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Association of Women Contractors Minnesota Sales & Use Tax for Contractors

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By Dan Severson and Shad Kraftson



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Introductions

- Dan Severson, CMI
 - I joined CLA in 2017 to grow CLA's Sales Tax Audit Defense practice.
 - Prior to joining CLA, I spent 10 years as a sales tax auditor with Minnesota Revenue, 4 of which were spent as the leader of the Sales Tax Division's Procedures Team.
 - I assist our clients with sales and use tax audit defense, appeals, refunds, and other problem-solving throughout the country and have successfully overturned audit assessments in full as well as worked fair settlement agreements between our clients and the state.



Introductions

- Shad Kraftson, CPA
 - I started at CLA in the SALT group after graduating from UW-Green Bay in 2021.
 - I enjoy helping CLA clients with their sales and use tax issues.
 - I serve as the primary point of contact with state taxing authorities for our CLA clients under audit.
 - Since sales tax compliance is so complicated for contractors, it is an industry I work with a lot and particularly enjoy.



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- Our Purpose
 - CLA exists to create opportunities — for our clients, our people, and our communities.
- Our Promise
 - **We promise to know and help you.**
- Our CLA Family Culture
 - We're one family, working together to create opportunities.
- Our Strategic Advantages
 - **Deep industry specialization**
 - Seamless integrated capabilities



Deep Industry Specialization

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OPPORTUNITIES
FOR OUR
CLIENTS



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2019 – 2022, 2024



Agenda

- Introduction to Sales Tax
- Sales and Use Tax for Contractors
- Sales and Use Tax for Property Installers
- Projects with Exempt Entities
- Projects with Manufacturers and other Use-Based Exemptions
- Compliance Issues
- Audit Issue and Trends
- Minnesota Retail Delivery Fee





Introduction to Minnesota Sales and Use Tax



Taxable Sales in Minnesota

Retail sales of tangible personal property

- Including prewritten computer software, digital products, and utilities

Sales of enumerated services

- Building cleaning and maintenance services
- Detective, security, and alarm services
- Lawn, garden, tree, and bush services
- Delivery of aggregate
- Others:
 - Admissions, laundry services, lodging, massage services, car wash services, parking services, pet services, telecommunication services, etc.



Nontaxable Sales in Minnesota

Construction Contracts

- Contracts to construct, alter, improve, or repair real property

Sales of Non-Enumerated Services

Sales of Real Property and Intangibles

- Sales of land, buildings, stocks, patents, etc.



Exempt Sales in Minnesota

Sales of Exempt Goods or Services

- Clothing, groceries, drugs, etc.
- No exemption certificate (ST3) required

Sales of Taxable Goods or Services to an Exempt Entity

- Qualifying churches, schools, local government's, etc.
- Exemption certificate (ST3) required

Sales of Goods or Services for an Exempt Use

- Manufacturing, agriculture, logging, etc.
- Exemption certificate (ST3) required



Use Tax

- Use tax is a compliment to Minnesota state and local sales tax.
- If the correct state and local sales tax was not paid to the vendor, use tax must be accrued and paid directly to the state.
 - Items withdrawn from inventory for taxable use
 - Items purchased online from a vendor who is not registered to collect Minnesota sales tax
 - Items brought into Minnesota from another state



