use tax paid to another state against the assessed South Dakota use

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[1] Ellingson is not contesting the use tax assessed on the rental of this piece of equipment. R 377, n. 5.
[2] The use tax rate as relevant to this appeal was four and one-half percent. However, as of July 1, 2023, the use tax rate was reduced to four and two-tenths percent. *See* SDCL 10-46-3 and 10-45-2.
[3] SDCL 10-46-8 specifically exempts property brought into the state for personal use by a nonresident from the use tax.

tax. SDCL 10- 46-6.1. If a taxpayer pays another state sales or use tax at a higher rate than South Dakota's use tax, no use tax is assessed by the Department. *Id.*

The table below represents each piece of equipment. It lists each piece of untaxed equipment that Ellingson purchased and brought into South Dakota for the completion of commercial projects, the purchase price Ellingson paid, the date purchased, the date the equipment was first brought into South Dakota, and finally the value the Department assigned to the equipment based on the application of SDCL 10-46-3 and ARSD 64:09:01:20, as described above. R 325-327; R 203-204.

Equipment	Purchase price	Date purchased	Date brought into S.D.	Value taxed
CAT 336EL excavator	227,500.00	04/07/2016	10/28/2019	147,875.00
CAT d8K Pullcat	62,500.00	02/28/ 2011	09/21/2017	21,354.17
FASTRAC Tractor	141,500.00	10/20/2011	10/17/2017	56,600.00
BRON 550 Plow	576,000.00	06/20/2013	10/17/2017	326,683.33
JCB FASTRAC	148,500.00	02/21/2013	04/19/2017	57,779.17
JCB FASTRAC	148,500.00	02/21/2013	05/16/2018	70,537.50
JCB FASTRAC	141,500.00	03/12/2012	04/23/2018	55,420.83
JCB FASTRAC	153,000.00	03/12/2012	11/16/2018	51,000.00
BRON 585 Plow	196,339.00	03/06/2018	11/18/2018	183,305.73
JCB FASTRAC	189,933.00	04/16/2018	04/17/2019	170,939.70
JCB FASTRAC	141,500.00	10/20/2011	09/21/2017	84,900.00

The Department assessed use tax against each piece of equipment used in South Dakota based upon the value at the time Ellingson brought the equipment into the state to complete commercial projects. To determine the taxable value of the equipment, the Department considered the purchase price of each item and then discounted the value of each by ten percent per year of ownership by Ellingson. R 173-192. After calculating the applicable depreciation for each piece of equipment, the Department determined that the total taxable value of all the equipment as $1,228,120.43. R 204-205. So, while Ellingson had purchased all the equipment for a total of approximately $1,978,772.00, that was not the value the Department based that unpaid use tax from, in fact that value was almost cut in half. *Id.* Ellingson was also assessed use tax of $5,400 on the piece of rental equipment Ellingson used in South Dakota. R 203-204. Therefore, on July 30, 2020, the Department issued Ellingson a certificate of assessment in the amount of $75,528.32 in unpaid use tax and interest. This amount included $60,665.44 in assessed use tax and $14,862.88 in statutory interest. R 150.

STANDARD OF REVIEW

A certificate of assessment, as defined by SDCL 10-59-4, is deemed prima facie correct. SDCL 10-59-8. Any taxpayer against whom a certificate of assessment is issued may make a written request for hearing before the secretary, but such request must be premised upon

the taxpayer's belief "that the assessment is based upon a mistake of fact or an error of law." SDCL 10-59-9. Accordingly, in order to meet or overcome the certificate of assessment's statutory presumption of correctness, Ellingson must prove by substantial, credible evidence that a mistake of fact or error of law resulted in an invalid assessment. SDCL 10-59-9; SDCL 19-19-301.

"Statutes which impose taxes are to be construed liberally in favor of the taxpayer and strictly against the taxing body. Statutes exempting property from taxation should be strictly construed in favor of the taxing power." *Butler Machinery Co. v. South Dakota Dept. of Revenue*, 2002 S.D. 134, ¶ 6, 653 N.W. 2d 757, 759 (internal citations omitted).

> Exemptions from tax are privileges accorded as a matter of legislative grace and not as a matter of taxpayer right. Tax exemptions are never presumed. [...] [T]he general rule has been established that the taxpayer has the burden of proving entitlement to a statutory exemption.

Matter of Pam Oil, Inc., 459 N.W.2d 251, 255 (S.D. 1990) (internal citations omitted).

Finally, "[t]here is a strong presumption that the laws enacted by the legislature are constitutional and the presumption is rebutted only when it clearly, palpably and plainly appears that the statute violates a provision of the constitution. Further, the party challenging the constitutionality of a statute bears the burden of proving beyond a reasonable doubt that the statute violates a state or federal

constitutional provision." *State v. Hauge*, 1996 S.D. 48, ¶ 4, 547 N.W.2d 173, 175.

ARGUMENT

SDCL 10-46-3, AS APPLIED TO ELLINGSON, IS CONSTITUTIONAL.

South Dakota's use tax is about fairness. SDCL 10-46-3 is meant to level the playing field between resident businesses which are subject to sales tax on property purchased in the state and those out-of-state businesses who choose to enter South Dakota and conduct business. It is also meant to ensure that these businesses pay a fair share of the available services and protections they enjoy while doing business within South Dakota. "Use tax serves as a sales tax substitute imposed on those who buy out of state and do not pay sales tax. The levy of the use tax attaches after the use of a tangible item or service occurs in South Dakota." *Western Wireless Corp. v. Dep.t of Revenue*, 2003 S.D. 68, ¶ 6, 665 N.W.2d 73, 75.

A. The language of SDCL 10-46-3 is clear and unambiguous.

The South Dakota Supreme Court has held when interpreting a statute:

> [W]e adhere to two primary rules of statutory construction. The first rule is that the language expressed in the statute is the paramount consideration. The second rule is that if the words and phrases in the statute have plain meaning and effect, we should simply declare their meaning and not resort to statutory construction."

Goetz v. State, 2001 S.D. 138, ¶ 15, 636 N.W.2d 675, 681.

