

Nonprofit, charitable hospitals are exempt from paying South Dakota sales and use tax on gross receipts generated from health services. Many hospitals now engage in activities that go beyond the traditional “hospital” services. This publication assists taxpayers in better understanding South Dakota’s tax structure as it applies to nonprofit hospitals. If your specific question is not answered in this Tax Fact Sheet please call our toll-free helpline at 1-800-TAX-9188 weekdays from 8-5 CT.

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.

General Information

South Dakota law defines a hospital as “...any establishment with an organized medical staff with permanent facilities that include inpatient beds and is primarily engaged in providing by or under the supervision of physicians, to inpatients, any of the following services: diagnostic or therapeutic services for the medical diagnosis, treatment or care of injured, disabled or sick persons; obstetrical services including the care of the newborn; or rehabilitation services for injured, disabled or sick persons.” (SDCL 34-12-1.1)

Nonprofit, charitable hospitals are specifically exempted from paying South Dakota sales and use tax. The tax exemption applies when purchases are made by an authorized official of the hospital, payment is made from hospital funds, and title to the property is retained by the non-profit hospital. The exemption does NOT apply if the tangible personal property or services are for the personal use of hospital employees or if the purchases are for use in the operation of a taxable retail business.

When a nonprofit hospital purchases tangible personal property, the hospital should issue an exemption certificate to their vendor. If this personal property is transferred to a for-profit entity, sales or use tax is due at the time of transfer. However, if it’s known at the time of purchase that the property is being purchased for the for-profit entity, sales tax should be paid at the time of purchase.

It is **VERY IMPORTANT** that accurate records of purchases and their uses are kept. In fact, SDCL 10-45-14 specifically states that “all institutions claiming this exemption shall prepare and maintain a list of all purchases on which exemption was claimed, fully itemized, showing name and address of vendors, description of property purchased, date or dates of purchase, purchase price and brief explanation of use or intended use.”

Hospital-Owned Clinics and Related Corporations

Some hospitals have nonprofit and for profit entities such as satellite clinics, nursing homes and surgical centers under their control. A for-profit entity is NOT exempt from sales and use tax, even though it is considered a part of a nonprofit hospital group. One of the entities (either the for-profit or the nonprofit hospital) is usually a wholly owned subsidiary of the other, qualifying the entities as members of a “controlled group” (see SDCL 10-45-20.3). When one member of a controlled group performs a service for another member of that same controlled group, no sales or use tax is due on that service. However, when tangible personal property is transferred from the non-profit entity to the for-profit entity, sales or use tax is due at the time of the transfer if sales tax was not paid at the time of the original purchase.

When equipment is purchased by the hospital but is shared among the members of a controlled group, whether or not that equipment is sales or use taxable depends on the principal user. The controlled group needs to keep accurate and complete records showing the use of that equipment. If these records show that the principal use is by the nonprofit hospital, then no sales or use tax will be due. If the percentage of use by sales/use taxable members of the controlled group is greater than the percentage of use by the sales tax exempt member, use tax will be due based on the full purchase price less any discounts or trade-ins. Examples of such equipment would be computers, telephone/communication systems, typewriters, etc.

Professional Services

Fees paid to third parties (i.e. attorneys, accountants) for services performed for the controlled group shall be allocated in proportion to the use of the services by each member of the group. If the records are inadequate to determine the proportionate use of the services, then the entire fee is subject to sales or use tax if there is use of the services by any entity or division other than the nonprofit, charitable hospital. Third party service providers should be encouraged to bill for-profit entities on a separate basis.

Equipment

Equipment that is primarily used for nonprofit, charitable hospital purposes is NOT subject to sales or use tax. The two-prong test to qualify for the exemption is that the equipment is principally used (1) *BY* the hospital (2) *FOR* hospital purposes. Hospital purposes relate to the services normally associated with the conduct of the hospital. (See the General Information section for the definition of a hospital.)

As an example, if the hospital purchases computer terminals for placement in a physician's office in a clinic for the principal use of communication between the physician and the hospital, and the hospital retains title to the computer terminal, no sales or use tax will be owed. This only applies to computer terminals which physicians use strictly for hospital related work and there is no fee to the physician for the use of the terminal.

Another example is when a hospital purchases 100 hospital beds. Sixty beds remain in the hospital, but 40 beds go to an affiliated nursing home. All of the beds are purchased BY the hospital, but only 60 are purchased FOR hospital purposes. Therefore, sales or use tax must be paid on the 40 beds that go to the nursing home.

