

Contractors

Sales Tax Fact Sheet 128

What's New in 2018

- We clarified the taxable sales price of the lease or rental of portable toilets. See Portable toilets on page 9.
- A 2017 law change added a definition of “real property” for purposes of sales tax. (Minnesota Statute 297A.61, subd. 58)
- We clarified when sellers are required to collect local sales taxes. See Local Sales and Use Taxes on page 10.

This fact sheet explains how sales and use tax applies to:

- Contractors and subcontractors who build, alter, repair, or improve real property
- Contractors who also sell products at retail

You must register to collect sales tax if you:

- Sell tangible personal property at retail
- Sell fabrication labor
- Owe use tax—even if you make no retail sales

Defining real property

Real property includes:

1. Land, whether owned or leased.
2. Buildings and structures constructed or erected on the land and intended to be permanent. In order to be permanent the building or structure must be attached to the land itself.
3. Improvements and fixtures incorporated into a building or structure, including building materials and supplies.

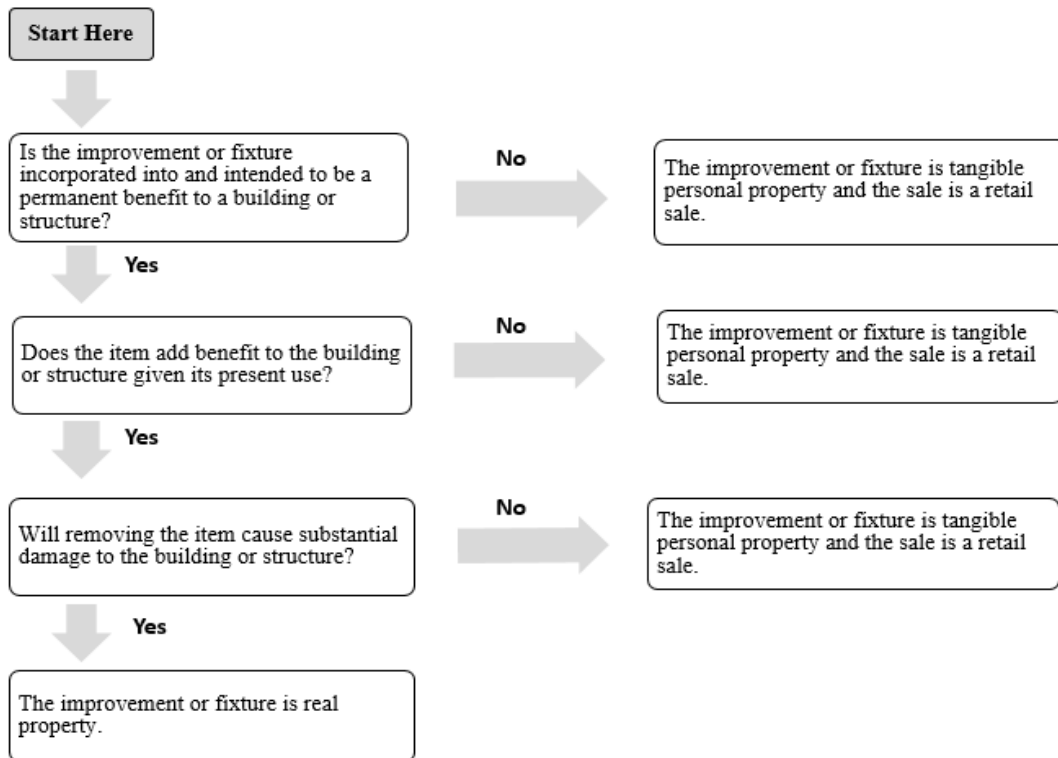
Real property does not include

Real property does not include tools, implements, or machinery and equipment that are both:

- Attached or installed into real property for use in a business or production activity, and
- Eligible for a business-related sales tax exemption under Minnesota Statute 297A.68; for example, machinery and equipment that qualifies for the capital equipment exemption, no matter the size, weight, or how it is incorporated into the real property.

For items that are not specifically excluded from the definition of real property, you must determine if the item meets the definition of real property under categories 1, 2, or 3 located above. For help in determining if an item is real property under category 3, see the flow chart and definitions below.

Is the improvement or fixture real property?



