



Volume 18 Number 2 June 2011

**Must Be Present to Win:
South Dakota's New Physical Presence Requirement for Charitable Sales Tax Exemption**

[Alexandra Hanson](#)

Dallas

1.214.969.5084

ahanson@jonesday.com

[Justin R. Thompson](#)

Dallas

1.214.969.5030

jrthompson@jonesday.com

As part of a recent review of tax-exempt nonprofit organizations, South Dakota adopted legislation requiring nonprofits to have a physical presence within the state in order to be exempted from sales tax. While the new law is estimated to affect only 30 organizations, it appears subject challenge as unconstitutional on the basis that it discriminates against out-of-state nonprofits. Can an entity have sufficient nexus to be subject to tax, but not sufficient nexus to qualify for exemption?

Effects of SB 39

Enacted March 15, 2011, and effective July 1, 2011, South Dakota Senate Bill 39 ("SB 39") requires nonprofit charitable organizations and religious or private educational institutions to have a physical location in South Dakota in order to qualify for an exemption from South Dakota sales tax.¹ Specifically, SB 39 would affect nonprofit charitable organizations which devote their resources exclusively to the relief of the poor, distressed, or underprivileged and which do not have a physical location in South Dakota. SB 39 would also affect private educational institutions accredited by the South Dakota Department of Education or the North Central Association of Colleges and Schools that do not maintain a campus in South Dakota, as well as religious educational institutions that do not maintain an in-state campus.

Charitable organizations and religious or private educational institutions without a physical presence in South Dakota would be affected by SB 39 only if they make purchases within the State of South Dakota, as these purchases would no longer be tax-exempt. Ultimately, SB 39 is unlikely to have far-reaching effects—only 25 charitable organizations and four religious educational institutions are likely to be affected.² However, for those out-of-state nonprofits that use the charitable exemption to buy materials in South Dakota tax-free, the revocation of tax-exempt status could have a significant impact on their working budgets in an already tight space.

¹ SB 39, 86th Leg., Reg. Sess. (S.D. 2011).

² Mark Wolski, *South Dakota Governor Signs Bill Requiring Charities to Have Presence to be Tax Exempt*, BNA Weekly State Tax Report (Apr. 1, 2011).

Constitutional Concerns

Because SB 39 taxes domestic and foreign organizations differently, it may violate the Commerce Clause of the United States Constitution. The Commerce Clause is derived from Congress's power to regulate commerce among the states, and its negative sweep (*i.e.*, the Dormant Commerce Clause) prohibits states from imposing barriers to trade, particularly in situations where a state has enacted legislation that treats residents differently from nonresidents. By limiting South Dakota's state sales tax exemption to nonprofits with a physical presence in the state, SB 39 may do just that.

The United States Supreme Court has held that state tax bills intended to provide greater tax benefits to domestic charitable interests are unconstitutional. For example, in *Camps Newfound/Owatonna, Inc. v. Town of Harrison*,³ the Court struck down a Maine statute that afforded a property tax exemption for charitable institutions serving residents within the state but offered a more limited tax benefit for charitable institutions serving non-Maine residents. The Court noted that the services which Camps Newfound, Owatonna, and other similarly situated charitable organizations provide to their principally nonresident campers "clearly have a substantial effect on commerce, as do state restrictions on making those services available to nonresidents."⁴ Further, the Court stated that attempts to encourage economic isolationism by prohibiting out-of-state access to in-state resources serve the "very evil that the dormant Commerce Clause was designed to prevent."⁵

Conclusion

South Dakota's SB 39 may run afoul of the United States Constitution by preventing foreign nonprofits from taking advantage of a state sales tax exemption afforded their in-state counterparts. While South Dakota desires to conserve state resources and provide tax-exempt status only to nonprofits directly benefiting state residents, such protectionism adversely affects foreign nonprofits, which rely on the sales tax exemption to garner the supplies necessary to support their missions.



This article is reprinted from the *State Tax Return*, a Jones Day monthly newsletter reporting on recent developments in state and local tax. Requests for a subscription to the *State Tax Return* or permission to reproduce this publication, in whole or in part, or comments and suggestions should be sent to Christa Smith (214.969.5165) in Jones Day's Dallas Office, 2727 N. Harwood, Dallas, Texas 75201 or StateTaxReturn@jonesday.com.

©Jones Day 2011. All Rights Reserved. No portion of the article may be reproduced or used without express permission. Because of its generality, the information contained herein should not be construed as legal advice on any specific facts and circumstances. The contents are intended for general information purposes only.

³ 520 U.S. 564 (1997).

⁴ *Id.* at 574.

⁵ *Id.* at 578.