

# Contractors

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Sales Tax  
Fact Sheet

*This fact sheet explains how sales and use tax applies to contractors and subcontractors who construct, alter, repair or improve real property. It also explains how tax applies if a contractor also sells products at retail.*

If you sell products at retail or sell fabrication labor, you must register to collect sales tax. You also must register if you owe use tax—even if you make no retail sales.

## Definitions

**Building materials** are items intended to become part of a building, structure, or road, or part of an addition, improvement, repair or alteration to real property.

A **construction contract** is a sale of building materials that includes the installation of those materials into real property.

A **contractor or subcontractor** contracts to furnish materials and labor to construct, alter, repair, or improve real property.

A **retailer** sells building materials but *does not install* the items.

A **contractor-retailer** contracts to improve real property and also makes retail sales of tangible personal property.

**Fabrication labor** is labor that results in a new or altered product that is tangible personal property. (See **Fabrication labor** on page 5.)

A **retail sale** is 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*.

A **materials only** contract is a retail sale.

**Real property** means land and structures that are attached to land, such as buildings, fixtures (i.e. plumbing and light fixtures), fences, railroad tracks, grain elevators, bridges, storage bins, silos, utility poles, and billboards.

**Landscapers** are considered to be contractors, for sales and use tax purposes. See Fact Sheet 121, Lawn and Garden Care, Tree and Bush Service, Landscaping, for more information.

## Guidelines for contractors and subcontractors

Sales by contractors or subcontractors of building materials that include the installation of those building materials into real property are construction contracts. Contractors or subcontractors must pay sales or use tax on the cost of all materials, supplies and equipment to complete the construction contract. Contractors or subcontractors should not charge sales tax to their customers on construction contracts. They pass this tax on to their customers as part of the materials cost, but do not itemize it separately on the customer's invoice.

Building materials and other items that are incorporated into real property are subject to Minnesota sales or use tax at the time of purchase. Generally, you pay sales tax at the time you buy materials, supplies and equipment. However, if the vendor does not charge

Minnesota sales tax, you owe use tax on the purchase price. See **Use tax** on page 2.

**Bleachers and lockers** that are attached to real property retain their identity as tangible personal property. The installer must charge their customer sales tax on the item and the labor to install the item. See Revenue Notice 04-04, Distinguishing Between Real Property and Tangible Personal Property and Fact Sheet 152, Labor, for more information.

### Repairs to real property

If you repair, replace or install items such as furnaces, garbage disposals, built-in dishwashers and stovetops, water heaters and softeners, and central air conditioners, or when you work on plumbing or electrical wiring, you've contracted for the improvement of real

property. The sale is a construction contract, not a retail sale. You, as the contractor, must pay the sales or use tax on the purchase price of materials used. Include the sales tax you paid in the total amount you charge your customer for parts and materials, but do not show the tax separately on your invoice.

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 3.

### **Purchases**

When you buy materials, supplies and equipment for use in Minnesota, you must pay Minnesota sales or use tax. Delivery charges for these items are also taxable (see Fact Sheet 155, *Delivery Charges*, for more information). Local tax is due if the items are used in an area with a local tax.

*Equipment and machinery* used for construction does not qualify for the capital equipment refund or for the farm machinery exemption.

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

### **Use tax**

If you buy materials, supplies, and equipment for use in Minnesota and no Minnesota *sales* tax is listed on the purchase invoice, you must report and pay Minnesota *use* tax directly to the state of Minnesota. If the materials are used in a construction project located in an area where there is a local tax, you must also report and pay any local use tax due.

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 (6.5 percent) and the rate of sales tax paid to the other state.

To pay use tax, register with the Minnesota Department of Revenue either online at [www.taxes.state.mn.us](http://www.taxes.state.mn.us) or by calling 651-282-5225. After you are registered, you must electronically file sales and use tax returns—either monthly, quarterly, or annually, depending on how your account was set up. See Fact Sheet 146, *Use Tax for Businesses*, for more information about use tax.