Building materials and supplies

Building materials and supplies are tangible personal property when purchased. They become real property when they are incorporated into and intended to be of permanent benefit to a building or structure. Examples include:

- Ceiling tiles
- Concrete
- Flooring
- Furnaces, ductwork
- Gutters
- Insulation
- Kitchen cabinets
- Lumber, sheetrock
- Nails, doors, windows
- Plumbing, sinks, toilets

Incorporation

Whether a building material or supply is incorporated into a building or structure depends upon a review of the facts and circumstances of each situation.

Example 1

- A residential customer has a kitchen cabinet installed.
 - When a freestanding cabinet is placed in position, and not incorporated into the property, it is considered tangible personal property.
 - When the cabinet is incorporated into the property, it is considered real property.

Example 2

- A business has a walk-in cooler installed.
 - When the walk-in cooler has raised floors that are designed for easy disassembly and removal, the walk-in cooler is tangible personal property.

- When the walk-in cooler has grouted-in tile or poured concrete floors, the level of incorporation is greater and the walk-in cooler is real property.

General Definitions

Construction contract

The sale of building materials that includes the installation of those materials into real property.

Contractor or subcontractor

A business that provides contracts to furnish materials and labor to build, alter, repair, or improve real property.

Contractor-retailer

A business that contracts to improve real property and also makes retail sales of building materials, supplies, equipment, or other tangible items.

Fabrication labor

Labor that results in a new or altered product (see page 9).

Incorporated

Incorporated means an addition or alteration to real property that meets both of the following requirements:

- It becomes part of, or is permanently affixed to, the property so that removal causes substantial damage
- It is intended to become permanent or remain for an indefinite period of time

Installation labor

Labor to set an item into position, or to connect, adjust, or program it for use. If the item being sold is taxable, charges to install it are also taxable.

Landscapers

Contractors, for sales and use tax purposes. For more information, see Fact Sheet 121B, *Landscaping Construction Contracts*.

Materials-only contract

The sale of building materials without installation. This is a retail sale.

Present use

Present use means the item benefits the building or structure and the function for which the space is intended to be used at the time the item is incorporated.

Examples of items that benefit the building or structure for its present use when the items are incorporated into the building or structure:

- Bowling alley lanes and ball returns
- Pneumatic tubing systems at a bank

Retailer

A business that sells building materials but does not install the items.

Retail sale

The sale of building materials, supplies, equipment, or other tangible items that are not installed into real property by the seller or seller's agent. See Guidelines for contractor-retailers on page 5.

Substantial damage

Substantial damage means removal of the item will physically impair the present function of the property. Substantial damage does not include minor cosmetics such as patching a hole in the wall.

Examples of substantial damage:

- Replacing a wall or floor
- Repairing underground plumbing

Guidelines for contractors and subcontractors

Contractors or subcontractors must pay sales or use tax on the cost of all materials, supplies, and equipment to complete a construction contract.

If you're a contractor or subcontractor, pass this tax on to your customers as part of the materials cost. Do not itemize it separately on customer invoices. Do not charge sales tax on construction contracts.

Building materials and other items that are installed into real property are taxable at the time of purchase. Generally, you pay sales tax when you buy materials, supplies, and equipment. However, if the supplier does not charge Minnesota sales tax, you owe use tax on the purchase price. See the Use tax section on page 9.

Note: Bleachers and lockers, even when bolted to real property, are a tangible item. The installer must charge their customer sales tax on the item and on the labor to install the item. For more information, see Revenue Notice 04-04, *Distinguishing Between Real Property and Tangible Personal Property and Fact Sheet 152, Labor – Installation, Fabrication, Construction, and Repair.*

Repairs to real property

Sales and use tax on the repair and maintenance of certain business equipment and machinery has been repealed effective April 1, 2014.

You're improving real property when you:

- repair, replace, or install items such as furnaces, garbage disposals, built-in dishwashers and stovetops, water heaters, and central air conditioners
- work on plumbing or electrical wiring (except for items that qualify as business machinery and equipment)

The sale is a construction contract. As a contractor, you must pay the sales or use tax on the purchase price of materials used.

If you sell repair parts or materials to your customer without installation, you've made a retail sale. See Guidelines for contractor-retailers on page 5.