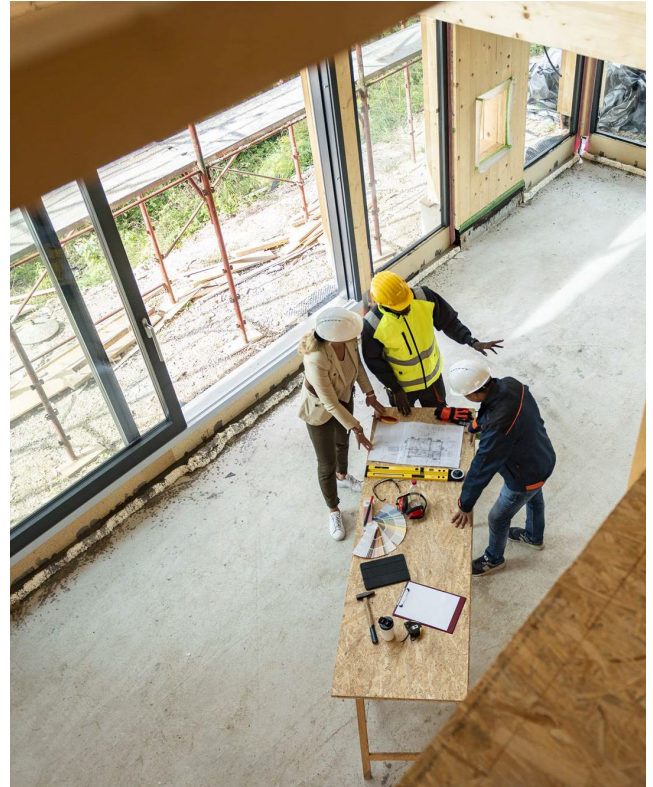


Sales and Use Tax for Contractors



Sales and Use Tax for Contractors

- Minnesota contractors generally owe sales or use tax on the cost of all materials, supplies, and equipment used to construct, alter, improve, or repair real property.



What is Real Property?

- Minnesota Statute 297A.61 Subd. 58

a) *"Real property" includes:*

- 1) *the land itself;*
- 2) *buildings and structures constructed or erected on the land and intended to be permanent; and*
- 3) *improvements and fixtures if incorporated into and intended to be of a permanent benefit to a building or structure given its present use, and that cannot be removed without causing substantial damage to the building or structure.*



What is Real Property?

b) Real property does not include tools, implements, machinery, and equipment attached or installed into real property for use in the business or production activity conducted thereon, that qualify for exemption under section 297A.68, regardless of size, weight, or method of incorporation into the real property.



Real Property Questions to Consider



Is the building or structure intended to be permanent?



Will the improvement or fixture be incorporated into real property?



Will the improvement or fixture provide a permanent benefit to the building given its present use?



Would removing the improvement or fixture cause substantial damage to the building or structure?



Does a business use-based exemption apply?

Items Generally Considered to be Real Property

- Land, roads, buildings, and permanent structures
- HVAC systems, furnaces and boilers
- Electrical (Internet) and plumbing systems
- Sewer and septic systems
- Lighting systems (but not temporary lighting)
- Elevators
- Landscaping and trees
- Flooring, built-in cabinets, bathroom fixtures



Contractor Relevant Taxable Services

- Lawn, Garden, Tree, and Bush Services
- Building Cleaning and Maintenance Services
 - HVAC cleaning and maintenance services
 - Final construction clean
 - Lighting maintenance
- Delivery of Aggregate
- Fabrication Labor
- Provision of Rental Equipment, Including Barbers



Service Contracts

- Cleaning Contracts – Taxable
 - Inputs are exempt
- Maintenance Contracts – Taxable
 - Inputs are exempt
- Repair Contracts – Nontaxable
 - Repair services must be separately stated from taxable services
 - Contractors owe tax on real property repair parts



Lawn, Garden, Tree, and Bush Services

- Taxable services include
 - Reseeding, spraying, aerating, fertilizing
 - Spreading mulch and planting when not part of an initial construction contract
 - Stump grinding
 - Tree, bush, and shrub removal, unless for a land clearing contract
- Nontaxable services include
 - Landscape and irrigation system construction contracts
 - Snow removal
 - Land clearing contracts – **initial** removal to “develop a site”



Aggregate Contractors

- Aggregate material that is spread in place is a construction contract
- Aggregate material that is not spread in place is a taxable sale of materials
- Aggregate retailers may qualify for the manufacturing exemption on equipment used to crush, screen, and produce the material
- Aggregate hauling services by a third party are taxable, except for:
 - Aggregate material used in road construction
 - Hauling customer-owned aggregate between locations





Sales and Use Tax for Property Installers



Sales and Use Tax for Property Installers

- Minnesota property installers generally will need to collect sales tax on both materials and labor when a project does not become a real property improvement, unless an exemption applies.



Items Generally NOT Considered Real Property

- Free-standing equipment
- Manufacturing equipment
- Temporary equipment
- Leased equipment
- Free-standing appliances
- Motor vehicles and food trucks
- Bleachers and lockers
- Hot tubs



Sales Tax Application

- Sales tax applies to the full invoice amount when installing tangible property.
 - Materials and labor are subject to sales tax
 - Additional charges are also taxable, such as delivery
- Materials and other inputs used in the taxable installation can be purchased exempt from sales tax.
 - The resale exemption applies
 - Provide ST3 – Certificate of Exemption to vendors





Projects with Exempt Entities



Projects with Exempt Entities

- An exempt entity's sales tax exemption generally does not flow through to contractors erecting or improving real property.
- Contractors must be designated as an exempt entity's purchasing agent to purchase materials exempt on their behalf.
- An ST3 alone is not sufficient.



