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This fact sheet is designed to inform you about South Dakota's application of contractors' excise tax to construction services provided to qualified utility companies. Contractors' excise tax is unique to South Dakota and many contractors are not familiar with it.

Information found in this document rescinds and replaces all previous written information on this subject. Readers and users of this publication are responsible for keeping informed about changes in tax laws and regulations by reading the department's newsletters, press releases, Tax Facts, and other documents published by the Department of Revenue.

Any person entering into a contract for construction services enumerated in Division C of the Standard Industrial Classification Manual of 1987 or engaging in services that include the construction, building, installation, or repair of a fixture to real property must have a South Dakota contractors' excise tax license. This includes repair or remodeling of existing real property or the construction of a new project.

Construction services for qualified utilities (qualified utility projects) are subject to tax under SDCL 10-46B, the alternative contractors' excise tax. All other construction services in South Dakota are subject to tax under SDCL 10-46A. The contractors' excise tax that applies to the original contract applies to all change orders to that contract.

Construction projects for the following types of utility companies are qualified utility projects subject to tax under 10-46B.

- Electric, Heating, Power, Water, and Gas Companies
- Telephone Companies
- Rural Electric, Telephone, or Water Supply Companies
- Rural Water Systems
- Railroads (if they own track in South Dakota)

All construction services or realty improvement work that is for property owned by a qualified utility and used for that utility are subject to excise tax under SDCL 10-46B.

Buildings built for a qualified utility to be used by that utility business are taxed under SDCL 10-46B as a qualified utility project. This includes offices, warehouses and storage buildings. Buildings built by a utility that are not part of the utility service, such as an apartment building, a city fire station or a non-utility building, are subject to tax under SDCL 10-46A.

Municipal Contracts

Construction projects for the following municipal utilities are subject to the regular contractors' excise tax of SDCL 10-46A.

- Municipal Sewer System
- Municipal Utility including electric, light, heat, and power
- Municipal Water System

Construction projects for Municipal Telephone Systems remain subject to the alternative contractors' excise tax of SDCL 10-46B.

Municipal mixed contracts, that include both roadwork and water or sewer work, are subject to the regular contractors' excise tax of SDCL 10-46A. Prime contractors bidding on municipal contracts that include roadwork and water or sewer work can provide prime contractor exemption certificates to subcontractors performing the following services: traffic control, striping, flagging, operation of pilot cars, signing, landscaping, seeding, sodding, mulching and erosion control.

The following project examples are subject to the regular contractors' excise tax of SDCL 10-46A:

1. A municipality approves replacement of a water main and pavement of a street in one contract.
2. A municipality replaces water main in a residential area.
3. A municipality approves replacement sewer lines, curb and gutter, and resurfacing of the street in one contract.

For tax application on contracts bid prior to February 25, 2010 please contact the Department at 1-800-829-9188.

Qualified Utility Projects

The following may or may not be qualified utility projects. If you are contracting with these types of businesses, please

Qualified Utility Projects

check with the Department to determine if the project will be taxed as a qualified utility project under SDCL 10-46B.

Pipelines:

- **Natural gas pipelines:** Construction services for a natural gas pipeline are a qualified utility project subject to tax under SDCL 10-46B. Businesses that furnish electricity, heat, power, water, or natural or artificial gas or distribute the same for public use by means of transmission lines, gas or water pipelines are held to be a light or power company, heating company, water company, or gas company (SDCL 10-35).
- **Pipelines that transport petroleum products:** Construction service for a pipeline that transports petroleum products is not a qualified utility projects and is subject to tax under SDCL 10-46A. This includes businesses that transport or transmit gas, gasoline, oils, or motor fuels by means of pipelines as a common carrier (SDCL 10-37).

Railroads:

- Construction services for a railroad that is a qualified utility are subject to tax under SDCL 10-46B. The railroad company must own tracks in South Dakota to be a qualified utility.
- If the railroad is not a qualified utility the contract is subject to tax under SDCL 10-46A.

Sanitary Districts:

- Construction services for a sanitary district that is also a water supply district are subject to tax under SDCL 10-46B because the water supply district qualifies as a qualified utility.
- Construction services for a sanitary district that is for waste water only are subject to tax under SDCL 10-46A.

Telephone Companies:

- Telephone companies, including Rural and Municipal telephone systems, are qualifying utilities. Cellular phone companies are not qualifying utilities. When a telephone company expands their business to provide wireless services, any construction for the wireless service will be subject to tax under 10-46B because the telephone company is a qualifying utility.
- The installation of telephones into pre-wired outlets, which are in a separate contract, is subject to sales tax.

