**SALES AND USE TAX**
**Construction Contracts –**
**Local Government, School Districts**

March 11, 2014

| | Yes | No |
|---|---|---|
| **DOR Administrative Costs/Savings** | | X |

Department of Revenue
Analysis of H.F. 2423 (Lesch), As Proposed to be Amended (H2423A1)

| | Fund Impact | | | |
|---|---|---|---|---|
| | **F.Y. 2014** | **F.Y. 2015** | **F.Y. 2016** | **F.Y. 2017** |
| | | (000's) | | |
| General Fund | $0 | ($11,900) | ($12,500) | ($13,100) |
| Natural Resources and Arts Funds | $0 | ($700) | ($700) | ($800) |
| Total – All Funds | $0 | ($12,600) | ($13,200) | ($13,900) |

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 amendment would grant a sales and use tax exemption to construction contractors and subcontractors for building, construction, or reconstruction materials used on work for local government (cities, counties, and townships) and public school districts. Contractors, subcontractors, and builders would pay the tax at the time the materials are acquired, and then file a refund claim with the Department of Revenue.

The bill and the amendment repeal Rule 8130.1200, Subpart 3. The effect is that other tax-exempt entities such as nonprofit organizations would have to buy construction materials directly in order acquire the materials tax exempt.

**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.
- 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 local government, including school districts, was estimated.
- The portion of construction materials that a contractor may currently acquire exempt under Rule 8130.1200, Subp. 3, was also estimated and subtracted out.
- 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.

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