Business machinery and equipment

Machinery and equipment, not included in the definition as real property, are considered tangible personal property. Contractors should buy these items exempt for resale by providing the seller a completed Form ST3, *Certificate of Exemption*. Specify the Resale exemption.

When billing customers, the contractor must tax the following unless a customer provided a completed exemption certificate:

- machinery and equipment
- installation labor and setup labor of the machinery and equipment
- delivery charges for the machinery and equipment

Previously, contractors had to enter into a purchasing agent agreement in order to purchase these types of items for resale.

Contracts with exempt organizations

You owe sales tax when you contract with exempt organizations such as churches, schools, and government agencies. An organization's exempt status cannot be used to buy materials exempt for use in a lump-sum contract covering both labor and materials for the construction, alteration, or repair of a building or facility.

You may buy materials tax exempt only when the exempt organization designates you as its purchasing agent. The written contract must clearly show all of the following:

1. the appointment has been made
2. the exempt organization takes title to all materials and supplies at the point of delivery
3. the risk of loss for all materials and supplies is that of the exempt organization
4. the exempt organization has responsibility for all defective materials and supplies including those incorporated into realty

These requirements apply to the prime contractor and subcontractors who supply both materials and labor.

To claim exemption, give the supplier a completed Form ST3, *Certificate of Exemption*. At the top of Form ST3, check that you are a contractor and have a purchasing agent agreement with an exempt organization. Enter the exempt organization and specific project. Use the applicable exemption code and write in “Purchasing agent agreement with exempt organization.”

You must keep documentation to show that a purchasing agent relationship exists, such as:

- a letter indicating the above information
- copies of the pages of the written contract showing items 1-4 above
- evidence of the organization’s exempt status

You must also keep records identifying all materials and supplies purchased for the exempt project.

The exemption only applies to building materials, equipment, and supplies that become part of the improvement to real property. An exempt organization cannot appoint a contractor as its purchasing agent for the purchase or lease of equipment used by the contractor in completing the construction contract.

For more information, see Revenue Notice 17-10, *Construction Contracts with Exempt Entities*.

Contracts outside Minnesota

Materials delivered to contractors in Minnesota for use in an out-of-state contract are subject to Minnesota tax unless the materials are not subject to tax in the state or country where the contract work is done.

You must give your vendor a completed Form ST3, *Certificate of Exemption*. For more information, see Fact Sheet 110, *Items for Use Outside of Minnesota*.

Materials delivered by a vendor directly to a construction site outside Minnesota are not subject to Minnesota tax.

Guidelines for contractor-retailers

If you are a contractor and also make retail sales, the rules for when and how you pay tax on your purchases depend on:

- whether you know how the items will be used when you buy them
- whether they will be used in a construction contract or sold at retail
- in some cases, whether you are “primarily a retailer” or “primarily a contractor”

If you know how the items will be used when you buy them

The sales tax treatment of your purchase depends on how you will use or resell the items.

- If the items will be used in a construction contract, pay sales tax when you buy them.
- If the items will be sold at retail, give the seller a completed Form ST3, *Certificate of Exemption*.

Examples

A carpet dealer sells carpeting either with or without installation.

- **Situation 1:** A contractor orders carpet and contracts with the dealer to install it in homes that the contractor is building. The sale is a construction contract because installing carpet is an improvement to real property. The carpet dealer must pay tax on all purchases of carpet, materials, supplies, and equipment used to install the carpet. The carpet dealer does not charge tax to the contractor.
- **Situation 2:** An individual special orders carpet that he intends to install himself in his basement. This is a retail sale. The carpet dealer must charge the customer sales tax on the selling price of the carpet.

If you do not know how the items will be used when you buy them

It depends on if you are primarily a contractor or primarily a retailer. You are:

- **primarily a contractor** if at least 50 percent of your business purchases are used for construction activity (See the next page for more information.).
- **primarily a retailer** if at least 50 percent of your business purchases are for retail sales (See the next page for more information.)

If you are primarily a contractor

Pay sales tax on all purchases. If you later sell any of these items at retail, deduct the cost of the materials you already paid tax on when you file your Sales and Use Tax return.

Follow these guidelines when filing your Minnesota Sales and Use Tax Return and invoicing your customer. The following assumes you paid sales tax to the vendor on all materials.