Purchasing Agent Agreements

- Cannot be for a lump sum job covering both labor and materials
 - The exempt entity must initially advertise for separate material and labor bids
 - The exempt entity must not be required to accept both bids from the same contractor
 - Separate contracts must be issued for materials and labor



Purchasing Agent Agreements

- Must show that the exempt entity:
 - Takes title to materials upon delivery
 - Assumes the risk of loss for materials; and
 - Is responsible for all defective materials
- Must list each subcontractor that the agreement applies to or must appoint the general contractor “and all subcontractors.”





Projects with Manufacturers and other Use-Based Exemptions



Manufacturing Exemption

- Known in Minnesota as the “Capital Equipment” exemption
- Capital equipment includes:
 - Machinery and equipment used primarily in manufacturing, fabricating, mining, refining tangible personal property and that are essential to the production process.
 - Machinery and equipment used in research and development, quality control, and testing
 - Machinery and equipment used to maintain environmental conditions that are essential to the production process.
 - Repair and replacement parts
 - Supporting foundations



Manufacturing Exemption

- Must distinguish between Real Property and Manufacturing materials
- In order for an item to qualify for the manufacturing exemption in Minnesota, the item must be necessary to produce an item ultimately sold at retail.
- Projects can have a mix of real property and exempt manufacturing work and on the same invoice.
 - Real property work materials are taxable to the contractor
 - Manufacturing work materials are exempt for resale



Dust Collection Systems

- Dust Collection Systems can be either exempt as manufacturing equipment, a taxable tangible property installation, or a nontaxable real property improvement.
- Example: Wood Window Manufacturer Dust Collection Systems
 - Permanently attached for collection of sawdust in wood cutting area
 - No direct impact on the item being manufactured
 - Real Property improvement
 - Materials sales taxable to the contractor, no sales tax on labor
 - Permanently attached for collection of dust within window frame paint booth
 - Direct impact on the item being manufactured
 - Exempt installation of manufacturing equipment
 - Materials purchased exempt for resale, no sales tax on labor or materials
 - Portable dust collector used for sawdust
 - No direct impact on the item being manufactured
 - Taxable tangible property sale and installation
 - Materials purchased exempt for resale, collect sales tax on materials and labor



Supporting CE and Use-Based Exemptions

- Material can be purchased from vendors exempt for resale using an ST3.
- The customer, or general contractor, must provide a completed Form ST3 claiming the exemption (most often, Box I “Qualifying capital equipment”).
 - “The purchaser must provide documentation to the contractor to identify the exempt portion of the project.” (Form ST3 Instructions).
- Refunds can be pursued for previous qualifying projects within the 3.5 year statute of limitations.



Other Qualifying Use-Based Exemptions

- Telecommunications equipment
 - Including heating, ventilating, and air conditioning equipment necessary for the telecommunications equipment to function
- Qualified data center equipment
 - Including environmental control equipment
- Others:
 - Certain steel reprocessing pollution control equipment
 - Wind energy conversion systems
 - Certain ski hill machinery and equipment
 - Certain waste processing equipment



Agricultural Exemptions

- Agricultural exemptions do not typically apply to contractors
- Building material does not qualify for the farm machinery exemption
- Material used to construct farm buildings, greenhouses, poultry facilities, grain bins, silos, etc. is taxable





Compliance Issues



Sourcing for Materials

- Contractors must first pay sales or use tax on construction materials at the rate applicable to the location where possession was taken.
 - If material is picked up at the supplier's location, the supplier should collect sales tax at the rate applicable to their location.
 - If material is delivered to the contractor's location or directly to the job site, the supplier should collect sales tax at the rate applicable to the delivery location.
 - If the supplier does not collect sales tax, use tax is due to the state at the applicable rate at the time of purchase.



Sourcing for Materials

- Contractors may owe additional use tax depending on the job site.
 - If the job site is in a jurisdiction with an equal or lessor rate to the rate already paid on the materials, no additional tax is due.
 - Unfortunately, there is no credit allowed if material is installed in a jurisdiction with a lower rate.
 - If the job site is in a jurisdiction with a higher rate than the rate already paid on the materials, additional use tax is due on the cost of the materials.



Sourcing for Materials

- If material was purchased in another state and the other state's sales or use tax was properly paid, Minnesota will allow a credit for the other state's tax paid.
 - Example: Assume \$1,000 of material was picked up from a supplier in Hudson, Wisconsin, and \$55 in Wisconsin sales tax was paid.
 - The material was installed in a construction contract in Minneapolis where the tax rate is 9.025%.
 - The contractor owes \$90.25 in Minnesota use tax, however, credit will be given for the \$55 paid to Wisconsin, for a net tax due to Minnesota of \$35.25.