Wind Energy Projects:

- Construction services for wind farms that will produce more than 5000 kilowatts of power are subject to tax under SDCL 10-46B. Construction services include the initial construction of, repairs to, and expansion of a wind farm.

- Wind farms, that began producing power prior to July, 2007, and produce more than 5000 kilowatts of power, that plan to expand should contact the Department to determine which tax applies.

Utility is the prime contractor:

- When a utility bills a third party for construction work done on utility owned property, the utility is the prime contractor and is subject to the contractors' excise tax under SDCL 10-46B because the work is for the utility company. The utility company may not issue prime contractor exemption certificates to contractors that work on this project.

A utility company's receipts are subject to tax under SDCL 10-46B when the utility company is performing construction services for another qualified utility company.

Example

A car damages a light pole. The utility hires a contractor to replace the pole and bills the driver for the replacement.

- The utility company has gross receipts subject to contractors' excise tax. Any contractor hired by the utility company will also owe excise tax on their receipts.

- When a utility receives payments for construction work done on the customer's property, the utility is the prime contractor but is subject to the contractors' excise tax under SDCL 10-46A because the work is NOT for a utility company. The utility company may issue prime contractor exemption certificates to contractors that work on this project.

Example

A property owner hires the utility company to install a new meter (property owner owns the meter).

- The utility company has gross receipts subject to contractors' excise tax. Any contractor hired by the utility company that receives a prime contractors' exemption certificate from the utility company will not owe excise tax on their receipts.

Utility sells material: The sale of material that does not include installation is subject to sales tax.

Customer hires contractor: The contractor hired by the customer, will owe contractors' excise tax under SDCL 10-46A. The contractor must include the value of owner-furnished material in their taxable gross receipts - because this is not a qualified utility project.

Tax Application

Qualified Utility Projects

Tax applies under 10-46B

The prime and subcontractors' tax liability is as follows:

Prime Contractors:

- Owe 2% contractors' excise tax on their gross receipts.
- Do not include the value of the owner-furnished material in their gross receipts subject to the contractors' excise tax.
- Owe 4% state and applicable municipal use tax on materials furnished by the owner if the owner does not document sales or use tax was previously paid.
- Owe 4% state and applicable municipal sales or use tax on material and services they purchase for the contract.
- Cannot issue prime contractor exemption certificates to subcontractors for a qualified utility project.
- Cannot deduct amounts paid to subcontractors in determining gross receipts subject to the contractors' excise tax.

Subcontractors:

- Owe 2% contractors' excise tax on their gross receipts.
- Owe 4% state and applicable municipal sales or use tax on material and services they purchase for the contract
- Cannot accept a prime contractors' exemption certificate for a qualified utility project.

The prime contractor's contract determines the tax application for all subcontractors. If the prime's contract is for a qualified utility construction project subject to tax under 10-46B, the subcontractors are also subject to tax under 10-46B.

Projects that are not qualified utility projects

Tax applies under 10-46A

The prime and subcontractors' tax liability is as follows:

Prime Contractors:

- Owe 2% contractors' excise tax on their gross receipts.
- Include the value of material furnished by the owner in their gross receipts subject to the contractors' excise tax.
- Owe 4% state, plus applicable municipal use tax on materials furnished by the owner if the owner does not document sales or use tax was previously paid
- Owe 4% state and applicable municipal sales or use tax on material and services they purchase for the contract.
- Must issue prime contractor exemption certificates to subcontractors.
- Cannot deduct amounts paid to subcontractors in determining gross receipts subject to the contractors' excise tax.

Subcontractors:

- Do not owe the 2% contractors' excise tax IF a prime contractors' exemption certificate is received for that project.
- Owe 4% state and applicable municipal sales or use tax on material and services they purchase for the contract.

The following are not qualified utility companies or qualified utility projects.

Construction services for these companies or projects are subject to tax under SDCL 10-46A.

WAPA - Western Area Power Administration: Construction projects for WAPA are not qualified utility projects because WAPA is a Federal entity.

Watershed Districts: Construction projects for watershed districts are not qualified utility projects.