> [Further,] [t]he intent of a statute is determined from what the legislature said, rather than what the courts think it should have said, and the court must confine itself to the language used. [...] When the language of a statute is clear, certain and unambiguous, there is no reason for construction, and the Court's only function is to declare the meaning of the statute as clearly expressed."

US West Communications, Inc. v. Public Utilities Com'n of State of S.D., 505 N.W.2d 115, 123 (S.D. 1993) (internal citations omitted).

This Court also interprets administrative rules in the same manner. "Administrative regulations are subject to the same rules of construction as are statutes. When regulatory language is clear, certain and unambiguous, our function is confined to declaring its meaning as clearly expressed." *Citibank, N.A. v. South Dakota Dep't of Revenue*, 2015 S.D. 67, ¶ 12, 868 N.W.2d 381, 387 (quoting *Westmed Rehab, Inc. v. Dep't. of Social Services*, 2004 S.D. 104, ¶ 8, 687 N.W.2d 516, 518 (citation omitted)). When determining that Ellingson owed use tax and the amount, the Department applied SDCL 10-46-3 and ARSD 64:09:01:20 in the manner clearly intended by the Legislature.

SDCL 10-46-3 provides:

> An excise tax is imposed on the privilege of the use, storage or consumption in this state of tangible personal property or any product transferred electronically not originally purchased for use in this state, but thereafter used, stored or consumed in this state, at the same rate of percent of the fair market value of the property at the time it is brought into this state as is imposed by § 10-45-2. The use, storage, or consumption of tangible personal property or any product transferred electronically more than seven years old at the time it is brought into the state by the person who purchased such property for use in another state is exempt from the tax imposed herein. The secretary may promulgate rules pursuant to

> chapter 1-26 relating to the determination of the age and value of the tangible personal property or the product transferred electronically brought into this state.

The plain meaning of SDCL 10-46-3 is clear that when an out-of-state business, such as Ellingson, brings personal property into the state to use, store, or consume that property, it was subject to use tax. At the time Ellingson brought the equipment into South Dakota the use tax rate was four and one-half percent, the same as the sales tax rate referenced in SDCL 10-45-2. SDCL 10-46-3 also clearly applies to property that is under seven-years-old and "not originally purchased for use in [South Dakota]" (emphasis added). Finally, this statute grants the Secretary of the Department of Revenue the authority to promulgate rules to determine the age and value of the property subject to use tax under this statute. SDCL-46-3. The Department did so by enacting ARSD 64:09:01:20, which reads:

> For the purposes of the exemption in SDCL 10-46-3, tangible personal property or any product transferred electronically must be more than seven years old as determined by its date of manufacture, if documented, or by the date of the purchase by the person bringing the property into this state. In the absence of independent documentary proof of the value of the tangible personal property or any product transferred electronically at the time it is brought into South Dakota, the value of the property is presumed to be the purchase price reduced by ten percent for each year of use of the property by the person bringing the property into this state. Statements, opinions, or depreciation schedules of the owner of the property are not independent documentary proof of the value of the property.

Because there is no ambiguity in either SDCL 10-46-3 or ARSD 64:09:01:20, statutory interpretation is not needed. Therefore, the

arguments by Ellingson, which seeks to have this Court reinterpret SDCL 10-46-3 and ARSD 64:09:01:20, should not be considered. (See AB 32-35). It is clear that the Legislature meant to assess use tax against the entire value of the equipment Ellingson used to complete construction projects in South Dakota. Further, were Ellingson seeking to change the law, that is the role of the legislature and not this Court.

B. SDCL 10-46-3 comports with the four prongs of the Complete Auto Test.

The U.S. Supreme Court indicated that it would uphold a tax "against [a] Commerce Clause challenge when the tax is applied to an activity with a substantial nexus with the taxing State, is fairly apportioned, does not discriminate against interstate commerce, and is fairly related to the services provided by the State." *Complete Auto Transit, Inc. v. Brady*, 430 U.S. 274, 279 (1977). These factors, known as the *Complete Auto* Test, are often cited by courts when examining state tax schemes.

Complete Auto involved a challenge to Mississippi sales tax assessed on vehicles assembled outside of the state but shipped to Mississippi. *Id.* The vehicles in question were shipped by rail from the General Motors plant in Michigan to Jackson, Mississippi, where Complete Auto Transit would pick them up and deliver them to various dealerships throughout the state. *Id.* at 276. The State of Mississippi assessed taxes on the vehicles brought into the state during a three-year period. *Id.* at 275.

The U.S Supreme Court noted that Complete Auto Transit did not challenge Mississippi's tax based on any of the factors of the *Complete Auto* Test. *Id.* at 278. Rather, Complete Auto Transit only argued that Mississippi could not tax an activity which is part of interstate commerce. The U.S. Supreme Court dismissed this argument, noting:

> It is a truism that the mere act of carrying on business in interstate commerce does not exempt a corporation from state taxation. 'It was not the purpose of the commerce clause to relieve those engaged in interstate commerce from their just share of state tax burden even though it increases the cost of doing business.'

Complete Auto, 430 U.S. at 288 (quoting *Colonial Pipeline Co., v. Traigle*, 421 U.S. 100 (1975) (quoting *Western Live Stock v. Bureau of Revenue*, 303 U.S. 250, 254 (1938))).

The fact that Ellingson is engaged in drain tile work throughout the United States does not make SDCL 10-46-3 or ARSD 64:09:01:20 per se unconstitutional simply because Ellingson is subject to tax on the equipment brought in for use in South Dakota. Rather, because the application of SDCL 10-46-3 and ARSD 64:09:01:20 comports with the four factors of the *Complete Auto* Test they are constitutional. As the application of SDCL 10-46-3 and ARSD 64:09:01:20 is constitutional the Department was correct in relying on them when assessing use tax against Ellingson.

This Court has upheld the assessment of use tax against a constitutional challenge in *Western Wireless*. 2003 S.D. 68, 665 N.W.2d 73. *Western Wireless* involved a cellular phone company that sent billing

information on its South Dakota customers to an out-of-state company to process and print bills. 2003 S.D. 68, ¶ 3, 665 N.W.2d at 74.

