

Capital Equipment

Sales Tax Fact Sheet 103

What's New

We clarified that purchasing agent agreements are not necessary for contractors to purchase capital equipment materials exempt from tax. See Building Materials and Supplies (page 5) and Purchases by Contractors (page 7).

If you buy or lease qualifying capital equipment for use in Minnesota, you are eligible for an exemption or a refund of state and local sales or use tax you paid. This fact sheet explains how Minnesota sales and use tax applies to capital equipment. For information on capital equipment for online data retrieval systems, see Revenue Notice 06-03, Online Data Retrieval for 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. Capital equipment also includes machinery and equipment used primarily to electronically transmit results retrieved by a customer of an on-line computerized data retrieval system.

To claim the exemption for eligible purchases give the supplier a completed Form ST3, *Certificate of Exemption*. Specify the Capital equipment exemption.

Any business may qualify for exemption on qualifying equipment used primarily to make a product for sale ultimately at retail. For example, a hardware store may claim exemption for a key-making machine – the key making machine qualifies as capital equipment even though the main business of a hardware store is not manufacturing.

Capital equipment includes, but is not limited to:

- Machinery and equipment used to operate, control, or regulate the production equipment
- Machinery and equipment used for research and development, design, quality control, and testing activities
- Environmental control devices that are used to maintain conditions such as temperature, humidity, light, or air pressure when those conditions are essential to and are part of the production process
- Materials and supplies used to construct and install machinery or equipment
- Repair and replacement parts, including accessories, whether purchased as spare parts, repair parts, or as upgrades or modifications to machinery or equipment
- Delivery and installation charges for qualifying equipment
- Materials used for foundations that support machinery or equipment
- Materials used to construct and install special purpose buildings used in the production process
- Ready-mixed concrete trucks where the ready-mixed concrete is mixed as part of the delivery process. The purchase of a ready-mixed concrete truck is exempt up-front from the sales tax on motor vehicles. Beginning July 1, 2015, the up-front exemption applies to leases of ready-mixed trucks or purchases of repair or replacement parts.

Note: The term capital equipment is not the same as capitalized assets. Items capitalized for accounting purpose do not automatically qualify as capital equipment. Items you expense for accounting purposes, such as leased equipment, may be considered capital equipment.

Capital equipment does not include:

- Farm machinery, aquaculture and logging equipment
- Motor vehicles taxed under Minnesota Statutes, section 297B (vehicles for road use)
- Building materials that become part of a general building structure or that are an addition, repair, improvement, or alteration to real property (see Building Materials and Supplies on page 5)
- Machinery or equipment used to receive or store raw materials
- Machinery or equipment used in the transportation, transmission, or distribution of petroleum, liquefied gas, natural gas, steam, or water through pipes, lines, tanks, or mains
- Telecommunications equipment and wire, cable, fiber, poles, or conduit used to provide telecommunications services
- Machinery or equipment used in restaurants to furnish, prepare, or serve prepared food
- Machinery or equipment used to provide the following **taxable services**:
 - Laundry and dry-cleaning services
 - Motor vehicle washing, waxing, and cleaning services
 - Building and residential cleaning, maintenance, and disinfecting and exterminating services
 - Detective, security, burglar, fire alarm, and armored car services
 - Pet grooming services
 - Lawn care, fertilizing, mowing, spraying and sprigging services; garden planting and maintenance; tree, bush, and shrub pruning, bracing, spraying, and surgery; indoor plant care; tree, bush, shrub, and stump removal; and tree trimming for public utility lines
 - Furnishing lodging, board, and care services for animals in kennels and other similar arrangements
- Machinery or equipment used for nonproduction purposes (see Non-Qualifying Activities on page 3)
- Any other items that is not essential to the integrated process of manufacturing, fabricating, mining, or refining

Definitions (as they relate to capital equipment)

Accessories to capital equipment – items that cannot function independently but are attached, connected, or fastened to a piece of equipment in order to function. Accessories include feeders, tools, jigs, patterns, dies, and molds. Accessories also include devices that upgrade, modernize, or modify the capabilities of the underlying equipment.

