

Industrial Production

Sales Tax Fact Sheet 145

What's New in 2017

We made the layout of this fact sheet easier to use.

Starting July 1, 2015, the capital equipment refund is an up-front sales tax exemption.

If you pay sales tax on purchases after June 30, 2015, you may still file a refund request for tax paid in error.

This fact sheet explains how Minnesota Sales and Use Tax applies to businesses involved in industrial production and also how to report and pay Sales and Use Tax.

Businesses must pay tax on administrative supplies, certain machinery (see Capital equipment, page 3), accessories, furniture, fixtures, and other items used to produce a product. However, materials used or consumed to produce a product may qualify for the industrial production exemption.

To be eligible for this exemption, the business must produce tangible personal property intended to be sold ultimately at retail. Industrial producers include manufacturers, fabricators, miners, and refiners (see the list below for examples).

The production process includes the following activities:

- Design, research, and development for production of a product
- Removal of raw materials from stock to begin production activities
- Actual production activities that effect changes to produce the product
- Testing and quality control of the product
- Placement of the product in finished goods inventory, or if the item is not placed into inventory, the last production process before loading the product for shipment

Examples of businesses engaged in industrial production:

- Bakeries
- Breweries
- Candy factories
- Chemical processing plants
- Clothing manufacturers
- Concrete plants and ready mix companies
- Creameries
- Electric generating plants
- Equipment manufacturers
- Film processors
- Flour and feed mills
- Food processing plants
- Foundries
- Glass making plants
- Machinery producers
- Mining operations
- Paint factories
- Paper mills
- Photographers
- Photo copy centers
- Printing companies
- Sawmills
- Shoe factories
- Smelting mills
- Soft drink bottling plants
- Steel mills
- Tanneries
- Tile producers
- Tool and die shops
- Vehicle assembly lines

Examples of businesses not engaged in industrial production:

- Agricultural operations
- Accounting firms
- Banks
- Car and truck washes
- Contractors
- Dry cleaners
- Hotels and motels
- Pipeline transmission companies
- Laundries
- Law firms
- Mobile phone services
- Movie theaters
- Restaurants
- Repair shops
- Service stations
- Retail stores
- Telephone companies
- Trucking operations
- Vending machine operators

Exempt purchases

To buy items exempt from tax, the purchaser must give a completed Form ST3, *Certificate of Exemption*, to the seller. The following are examples of exempt purchases:

- Chemicals, materials, and supplies used in treating waste (including water) generated as a result of a production process
- Chemicals used or consumed in production, including chemicals used for cleaning food processing equipment
- Component parts and ingredients of a product
- Crucibles, thermocouple protection sheaths and tubes, stalk tubes, refractory materials, molten metal filters, and filter boxes, degassing lances, and base blocks used in metal casting
- Fuels electricity, natural gas, water, steam, propane gas, and L.P. gas used directly in the production process. For more information, see Fact Sheet 129, *Utilities Used in Production*.
- Industrial gases used in production (oxygen, acetylene, argon)
- Materials that directly affect the product, such as grinding and polishing compounds, and sanding disks
- Materials used for the original painting and cleaning of products
- Materials used one time in production, not consumed, but discarded after one use, such as key lines, typesetting, paper pans and cake liners, disposable dishes, swabs, and lab testing solutions
- Petroleum products and lubricants used in production equipment, such as oil, grease, radiator antifreeze, penetrating oil, pulsar oil, and surge oil
- Product identification labels, including combination labels that identify the product and price
- Product packaging materials
- Separate detachable tools (see below for qualifications)

Form ST3, Certificate of Exemption

To buy items exempt from tax, you must give the vendor a completed Form ST3, *Certificate of Exemption*. The reason for the exemption is Industrial production to buy items that are consumed in the production process or that are ingredients or components of the final product. Use Percentage exemption to exempt a percentage of fuels or energy, based upon consumption during the production process. Use Resale exemption when the item purchased will be resold in its original form.

Special tooling

Special tooling is exempt. Special tooling means tools, dies, jigs, patterns, gauges, and other special tools that have value and use only for the buyer and use for which they are made. A tool may be purchased exempt if all of the following conditions are met:

1. It is not standard enough to be stocked or ordered from a catalog or other sales literature
2. It must be produced in accordance with special requirements peculiar to the buyer
3. It is not commonly usable by someone else whose conditions for possible use of the material are reasonably similar

Materials purchased to make your own special tooling are taxable, because materials are not special tools as described above.

Some accessory tools, dies, molds, and other short-lived items that don't qualify as special tooling may qualify for the separate detachable unit exemption.