For this type of sale	Handle tax this way
Construction Contract	<ul style="list-style-type: none">• Do not itemize tax on your customer's invoice.• On your sales tax return, report the total contract amount as Gross Receipts.
Retail Sales	<ul style="list-style-type: none">• Charge sales tax on the total selling price.• Itemize tax on your customer's invoice.• On your sales tax return:<ul style="list-style-type: none">• Report the total sales as Gross Receipts.• Report the difference between the sale price and your cost of materials as General Rate Sales.

Example

A roofer who usually installs or repairs roofs pays sales tax on all purchases of materials. One customer buys shingles for \$100 from the roofer with no installation. This is a retail sale, and the roofer must charge the customer sales tax of \$6.88 (currently 6.875 percent of \$100, local taxes may apply depending on the location where the materials are installed).

The roofer paid \$70 plus \$4.81 sales tax to his supplier when he bought the shingles. To report the sale and get credit for the sales tax already paid on the shingles, the roofer includes this sale when he files his sales and use tax return as follows:

Gross Receipts	\$100
General Rate Sales	\$30
(\$100 sales price - \$70 cost)	

Sales tax is never included in the retail price or the cost of materials when calculating general rate sales.

Keep your receipts and invoices. Your records must show that you paid sales tax on your materials.

If you are primarily a retailer

Do not pay sales tax on your purchase. Give the supplier a completed Form ST3, *Certificate of Exemption*. Collect sales tax from your customer when you sell taxable items at retail.

If any items purchased exempt for resale are later used in a construction contract, you must report the cost of the items as use tax purchases when filing your sales and use tax return.

Follow these guidelines when filing your Minnesota Sales and Use Tax Return and invoicing your customer. The following assumes you purchased all materials exempt from sales tax.

For this type of sale	Handle tax this way
Construction Contract	<ul style="list-style-type: none"> • Do not itemize tax on your customer’s invoice. • On your sales tax return: <ul style="list-style-type: none"> • Report the total contract amount as Gross Receipts • Report your cost for materials as Use Tax purchases
Retail Sales	<ul style="list-style-type: none"> • Charge sales tax on the total selling price. • Itemize tax on the customer’s invoice. • On your sales tax return, report the total sales price as Gross Receipts and General Rate Sales.

Example

A dealer sells appliances including garbage disposal units. Most sales are over-the-counter retail sales so the dealer is primarily a retailer. Occasionally, a customer wants the dealer to install a garbage disposal.

The sale and installation of the garbage disposal is a contract for the improvement of real property. The dealer charges the customer \$139 for the installed unit.

The dealer must report the cost of the garbage disposal unit as use tax purchases when filing the sales and use tax return.

Aggregate and Concrete Sales

Construction contract

If an aggregate seller delivers and spreads aggregate material so that no further leveling or movement is required by the purchaser, the sale is an improvement to real property and not taxable. The aggregate seller must pay sales or use tax on their cost of any taxable products or services used to complete the contract.

Retail sale

An aggregate seller must charge sales tax on both the material and delivery charges when:

- They dump aggregate material in a pile
- The construction contract does not require them to deposit the material so that no further leveling or movement is required

Note: Sales to cities, counties, and townships are generally not taxable. For more information, see the Government – Local Governments Industry Guide.

Delivery (hauling) of aggregate materials

Delivery (hauling) of aggregate materials and concrete block is taxable, except as noted below or if an exemption applies. Delivery charges for aggregate are taxable regardless of:

- Who delivers the materials (the seller or a third-party hauler)
- Whether the materials will be used to improve real property
- How the materials are deposited at the delivery site

Nontaxable delivery of aggregate

Delivery (hauling) of aggregate is not taxable when the charges are:

- To move customer-owned aggregate or concrete block from one location to another.
- For delivery of aggregate by third-party haulers, if the aggregate will be used in road construction as defined in Minnesota Statute 297A.61, subdivision 3.

Examples

- An aggregate seller has a contract to sell and spread aggregate materials to build a parking lot. The seller provides and hauls aggregate materials to the construction site in their own vehicles. They spread and level the aggregate materials so no further leveling or movement is required. This is an improvement to real property and the charges are not taxable.
- A construction company buys aggregate material to use in the construction of a parking lot. The company hires a third-party hauler to pick up the aggregate at the seller's pit and to deliver it to the construction site. The construction company owes sales or use tax on their purchase of the aggregate and the third party delivery charges. The delivery charge is taxable even if the hauler is required to spread or level the aggregate material on the parking lot for the purchaser. Charges by the construction company to their customer are not taxable.