### **Construction contracts with exempt organizations**

When you contract with exempt organizations such as churches, schools, and federal government agencies, you must pay sales tax on all materials used on the construction contract, just as you do for any other construction contract. An organization's exempt status

**may not** 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.

The only time you may buy materials tax exempt is when the organization designates you as its purchasing agent, and the written contract must clearly show that:

1. the appointment has been made;
2. the exempt organization takes title to all materials and supplies at point of delivery;
3. the risk of loss for all materials and supplies is that of the exempt organization; and
4. the exempt organization, not the purchasing agent, has responsibility for all defective materials and supplies including those incorporated into realty.

To claim exemption the contractor should give the supplier a fully completed exemption certificate, Form ST3. At the top of the ST3 check that you are a contractor and have a purchasing agent agreement with an exempt organization. Enter the exempt entity name and specific project. Also use exemption code M and write in "Purchasing agent agreement with exempt entity." The contractor must keep documentation to show that a purchasing agent relationship exists, such as:

- a letter indicating the above information;
- copies of the page(s) of the written contract showing items 1-4 above; and
- evidence of the organization's exempt status.

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

See *Revenue Notice #95-05, Construction Contracts-Purchasing Agent Exemption*, for more information.

Most *state and local* government agencies are not exempt from sales tax. Contractors must pay sales tax on purchases of building materials used on construction contracts with state and local government agencies.

### **Direct pay companies**

Companies that hold a Minnesota direct pay number (issued by Minnesota Revenue) can not assign their direct pay status to a contractor, unless there is a valid purchasing agent agreement between the contractor and the direct pay permit holder.

### **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 fully completed Certificate of Exemption, Form ST3, using Exemption Code M and writing in, “Materials for business use in a state where no sales tax applies” to buy materials exempt from Minnesota sales tax. See Fact Sheet 110, Items for Use Outside Minnesota, for more information.

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

### ***Building cleaning and maintenance***

Cleaning, maintenance, disinfecting and exterminating services are taxable when you buy these services as part of a contract for the construction, reconstruction, or remodeling of a building or residence. Final cleaning, including duct cleaning, of a building after construction, is also taxable.

These services are also taxable when performed at your office or place of business.

Separate charges for the removal of construction debris or demolition waste are not taxable.

### ***Land clearing contracts***

Tree, bush, shrub and stump removal services that are sold to contractors or subcontractors as part of a land-

clearing contract are exempt. A “land-clearing contract” is a contract for the removal of trees, bushes, and shrubs including the removal of roots and stumps to develop a site. This exemption does not apply to land clearing of a portion of a site to allow for remodeling, expanding or improving an existing structure.

### ***Surety deposits for out-of-state contractors***

By law, eight percent of each payment to out-of-state contractors for work done in Minnesota must be withheld as a surety deposit on any contract that exceeds or that can reasonably be expected to exceed \$50,000. However, this requirement may be waived if certain conditions are met. For details, download the Surety Deposits Fact Sheet from our web site or call the Withholding Tax Division at 651-282-9999 to request one.

### ***Withholding affidavit for contractors***

A Withholding Affidavit for Contractors (IC-134) must be certified by the Department of Revenue before final payment is released on government contracts of any amount. For more details, contact the Withholding Tax Division at 651-282-9999.

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## **Guidelines for contractor-retailers**

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

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

- Pay the sales tax to the seller if the items are to be used in a construction contract.
- Give a fully completed Certificate of Exemption, Form ST3, claiming the resale exemption, to the seller if the items are for resale.

**For example:** 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 the homes the contractor is building. Installing carpet is an improvement to real property and the sale is a *construction contract*. The carpet dealer must pay tax on all purchases of carpet, materials, supplies, and equipment used to install the carpet. The tax expense should be included in the total amount the carpet dealer charges the contractor, but the tax should not be itemized separately.

**Situation 2.** An individual special orders carpet that he intends to install himself in his basement. This sale is a *retail sale*. The carpet dealer must charge sales tax on the retail selling price of the carpet and itemize sales tax on the customer’s invoice. The dealer should give a fully completed Certificate of Exemption, Form ST3, claiming the resale exemption, to the supplier to buy the carpet without paying tax.