The company then sent the bills back to customers in South Dakota. *Id.* at ¶ 2. In upholding South Dakota's assessment of use tax, this Court found that the state's use tax met the four requirements of the *Complete Auto* Test. *Id.* "A tax is not an unconstitutional burden on interstate commerce if the taxed activity is sufficiently connected to the state to justify the tax, the tax is fairly related to benefits provided to the taxpayer, the tax does not discriminate against interstate commerce, and the tax is fairly apportioned. The use tax here passes these tests." *Id.* at ¶ 15.

1. There is a substantial nexus between the State and Ellingson's business.

The first prong of the Complete Auto test is whether a sufficient connection with the state to justify the tax. *Complete Auto*, 430 U.S. at 279. This is sometimes referred to as the substantial nexus prong. Regarding the nexus prong, the U. S. Supreme Court recently modified the nexus test for determining whether an entity is subject to state taxation. In *South Dakota v. Wayfair, Inc.*, the U.S. Supreme Court was asked to revisit its previous rule that an entity must have a physical presence within a state for it to be subject to state taxation. 138 S. Ct. 2080 (2018). The U.S. Supreme Court acknowledged that it's previous opinion in *Quill Corp. v. N. Dakota by & through Heitkamp*, 504 U.S. 298,

112 S. Ct. 1904 (1992), had created a "an inefficient 'online sales tax loophole' that gives out-of-state businesses an advantage." *Wayfair*, 138 S.Ct. at 2092 (citation omitted). The U.S. Supreme Court expanded on this by explaining:

> The physical presence rule as defined and enforced in *Bellas Hess* and *Quill* is not just a technical legal problem—it is an extraordinary imposition by the Judiciary on States' authority to collect taxes and perform critical public functions. [...] *Quill*'s physical presence rule intrudes on States' reasonable choices in enacting their tax systems. And that it allows remote sellers to escape an obligation to remit a lawful state tax is unfair and unjust. It is unfair and unjust to those competitors, both local and out of State, who must remit the tax; to the consumers who pay the tax; and to the States that seek fair enforcement of the sales tax, a tax many States for many years have considered an indispensable source for raising revenue.

Id. at 2095–96 (2018) (referring to *National Bellas Hess, Inc., v. Dept. of Revenue*, 386 U.S. 753 (1967) and *Quill, supra*).

The U.S. Supreme Court concluded "such a nexus is established when the taxpayer 'avails itself of the substantial privilege of carrying on business' in that jurisdiction." *Wayfair*, 138 S.Ct. at 2099 (quoting *Polar Tankers, Inc. v. City of Valdez*, 557 U.S. 1, 11 (2009)). After the U.S. Supreme Court's decision in *Wayfair*, it is no longer necessary for an out-of-state business to even be physically present within a state to meet the first prong of the *Complete Auto* Test. Since approximately thirty jobs were completed by Ellingson during the audit period within South Dakota, Ellingson's physical presence within South Dakota meets the first prong.

2. SDCL 10-46-3 is rationally related to the benefits and services provided by South Dakota.

The second prong of the Complete Auto Test asks whether a tax is rationally related to the benefits and services a state provides. The State of South Dakota provides services to both its citizens, and those who come to the state to conduct business. Even if an out-of-state business is only in the state for a single day, it may still be required to pay for the cost of services provided as part of the common good.

> A tax is not an assessment of benefits. It is, as we have said, a means of distributing the burden of the cost of government. The only benefit to which the taxpayer is constitutionally entitled is that derived from his enjoyment of the privileges of living in an organized society, established and safeguarded by the devotion of taxes to public purposes. Any other view would preclude the levying of taxes except as they are used to compensate for the burden on those who pay them, and would involve abandonment of the most fundamental principle of government—that it exists primarily to provide for the common good."

Commonwealth Edison Co. v. Montana, 453 U.S. 609, 622–23 (1981) (quoting *Carmichael v. Southern Coal & Coke Co.*, 301 U.S. 495, 521-523 (1937)).

Additionally, a business is not required to be charged only for the specific services it uses within the state. "If the event is taxable, the proceeds from the tax may ordinarily be used for purposes unrelated to the taxable event. Interstate commerce may thus be made to pay its fair share of state expenses and 'contribute to the cost of providing all governmental services, including those services from which it arguably receives no direct 'benefit.'" *Oklahoma Tax Com'n v. Jefferson Lines, Inc.*,

514 U.S. 175, 199–200 (1995) (citations omitted) (emphasis original). While SDCL 10-46-3 is assessed against the depreciated value of Ellingson's equipment, the money owed by Ellingson is used to provide for all services available to both in-state and out-of-state residents within South Dakota.

Ellingson argues that SDCL 10-46-3 is not rationally related to the benefits that it was provided because the statute does not take into account the amount of time an out-of-state business is conducting business within South Dakota. AB 25-26. However, there is no statutory requirement that South Dakota pro-rate the taxation of out-of-state businesses based on a specific length of time that business is in the state. In fact, as stated above, South Dakota's statutory structure is clear and unambiguous and must be applied. Just because Ellingson would calculate it differently, does not make it unconstitutional and the remedy to change it is not before this Court, but with the South Dakota legislature.

When Ellingson brought its equipment into South Dakota to complete thirty commercial projects, its employees had access to all the public services available to South Dakota's citizens including use of roads and bridges, police protection, and use of the court system. For the privilege of doing business in South Dakota, Ellingson must pay its fair share of the cost of providing all those available services. To cover

the fair share of the cost of providing these services, SDCL 10-46-3 imposes a use tax a single time.

3. SDCL 10-46-3 does not discriminate against interstate commerce.

Under the third prong of the *Complete Auto* Test, courts consider whether a state tax discriminates against interstate commerce. To this point, the U.S. Supreme Court has stated that:

> '[D]iscrimination' simply means differential treatment of in-state and out-of-state economic interests that benefits the former and burdens the latter. If a restriction on commerce is discriminatory, it is virtually *per se* invalid. By contrast, nondiscriminatory regulations that have only incidental effects on interstate commerce are valid unless 'the burden imposed on such commerce is clearly excessive in relation to the putative local benefits.'

Oregon Waste Systems, Inc. v. Dep.t of Environmental Quality of State of Or., 511 U.S. 93, 99 (1994) (internal citations omitted).

