SALES AND USE TAX
Real and Personal Property Definitions

Department of Revenue
Analysis of H.F. 1 (1st Special Session), Omnibus Tax Bill, Article 3, Sections 6 and 7

EXPLANATION OF THE BILL

The definitions for real property and tangible personal property affect when the sales and use tax is due. Generally, for sales of tangible personal property, the sales tax is due on sales to the final user. However, for construction contractors who purchase items considered to be incorporated into real property, the items purchased are considered to be used by the contractor and contractors pay sales tax at the time of their purchase.

Current Law: Recent court decisions have directed that the property tax definition of real property be used for sales and use tax purposes, which is a departure from previous sales and use tax requirements for contractors. The current law property tax definition for real property is limited to property that is: 1) integrated with the building, 2) of permanent benefit to the building regardless of the present use of the building, and 3) would cause damage if removed. Also, improvements to real property do not include tools, implements, machinery, and equipment attached to, or installed in real property for use in the business or production activity conducted thereon, regardless of size, weight, or method of attachment.

Proposed Law: The proposal creates a separate definition of real property specific to sales tax that: 1) includes improvements and fixtures incorporated into and intended to be of permanent benefit to a building given the present use of the building if they cannot be removed without causing damage to the building, and 2) excludes tools, implements, machinery, and equipment installed into real property for use in a business or production activity that qualify for a sales tax exemption under current law.

REVENUE ANALYSIS DETAIL

- When contractors pay sales tax on their purchases, as compared to charging sales tax to the final user, less sales tax is collected since the tax applies only to the item purchased, excluding the retail markup and installation labor. The estimates reflect the lower collections on the smaller tax base.

<table>
<thead>
<tr>
<th>Fund Impact</th>
<th>FY. 2017</th>
<th>FY. 2018</th>
<th>FY. 2019</th>
<th>FY. 2020</th>
<th>FY. 2021</th>
</tr>
</thead>
<tbody>
<tr>
<td>General Fund</td>
<td>($540)</td>
<td>($6,700)</td>
<td>($6,900)</td>
<td>($7,100)</td>
<td>($7,300)</td>
</tr>
<tr>
<td>Natural Resources and Arts Funds</td>
<td>($30)</td>
<td>($400)</td>
<td>($400)</td>
<td>($400)</td>
<td>($400)</td>
</tr>
<tr>
<td>Total – All Funds</td>
<td>($570)</td>
<td>($7,100)</td>
<td>($7,300)</td>
<td>($7,500)</td>
<td>($7,700)</td>
</tr>
</tbody>
</table>

Effective for sales and purchases made after the day following final enactment.
REVENUE ANALYSIS DETAIL (Cont.)

- The estimates are based on information from the 2012 Economic Census for segments of the commercial construction industry in Minnesota impacted by the proposal. The Census reports the value of construction costs for materials, components, and supplies.
- For the affected items, it is assumed that markup is 20% and installation labor costs are 20% of the total costs.
- The estimates are expected to increase based on growth rates published by IHS Global Insight.
- Additional information on the revenue impacts will become available as recent court decisions continue to be implemented administratively.
- The estimates for fiscal year 2017 are for one month of impact.

Source: Minnesota Department of Revenue
Tax Research Division
www.revenue.state.mn.us/research_stats/Pages/Revenue-Analyses.aspx

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