### **If you don’t know how the items will be used when you buy them:**

Determine 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;

***primarily a retailer*** if at least 50 percent of your business purchases are sold at retail.

**If you are primarily a contractor**, pay sales tax to your suppliers on all purchases.

If any of these items are later sold at retail, you may deduct the cost of the materials on which you already paid tax when you report your *General rate sales* on your sales and use tax return.

**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 \$6.50 (6.5 percent of \$100).

The roofer paid \$70 plus \$4.55 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 electronically 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 either the retail price or cost of materials when calculating general rate sales.

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

### Primarily a contractor

If you are primarily a contractor, follow this example when electronically filing your Minnesota sales and use tax return and invoicing your customer.

The following assumes that sales tax was paid directly to the vendor on materials purchased.

Type of sale	Itemize tax on customer's invoice?	How to report sales tax return
Construction contract	No	Total contract as <i>Gross receipts</i>
Retail sales	Yes, charge sales tax on the total selling price	Total sales as <i>Gross receipts</i> , and difference between selling price and cost of materials as <i>General rate sales</i>

**If you are primarily a retailer**, you must give a Certificate of Exemption, Form ST3, claiming the resale exemption, to your suppliers to claim exemption on all purchases.

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

**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 a *Use-tax purchase* when electronically filing the sales and use tax return. This tax should be included in the \$139 charged to the customer but should **not** be shown separately on the customer's invoice.

### Primarily a retailer

If you are primarily a retailer, follow this example when electronically filing your Minnesota sales and use tax return and invoicing your customer.

The following assumes that all materials were purchased exempt from sales tax.

Type of sale	Itemize tax on customer's invoice?	How to report sales tax return
Construction contract	No	Total contract amount as <i>Gross receipts</i> and cost of materials as <i>Use-tax purchases</i>
Retail sales	Yes, charge sales tax on the total selling price	Total sales as <i>Gross receipts</i> and <i>General rate sales</i>

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## General information

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### **Contractors improperly charging sales tax**

If a contractor improperly charges a customer sales tax on an improvement to real property, and the customer files a purchaser refund claim with the Department of Revenue, sales or use tax may be assessed against the contractor on the cost of materials used in the construction contract. The assessment may be made within 3 ½ years of the sale, or one year after the date of the refund order, whichever is later. This applies to purchaser refund claims filed on or after June 3, 2005.

### **Fabrication labor**

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

If you **buy or sell** fabrication labor, the charge is subject to sales or use tax. For example, if a contractor makes heating ducts for a building and sells them to a customer *without installation*, the entire charge for the ducts (labor and material) is taxable. Fabrication labor is taxable, even when the customer provides the materials. Examples include gravel crushing, pipe cutting or threading, custom sawing or milling lumber, and rolling, cutting or forming metal.

If you fabricate materials as *part of a construction contract*, the labor is not taxable. For example, if a contractor both fabricates heating ducts *and installs* them, the charge to the customer for making the installed ducts is not taxable. The contractor must pay sales or use tax on materials used.

See Fact Sheet 152, Labor, for more information.

### **Sales of aggregate and gravel, crushed rock, sand, or dirt**

**Construction contract:** Sales of aggregate, gravel or similar materials are an improvement to real property if the sales contract requires both the delivery and depositing substantially in place of the materials. Deposited substantially in place means deposited on the project site directly or through spreaders where it can be spread from or compacted at the location where it was deposited. Charges for materials in these situations are not taxable to the customer.

The contractor must pay sales or use tax on these materials used to improve real property. If the contractor owns a gravel pit and uses his/her own gravel for improving real property, no use tax is due.

**Retail sale:** If the aggregate material is merely dumped in a pile, or if the contract does not require the

hauler to deposit the aggregate material substantially in place, it is a sale of tangible personal property and the contractor must charge sales tax on both the materials and the delivery charges.