For more information, see:

- Fact Sheet 155, *Delivery Charges*
- Revenue Notice 02-12, *Taxable Delivery Charges – Aggregate Materials*
- Revenue Notice 02-17, *Taxable Sales - Delivery of Aggregate Materials and Concrete Block*

Ready-mixed concrete and trucks

Sales price

Ready-mixed concrete sold from a ready-mixed concrete truck, without installation, is taxable, including transportation, delivery, or other service charges. No deduction is allowed for these charges, even if the charges are separately stated.

Trucks

Purchases of ready-mixed concrete trucks are exempt from the Motor Vehicle Sales Tax.

Fuel

Purchases of fuel for ready-mixed concrete trucks are subject to Petroleum Excise Tax.

Fuel to run power take-off units

Purchases of fuel to run the power take-off units on ready-mixed concrete trucks may be eligible for a refund of petroleum tax. To request a refund, submit Form PDR-1, *Minnesota Motor Fuel Claim For Refund*.

Starting July 1, 2017, special fuel to operate a power take-off unit or auxiliary engine in or on a licensed motor vehicle is exempt from sales tax.

Leases of trucks, repair and replacement parts

Leases and purchases of repair or replacement parts for ready-mixed concrete trucks, may be eligible for the capital equipment exemption if the truck is used 50 percent or more of the time to sell ready-mix at retail (without installation).

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

General Purchases

Delivery charges

If the item being sold is taxable, charges by the seller to deliver it are also taxable. For more information, see Fact Sheet 155, *Delivery Charges*.

Construction equipment and machinery

Equipment and machinery used for construction does not qualify for the capital equipment or the farm machinery exemptions.

Building cleaning and maintenance

Building cleaning and maintenance services at businesses and residences are taxable. This includes final cleaning charges, including duct cleaning of a building after construction. Separate charges for the removal of construction debris or demolition waste are not taxable.

Fabrication labor

Fabrication labor makes or creates a product or alters an existing product into a new or changed product.

Fabrication labor is taxable when the customer provides the materials, either directly or indirectly.

For more information, see Fact Sheet 152, *Labor – Installation, Fabrication, Construction, and Repair*.

Portable toilets

The lease or rental of portable toilets with related maintenance, waste removal, and cleaning services is subject to sales tax. The entire contract price, even if the lease or rental price is separately stated from the services, are taxable. The related maintenance, waste removal, and cleaning services are taxable because they are necessary to complete the sale of the lease or rental of the portable toilet.

Residential utilities

Utilities supplied for residential heating during construction of a residence are not taxable.

Land clearing contracts

A land-clearing contract is for the initial removal of trees, bushes, shrubs, and stumps to develop a site. These services are exempt from sales tax.

Charges for the removal of trees, stumps, bushes, and shrubs that are being removed for remodeling, improvement, or expansion of an existing structure are taxable.

Examples

- A developer purchases an empty lot to build new housing or a commercial building. The developer contracts with a landscaper to remove trees and stumps on the site. These services are exempt from sales tax because you are developing a new site.
- A homeowner has a large area of land between his or her maintained lawn and a nearby river. The homeowner decides to clear the land and install a garden and dock. The land-clearing services are taxable because you are expanding a pre-existing site.

Use tax

If you buy materials, supplies, and equipment for use in Minnesota and the seller does not charge Minnesota Sales Tax on the purchase invoice, you must report and pay use tax to the Department of Revenue. You must also report and pay local use tax if the materials are for a construction project in an area with a local tax.

If you were required to pay sales tax to another state for the materials, you're eligible for credit against the Minnesota Use Tax. The percent of use tax due is the difference between the Minnesota rate and the rate of sales tax paid to the other state.

For more information, see Fact Sheet 146, *Use Tax for Businesses*.

Miscellaneous Information

Equipment sales and rentals

Charges to rent your construction equipment (without an operator) to another contractor are taxable.