Separate detachable units

Accessory tools, dies, molds, and other short-lived items are exempt if all three of the following requirements are met:

1. It must be an accessory tool, equipment, or short-lived item that attaches to a machine while in use. It must be purchased separately from the basic machine, or their cost must be separately stated.
2. It must be used in producing a direct effect on the product. Direct affect causes physical or chemical change on or within materials being processed, or determines shape, contour, configuration, content, or arrangement of the product.
3. Its ordinary useful life is less than 12 months when used continuously in production under normal conditions of the user. Junking, scrapping, or wearing out is conclusive evidence of the end of a tool's useful life. Retention and re-use are evidence of continued useful life.

Materials to make your own qualifying detachable tools may be purchased exempt.

Separate detachable units do not include the basic machine or any components included in the original purchase price.

Examples of separate detachable units that may qualify for exemption include:

- Abrasive and polishing belts
- Barrels and screws for extruder machines
- Cutting tools
- Dies
- Drill bits
- Grind wheels (used to affect product)
- Hand tool attachments
- Jigs
- Materials to make qualifying detachable tool
- Molds
- Patterns
- Polishing felt strips and buffers
- Printing plates
- Reamers
- Sanding sheets and discs
- Saw blades
- Stone sawing wires

Other items used in cutting or welding processes that do not physically come in contact with the product but have a direct effect on it, may qualify for exemption. Examples include:

- Contact tips
- Copper outer cups
- Cutting tips
- Electrodes
- Gas diffuser items
- Nozzles
- Plastic inner cups
- Shield cups
- Spray nozzles

Examples of items that are not separate detachable units (but may qualify for the capital equipment exemption):

- Arbors
- Batteries
- Bearings
- Collets
- Conveyor belts
- Drill chucks
- Gears
- Grinding wheels (used to sharpen tools)
- Power hand tools
- Pulleys
- Seals
- Shafts
- Soldering irons

Capital equipment

Capital equipment means machinery and equipment purchased or leased, and used in Minnesota by the purchaser or lessee primarily for manufacturing, fabricating, mining, or refining tangible personal property to be sold ultimately at retail

if the machinery and equipment are essential to the integrated production process of manufacturing, fabricating, mining, or refining.

Examples of qualifying capital equipment include:

- Production machinery, equipment, fixtures, implements
- Materials to make one's own production tools
- Tools purchased to create tools or special tooling used in the production process

For more information, see Fact Sheet 103, *Capital Equipment*.

Beginning July 1, 2015, the capital equipment exemption is allowed at the time of purchase. To purchase exempt, the purchaser must give the seller a completed Form ST3, *Certificate of Exemption*.

Before July 1, 2015, you must pay sales or use tax when you buy or lease capital equipment and apply for the refund.

Packaging materials

Nonreturnable materials used to package products can be purchased exempt. Returnable containers are taxable, except when used to package food and beverages.

Examples of exempt packaging include:

- Nonreturnable internal packaging materials which shape, form, stabilize, and protect contents
- Nonreturnable pallets and skids
- Nonreusable external packaging materials or dunnage which protects, braces, pads, or cushions against damage, motion, shock, or breakage, such as cartons, containers, cans, boxes, and bags
- Packaging for food and beverage products, materials used to repair or recondition returnable food and beverage containers; and returnable packaging for food and beverage products
- Product identification labels including combination labels that identify the product and price for customers
- Stuffing materials such as straw, dry ice, excelsior, shredded paper, foam, cotton batting, sawdust, and other similar fillers
- Warranty cards, owner manuals, content lists, instruction sheets, and materials safety data sheets
- Wrapping materials such as paper or plastic wrap, wire, tape, staples, etc.

Examples of taxable packaging:

- External and internal packaging materials returnable to the vendor
- Labels that do not contain package content information for customers, including price tags, shipping tags, address labels, invoices, packing slips, and envelopes
- Returnable containers such as steel drums, barrels, bottles, gas cylinders, boxes, tanks, sacks, cans (except when used to package food and beverages)
- Returnable skids and pallets including raw materials purchased to construct, repair, or recondition them
- Reusable materials used for handling, storing, or moving materials within or between the production facilities
- Warning labels that give shipping directions, such as "do not drop" or "do not stack"

Note: Deposits that are charged to customers as security for the return of containers are not taxable if separately stated on the invoice.

Research and development, prototypes

Quality control, testing, design, and research and development activities are part of the production process. Items used or consumed in such activities are exempt. Purchases of prototypes or materials to make prototypes for research and development activities are exempt from sales tax.