**Delivery** of aggregate materials and concrete block is a taxable service. Charges for delivery of aggregate materials and concrete block are taxable when performed by someone other than the seller if the delivery would have been taxable when performed by the seller. For more information, see Fact Sheet 155, Delivery Charges; also see Revenue Notices 02-12 for a definition of aggregate materials and 02-17 for examples of taxable and non-taxable delivery charges.

**Sales to a town** of gravel, machinery, equipment and accessories used exclusively for road and bridge maintenance are not taxable. See Fact Sheet 142, Sales to Government, and Revenue Notice 99-16, Sales Tax Exemption for Towns, for more information.

### **Ready-mixed concrete and trucks**

**Sales price.** The taxable sales price of ready-mixed concrete sold from a ready-mixed concrete truck includes 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 sales tax on motor vehicles.

**Fuel to propel ready-mixed concrete trucks** over the road is subject to petroleum excise tax.

**Fuel to run the power take-off unit on a ready mixed concrete truck** is eligible for a refund of petroleum tax. To request a refund of state petroleum tax paid, download Form PDR-1, Minnesota Motor Fuel Claim for Refund, from our web site or call the Petroleum Division at 651-296-1961 to request one.

- If the ready-mix is sold without installation, the industrial production exemption applies and no use tax is due on the fuel used to run the power take-off unit.
- If the ready-mix is used in a construction contract, you must pay use tax on the fuel to run the power take-off unit. Report the amount as *Use-tax purchases* when electronically filing your sales and use tax return.

**Leases of ready-mixed concrete trucks and their repair and replacement parts** are taxable. However, if the truck is used primarily (50 percent or more of the time) to sell ready-mix without installation, you may qualify for a refund of sales or use tax paid. See Fact Sheet 103, Capital Equipment, and Form ST-11, Capital Equipment Refund Claim, for more information.

### **Equipment sales and rentals**

If you rent your construction equipment (without an operator) to another contractor, you must charge sales tax on the rental price. There is no longer an occasional sale exemption for the rental of business equipment. If you rent equipment (without an operator) from another contractor to use in your business and the other contractor doesn't charge you sales tax, you must pay use tax on the rental price.

If you sell equipment or other items that were used in your business, those sales may be subject to tax. See Fact Sheet 132, Occasional Sales of Business Equipment and Goods, for more information.

### **Helpful hints**

Some businesses have a difficult time determining the actual material cost when billing retail sales or construction contracts. Following are some suggestions:

- 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 four of Fact Sheet 146, Use Tax for Businesses, to keep track of your use tax owed.

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

## **Local sales and use taxes**

If you are located or working in an area with a local tax, local sales or use tax may also be due. Contractors who take delivery of materials in a locality with local tax must pay the local tax on the material, even though the materials may be used in a contract outside the local tax area. Local taxes are listed and explained in detail in Fact Sheet 164, Local Sales and Use Taxes.

### **References**

M. S. 297A.61, Subd. 3(g)(6)(iii), Building cleaning and maintenance  
M. S. 297A.61, Subd. 4, Retail sale  
M. S. 297A.68, Subd. 14, Property in transit  
M. S. 297A.68, Subd. 2(b)(2), Materials consumed in industrial production  
M. S. 297A.68, Subd. 5(b)(8), Capital equipment  
M. S. 297A.68, Subd. 40, Land clearing  
M. S. 297A.70, Exemptions for governments and non-profit groups  
Revenue Notice 95-05, Construction Contracts - Purchasing Agent Exemption  
Revenue Notice 99-16, Sales Tax Exemption for Towns  
Revenue Notice 02-12, Taxable Delivery Charges – Aggregate Materials  
Revenue Notice 02-17, Taxable Sales – Delivery of Aggregate Materials and Concrete Block  
Revenue Notice 04-04, Distinguishing Between Real Property and Tangible Personal Property

### **Other fact sheets you may need:**

A Step-by-Step Guide to Filing and Paying Sales and Use Tax Electronically, #170  
Building Cleaning and Maintenance, #112  
Labor, #152  
Lawn and Garden Care, Tree and Bush Service, Landscaping, #121  
Local Sales and Use Taxes, #164  
Use Tax for Businesses, #146