



This Week in State Tax (TWIST)

October 10, 2022



SOUTH DAKOTA



to listen to the
podcast please
[click here.](#)

South Dakota: Court Rules in State's Favor on Computation of Federal Tax Deduction

Recently, the South Dakota Supreme Court addressed the computation of a bank's deduction for federal taxes paid. Under South Dakota bank franchise tax law, a financial institution is allowed a subtraction for taxes imposed under the Internal Revenue Code. The bank at issue was part of a federal consolidated return, but filed a separate South Dakota bank franchise tax return. The method used by the bank to compute the deduction for the disputed tax years was to take its separate federal taxable income and multiply it by 35 percent. The resulting deduction was between 133 percent and 175 percent higher than the total payments to the IRS of the bank's consolidated group. After an audit, the Department's view was that the subtraction was limited to the amount of federal taxes the bank actually paid, which would be taxes after the application of various credits. A trial court upheld that position, and the taxpayer appealed to the state's highest court.

The issue in the case centered whether "taxes imposed" meant total income multiplied by the applicable tax rate or meant the amount of taxes paid or compulsory tax liability required by federal law. After determining that the statutory text did not answer the question before it, the court reviewed the overall statutory scheme and determined that the Legislature did not intend to allow a taxpayer to subtract amounts for taxes imposed that did not involve the payment of money. In the court's view, a taxpayer should not expect to subtract a larger amount of federal taxes than it is obligated to pay. To do otherwise would lead to a disproportionately large deduction and irrational results that would not correspond to the amount of federal tax owed. In reaching this conclusion, the court rejected the bank's argument that the credits claimed were equivalent to the expenditure of cash. While the court may have described a tax credit as a rebate, it had never held that its use is the same as an expenditure of money. The court also rejected the taxpayer's argument that the Department's lack of guidance on the proper method of computing the deduction meant the Department was required to accept the bank's methodology. Please contact [Jodie Scott](#) with questions on *U.S. Bank N.A. v. South Dakota Dep't of Revenue*.



For more news and insights on tax developments, follow KPMG's U.S. Tax practice on Twitter – [@KPMGUS_Tax](#).

kpmg.com/socialmedia