Equipment and machinery – mechanical, electronic, or electrical devices, tools, or hand tools. It includes computers and software used to operate qualifying equipment, as well as any sub-unit or assembly of the equipment. Devices necessary to control, regulate, or operate the production equipment are also included.

Essential – the equipment must perform a necessary or indispensable step in the production process. The fact that a particular piece of equipment is required by law or is a practical necessity does not make it essential to the production process.

Fabricating – making or assembling components to work in a new or different manner.

Foundations – qualify if they are the base or support the structure necessary for qualifying equipment. It does not include the foundation for a building unless the building is a special purpose building.

Manufacturing – changing the form, composition, or condition of raw materials into a new product. For purposes of the capital equipment exemption, manufacturing includes generating electricity or steam for sale at retail. Manufacturing does not include repair or refurbishing items returned to the original owner.

Materials and supplies – items necessary to construct or install qualifying capital equipment, such as nails, bolts, screws, pipes, lumber, and wire used to secure or assemble the equipment in the facility.

Mining – extracting ore, materials, or peat from the earth. It includes underground, surface, and open-pit mining operations. It also includes any surface mining to obtain building stone, limestone, gravel, sand, or other surface materials.

Online data retrieval systems – a computerized system whose database of information is equally available and accessible to all customers.

Pollution control equipment – used to eliminate, prevent, or reduce pollution resulting from production activities.

Primarily – the equipment must be used 50% or more of its operating time in a qualifying activity.

Product – for this fact sheet, means tangible personal property, electricity, and steam.

Refining – means converting natural resources to a product; purifying materials such as oil, metal, sugar, and fats; and treating of water to be sold at retail.

Repair or replacement parts – used to restore capital equipment to its original or intended operating condition, including parts that upgrade or modernize equipment, as well as spare parts.

Sold ultimately at retail – the product being produced must be intended for sale at retail. This does not mean that the producer must make the retail sale, or that the product be subject to sales tax. For example, equipment used in producing a product for sale at wholesale, and equipment used for producing nontaxable products such as clothing, qualify as capital equipment. A construction contract to improve realty is not a retail sale.

Integrated Production Process

Capital equipment must be used by the purchaser (see Used by the Purchaser on page 6) primarily in a qualifying activity within an integrated production process. The integrated production process means the series of activities that result in the production of a product to be sold ultimately at retail, including the actual production process. The production process begins with the removal of raw materials from inventory and ends when the last process prior to loading for shipment has been completed, and also includes research and development and design of the product.

Qualifying Activities

- Constructing, cleaning, maintaining, and repairing equipment, tools, or repair parts for equipment used in a qualifying activity
- Maintaining conditions such as temperature, humidity, light, or air pressure when those conditions are essential to and a special requirement of the production process. This includes maintaining finished goods inventory by the producer but does not include general space heating and lighting.
- Outside fabrication labor services contracted for by a manufacturer if those services are essential to the production of the product
- Packaging of the completed product. This includes all packaging done before loading the completed product for shipping but does not include returnable items such as pallets used in shipping.
- Production activities to produce the product. This includes machinery and equipment that operate, control, or regulate production equipment
- Quality control and testing activities done on the product
- Removal of raw materials from stock to begin the actual production activities
- Research, development, and design to produce a product (see page 7)
- Storing work-in-process, but not including storing raw materials in inventory

Non-Qualifying Activities

- Plant cleaning, disposal of scrap waste, plant communications, heating, cooling, lighting, or safety
- Plant security, fire prevention, first aid, and hospital stations
- Pollution control, prevention, or abatement
- Receiving or storing raw materials
- Support operations or administrative activities used to maintain the integrated production process including management, direction, and overseeing of a business, for example:
 - Cleaning, repair, or maintenance of the plant facilities
 - General janitorial activities
 - Inventory management
 - Warehousing
 - Internal product and production tracking

- Sales and distribution activities
- Construction, maintenance, or alteration of real property, unless such items are foundations for qualifying equipment or are for special purpose buildings, as defined later in this fact sheet
- Providing a safe work environment for employees
- General office administration including clerical, personnel, and accounting activities
- Customer service activities, including repairs
- Managerial functions such as business and production analysis and supervision