This exemption excludes machinery, equipment, tools (except qualifying detachable tools), general operating supplies and construction contracts. However, certain equipment may qualify for the capital equipment exemption.

Taxable purchases

Many items that are not used or consumed in the production process or do not qualify for the capital equipment exemption are taxable. Below is a list showing examples of items that are subject to sales or use tax.

- Chemical and cleaning agents used to clean
 - Production tools and equipment
 - Areas around food processing equipment
 - Buildings and structures
- Computer hardware, supplies, canned or packaged software and software maintenance agreements (unless qualifying production equipment). For more information, see Fact Sheet 134, *Computer Software*.
- Furniture
- Items used primarily to facilitate loading, unloading, handling, transportation, or storage of products before the manufacturing process begins or after it ends
- Janitorial cleaning materials or services. For more information, see Fact Sheet 112, *Building Cleaning and Maintenance*.
- Materials used to construct or remodel real property
- Office supplies and equipment
- Protective safety clothing. For more information, see Fact Sheet 105, *Clothing*.
- Taxable advertising materials and point of sale displays
- Training materials and supplies
- Utilities for heating and lighting and other non-production functions

Other taxable activities

The following activities generally are not part of the production process. All materials, supplies, or equipment purchased in connection with these activities are taxable.

- Administrative activities
- Handling, movement, storage, and preservation of finished goods
- Loading product for shipment
- Painting, cleaning, repairing, and maintenance of facilities
- Storage and preservation of raw materials before the production process begins
- Support activities such as plant security, fire prevention, first aid, plant cleaning, scrap and waste disposal, space heating, lighting, pollution control, safety, and management measurement of production process
- Taxable services such as building cleaning, lawn care, security, and laundry and dry cleaning services, including cleaning of rags, mats, and linens
- Transportation, transmission, or distribution of petroleum, liquefied gas, natural gas, steam, or water through pipelines

How to report use tax

Sales tax is generally charged by the seller at the time of sale. However, if the seller doesn't charge Minnesota Sales Tax, you must pay use tax. Use tax is due on purchases of taxable items and services when no sales tax was charged by the seller at the time of sale. You must pay use tax when you:

- Buy items online, by mail or phone order from a retailer outside Minnesota for use in Minnesota when sales tax was not charged by the seller.
- Buy items in another state for use in Minnesota that were taxed at a rate lower than the Minnesota rate.
- Buy items exempt for use in industrial production, but take the items out of inventory for business or personal use.
- Buy items from a Minnesota seller who does not collect the sales tax, but you put the items to a taxable use.

Report and pay the Minnesota use tax and any applicable local tax to the Department of Revenue when you electronically file your Sales and Use Tax return. For more information, see Fact Sheet 146, *Use Tax for Businesses*.

Sales by manufacturers

Sales for resale

Sales to others solely for the purpose of resale are exempt from sales tax if the purchaser gives you a completed Form ST3, *Certificate of Exemption*.

If you sell your products to someone for their own use, you must charge sales tax on the taxable items.

Installation labor

Installation labor is labor to set an item into position or to connect, adjust, or program it for use. Installation labor is part of the sales price of a taxable item and is taxable. Third party installation charges are taxable if the installation would have been taxable if provided by the seller of the taxable item.

Fabrication labor

Fabrication labor is labor that results in a new or changed product and is generally taxable, whether the customer or the seller provides the materials for the product. If fabrication labor is for resale, it is not taxable.

Delivery charges

If the item being sold is taxable, charges by the seller to deliver it are also taxable.

Equipment sales

If you sell equipment or other items that were used in your business, the sale may be subject to sales tax. For more information, see Fact Sheet 132, *Isolated and Occasional Sales*.

Local Sales and Use Taxes

If you are located or working in an area with a local tax, local sales or use tax may also be due. Local taxes are listed and explained in detail in Fact Sheet 164, *Local Sales and Use Taxes*.

Legal References

Minnesota Statute 297A.68

subd. 2, Materials consumed in industrial production

subd. 6, Special tooling

Minnesota Rule 8130.1100, Utilities and Residential Heating Fuels

Minnesota Rule 8130.5500, subp. 8 and 9, Materials to make Separate Detachable Tools

Minnesota Rule 8130.5550, Special Tooling

Other Fact Sheets

103, *Capital Equipment*

105, *Clothing*

112, *Building Cleaning and Maintenance*

129, *Utilities Used in Production*

132, *Isolated and Occasional Sales*

134, *Computer Software*

146, *Use Tax for Businesses*

152, *Labor – Installation, Fabrication, Construction, and Repair*

164, *Local Sales and Use Taxes*