Cafeterias

Meals

The sale of food is subject to sales or use tax. Gross receipts resulting from sales to non-patients are sales taxable at the state sales tax rate and applicable municipal sales and municipal gross receipts tax. Patient meals are to be reported for state use tax purposes on line 2 of the return using the rate of \$9.66 per patient per day and on the line applying to the appropriate general city tax rate (this amount does not include newborn patients). In-patient hospital meals paid for by a public entity (including Medicare, Medicaid, CHAMPUS, Indian Health Services, or county poor relief patients) are exempt from tax.

Cafeteria Equipment

The purchase of equipment by the hospital to be used in the preparation of food is not subject to sales or use tax.

Catering

Any catering done by the hospital is subject to state sales tax and applicable municipal sales and municipal gross receipts tax. South Dakota Law (10-45-14) states that the exemptions to nonprofit charitable hospitals are only for purchases that are made by authorized officials, payment made from the institution funds, and title to the property is retained in the name of such institution. This exemption does not extend to sales to or purchases for the personal use of officials, members, or employees of such institutions.

Patient Comforts/Services

Welcome Kits/Comfort Kits

When admitted to a hospital, a patient is normally provided items to be used for personal grooming and hygiene, e.g. combs, toothbrushes, tissues, mouthwash, etc. The items in these personal use kits are subject to sales or use tax depending on the situation:

- If the hospital gives these kits to the patients, then use tax is due on the cost of the items.
- If the hospital sells the kits or individual items to the patients, then sales tax is due on the amount charged to the patient.
- If the items in the kit are given to the hospital by the manufacturer as promotional items, then the manufacturer is responsible for South Dakota use tax.

Accommodation Centers

When a hospital supplies sleeping rooms for non-patients, sales tax is due on the gross receipts. Services such as housekeeping and security used in the accommodation centers are not subject to sales or use tax when supplied by the nonprofit hospital.

Television Rental

Gross receipts from the rental of televisions are subject to sales tax. The purchase of television sets by a nonprofit, charitable hospital for patient use in the hospital is not subject to sales or use tax. Other equipment, such as cables, satellite dishes, etc., if purchased by the nonprofit hospital, are exempt from sales tax. The installation of satellite dishes is subject to contractors' excise tax. (ARSD 64:06:02:22.01) If the equipment purchased by a nonprofit hospital is used by the contractor to install a satellite dish, the equipment is subject to use tax by the contractor.

Telephones

Telephones in patient rooms are necessary for both the patients' well being and the doctors' and nurses' convenience and, therefore, are not subject to sales or use tax.

Home Healthcare and Hospice Programs

Gross receipts for home healthcare are exempt from sales and use tax, whether the organization is nonprofit or for-profit. Supplies, equipment and other tangible personal property are not taxable if the program is operated by the nonprofit, charitable hospital.

Other Hospital Outreach Programs

Alcohol and Drug Rehabilitation Centers, Schools of Nursing, Medical Research Libraries, and related programs operated by nonprofit hospitals are exempt from the sales and use tax. However, if such programs are operated under entities separate from the hospital, such entities are required to apply for exempt status from the Department of Revenue. Once their application for exempt status has been approved, such entities will receive an exempt status number which allows them to make sales or use tax exempt purchases.

Educational Classes

When the hospital provides classes such as childbirth classes, quit smoking clinics, and athletic injury classes, the fees are exempt from sales and use tax as health services if provided by licensed or certified healthcare professionals.

Miscellaneous Items

Hospitals provide some services and tangible personal property that are not related to healthcare. If the service or tangible personal property is directly related to the providing of health services, it is exempt. As an example, providing a humidifier for a patient's use is health-related (environmental control) and the charges are exempt. On the other hand, charges made by the hospital for TV or personal laundry are not part of the health service and are sales or use taxable.

If the hospital provides temporary help to a clinic or other non-related facility, this is a sales taxable service. The following services are also sales taxable when provided to non-related facilities or clinics:

- Accounting services
- Copies of medical records (other than Medicare, Medicaid, or other public entities)
- Janitorial services
- Laundry services

Day Care Centers

Many hospitals now provide childcare and babysitting services for employees, patient families, and others. The gross receipts from these services are not subject to sales tax. If the day care center is solely for the benefit of hospital employees, no tax is due on services, equipment, supplies, or other tangible personal property used by the center. If the day care center is solely for the benefit of parents not employed by the hospital, sales or use tax is due on those items. When a hospital provides day care for both employees and non-employees, the sales tax on these items is prorated based on the percentage of non-employee vs. employee users of the service.