Examples of Integrated Production Process

1. A newspaper publisher buys a computer system to permanently store completed news stories for future reference. The publisher also adds devices for security control. Some devices measure the quality of the ink flow and its color, while others are used for employee and job scheduling. The computer system and the devices used to store completed stories and measure the quality of the actual product qualify as capital equipment. The devices used for employee and job scheduling do not qualify because they do not control or regulate production equipment and do not have an effect on the product.
2. A wood products fabricator buys boxing, shrink-wrapping, and palletizing equipment to package products before placing them into finished goods inventory. All the equipment is being used to package products prior to loading for shipment and therefore qualifies as capital equipment.
3. A meat packer builds a new plant. Environmental control systems are installed throughout the plant. The system used for storage of raw meat does not qualify since capital equipment does not include equipment used to receive or store raw materials. The systems for the production areas qualify as capital equipment – these systems maintain very cold temperatures to ensure that meat products are not contaminated by bacteria, and for storage of the completed meat products. The systems for support and administrative areas do not qualify.
4. A bakery installs a washing system to clean and sterilize baking pans and production equipment. They also purchase pressure washers used to clean the floors and walls. The washing system to clean and sterilize baking pans and production equipment qualifies as capital equipment because it affects the quality of the baked product. The pressure washers do not qualify since they are used in support operations for general plant maintenance and cleaning.
5. A foundry adds equipment to construct and maintain special tooling. The equipment is used to assemble and maintain production equipment and non-production equipment and to make general building repairs. Equipment used primarily (50% or more of its operating time) to create and maintain special tooling and production equipment qualifies as capital equipment. If the equipment is used more than 50% of its operating time for work on nonproduction equipment or in other non-qualifying activities, it does not qualify as capital equipment.
6. An industrial machinery manufacturer adds several pieces of equipment to its research and development shop. The equipment includes additional computer aided design (CAD) and computer aided manufacturing (CAM) systems, a blueprint machine, and an integrated communication system. The blueprint machine prepares blueprints for use by employees during the assembly process. The integrated communication system keeps track of costs and labor hours for each piece of machinery during the assembly process. The CAD and CAM systems and the blueprint machine qualify as capital equipment. The communication system does not qualify since it is used for plant communications.
7. A candy wholesaler buys bulk candies from manufacturers, blends various candies together, and packages the assortment into individual bags. The equipment used to blend candies together and to package the candy into individual bags qualifies as capital equipment.
8. A wood products manufacturer expands operations by adding collection systems for wood waste, conveyors, a boiler, and equipment to generate electricity. The equipment is used collectively to generate electricity that powers the facility and the production equipment and qualifies as capital equipment.
9. A manufacturer contracts with an outside fabricator for precision drilling to be performed on its steel tubes. While the outside fabricator does not produce a product that will be sold ultimately at retail, the precision drilling is essential to the integrated production process for the manufacturer. Any equipment and machinery used 50% or more of the time to fabricate tangible personal property for another manufacturer's product qualifies as capital equipment.
10. A retailer selling lumber and other building materials, buys a saw and sander to cut and finish wood for its customers. While the business is primarily a retailer, the saw and sander are used to fabricate lumber that is sold at retail. The saw and sander qualify as capital equipment.

11. A manufacturer buys catwalks, man lifts, and boom lifts that are used to give employees access to the production equipment for maintenance and repair. The catwalks, man lifts, and boom lifts do not qualify as capital equipment since they do not have a direct effect on the maintenance or repair, but rather have the indirect effect of giving the employee access to the equipment. Only equipment used to actually maintain, repair, or install capital equipment qualifies.
12. A city sells electricity at retail to its residents. The lines and poles to transport the electricity, up to the last transformer outside the customer's location, qualify for the capital equipment exemption. The city also buys digging equipment and a hoist to install the poles. This equipment, including all materials necessary to install the poles, qualifies for the exemption.
13. A cabinet maker manufactures and installs cabinets into homes and businesses. The cabinet maker is producing a product, which is installed into real property. Since the cabinet maker does not make a retail sale of cabinets, the equipment is used to manufacture the cabinets does not qualify for the capital equipment exemption.

