

MINNESOTA • REVENUE

SALES AND USE TAX Construction Contracts – Sales Tax Exempt Entities

March 10, 2014

	Yes	No
DOR Administrative Costs/Savings		X

Department of Revenue
Analysis of S.F. 1862 (Rest), As Proposed to be Amended (SCS1862A10)

	Fund Impact			
	F.Y. 2014	F.Y. 2015	F.Y. 2016	F.Y. 2017
	(000's)			
General Fund	\$0	(\$16,000)	(\$16,700)	(\$17,400)
Natural Resources and Arts Funds	\$0	(\$900)	(\$1,000)	(\$1,000)
Total – All Funds	\$0	(\$16,900)	(\$17,700)	(\$18,400)

Effective for sales and purchases made after June 30, 2014.

EXPLANATION OF THE BILL

Current Law: Construction materials and supplies are generally taxable in Minnesota. Parties that are exempt from paying sales tax, such as cities, counties, townships, school districts, state institutions of higher education, public libraries, hospitals and nursing homes, and charitable, educational, and religious organizations may purchase construction materials directly without paying sales tax (with certain exceptions). However, building, construction, and reconstruction materials purchased by a contractor or subcontractor as part of a lump-sum or similar type of contract with a guaranteed maximum price covering both labor and materials are taxable, even if the project owner is exempt from sales tax.

There is an administrative rule (8130.1200, Subpart 3) under which an exempt entity may designate a construction contractor as its purchasing agent so that the contractor can acquire the construction materials exempt from tax. Stringent conditions must be met before the contractor can legally act as the exempt entity's purchasing agent.

Proposed Law: The proposed amendment would grant a sales and use tax exemption to construction contractors and subcontractors for building, construction, or reconstruction materials used on work for the listed sales tax-exempt entities.

The affected entities include:

1. Cities, counties, townships, school districts, and hospitals and nursing homes owned and operated by cities and counties;
2. Nonprofit, sales tax-exempt charitable, educational, and religious institutions;
3. Nonprofit, sales tax-exempt hospitals, nursing homes, boarding care homes, and outpatient surgical centers;
4. Critical access dental providers; and

EXPLANATION OF THE BILL (Cont.)

5. Materials used in construction, reconstruction, repair, maintenance, or improvement of public infrastructure if purchased by a contractor for work done for a school district, city, county, or township.

The amendment does not exempt contractor-purchased materials for the projects of other sales tax-exempt entities such as the University of Minnesota, Minnesota State Colleges and Universities, county law libraries, state agency libraries, the State Library, and the Legislative Reference Library.

The amendment provides that for purchases made by a contractor or subcontractor of a qualifying exempt entity the tax must be paid up front and then refunded by the Department of Revenue to the contractor under the refund provisions of current law.

REVENUE ANALYSIS DETAIL

- The estimates are based on the U.S. Census publication *Annual Value of Construction Put in Place*. The applicable Census reports were for state and local government construction and private construction. National figures for 2012 and 2013 were averaged for a state fiscal year 2013 estimating base.
- For governments, the national figures were apportioned to Minnesota at 1.7%, the state's share of state and local government construction according to the 2007 Census of Governments. The portion attributable to state government was estimated and excluded from the estimate. The portion of construction materials that a contractor may currently acquire exempt under Rule 8130.1200, Subp. 3, was also estimated and subtracted out.
- For nonprofit organizations and institutions, the Census report of private construction was used. Minnesota apportionment was also assumed to be 1.7%. The portion attributable to nonprofits was estimated. Also, use of the current administrative rule was estimated and excluded.
- It was estimated that 42% of the value of qualifying construction was attributable to normally taxable building and construction materials.
- Annual growth for governmental entities was taken from IHS Global Insight, Inc. For nonprofit organizations annual growth was estimated at 2.5%.

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