

June 2016

**This Tax Facts is designed to explain how sales and use tax applies to Real Estate Brokers' commissions and products or services purchased or sold. If this Tax Facts does not answer your specific question, please call the department's toll-free Helpline at 1-800-829-9188 between 8:00 AM – 5:00 PM CST, Monday through Friday.**

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

## **Commissions**

Commissions received by a real estate broker under any type of agency agreement or any fee originating from the sale of real property sold in the state of South Dakota, regardless of the broker's or agent's residence, are subject to state and applicable municipal sales tax based on where the property is located.

Sales tax is due during the reporting period the broker receives the commission, usually at the time of closing. The broker pays sales tax on the full commission received, without deduction for amounts paid to broker associates or salespersons or other expenses.

- Broker - The broker(s) is responsible for sales tax on the total commission received.
- Broker associate or salesperson – A broker associate or salesperson is a representative of the broker with whom he/she is affiliated. The broker associate or salesperson does not owe sales tax on the commission received as the listing or selling broker associate or salesperson.

**Example:** Broker A lists a house. A broker associate affiliated with Broker A contacts a buyer, shows a house listed with Broker A and obtains an offer that is accepted. When the closing occurs the full commission of \$10,000 is paid to Broker A. Broker A then remits a 40% commission split, \$4,000, to the broker associate. Broker A owes sales tax on the full commission of \$10,000. The broker associate does not owe sales tax on the \$4,000 commission split.

**Multiple Listing Service.** Under a multiple listing agreement, more than one broker may be involved in the sale of a property. In some instances, the listing broker is paid the commission and applicable sales tax at the time of closing. The listing broker sends the selling broker the agreed upon share of the commission along with the applicable sales tax. Both brokers remit the applicable sales tax on their respective portions of the commission.

**Example:** A house in Pierre sells for \$175,000. The commission is

split between the listing and selling brokers. The listing broker collects \$10,500 plus \$682.50 (state and Pierre city sales tax) at the time of closing. The listing broker keeps 50% of the commission and sends 50% to the selling broker. Each reports tax on \$5,250 at 6.5%.

**Referral Fees** - The agency receiving the referral fee owes sales tax based on its location.

## **Office Help and Other Services**

**Services provided by office personnel, broker associates or salespersons** may be subject to sales or use tax. However, sales tax does not apply to broker commission splits to broker associates or salespersons in regard to their listing and selling activities.

1. When a service provider is an employee and the real estate company is paying withholding taxes, the wages are not subject to sales or use tax.

2. A company paying a service provider on an hourly basis that is not paying withholding taxes should contact the Department of Labor ([www.dol.sd.gov](http://www.dol.sd.gov)) to determine if withholding is required. If withholding is not required, the service provider is an independent contractor. Amounts paid to an independent contractor are subject to sales or use tax. The real estate company is responsible for remitting use tax if the service provider does not charge sales tax.

### **Examples:**

- a. An independent contractor is paid \$12 an hour to answer calls and schedule appointments. The payment each week shows the number of hours and hourly rate. Because this is not for a specific client, use tax is due on the amount paid to this person.
- b. The broker hires a broker associate on an hourly basis to do a few jobs. The broker associate answers the phone, places signs on three properties, and shows a property to a prospective buyer. The broker associate was paid for 5 hours work at \$15.00 per hour. No withholding is done. This is an independent contractor. Because the services were for multiple clients, these services cannot be purchased for resale. Sales or use tax is due on the \$75.00 paid to the salesperson.

3. If the independent contractor provides services for a specific client and the invoices and payment information indicate the services are for a specific client, the services may be purchased for resale.

**Example:** A broker associate hosts an open house and shows the house to three prospective buyers for the broker. The broker sells the house and pays the broker associate \$200. The invoice states the owner and property for which the service was provided. The \$200 is not subject to sales or use tax.

**Temporary help** services are subject to state and city sales tax where the services are used.

### **Licensing and Insurance**

Brokers do not owe sales tax on amounts received as reimbursement for fees paid on behalf of a broker associate or salesperson if the broker associate or salesperson is legally liable for those fees.

- **License Fees.** Licensing fees paid to the State are not subject to sales tax. Because these fees are required by law, brokers who pay the licensing fees of their broker associates or salespersons do not owe sales tax if reimbursed by the broker associates or salespersons.
- **Errors & Omissions Insurance.** Premiums paid for insurance policies are not subject to sales tax. Brokers do not owe sales tax on reimbursements for Errors & Omissions Insurance because the licensee is legally liable for this insurance.

### **Meeting Expenses**

Reimbursements the broker receives from broker associates or salespersons for meeting or meal expenses the broker paid on behalf of the broker associates or salespersons are not subject to sales tax. Sales or use tax should be paid on all taxable services or products purchased.

### **Rent and Office Expenses**

A company may bill expenses such as utilities, phone calls, copies, desk rent or office space rent to the broker associates, salespersons, or other people that share an office.

1. A company that owns an office building does not owe sales tax on the rental of office space. Charges for any optional services offered by the owner are subject to sales tax.