Note: The integrated production process is similar but not the same as the industrial production process. The result is that even though the equipment may qualify for the capital equipment exemption, items used or consumed in the equipment (such as fuels) may not qualify for the industrial production exemption. For more information, see the *Industrial Production* Fact Sheet.

Building Materials and Supplies

Building materials and supplies for special purpose buildings, for foundations that support capital equipment, or used to install capital equipment, qualify as described below. The qualifying materials are exempt when purchased by the owner. If the owner provides a completed Form ST3, Certificate of Exemption to the contractor, the contractor may purchase the materials exempt. The owner should specify the Capital equipment exemption on Form ST3. (See Purchases by contractors on page 7.)

Note: It is the purchaser's responsibility to understand the exemptions for which they qualify before issuing an exemption certificate. If it is determined the purchaser did not qualify for the claimed exemption, the purchaser is liable for any taxes and penalties legally due.

Special Purpose Buildings

A special purpose building is a structure that because of its size or method of installation would normally be considered real property, rather than tangible personal property. To be considered a special purpose building, the structure must serve or perform a function essential to the production process and must be used in producing a product to be sold ultimately at retail. Purchases of building materials and supplies that become part of a special purpose building qualify for the capital equipment exemption.

Examples of special purpose buildings include:

- Clean-room facilities, independent flash-freeze tunnels, or self-enclosed paint booths.
- Research facilities such as wind tunnels or test stands used primarily for product development or testing.
- Tanks, bins, or silos used primarily for temporary storage of work in process. Facilities used to receive or store raw materials prior to the production process or to store raw materials on the production floor do not qualify as special purpose buildings.

Building materials qualify for the capital equipment exemption if at least 67% of the total floor area of an addition, modification, or new building qualifies as a special purpose building.

Foundations

Building materials used for foundations that are specifically designed and constructed to support equipment qualify for the capital equipment exemption. However, the fact that foundation materials qualify does not mean the building itself qualifies as a special purpose building. The building must meet the criteria outlined above to qualify as a special purpose building.

Installation and Support

Building materials and supplies used to install qualifying equipment are eligible for the capital equipment exemption.

Non-Qualifying Building Materials

Building materials used for the following purposes do not qualify for the capital equipment exemption:

- General purpose manufacturing, industrial, or commercial buildings
- Buildings designed to protect equipment from the elements, to provide space cooling or heating, or to allow equipment to perform at optimal levels
- Buildings that are modified to allow for the installation of an assembly line or conveyance system when such modifications do not affect the product
- Buildings that are only modified by incorporating special foundations to support qualifying equipment

Examples

- A 10,000 square foot addition for a clean room is added to an existing production facility. About 2,000 square feet of the addition is used for an office and restrooms. The building materials to construct the entire addition qualify for the capital equipment exemption, since at least 67% of the total floor area of the addition qualifies as a special purpose building.
- An asphalt mixing plant builds a new facility in Minnesota. A roof is built over the mixing plant equipment to protect it from the elements. The roof is not a special purpose building since it has no direct effect on the product being produced.
- A brewery builds a new plant in Minnesota. Large silos are needed for storage of the raw hops and barley and other silos are used to maintain constant temperatures of work in process during fermentation. The silos used for fermentation are special purpose buildings and qualify for the capital equipment exemption. The silos used to hold raw materials do not qualify since they are used for storage before the beginning of the production process.
- A manufacturer builds a new facility in Minnesota. Materials and supplies used to install the equipment and to build necessary support structures for the capital equipment qualify for the capital equipment exemption. The building foundation needs to be reinforced to support the weight of the manufacturing equipment. Therefore, materials and supplies used to build the foundation necessary to support the equipment qualify for the capital equipment exemption. Other building materials used to construct the facility don't qualify for a capital equipment exemption.