Projects Subject to Contractors' Excise Tax

- Land clearing
- Underground storage tanks installation and removal
- Poles –Treating poles that are installed with a wood preservative that is brushed on, replacing, or repairing poles
- Moving lines, poles, cable, and pipe
- Installation of Utility Buildings, Pre-wired - construction of buildings that are pre-wired for controls and switching, i.e., telephone switching stations

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- Remediation and cleanup of soil (see leakage detection and monitoring services under Services subject to sales tax.)

Services subject to sales tax

The following services are subject to the 4% state plus applicable municipal sales tax. A prime contractor cannot issue a prime contractors' exemption certificate to service providers that are subject to sales tax.

- Monitoring of water wells
- Cleanup of water
- Locating lines, poles, cable and pipes
- Poles
 - Treating poles that are not installed
 - Inspecting, without repair or replacement, which may include boring into the pole and inspecting for decay, marking those with decay, and sending reports to the utility company
- Pressure testing of pipelines
- Soil cleanup
- Tree trimming and clearing
- X-raying or inspecting pipeline welds
- Laboratory analysis of water and soil samples
- Leakage detection and monitoring services:
 - A testing service is subject to sales tax even if the testing company drills a hole to obtain a sample and puts a casing in this test hole. If a contractor is hired to drill the test hole, that contractor's receipts for drilling are subject to contractors' excise tax. The testing company cannot give the contractor a resale or prime contractors' exemption certificate. Monitoring of test holes is subject to sales tax.
 - Remediation or cleanup of the soil is subject to contractors' excise tax. If the contract includes testing and cleanup of soil the entire charge is subject to contractors' excise tax.
- Construction of prewired utility buildings or sheds that are not installed.

Hookup and Connection Charges

Hookup Only

Hookup or connection charges for utility services are subject to sales tax if the utility service is subject to sales tax.

- Electrical and natural gas hookups are subject to sales tax because the sale of electricity and natural gas is subject to sales tax.
- Water and sewer hookups are exempt from sales tax

because water and sewer sales and services are exempt from sales tax.

Temporary hookups during construction are subject to sales tax.

Hookup with sales of material

Hookup or connection charges that include the sale of material, but not the installation, are subject to sales tax. If the utility itemizes the charges for the hookup and for the material then they may tax the material and not the hookup if the hookup is for an exempt utility service. If it is all included in one flat fee, the entire fee is taxable.

Hookup with construction services

Hookup or connection charges for utilities that include construction services are subject to contractors' excise tax.

This may include the charges to bring the utility to the structure, digging trenches, putting in culverts, running lines, or putting in controls. SDCL 10-46B will apply if the property installed is owned by the qualified utility company. SDCL 10-46A will apply if the property installed is sold to or owned by the customer or property owner.

Example

1. A utility company installs a line from their pipeline to the customer's location. The utility company bills the customer for the installation. This line will be owned by the customer.

The utility's charge to the customer for the line installation is subject to contractors' excise tax under 10-46A. The utility company should provide a prime contractors' exemption certificate to any subcontractor they hire for this project.

2. The utility company extends their line to the customer's property. The utility company bills the customer for this extension, but will retain ownership to the line.

The utility's charge to the customer for the line extension is subject to contractors' excise tax under 10-46B. Any subcontractor hired by the utility company will also owe excise tax on their receipts.

If the hookup or connection charge is listed separate from the construction services the hookup or connection charge is subject to sales tax or exempt from tax if the utility service is exempt from sales tax.

Deposits and Other Fees

The deposit for a utility service, including electricity, natural gas, telephone, or water or sewer service, is not subject to sales tax. Utilities that paid sales tax on deposits in the past should refund the sales tax to the customer when the deposit is refunded.

The following charges for utility services are subject to sales tax if the utility service is subject to sales tax:

- Disconnect fees
- Tap fees
- Collection fees
- Meter deposit fees

Gross Receipts

Contractors' excise tax is calculated on total gross receipts. Gross receipts are defined as the total amount received including, but not limited to, sales tax, use, and contractors' excise tax, materials, labor, profit, owner-furnished material, and any other expenses. Gross receipts for qualified utility projects do not include owner-furnished material. A contractor cannot take a deduction for the cost of the property sold, cost of the materials used, the cost of services or labor purchased, amounts paid for interest or discounts, or any other expenses or losses.

The contractors' excise tax and the contractor's sales and use taxes are part of the contractor's total bill and are collectible from all entities, both public and private. State law allows contractors to list their tax expense as a separate line item on all contracts and bills.