South Dakota's use tax is meant to address two important concerns. First, the use tax is meant to prevent the state from losing tax revenue from South Dakota residents purchasing out-of-state goods or services for in-state use. *Western Wireless*, 2003 S.D. 68, ¶ 7, 665 N.W.2d at 75. Second, the use tax ensures local providers are not undercut by out-of-state businesses who are not subject to the same tax as in-state counterparts. *Id.*

South Dakota has an interest in ensuring it has sufficient funds to make services available to all within its borders. When any business enters South Dakota, its employees have access to all the same services

and infrastructure as the state's residents. Out-of-state businesses should contribute for the services that are made available to them while they are doing business in South Dakota. Since Ellingson has access to the benefits provided by South Dakota while doing business here, it is only fair to ask that Ellingson contribute to the cost of providing these services.

As applied in this case, the use tax ensures that out-of-state businesses do not have a price advantage over their in-state competitors who are subject to state sales tax. This is true both in terms of South Dakota residents purchasing goods outside of the state and bringing them back to South Dakota as well as out-of-state businesses who solicit business in the state. This reasoning was supported in *Wayfair*, when the U. S. Supreme Court stated, "*Quill* puts both local businesses and many interstate businesses with physical presence at a competitive disadvantage relative to remote sellers. Remote sellers can avoid the regulatory burdens of tax collection and can offer *de facto* lower prices caused by the widespread failure of consumers to pay the tax on their own." *Wayfair,* 138 S. Ct. at 2094 (referring to *Quill, supra).*

Without the imposition of the use tax here, Ellingson will not have paid any sales or use tax on the equipment it used to complete projects in South Dakota. However, a South Dakota business doing the same work as Ellingson, and using the same equipment purchased within the state, is liable for sales tax on that equipment. This automatically gives

Ellingson an unfair competitive advantage because it does not have to add the cost of use tax into its bids, meaning Ellingson can more easily undercut in-state competitors bids. It is not the intention of the Commerce Clause to protect out-of-state business from taxes that must be paid by local businesses, thereby discriminating against the in-state business.

Ellingson argues that the two "vital concerns" articulated in *Western Wireless*, namely avoiding loss of vital tax revenue and to ensure fair competition between in and out-of-state businesses, are supported by imposition of SDCL 10-46-2,[4] and therefore SDCL 10-46-3 is unnecessary. AB 15. While it is true that SDCL 10-46-2 prevents in-state residents from purchasing tangible property outside of the state to evade state sales tax, it does not apply to services purchased out-of-state. The absence of a use tax would allow South Dakota's residents to purchase services from out-of-state businesses and thereby avoid sales tax on such transactions.

4. SDCL 10-46-3 is fairly apportioned.

When determining if a statute is fairly apportioned, courts have considered two factors. "For over a decade now, we have assessed any

[4] SDCL 10-46-2 provides "[a]n excise tax is hereby imposed on the privilege of the use, storage, and consumption in this state of tangible personal property purchased for use in this state at the same rate of percent of the purchase price of said property as is imposed pursuant to chapter 10-45."

threat of malapportionment by asking whether the tax is 'internally consistent' and, if so, whether it is 'externally consistent' as well." *Jefferson Lines, Inc.*, 514 U.S. at 185 (citations omitted).

a. Internal Consistency

"To be internally consistent, a tax must be structured so that if every State were to impose an identical tax, no multiple taxation would result." *Goldberg v. Sweet*, 488 U.S. 252, 261 (1989) (citing *Container Corp. of America v. Franchise Tax Board*, 463 U.S. 159 (1983)). The U.S. Supreme Court examined the internal consistency of a Washington State use tax statute in *Henneford v. Silas Mason Co.*, 300 U.S. 577 (1937). With facts very similar to the ones here, the State of Washington imposed a two percent use tax on property brought into the state. *Id.* at 580. The contractor was assessed use tax on equipment brought used to help construct the Grand Coulee Dam. *Id.* at 579. The contractor then challenged the Washington use tax as an unconstitutional burden in interstate commerce. *Id.* at 578. Like Ellingson in this case, the contractor argued that Washington could not tax property which was purchased in another state and used in Washington. *Id.* The U. S. Supreme Court held that Washington's use tax was constitutional:

> Equality is the theme that runs through all the sections of the statute. There shall be a tax upon the use, but subject to an offset if another use or sales tax has been paid for the same thing. This is true where the offsetting tax became payable to Washington by reason of purchase or use within the state. It is true in exactly the same measure where the offsetting tax has been paid to another state by reason of use or purchase there. No one who uses

> property in Washington after buying it at retail is to be exempt from a tax upon the privilege of enjoyment except to the extent that he has paid a use or sales tax somewhere. [Everyone] who has paid a use or sales tax anywhere, or, more accurately, in any state, is to that extent to be exempt from the payment of another tax in Washington.

Id. at 583–84.

The Washington use tax was internally consistent because out-of-state businesses were only subject to tax once. *Id.* Any tax a business had previously paid was credited towards the Washington use tax owed. *Id.* The same is true here.

Because under the Commerce Clause a business is only subject to taxation from a single state, it is also permissible for a state to tax an entire transaction even if that transaction occurs in multiple states. In *Jefferson Lines*, 514 U.S. at 177, the U.S. Supreme Court was asked to consider whether Oklahoma could tax the entire price of an interstate bus ticket originating from that state. Jefferson Lines filed for bankruptcy in October 1989, and the Oklahoma Tax Commission filed proof of claims for the uncollected taxes on interstate travel tickets sold by Jefferson in the State of Oklahoma. *Id.* at 178. Much like Ellingson in this case, the appellant in *Jefferson Lines* argued that the Commerce Clause prohibited Oklahoma from taxing the entire cost of the fare because only a portion of the trip occurred in Oklahoma. *Id.* The U.S. Supreme Court upheld Oklahoma's imposition of tax on Jefferson Lines' bus ticket sales in the state. *Id.* at 175. It explained, "if every State were to impose a tax identical to Oklahoma's-i.e., a tax on ticket sales within

the State for travel originating there-no sale would be subject to more than one State's tax." *Id.* at 175.