Used by the Purchaser

To qualify as capital equipment, the item must be used by the purchaser or lessee in Minnesota. If a manufacturer buys equipment and contracts with another party to use the equipment to produce the manufacturer's product, the manufacturer can claim the exemption if there is a written agreement between the principal purchaser or lessee and a second party containing all the following elements:

- The agreement must state that the principal manufacturer will purchase and provide the second party with capital equipment necessary to fulfill the agreement.
- The agreement must include provisions for payment to the second party for manufacture of the principal's product.
- There must be no payment by the second party for use of the machinery or equipment.
- None of the capital equipment purchased or leased by the principal is used by the second party for its own use.
- The principal must purchase and pay for the capital equipment in its own name and must include the equipment on its balance sheet as a depreciable asset.
- The principal must hold title to, or be the lessee of, the equipment at all times, even at the end of the agreement between the principal and the second party.
- The risks of ownership or leasehold for the capital equipment must remain with the principal at all times rather than with the second party.

Example

- A snack manufacturer expands its product line and enters into an agreement with a second company to produce a specific snack line. The snacks will be sold under the manufacturer's label. Under the terms of the agreement, the manufacturer purchased and installed all equipment necessary to produce the new snack line in the second company's plant. The second company receives payment on a per-completed-case basis.

The terms of the agreement require the equipment be used only for production of the new snack product. Title remains at all times with the snack manufacturer. At the end of the agreement, the equipment will be returned to the snack manufacturer. The equipment purchased by the snack manufacturer for the new snack line qualifies for the capital equipment exemption.

Purchases by Contractors

To qualify as capital equipment, the items must be used by the purchaser or lessee in a qualifying activity. When a contractor buys and installs equipment as part of an improvement to real property, the contractor is considered the purchaser and no capital equipment exemption is generally allowed. However, a qualifying purchaser may provide a contractor a completed Form ST3, Certificate of Exemption claiming the capital equipment exemption.

Capital equipment is excluded from the definition of real property. When a contractor receives a completed Form ST3 claiming capital equipment, they may purchase the qualifying material exempt from sales tax for the purpose of resale. When billing the customer, do not charge sales tax on the capital equipment or related labor charges.

Note: It is the purchaser's responsibility to understand the exemptions for which they qualify before issuing an exemption certificate. If it is determined the purchaser did not qualify for the claimed exemption, the purchaser is liable for any taxes and penalties legally due.

Research and Development

Quality control, testing, design and research and development activities are part of the production process. Equipment used by the manufacturer, fabricator, miner, or refiner for research, development and design activities, regardless of whether a product is actually produced and sold at retail, qualifies as capital equipment.

Equipment used primarily by a research and development company, consulting company, or similar organization qualifies as capital equipment when both are true:

- The equipment is used to develop a specific product at the request of a manufacturer, fabricator, miner, or refiner
- The equipment is used primarily for the research, development, and design of the specific product.

Examples

- A manufacturer hires a company to develop a treatment to extend the shelf life of a product. The equipment used by the company in its research and development activities qualifies for the capital equipment exemption if it is used 50% or more of its operating time to develop products intended to be sold ultimately at retail.
- A retailer buys computer equipment to be used exclusively to design packaging for a shirt sold at retail. The retailer contracts with a manufacturer to produce the packaging and the shirts. Since the package design is a part of the integrated production process, the retailer's computer equipment qualifies for the capital equipment exemption.

Local Sales and Use Taxes

If you are located or make sales into an area with a local tax, you may owe local sales or use tax. For more information, see the *Local Sales and Use Tax Guide*.

Legal References

Minnesota Statute 297A.68, subd. 5, Capital Equipment

Minnesota Statutes 297A.75

subd. 1, Tax collected

subd. 3, Application

Revenue Notices

96-10, Lease Renewal or Buyout

96-13, Used by the Purchaser

96-14, Research, Development, and Design

96-15, What Activities Qualify

97-04, Special Purpose Buildings

97-05, Integrated Production Process for Tangible Personal Property

06-03, Online Data Retrieval for Capital Equipment

18-03, Capital Equipment; Construction as Purchasing Agent

18-04, Improvements to Real Property

Fact Sheets

Industrial Production

Use Tax for Businesses

Utilities Used in Production

Guides

Contractors and Other Property Installers

Local Sales and Use Tax