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

Improperly charging sales tax

If you improperly charge sales tax on items that become real property, and the customer files a request for refund, the Minnesota Department of Revenue may assess sales or use tax against you on the cost of materials used in the construction contract.

Direct Pay authorization

A Minnesota Direct Pay authorization may be used by a contractor only when there is a valid purchasing agent agreement in place between the contractor and the direct pay company.

Surety deposits for Non-Minnesota Construction Contractors

If you hire or contract with a non-Minnesota contractor to perform construction work in Minnesota, you must withhold 8 percent (.08) of their compensation as a Minnesota surety deposit. Payments are subject to 8 percent withholding only if the work was performed in Minnesota and the value of the contract exceeds \$50,000.

The cash surety is deposited with the department and is used as a surety to guarantee that the contractor has fulfilled the requirements for withholding, sales and use, franchise, and income taxes. For more information, see Withholding Tax Fact Sheet 12, *Surety Deposits for Non-Minnesota Construction Contractors*.

Construction Contracts with State of Local Government Agencies

No state agency or local unit of government can make a final payment to a contractor until the department has certified that the contractor and any subcontractor have fulfilled state withholding tax laws.

The contractor and subcontractor must submit a Contractor Affidavit (IC-134) to the department to apply for a Certificate of Compliance. For more information, see Withholding Tax Fact Sheet 13, *Construction Contracts with State or Local Government Agencies*.

Local Sales and Use Taxes

If you are located in or make sales into an area with a local tax, you may owe local sales or use tax.

Contractors who take delivery of materials in an area with local tax must pay that local tax on the material, even though the materials may be used in a contract outside the local tax area.

Credit for local tax paid

If you pay local sales tax in Minnesota to one locality but use the items in another area that imposes local sales and use tax, you are allowed a credit for the local sales tax already paid.

For more information, see Fact Sheet 164, *Local Sales and Use Taxes*.

Helpful hints

Some businesses have a difficult time determining the actual material cost when billing retail sales or construction contracts. The following suggestions provide some general guidelines to help make this determination.

- For construction contracts, note the material cost on the office copy (not the customer copy) of the sales invoice. If you buy materials exempt for resale, the material cost to be reported as use tax purchases when electronically filing your sales and use tax return can be easily determined at month end by adding the figures noted on the office copies.
- If the mark-up percentage used by the contractor-retailer is uniform for all materials, a percentage may be used to determine the material cost.
- If inventory records are updated from sales invoices, this would be a convenient time to ensure that the correct material cost is noted on invoices that involve retail sales. If you have paid tax on material purchases, this would allow you to accurately calculate tax owed on the markup amount.
- Use the worksheet on page 5 of Fact Sheet 146, *Use Tax for Businesses*, to track your use tax owed.

- The accounting records of a contractor-retailer must clearly reflect the use of all items purchased. These records should substantiate the proper sales and use tax liability.

Legal References

Minnesota Statutes 297A.61

subd. 3(g)(6)(iii), Building cleaning and maintenance

subd. 4, Retail sale

subd. 58, Real property

Minnesota Statutes 297A.68

subd. 2(b)(2), Materials consumed in industrial production

subd. 5(b)(8), Capital equipment

subd. 14, Property in transit

subd. 19, Petroleum products

subd. 40, Land clearing

Minnesota Statutes 297A.70, Exemptions for governments and nonprofit groups

Revenue Notices

99-16, Sales Tax Exemption for Towns

02-12, Taxable Delivery Charges – Aggregate Materials

02-17, Taxable Sales – Delivery of Aggregate Materials and Concrete Block (modified 6/08)

04-04, Distinguishing Between Real Property and Tangible Personal Property

17-10, Construction Contracts with Exempt Entities

18-05, Lease or Rental of Tangible Personal Property – Portable Toilets

Other Sales Tax Fact Sheets

112, *Building Cleaning and Maintenance*

121B, *Landscaping Construction Contracts*

146, *Use Tax for Businesses*

150, *Manufactured Homes, Park Trailers, and Modular Homes*

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

155, *Delivery Charges*

164, *Local Sales and Use Taxes*

Withholding Tax Fact Sheets

12, *Surety Deposits for Non-Minnesota Construction Contracts*

13, *Construction Contracts with State or Local Government Agencies*

Industry Guides

Government – Local Governments