Bid Factor: A factor of 2.041% can be used to calculate excise tax due when preparing a bid or bill. This factor allows the contractor to recover the excise tax. The factor 2.041% is used to prepare a bid or bill, however, a straight 2% rate is used when calculating the excise tax on the contractors' excise tax return.

A Bid Factor Calculator, which is an excellent tool for calculating South Dakota contractors' excise tax, is available on the department's website, at <http://dor.sd.gov/>. The calculator is a form that can be viewed with Adobe Acrobat Reader. The user will enter their figures and the form automatically calculates the tax due. Users can also print a Bid Factor Sheet without the calculation fields for use out in the field or if they don't have access to a computer.

Owner-Furnished Materials

For qualified utility projects subject to tax under SDCL 10-46B the prime contractor:

- Owes 4% state and applicable municipal use tax on materials furnished by the owner if the owner does not document sales or use tax was previously paid.
- Owes 4% state and applicable municipal use tax on all material furnished by a government agency.
- Includes the use tax they owe on the value of the owner-furnished materials in the gross receipts subject to contractors' excise tax.
- **Does not** owe contractors' excise tax on the value of the owner-furnished materials (do not include the value of the material on the Owner-Furnished Materials line of the contractors' excise tax return.)

Use tax is due during the reporting period the material is furnished to the contractor.

For projects that are not for a qualified utility that are subject to tax under SDCL 10-46A the prime contractor:

- Owes 4% state and applicable municipal use tax on materials furnished by the owner if the owner does not document sales or use tax was previously paid.
- Owes 4% state and applicable municipal use tax on all material furnished by a government agency.
- Includes the use tax they owe on the value of the owner-furnished materials in the gross receipts subject to contractors' excise tax.
- Owes 2% contractors' excise tax on the value of the owner-furnished materials and the use tax due on these materials. (Include the value of the material and the use tax paid by the owner on the Owner-Furnished Materials line of the contractors' excise tax return.)

Contractors' excise tax and use tax are due on the owner-furnished materials during the reporting period the material is furnished to the contractor.

Use Tax

When sales tax is not paid to the supplier on sales taxable services, supplies, materials, and equipment at the time of purchase, use tax is due on products or services used, stored, or consumed in South Dakota.

Use tax is due:

- When a retailer/contractor removes materials or equipment from inventory that was purchased without tax to install into real property;

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- When a sales tax exempt entity furnishes materials to a contractor to perform a realty improvement.
- When material is purchased from an unlicensed supplier.

The use tax rate is the same as the 4% sales and municipal tax rates. Use tax is due on the purchase price or the fair market value, whichever is greater.

Use tax must be reported when the item used comes into South Dakota or when it is taken out of inventory to be used in a construction project.

City Use Tax on Electrical Supplies

Electrical supplies purchased by any qualified utility company and that are specifically intended for use outside the city limits are not subject to municipal sales or municipal use tax when stored within the city limits. If the supplies are used within the city limits, the utility company will owe city use tax on the value of the supplies.

Additional information on contractors' excise tax and use tax may be found in the following documents that are available on the Department's website at <http://dor.sd.gov/> or by calling 1-800-829-9188.

- Contractors' Excise Tax Manual
- Bid Factor Calculator
- Communication Equipment Installation and Repair Tax Facts
- Realty Improvements for Exempt Entities Tax Facts

Talk to Us!

If you have a tax problem or question, call the South Dakota Department of Revenue toll-free at 1-800-829-9188. Visit us on the web at <http://dor.sd.gov/>, email us at bustax@state.sd.us or write us:

**South Dakota
Department of Revenue
445 East Capitol Ave.
Pierre, SD 57501-3185**

Aberdeen
14 South Main, Suite 1-C
Aberdeen, SD 57401

Sioux Falls
300 S. Sycamore Suite 102
Sioux Falls, SD 57110

Mitchell
417 N. Main, Suite 112
Mitchell, SD 57301

Watertown
715 S Maple
Watertown, SD 57201

Rapid City
1520 Haines Avenue, Suite 3
Rapid City, SD 57701

Yankton
1900 Summit Street
Yankton, SD 57078-1951

What's changed in this Tax Fact?

1. Construction services for property owned by a qualified utility is subject to excise tax under SDCL 10-46B. Previously, SDCL 10-46A applied when the construction service was paid by a third party even if the work was on utility owned property. (page 1, page 2 Utility is prime contractor, and page 4 Hookup with construction services)
2. Deposits for utility services, including electricity, natural gas, telephone, or water or sewer services, are no longer subject to sales tax. (page 5)