Sales or use tax is due on the meals provided to the children of the day care center. The use tax will be computed based on \$9.66 per day, per child, or, at the discretion of the hospital. A documentable cost may be used and taxed at the state sales tax and applicable municipal sales tax.

Wellness/Fitness Centers

Wellness/Fitness Centers owned and operated by a nonprofit, charitable hospital are considered to be a part of the healthcare service of that hospital. The tax liability of these centers is:

- Gross receipts resulting from membership fees or charges for specific physical fitness classes are subject to sales tax.
- Sales of tangible personal property, such as athletic socks, t-shirts, concessions, etc., are subject to sales tax.
- Equipment and supplies purchased by the hospital for the wellness centers are subject to use tax based on its property valuation. (Property tax is based on a time/use and members under doctor's orders percentage.)
- Health-related classes such as childbirth classes, quit smoking classes, and athletic injury classes are exempt from sales or use tax when conducted by a licensed or certified healthcare professional.

Reporting

For reporting purposes, the hospital should include all receipts in its gross and claim the exempt sales as deductions. It is important that the hospitals remember that they are required by SDCL 10-45-14 to keep a list of all purchases for which an exemption is claimed. Hospitals must report their receipts and deductions on the return provided to them by the SD Department of Revenue.

Bad Debts

Only businesses on the accrual basis of accounting can take credit for bad debts. Credit for sales taxes paid on bad debts must only be taken on the next sales tax return filed following the federal income tax return in which the bad debts are charged off. Businesses using the cash basis of accounting may NOT claim deductions for bad debts.

Exemption Certificates

ARSD 64:06:01:15 states that "Religious educational institutions, nonprofit charitable hospitals, and relief agencies must furnish exemption certificates when making exempt purchases... If sales of the same nature are continuous, a blanket exemption certificate may be accepted for a stated period of time, but not for more than one year." It is important that hospitals issue an exemption certificate whenever making a sales tax exempt purchase.

If purchases are made by an entity which is not the qualifying, nonprofit charitable hospital, and the items purchased will be allocated to the various subsidiaries or divisions of the group, then a n exemption certificate should be provided to the vendor. Use tax is due on any items used by the non-qualifying entity.

Municipal Tax

Many municipalities in South Dakota have a sales and use tax in addition to the state sales 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 tax.

Municipalities may also have a 1% gross receipts tax. The municipal gross receipts tax (also referred to as the Bed, Board, and Booze tax) is a 1% tax that is in addition to the municipal sales tax. The gross receipts tax can be imposed on alcoholic beverages, eating establishments, lodging accommodations, ticket sales, and admissions to places of amusement, or athletic and cultural events.

A list of municipal tax rates is available on our website at www.state.us.sd/drr or by calling 1-800-TAX-9188.

South Dakota Codified Laws and Regulations

The laws and regulations regulating the taxation of hospitals are:

SDCL 10-45-5.2. Services enumerated in Standard Industrial Classification Manual subject to tax - Other services subject to tax.

SDCL 10-45-12.1. Services specifically exempt from the tax. (This section includes medical and social services.)

SDCL 10-45-14. Exemption of sales to educational institutions and hospitals.

SDCL 10-45-14.1. Exemption of nutritional supplements.

SDCL 10-45-14.9 Exemption of insulin sales.

SDCL 10-45-14.10 Exemption of certain drugs.

SDCL 10-45-14.11 Exemption of certain durable medical equipment, mobility enhancing equipment and prosthetic devices.

SDCL 10-45-14.12 Exemption of certain medical devices.

SDCL 10-45-15. Exemption of property of educational institutions and hospitals.

SDCL 10-46-15.1. Exemption of insulin for human use.

SDCL 10-46-15.5 Exemption of prescribed drugs for human use.

SDCL 10-46-15.6 Exemption of prescribed, durable medical equipment, mobility enhancing equipment and prosthetic devices for human use.

SDCL 10-46-15.7 Exemption of prescribed medical devices used by humans.

SDCL 10-45-20.3. "Controlled group" defined.

SDCL 34-12-1.1(4). Definition of terms.

ARSD 64:06:01:08. Exemption Certificates.

ARSD 64:06:01:08.01. Exemption Certificate - Forms accepted.

ARSD 64:06:01:15. Exemption Certificates.

ARSD 64:06:02:72. Hospitals - Taxable charges and subsistence.

ARSD 64:06:02:73. Hospitals - Nontaxable charges.

ARSD 64:06:02:74. Hospitals - License required - Purchases for members or employees taxable.

Talk to Us!

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

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