Official Opinion No. 80-75, School District Excise Tax Liability

December 12, 1980

The Honorable Dale V. Andersen
State Representative
Box 147
Mitchell, South Dakota 57301

Official Opinion No. 80-75

School District Excise Tax Liability

Dear Representative Andersen:

You have furnished me with copies of letters from the Department of Revenue, the Department of Education and Cultural Affairs and the attorneys for the Mitchell School District. Their joint concern is with certain construction projects at post-secondary, secondary and secondary multidistrict vocational schools in the nature of on-site and to be moved homes. These are built by students enrolled in the vocational program and may be school financed or privately financed. I am advised there are at least eighteen districts in the state which undertake to manufacture and sell buildings or homes.

The question raised deals with the obligation, if any, of the school district for (1) sales or use tax on construction materials, supplies and equipment used in the project, and (2) liability for the South Dakota contractors' excise tax.

Turning first to the sales tax, that tax is imposed upon the gross receipts from the privilege of engaging in the sale of tangible personal property or services in South Dakota, SDCL 10-45. The terms in the definition in § 10- 45-1 are rather broad; for example, retailer includes 'every person engaged in the business of selling tangible goods, wares or merchandise at retail. . . .' Retail means 'the sale of tangible personal property to the consumer or user thereof or to any person for any purpose other than for resale. . . .' (Emphasis added.)

An initial question has been raised as to whether or not the districts whose students are physically engaged in constructing the buildings are in fact 'engaging in business.' Although our court seems to have held that isolated business acts do not constitute carrying on a

business, they do hold that sustained business activity on a continuous basis performing all the acts incidental to a continuing business does constitute engaging in business. Ward Co. Inc. v. Department of Revenue, 284 N.W.2d 883 (S.D. 1979). Business by definition (§ 10-45-1(1)) includes 'any activity engaged in by any person or caused to be engaged in by him, with the object of gain, benefit, or advantage, either direct or indirect.' The business here involved is the planning, preparation, actual construction, sale and delivery or finishing of the building and the work done amounts to carrying on a business whether done by a private contractor, builder or students under the vocational program.

There is an initial difference, however, in the tax liability since under SDCL 10-45-10 there is a specific exemption for the gross receipts from sales to a public or municipal corporation. Our court has considered school districts to be 'public corporations,' Sanders v. Independent School District, 150 N.W. 473 (S.D. 1915) and 'municipal corporations,' Egan Independent Consolidated School District No. 1 v. Minnehaha County, 270 N.W. 527 (S.D. 1936). Persons selling supplies and materials to a district would not have a tax liability on their gross receipts from such sale. Likewise the district itself, as a public or municipal corporation which uses, stores or consumes tangible personal property is exempt from the complementing use tax under SDCL 10-46-7. This will be discussed further in later paragraphs.

It should be noted, however, that our court in the case of Friessen Construction Company V. Erickson, 238 N.W.2d 278 (S.D. 1976) held that the direct or indirect application of the use tax to municipalities is not prohibited by article XI, section 5 of the Constitution which exempts such property from property taxes.

In Friessen a contractor who used tangible personal property which had been purchased tax exempt by the municipality was subject to the state use tax under SDCL 10-46-5.

Under the generally accepted rule of taxation as stated in 2 Cooley on Taxation, Fourth Edition, Section 672, pages 1403 to 1408:

An intention on the part of the legislature to grant an exemption from the taxing power of the state will never be implied from language which will admit of any other reasonable construction. Such an intention must be expressed in clear and unmistakable terms, or must appear by necessary implication from the language used, for it is a well settled principle and when a specific privilege or exemption is claimed under a statute, charter or act of incorporation, it is to be construed strictly against the property owner and in favor of

the public. This principle applies with peculiar force to a claim of exemption from taxation. Exemptions are never presumed, the burden on the claimant to establish clearly his right to exemption and an alleged grant of exemption will be strictly construed and cannot be made out by inference or implication but must be beyond reasonable doubt. In other words, since taxation is the rule, an exemption the exception, the intention to make an exemption ought to be expressed in clear and unambiguous terms; . . .

This office has held that with respect to excise taxes such as the sales, use or gasoline tax the state and its political subdivisions are liable for the same unless exempted therefrom. Official Opinion No. 75-148. See also Official Opinion 75-161.

If the district, therefore, purchases materials to build a house with district or other controlled funds and builds the same to be moved it would be selling tangible personal property although the same may be intended as a realty improvement contract and therefore it would have a tax liability on its gross receipts from the sale of such property.

A point on the sales tax has been raised with respect to SDCL 10-45-13 which purports to exempt gross receipts from engaging in an educational activity for not more than five consecutive days. Because it appears the district is engaging in activity for more than five days, that section would not be applicable. That section also provides that all organizations claiming this exemption shall 'pay this tax on all goods and services otherwise subject hereto and used in the conduct of such activities.' If the school is claiming the exemption under § 10-45-13 it may only do so having paid the tax when it purchased the materials and supplies; it cannot have it both ways. An opinion of this office issued in 1977, Official Opinion No. 77-14, comes close to answering this question but in fact does not discuss the matter of the requirement for payment of sales tax under § 10-45-13 on goods and services used in the otherwise exempt educational activity. There obviously is a large difference in the amount of supplies and materials which would be needed to put on a music contest or school play as opposed to materials in constructing a building. That opinion is generally inapposite here.

With respect to the South Dakota use tax, SDCL 10-46, as a public or municipal corporation the school district would not be subject to any use tax, § 10-46-7, as a consumer of materials used in a house which is built onsite and not to be moved. Since the district is using tangible personal property and converting the same to a realty improvement, there would be no use tax on the transaction on the part of the owner of the land since at the

time he becomes the owner of the structure it no longer is tangible personal property and the condition of tangible personal property is the only application of the use tax under § 10-46-2, 3 or 4.

The third tax involved is the new contractors' excise tax, § 10-46A. Prior to the amendment in 1980, it was a 4 percent tax; it has now been reduced to a 1 1/2 percent tax and relates to those individuals building or making realty improvements among which are included the type of buildings here involved. The buildings here in question are basically prefabricated; in other words, they are generally moved onto the site. The question becomes one of fact as to what the actual transaction was which takes place. Obviously if the building is erected on the owner's site, the total contract price would be subject to contractors' excise tax. If the building is merely sold to the owner of the site and the district does nothing so far as installation of the building, the only tax so far as the district is concerned would be the sales tax on its gross receipts. Whoever installs the building becomes the realty improver and must pay a tax on his gross receipts from the installation of the building. If the building is sold to the owner of the site and he himself installs it on the property, the facts as to that person's operation would have to be looked into to determine whether he would come under § 10-46A-5 as a person making a realty improvement without a realty improvement contract and whether or not it was isolated or occasional and whether he held himself out as engaging in the business of making such realty improvement contracts.

The third situation which arises could be the one where the district might sell the unit to a broker or some other person for resale. In that event the district would not have a tax liability but the person finally selling to the consumer or becoming the consumer of that property would incur the liabilities above referred to. With respect to other applications of the contractors' excise tax see Official Opinions 80-41 and 80-62.

Respectfully submitted,

Mark V. Meierhenry
Attorney General