Similarly, in this case, SDCL 10-46-3 is internally consistent because Ellingson is not subject to multiple states' taxation on its equipment. Once Ellingson pays use tax for the equipment used on projects in South Dakota, it is no longer subject to sales or use tax in any other jurisdiction it enters with that equipment. Alternatively, had Ellingson paid sales or use tax on that equipment purchase prior to coming to South Dakota to transact business, South Dakota would have given a credit towards the assessed use tax.

> The amount of any use tax imposed with respect to tangible personal property, any product transferred electronically, or services shall be reduced by the amount of any sales or use tax previously paid by the taxpayer with respect to the property on account of liability to another state or its political subdivisions. However, no credit may be given under this section where taxes paid on tangible personal property, any product transferred electronically, or services in another state or its political subdivisions of that state does not reciprocally grant a credit for taxes paid on similar tangible personal property or any product transferred electronically.

SDCL 10-46-6.1. Ellingson acknowledged that it paid no tax on any of this equipment either in the state where it was purchased or in any other state.

b. External Consistency

The second requirement for fair apportionment is that a tax be externally consistent. "The external consistency test asks whether the State has taxed only that portion of the revenues from the interstate

activity which reasonably reflects the in-state component of the activity being taxed." *Goldberg*, 488 U.S. at 262.

Ellingson argues that by taxing the entire value of the equipment it used in South Dakota, the Department is taxing more than its fair share. First, as noted above, the Department did not tax the entire value of the property—rather the value was depreciated according to ARSD 64:09:01:20. Additionally, the U. S. Supreme Court considered and rejected this argument in *Jefferson Lines*. 514 U.S. at 186. It reasoned that a state could tax an entire transaction that originated within its borders and still be externally consistent.

> A sale of goods is most readily viewed as a discrete event facilitated by the laws and amenities of the place of sale, and the transaction itself does not readily reveal the extent to which completed or anticipated interstate activity affects the value on which a buyer is taxed. We have therefore consistently approved taxation of sales without any division of the tax base among different States, and have instead held such taxes properly measurable by the gross charge for the purchase, regardless of any activity outside the taxing jurisdiction that might have preceded the sale or might occur in the future.

Id. at 186 (citing *McGoldrick v. Berwind-White Coal Mining Co.*, 309 U.S. 33 (1940)).

SDCL 10-46-3 could assess use tax against the entire value of the property Ellingson used within the state and still be externally consistent. South Dakota is not attempting to assess use tax on any property or projects completed outside of the state. Because South Dakota only levied use tax against the machinery Ellingson used on

commercial projects completed in South Dakota, SDCL 10-46-3 is externally consistent.

Ellingson proposes an alternate formula by which SDCL 10-46-3 would only be calculated based on the time its equipment was used in the state. While Ellingson was assessed use tax on the entire value of each piece of equipment when it was used in South Dakota, the assessed value of Ellingson's equipment was discounted based on a ten percent per year depreciation. Ellingson had not previously paid any sales or use tax on this equipment and has not been subject to use tax since completing work in South Dakota. As set forth above, SDCL 10-46-3 is unambiguous and therefore this Court should simply affirm its application to Ellingson.

C. SDCL 10-46-3, as applied, does not violate Ellingson's due process rights.

Due process analysis contains many of the same elements as interstate commerce. The overlap between the two means that a statute which comports with the requirements of interstate commerce will also be in line with due process. Because SDCL 10-46-3 comports with interstate commerce, it also aligns with due process.

"Whether a state tax violates the due process clause is determined by whether the tax has relation to opportunities, benefits, or protection afforded by the taxing state." *Montana-Dakota Utilities Co.*, 337 N.W.2d 818, 820 (citations omitted). As argued above, when Ellingson brings

equipment into South Dakota to complete drain tile projects, it is afforded all the benefits provided to in-state businesses regardless of whether it intends to be in the state for a single day or to be here permanently. Further, Ellingson has exercised its due process throughout this matter, first requesting an administrative hearing, then appealing that decision to the Circuit Court, and now finally this Court, services that are provided through the very use tax Ellingson seeks to have overturned for lack of use of State services.

CONCLUSION

The Circuit Court found that SDCL 10-46-3 comported with the factors outlined by *Complete Auto, supra.*, and was constitutional as applied to Ellingson. For the reasons stated above, the Department requests that this court rule that SDCL 10-46-3 is constitutional as applied to Ellingson and affirm the Circuit Court.

Respectfully submitted,

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CERTIFICATE OF COMPLIANCE

1. I certify that the Appellee's Brief is within the limitation provided for in SDCL 15-26A-66(b) using Bookman Old Style typeface in 12-point type. Appellee's Brief contains, 5,725 words.

2. I certify that the word processing software used to prepare this brief is Microsoft Word 2016.

Dated this 17th day of July, 2023.

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CERTIFICATE OF SERVICE

The undersigned hereby certifies that on July 17, 2023, a true and correct copy of Appellee's Brief in the matter of *Ellingson Drainage, Inc. v. South Dakota Department of Revenue* was served electronically through Odyssey File and Serve upon Shawn M. Nichols at SNichols@cadlaw.com and Andrew S. Hurd at Andrew Hurd at AHurd@cadlaw.com.

/s/ Joe Thronson
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IN THE SUPREME COURT

OF THE

STATE OF SOUTH DAKOTA

No. 30280

ELLINGSON DRAINAGE, INC.

Petitioner/Appellant,

vs.

THE SOUTH DAKOTA DEPARTMENT OF REVENUE

Respondent/Appellee.

Appeal from the Circuit Court
Sixth Judicial Circuit
Hughes County, South Dakota

The Honorable Christina Klinger, Presiding Judge

REPLY BRIEF OF APPELLANT ELLINGSON DRAINAGE, INC.

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Notice of Appeal Filed March 1, 2023

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I. The Department is either misapplying SDCL § 10-46-3, or it is unconstitutional.

A. SDCL § 10-46-3 should tax only property that has come to rest in the forum state and become part of the common mass of property.