**Example:** Broker A owns an office building. Broker A charges that each pay a portion of the utilities and phone service. Because the utilities and phone service are not optional, the entire charge is not subject to sales tax whether billed as a lump sum or the charges are itemized.

2. A company leasing office space from the building owner may split the office rent with others working in that office and may charge for various services. Charges for desk or office rent are not subject to sales tax. If the company bills separately or itemizes charges for other services, those charges are subject to sales tax. Examples of taxable charges include equipment rental, phone services, utilities, office help, copies, snow removal, and cleaning.

**Example:** Broker B leases office space from the owner of a building and bills broker associates monthly for their share of the office, including a separate charge for utilities and phone service. Sales tax applies to the utilities and phone charges. If Broker B had charged a flat fee per month that included space, utilities and phone, no sales tax would be due.

### **REALTOR® and Other Associations**

These are membership organizations the broker, broker associate, or salesperson may choose to join. Membership fees are not subject to sales tax. Services provided by a membership organization, such as multiple listing services, are not subject to sales tax. The sale, lease, or rental of tangible personal property or products transferred electronically is subject to sales tax. The association is responsible for paying sales or use tax on all purchases of products and services. Taxable items may include books printed with listings, flyers, and locks, keys, or key readers used to access the properties. Any charges by the broker to the broker associate or sales person for association fees are not taxable; charges by the broker for taxable items are subject to sales tax.

### **Advertising**

Advertising services where the service provider creates or prepares the ad and places the ad in the media are exempt from sales tax. Either creating an ad or placing an ad without the other service is subject to sales tax. Any charges by the broker to the broker associates or salespersons for exempt advertising services are not subject to sales tax. Charges by the broker to the broker associates or sales persons for taxable services, flyers, or brochures are subject to sales tax.

#### **Newspaper, Radio, Magazine**

- Fees to create an advertisement and place the advertisement in the media are not subject to sales tax.
- A fee to create an advertisement that is not placed in the media by the business that created the ad is subject to sales tax.
- Charges by a newspaper, radio, magazine or other form of media for the placement of an ad are not subject to sales tax.

#### **Websites**

- Charges by an agency to create a website and place a website on the Internet are not subject to sales tax. The agency must create and place the website for this to be an exempt advertising service.
- Charges by an agency to create a website that is transferred to the owner, and not placed on the Internet by the agency, are subject to sales tax.
- Web hosting services, domain name registration, and services other than creating and placing the website are subject to sales tax.
- Charges by a website owner for another business to place an advertisement or a listing on an existing website are not subject to sales tax.
- Charges by an agency to create and place virtual tours on the Internet are not subject to sales tax. Charges by an agency to create a virtual tour that is not placed on the Internet by that agency are subject to sales tax. Charges by the owner of an existing website to an agency for placement of its virtual tour on the existing website are not subject to sales tax.

**Flyers and brochures.** Charges to create and print flyers and brochures are subject to sales tax as a sale of tangible personal property.

**Multiple Listing Services (MLS) Websites.** The MLS develops and places websites on the Internet for the participants in the multiple listing area. The development and placement of a website is an exempt advertising service. Charges for placing ads or listings on an existing website are not subject to sales tax. All purchases by a MLS company are taxed. All sales of products by a MLS are taxable, i.e., copies of listings, keys and locks. Charges by the broker to the broker associates or salespersons for MLS services that are exempt advertising services are not subject to sales tax.

See **Advertising Tax Facts** for further information.

## **Earnest Money**

Earnest money held by the real estate broker on behalf of their client is not subject to state and city sales tax. However, if the earnest money is used as part of the broker's commission at closing that is subject to state and city sales tax based on the property location. Earnest money paid to the homeowner or returned to the seller is not subject to sales tax.

## **Exempt Entities**

Sales to the federal government, its agencies, and the State of South Dakota and any public or municipal corporations of the State of South Dakota are exempt from sales tax. If the broker's contract is with the government or state and payment of the commissions is from the government or state, no sales tax applies. If the broker's contract is with the buyer, who is not a government entity, and the buyer pays the commission, then the commissions are subject to sales tax.

**Example:** When the real estate broker represents the Department of Housing and Urban Development (HUD) for the sale of a property and HUD has a contract to compensate the agent, the commission paid to the broker is exempt from tax since HUD is a government entity.

## **Franchise Fees**

Royalty fees paid by a franchisee strictly for the privilege of engaging in business using the franchiser's name are not subject to sales or use tax. However, royalty fees are taxable if the franchiser charges the franchisee a flat fee which includes royalty fees and products or services. When taxable sales are included within the royalty fee, and not separately stated, the entire royalty payment is subject to South Dakota sales or use tax. Examples of taxable items that may be included with the royalty fee are training, accounting, software, signs, and promotional items.

See **Franchise Tax Facts** for additional information.

## **Appraisals**

Real estate appraisals are subject to state & applicable municipal tax where the report is delivered.

## **Foreclosures**

Banks or finance companies often contract with brokers to sell properties they obtained through foreclosure. Commissions received from the sale of foreclosed properties are subject to sales tax. Banks and financial companies are not exempt from sales tax. Any person or retailer subject to sales tax may add the tax to his or her price or charge. (SDCL 10-45-22) Brokers are responsible for remitting sales tax whether or not the tax is collected from the client.