Sourcing for Equipment

- Equipment is typically sourced to the location where the business is located or where the equipment is stored.
- However, states are getting more aggressive and assessing additional local tax when equipment is used in a higher tax state or area.
- Recent Use Tax Court Case: Ellingson Drainage Inc v South Dakota Department of Revenue



Sourcing Case Studies

- North Dakota contractor purchasing from Minnesota material supplier
 - The supplier shipped the material to a lumber company in Minnesota
 - The lumber company later brought the material to the North Dakota job site with the lumber package
 - The vendor incorrectly collected North Dakota sales tax
- Minnesota contractor purchasing fuel from Wisconsin supplier
 - The Minnesota contractor hired a freight company to deliver the material to them from the Superior terminal
 - The vendor incorrectly collected Wisconsin sales tax



Contractor-Retailers

- Contractors who make retail sales without installation or who provide taxable services are making taxable sales and must collect and remit sales tax.
- Credit can be taken for sales or use tax paid on material that is resold at retail or used to provide a taxable service.
 - If a contractor-retailer's sales are primarily at retail without installation, the state allows the contractor-retailer to purchase all their material inventory exempt for resale.



Projects in Other States



If a contractor purchases material in Minnesota and later installs it in another state, Minnesota sales and use tax is still generally due.



Other states will generally allow a credit for the Minnesota tax paid.



Beware: Each state has different rules for construction contractors.



Audit Issues and Trends



Burden of Proof

- Auditor concern is to confirm that tax was paid on purchase invoices for real property projects.
 - Lack of supporting documentation leads to assessed tax
 - Purchase agent agreements
 - ST3s
 - Burden laid on the taxpayer (contractor)
- Auditors may or may not give credit for tax paid on materials if assessed as a taxable installation project.
 - Provide proof materials used in certain project
 - Can file refund separately
 - Burden laid on the taxpayer (contractor)



Subcontractor Does Work - GC Liable

- Example: General contractor involved in new build of auto dealership
 - Majority of work utilizes subcontractors
 - Subcontractors perform tangible property installations assuming to be real property installations
 - Subcontractor invoices general for all-in material and labor for installation of A/V equipment without tax
 - Sales tax should be paid on materials
 - General contractor held liable under audit for sales tax on full invoice unless proof of tax paid on materials provided
 - Can be difficult to gather 2-3 years post-install



Purchase Agent Agreement Gone Awry

- Example: Contractor working as a sub on a large construction project for a city
 - All contract documents stated tax exempt project
 - Subcontractor used ST3 to purchase material exempt
 - Purchase Agent agreement in place for the GC
 - No subcontractor assignment
 - Subcontractor held liable for material use tax
- Important to have language in the Purchase Agent agreement to cover all subcontractors
 - Can be difficult



Isolated and Occasional Sales and Purchases

- Sales and purchases of equipment and materials are generally subject to sales tax, even if outside the normal course of business
- Isolated and occasional sales exemptions exist but must meet specific criteria
 - Sales of substantially all assets
 - Sales in qualifying liquidations, distributions, contributions, transfers, reorganizations, etc.



Contact Us



- Don't go it alone
- If you are under audit in any state, reach out



Minnesota Retail Delivery Fee



Minnesota Retail Delivery Fee

- New \$0.50 fee to fund transportation infrastructure
- The RDF generally applies to transactions that:
 - Involve delivery to a location in Minnesota
 - Are \$100 or more; and
 - Are considered a taxable “retail sale” for sales tax purposes



Minnesota Retail Delivery Fee



The fee is imposed on retailers, who can choose to collect it, but do not have to.

Contractors may see this new fee on vendor invoices for materials, supplies, and equipment.

Contractors generally do not have to remit the fee themselves, unless they make retail sales of delivered material.

Retail Delivery Fee Exemptions

Retailers with Minnesota retail sales of less than \$1,000,000 in the previous calendar year

Sales for resale

Deliveries to purchasers who are exempt from sales tax

Deliveries made with vehicles require special MnDOT permits

Drugs and medical devices

Food and prepared food

Certain baby products





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- Audit Defense and Appeals
- Reverse Audits/Refund Reviews
- Process Reviews
- Nexus Studies



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- **Wealth Advisory** – Investments, financial planning, business owner solutions, etc.
- **Consulting and Outsourcing** – Outsourced accounting services, deal services, talent solutions, etc.





Questions?



Thank you!

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