The Department spends much of its brief attacking arguments that Ellingson does not make, and that have nothing to do with question before the Court. Ellingson does not argue that merely engaging in interstate commerce exempts one from use tax. *See Complete Auto Transit, Inc. v. Brady*, 430 U.S. 274, 277-78 (1977). Ellingson also does not argue that it cannot be taxed, in theory, for its presence for a single day in South Dakota. Ellingson's argument is that taxing its property under SDCL § 10-46-3 has resulted in a wholly disproportionate and unfair tax burden relative to its very brief presence in the state.

Nor does Ellingson argue that the statutory-regulatory scheme is ambiguous. Rather, Ellingson argues that the only way to apply SDCL § 10-46-3 so that it comports with Due Process and the Commerce Clause, is to apply it only where the property has come to rest and become part of the common mass of property in South Dakota. Property purchased out-of-state—with no intent at the time of purchase that the

property would be used in South Dakota—which is subsequently brought into South Dakota should not be subject to the use tax under SDCL § 10-46-3 unless the property was coming to rest in South Dakota and becoming part of the common mass of property therein. *See Henneford v. Silas Mason Co.*, 300 U.S. 577, 582 (1937).

The Department's reading of SDCL § 10-46-3 would subject every traveler to South Dakota to array of odd and unreasonable tax obligations. The Department is applying SDCL § 10-46-3 to Ellingson's operations and presence in South Dakota in such a way that it could impose use tax on any out-of-state individual who comes into South Dakota for any purpose who has not previously paid sales or use tax on the personal property they bring with them. The Department's brief states that "[t]he plain meaning of SDCL § 10-46-3 is clear that when an out-of-state business, such as Ellingson, brings personal property into the state . . . it was subject to use tax." AB 9. But there is nothing in the statute which limits its application to businesses. The Department's proposed application would apply to anyone who enters the state and uses or consumes property that was not originally intended for use therein.

Under this interpretation, the Department of Revenue would have been permitted to take advantage of events like the Sturgis

Motorcycle Rally to tax any of the bikers' personal property that was not previously subject to tax—or any one of the millions of tourists that South Dakota gets each year. Not only that, but individuals from small communities in Nebraska, Iowa, or Minnesota would be subject to the tax when making day trips to South Dakota cities on the border. Indeed, travelers from Illinois passing through South Dakota on their way to Yellowstone National Park could be required to pay South Dakota use tax on the food they brought with them, the clothes they are wearing, and any untaxed vehicle they are driving on Interstate 90.

Such an application violates Due Process because it is not rationally related to the "opportunities, benefits, or protection afforded by the taxing state". *Montana-Dakota Util. v. S.D. Dept. of Rev.*, 337 N.W.2d 818, 820 (S.D. 1983). The Department's application of the use tax does not consider the degree to which the taxed property was used in South Dakota, yet it seeks to impose a tax equal to what a South Dakota resident would be taxed (subject to the depreciation mechanism in ARSD 64:09:01:20). It simply cannot be true that a Minnesota company that uses a piece of machinery in South Dakota for a single day enjoys the same benefits, protections, and value from the State of South Dakota that a life-time resident using that same property enjoys—yet the Department argues that they should be subject to the

same base tax rate. As explained further in Ellingson's initial brief and in section IV(A), *infra*, the depreciation schedule that the Department relies on for softening the blow of SDCL § 10-46-3 is wholly arbitrary under the Department's current application of the tax. The constitution does not "tolerate any result, however distorted, just because it is the product of a convenient mathematical formula which, in most situations, may produce a tolerable product." *Norfolk & W. Ry. Co. v. Missouri State Tax Comm'n*, 390 U.S. 317, 327 (1968).

Additionally, such application of SDCL § 10-46-3 violates the Commerce Clause because it is not rationally related to the services provided by South Dakota nor is the tax fairly apportioned. The equipment in question has neither remained in South Dakota nor been integrated into the state's general mass of property. Moreover, its use in South Dakota constitutes, at most, 10% of its useful life—the other 90% being spent on projects outside of South Dakota. However, the imposed tax rate mirrors that of property purchased and used entirely within the state. The benefits South Dakota offers to wholly in-state property and activities are disproportionate to those extended to fleeting, interstate undertakings. Consequently, the proposed 4.5% tax on temporary equipment usage in the state bears no equitable relation

to the benefits provided by South Dakota, thus rendering it an unconstitutional imposition on interstate commerce.

Ellingson's exemption from sales or use tax in those states where its equipment is predominantly used does not justify South Dakota's tax imposition. *See Central Greyhound Lines, Inc. v. Mealey*, 334 U.S. 653, 663 (1948) ("[E]ven if neither Pennsylvania nor New Jersey sought to tax their proportionate share of the revenue from this transportation, such abstention would not justify the taxing by New York of the entire revenue"). The tax should be determined by Ellingson's activity within South Dakota and the attendant benefits received—independent of potential tax collection by other states. It is worth noting that the primary states of Ellingson's operations have not taxed its equipment-use due to those state's more restrictive tax statutes, compared to South Dakota, which confine their use taxes to the taxable event contemplated by SDCL § 10-46-2.

II. The cases cited by the Department do not support the constitutionality of its proposed application of SDCL § 10-46-3.

A. Many of the cases cited by the Department are sales tax cases and do not provide the relevant analysis.

While the interstate commerce test from *Complete Auto* is applicable to the analysis in this case, that is the extent to which this Court should rely on *Complete Auto*. *Complete Auto* is a case about the

imposition of a sales tax, and much of the analysis outside the black-letter analysis of the Test's four prongs is irrelevant to the case at bar. *Complete Auto Transit, Inc.*, 430 U.S. at 275. Contrary to the argument in the Department's brief, the tax was not imposed "on the vehicles brought into the state" but rather on "gross proceeds of sales or gross income values" that the taxpayer received as a result of contracting for the transportation of those vehicles from the railhead to the dealers—it's a sales tax case not a use tax case. *Id.* at 275-76.

South Dakota v. Wayfair, Inc., 138 S. Ct. 735 (2018) is a case about sales tax imposed on the online purchase of goods from within South Dakota from online retailers outside of the state, and required that those out-of-state retailers remit South Dakota sales tax on those sales even though they are not physically present in the State—overruling the standard from *Quill Corp. v. N. Dakota by & through Heitkamp*, 504 U.S. 298 (1992). Again, the imposition of a sales tax is a materially distinguishable incidence of taxation from the imposition of a use tax.