## **Home Inspections**

Home inspection services are subject to state and applicable municipal sales tax based on the location of the property.

## **Home Warranties**

The sale of home warranties, which may cover the structure and appliances, is subject to state and applicable municipal sales tax. Brokers, broker associates, or salespersons do not owe sales tax on commissions they receive from the sale of a home warranty.

## **Real Estate Auctions**

Auctioneer commissions for the sale of real property are subject to state and applicable city tax based on where the property is located. The sale of real property, land and buildings, is not subject to sales tax except for buildings sold with the requirement that they must be moved.

See **Auctioneer Tax Facts** for further information.

## **Spec Homes**

Any person that makes a realty improvement and sells the property containing the realty improvement within four years of its completion is subject to contractors' excise tax. This includes new construction and remodeling of existing buildings. This may be referred to as a spec building or house flipping. Brokers, salespersons, investors, individuals, and contractors are examples of people that may be spec builders.

See **Speculative Builders, \$100,000 Rule Tax Facts** for further information.

## **Asset Management Companies**

An asset management company manages assets an owner has in inventory for sale. An asset management company may provide services from maintenance to selecting the brokers and will see that transactions are completed through closing. Services provided by these companies are subject to state and applicable municipal sales tax based on where property managed is located. An asset management company cannot deduct expenses incurred from its taxable gross receipts, except for items the client is legally liable for, such as property tax or filing fees.

Examples of services or products sold by asset management companies:

- Valuation
- Appraisals
- BPO's (A broker's price opinion (BPO) as to the value of property may be used when a full appraisal is not necessary.)
- Marketability analysis
- Market plan
- Recommended sales price
- Broker selection and monitoring
- Analysis of sales "As is" or "As repaired"
- Eviction management
- Cash for keys (CFK)
- Contract negotiations
- Title curative (Researches documentation to obtain clear titles)
- Closing, funding

An asset management company may have a network of recommended brokers for their clients to use. Fees paid by brokers to be included in this network are subject to sales tax based on the management company's location. Brokers owe use tax based on the broker's location if the management company does not charge sales tax.

Services such as appraisals or BPOs sold to an asset management company are subject to sales or use tax based on the management company's location.

**Example:** A bank has several homes it foreclosed on in Sioux Falls and Brandon. It hires an asset management company to handle the process of selling these homes. The asset management company cleans the property, obtains appraisals, selects a broker for the bank to contract with, negotiates the offers, and reviews all transactions through the closing. Fees charged by the asset management company for the homes in South Dakota are subject to the state sales tax. In addition, fees for homes in Brandon are subject to Brandon municipal tax and fees for homes in Sioux Falls are subject to Sioux Falls municipal tax.

An asset management company will owe sales or use tax on services it purchases. Services performed on the property such as staging, cleaning, snow removal, and lawn mowing are subject to sales or use tax at the property location. Contractors hired to repair a property will owe contractors' excise tax on their receipts.

### **Use Tax**

Products or services purchased from an unlicensed business are subject to use tax. The state use tax rate is 4.5%, plus applicable municipal use tax, and is payable to the Department of Revenue in the filing period in which the supplies or services are received.

Products delivered into South Dakota are subject to the South Dakota sales or use tax, even if the supplier charges another state's sales tax. When a purchase is made out-of-state and possession is taken out-of-state the supplier may charge that state's sales tax. If

the other state's sales tax is the same or more than South Dakota's tax, there is no South Dakota use tax due. If it is less than South Dakota's, the difference is due in use tax. The state use tax plus applicable municipal use tax must be added together to determine if additional tax is owed.

**Examples** of use taxable items are:

- Computers
- Software
- Office Supplies
- Paper
- Laminating and binding services
- Equipment
- Furniture
- Law Books
- Internet database services
- Maintenance Agreements

### **Municipal Tax**

Many municipalities in South Dakota impose sales and use tax in addition to the state tax. If the customer receives a product or service in one of these municipalities, the product or service is subject to that municipality's sales or use tax. A list of municipal tax rates is available on our website at <http://dor.s.gov> or by calling 1-800-829-9188.

It is the taxpayer's responsibility to remit the correct sales tax. If the taxpayer relies on the customer's representation of his or her taxing jurisdiction and that information is incorrect, the taxpayer will be responsible for any additional sales tax due.

TaxMatch, the department's Geographic Information System (GIS), will help users quickly find the correct tax rate and codes for locations throughout South Dakota. Users enter any South Dakota address into the Tax Match System; the system will then provide all the applicable tax codes and rates for that address. For quick and easy access, look for the GIS icon on the department's web site at <http://dor.sd.gov>.

### **Required Records**

Brokers must have a South Dakota sales tax license for each place of business within the state. The Department of Revenue – Business Tax Division requires records be kept for at least three years and be available for inspection during business hours. This includes records such as purchase and sales invoices, bills of lading, books of all receipts and sales, cash register receipts, and other pertinent papers and documents. Please note that other state or federal agencies may require a longer retention period.

## **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](mailto:bustax@state.sd.us) or write us:

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