Likewise, the facts and analysis of *Jefferson Lines* are inapplicable to this case. The taxable event in *Jefferson Lines* was the purchase of a bus ticket—the purchase of a good or service. *Oklahoma Tax Comm'n v. Jefferson Lines*, 514 U.S. 175, 178 (1995). Or, as stated

by the Court, "[t]he taxable event here comprises agreement, payment, and delivery of some services in the taxing state." *Id.* at 191. The Court held that the *sale* of a good or service is "viewed as a discrete event facilitated by the laws and amenities of the place of sale[.]" *Id.* at 186, 188.

The tax in this case is predicated only on Ellingson having briefly used equipment in South Dakota, that was purchased with no intention of using it in South Dakota, and that had not previously been subject to sales or use tax in another state. This is not a discrete, taxable event in the way that a sale is. There is no "local transaction" that is being taxed. There is no allegation that Ellingson or the customer failed to pay any sales tax for the services performed and materials provided by Ellingson during the projects it performed in South Dakota. Nor is there an allegation that Ellingson and its employees failed to remit the tax due on the fuel, food, or any other good or service purchased by Ellingson or its employees within the State of South Dakota.

B. The use tax cases cited by the Department are inapplicable beyond their general rules regarding interstate commerce.

Outside of setting forth the general rules and policy regarding uses taxes generally in South Dakota, *Western Wireless* has limited application in this case because Ellingson has never argued that

interstate commerce cannot be taxed. In *Western Wireless*, the taxpayer had physical offices in Sioux Falls and Rapid City and contracted with an out-of-state vendor for services directed toward South Dakota. The taxpayer, "use[d] the billing service 'in South Dakota to conduct its business," and they were taxed on the value of billing services that were purchased for use in South Dakota. *Western Wireless Corp. v. Dep't of Revenue*, 2003 S.D. 68, ¶ 14, 665 N.W.2d 73, 77. Again, that is a wholly different taxable event than is present in this case.

Henneford v. Silas Mason Co. likewise provides guidance in terms of the general constitutional parameters of use taxes, but the specific tax imposed is materially distinguishable from the one imposed here. The Washington Tax Commission's rules, in the context of the application of its use tax, provided that "property is put to use by the first act after delivery is completed within the state by which the article purchased is actually used or is made available for use with intent actually to use the same within the state." *Henneford*, 300 U.S. at 583. Thus, the tax was only imposed if either the property was first put to use in Washington or was made available for use in Washington with the intent that it be used in Washington. That is essentially the use tax imposed by SDCL § 10-46-2 which Ellingson agrees is constitutional.

The Court held that the tax was "not upon interstate commerce, but upon the privilege of use after commerce is at an end."

> Things acquired or transported in interstate commerce may be subjected to a property tax, non-discriminatory in its operation, *when they have become part of the common mass of property within the state of destination* . . . For like reasons they may be subjected, when *once they are at rest*, to a non-discriminatory tax upon use or enjoyment.

Id. at 582 (emphasis added). This analysis aligns with the two stated objectives of use taxes—i.e., placing retailers in Washington on equal footing with out-of-state businesses and ensuring that the state is able to collect its fair share when buyers "place their orders in other states in the effort to escape payment of the tax on local sales." *Id.* at 581; *See also Western Wireless Corp.*, 2003 S.D. 68, ¶ 7, 665 N.W.2d at 75. This analysis supports Ellingson's proposed application of SDCL § 10-46-3.

III. The Department's argument that without SDCL § 10-46-3, there would not be a South Dakota use tax on services rendered from out-of-state is without merit.

The Department appears to argue that SDCL § 10-46-2 does not provide for a use tax on the purchase of out-of-state services, thus SDCL § 10-46-3 is necessary to supplement that gap. AB 18. First, the argument itself is a non sequitur—the absence of a taxation statute does not empower the Department of Revenue to tax using an inapplicable statute just because it believes the legislature missed

something. Second, SDCL § 10-46-3 expressly applies only to "tangible, personal property" or "product[s] transferred electronically"—it does not apply to services. Furthermore, the legislature has provided a tax on services. SDCL § 10-46-2.1 expressly provides for a use tax on services rendered in South Dakota. In fact, as stated above, that is part of the basis for the use tax that was applied in *Western Wireless*. *Western Wireless Corp. v. Dep't of Revenue*, 2003 S.D. 68, ¶ 8, 665 N.W.2d 73, 76 ("To support imposing use tax on the billing services Western purchases, the Department relies on SDCL 10-46-1(13) and 10-46-2.1 (use tax on services)").

IV. Ellingson's interpretation of SDCL § 10-46-3 renders it constitutional.

Neither party has found authority that is directly on point relating to a use tax on property that is brought into the state, where the owner had no intent at the time of purchase to do so. This is likely due to how few states have such a rule. Ellingson's initial brief provided the extent to which it was able to find applicable authority. Nevertheless, general rules regarding taxing interstate commerce are instructive. Additionally, the nature of SDCL § 10-46-3's overall scheme is indicative of how it is to be applied.

A. The Application of SDCL § 10-46-3 proposed by Ellingson comports with the existing language and tax scheme and renders meaningful each portion thereof.

The Court should interpret SDCL § 10-46-3 in alignment with the primary objectives of a use tax: (1) preventing the state's loss of tax revenue from in-state use of out-of-state purchases, and (2) protecting local businesses from competition with out-of-state entities circumventing sales tax. *Western Wireless Corp.*, 2003 S.D. 68, ¶ 7, 665 N.W.2d at 75. SDCL § 10-46-3 is designed to complement SDCL § 10-46-2, and the above concerns should be applied consistently across all use tax provisions within South Dakota's code.

South Dakota's uses taxes are intended to supplement sales taxes to mitigate potential disadvantages to South Dakota when purchases are made in jurisdictions with disparate tax structures. The "one-time" tax is designed to balance benefits to purchasers against the state's potential revenue loss. SDCL § 10-46-3 should be applied consistent with this principle. Specifically, it should apply only when an individual, initially having no intent to use purchased property within South Dakota, subsequently relocates the property to South Dakota such that the property's remaining useful life will be used, stored, or consumed in South Dakota. In other words, it should apply only when the property has come to rest in South Dakota and has become part of

the common mass of property. This interpretation is both constitutional and comports with the vital concerns of use taxes. *Western Wireless Corp.*, 2003 S.D. 68, ¶ 7, 665 N.W.2d at 75; *Henneford*, 300 U.S. at 583.

Further, the depreciation mechanism in ARSD 64:09:01:20 is wholly arbitrary if SDCL § 10-46-3 is to be applied argued by the Department. It makes sense only if it is to be used as a proxy for the remaining useful life of the property when it is brought into South Dakota. It's never been argued that a seven-year-old piece of machinery is any less of a burden on the infrastructure[1], or that Ellingson does not receive the same benefits or protections as it would if it used a new piece of machinery. The seven-year depreciation scheme makes sense, however, if the intent of the regulation contemplates that older property that is relocated to South Dakota will enjoy the state's benefits and protections for less time than newly purchased property.

B. Ellingson's proposed application comports with Due Process and the Commerce Clause.

The first line of the Department's argument section states: "South Dakota's use tax is about fairness." However, there is nothing fair about the way in which it is being applied to Ellingson. The current

[1] Given improvements in technology over time, it may be more of a burden on the infrastructure and environment to use older equipment.

tax imposed on Ellingson is not rationally related to the opportunities, benefits, or protections provided by South Dakota, *Montana-Dakota Utilities Co.*, 337 N.W.2d at 820; and does not "reasonably reflect[] the in-state component of the activity being taxed." *Western Wireless Corp.*, 2003 S.D. 68, ¶ 18, 665 N.W.2d at 78-79 (quoting *Goldberg v. Sweet*, 488 U.S. 252, 262 (1989)). The application of SDCL § 10-46-3, and its surrounding scheme, proposed by Ellingson satisfies the constitutional rules that the Departments' current application fails to meet.

Ellingson's proposed application satisfies Due Process because the property taxed thereunder would be rationally related to the opportunities, benefits and protections afforded by South Dakota. The individual or entity bringing property into the state would be subject to use tax at the rate contemplated by SDCL § 10-45-2, and that figure would be modified pursuant to ARSD 64:09:01:20 to reflect the Department's recognition that it is not entitled to tax the full value of property which has spent some portion of its useful life outside of South Dakota. The out-of-state individual or entity would be subject to the same tax burdens as citizens of South Dakota—subject to an offset for the out-of-state use of the property.

Under much of the same analysis, such application would comport with the Commerce Clause by "reasonably reflect[ing] the in-state" use and consumption of the property. The tax would be imposed on the same rate that it is imposed on citizens of South Dakota, but there would be a reduction to reasonably reflect the out-of-state use and consumption of the product for which South Dakota provided no benefits or protections.

The only way to reach a fair result if SDCL § 10-46-3 applies as the Department urges, is to apply some kind of pro-rated schedule as set forth in Section II(B) of Ellingson's initial brief. This application, however, would be wholly divorced from the current language of the statute and would likely require legislative intervention. The interpretation and application encouraged by Ellingson—that property not be subject to SDCL § 10-46-3 unless it becomes part of the common mass of property in South Dakota—does not require rewriting the statute and provides a constitutional means of applying it.

C. Ellingson's proposed application would assuage the Department's fear regarding potential disadvantages to South Dakota and its businesses.

As an initial matter, the Department appears to argue that without South Dakota's imposition of SDCL § 10-46-3, Ellingson will per se have an economic advantage over South Dakota businesses. AB

17 - 18. This argument completely fails to address the fact that Ellingson is subject to a whole host of taxes in Minnesota which South Dakota businesses are not subject to—not least of which is Minnesota's state income tax. Minn. Stat. § 290.014, subd. 1; Minn. Stat. § 290.03. The Department paints in broad strokes while disregarding the fact that Minnesota has some of the highest taxes in the Country. Article: The Vast Injustice Perpetuated by State and Local Tax Policy, 37 Hofstra L. Rev. 117, 140 n. 84, 86 (2008). There is no evidence in this case that, on net, Ellingson pays less tax overall than South Dakota businesses. Indeed, it may be true that Ellingson is disadvantaged compared to South Dakota businesses on this single metric.

The focus of the analysis should be the taxpayer's intent to disadvantage the taxing forum by exploiting the tax schemes of various jurisdictions to the taxing states detriment. It's pivotal to note that there's no detriment to South Dakota or its merchants when out-of-state entities, without initial intent for in-state use, introduce property to South Dakota due to their subsequent residency or relocation of the property to the State. Neither South Dakota nor its businesses were ever intended to be the recipient of the business or tax revenue from the purchase of that property. However, because the property will spend some amount of its useful life in South Dakota beyond the time

which it is brought into the state, the State should be able to tax a reasonable value thereof. That's where ARSD 64:09:01:20 applies. That regulation shows the Department's recognition that the full amount of the tax should not be levied on property that did not spend its entire useful life in South Dakota. But the rationale for applying ARSD 64:09:01:20 only makes sense in the event of relocating property to South Dakota—otherwise it is a wholly arbitrary reduction, apparently designed to superficially assuage the taxpayer's concerns.

CONCLUSION

For the forgoing reasons, Ellingson respectfully requests that the Court find the Department's application of SDCL § 10-46-3 unconstitutional and reverse the Circuit Court's ruling.

Dated this 16th day of August, 2023.

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CERTIFICATE OF COMPLIANCE

I hereby certify that Ellingson's Reply Brief complies with the Type-Volume requirements of SDCL 15-26A-66 in the following manner: The Brief was prepared using Microsoft Word and uses proportionally spaced font [Century] in 13-point type. Based on the word-count feature of the MS Word processing system, the Reply Brief contains 3,540 words.

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The undersigned attorney hereby certifies that a true and correct copy of the Reply Brief of Appellant Ellingson Drainage, Inc., was electronically filed and served through Odyssey File and Serve System to:

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