

October 12, 2007

Legislative Reference Library
645 State Office Building
100 Reverend Dr. Martin Luther King Jr. Blvd.
St. Paul, Minnesota 55155

Re: In The Matter of the Proposed Amendment of Rules of the Minnesota Department of Revenue Governing Isolated and Occasional Sales and Sales of Personal Property Used in a Trade or Business, Amending *Minnesota Rules*, Part 8130.5800

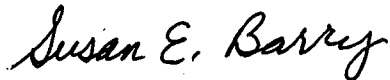
Dear Librarian:

The Minnesota Department of Revenue intends to adopt rules governing the application of Minnesota sales and use tax laws to isolated and occasional sales and sales of personal property used in a trade or business. We plan to publish a Dual Notice of Intent to Adopt Rules in the October 22, 2007, State Register.

The Department has prepared a Statement of Need and Reasonableness. As required by Minnesota Statutes, sections 14.131 and 14.23, the Department is sending the Library a copy of the Statement of Need and Reasonableness at the time it is available to the public.

If you have any questions, please contact me at (651) 556-4062.

Yours very truly,



Susan E. Barry
Attorney/ Rules Coordinator
Appeals & Legal Services Division
Minnesota Department of Revenue

Enclosure: Statement of Need and Reasonableness

Minnesota Department of Revenue

STATEMENT OF NEED AND REASONABLENESS

Proposed Amendment to Minnesota Rules, part 8130.5800, Governing isolated and occasional sales and sales of personal property used in a trade or business.

INTRODUCTION

The Minnesota Department of Revenue proposes to amend Minnesota Rules, part 8130.5800. Since the rule was originally published in 1974, the governing statutes have changed a number of times. Definitions were added to clarify when the exemption for isolated or occasional sales applies. The original law, Minnesota Statutes, section 297A.25, subdivision 12, was divided into two separate provisions: section 297A.67, subdivision 23 deals with occasional sales by individuals that are not made in the normal course of business. Section 297A.68, subdivision 25, deals with the sale of tangible personal property primarily used in a trade or business, provided the sale is not made in the normal course of business and some other conditions apply.

The proposed rule would likely affect individuals who make occasional sales while they are not engaged in the business of selling that kind of property or service; businesses that sell taxable property; businesses that sell farm machinery; people who sell tangible personal property at flea markets, craft shows, and similar events, as well as operators of these types of shows and events; and brokers and auctioneers.

This document, the Statement of Need and Reasonableness (SONAR), has been prepared to establish the statutory authority, need for, and reasonableness of the proposed rules. It is submitted pursuant to Minnesota Statutes, section 14.23, and Minnesota Rules, part 1400.2070, requiring a Statement of Need and Reasonableness.

The Request for Comments was published in the *State Register* on Monday, June 17, 2002 (26 S.R. 1733). No comments were received.

ALTERNATIVE FORMAT

Upon request, this Statement of Need and Reasonableness can be made available in an alternative format, such as large print, Braille, or cassette tape. To make a request, contact

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STATUTORY AUTHORITY

The Department's general statutory authority to adopt rules is set forth in Minnesota Statutes, section 270C.06. It provides that the Commissioner of Revenue has the authority to "administer and enforce the

assessment and collection of state taxes . . . , and, from time to time, make, publish, and distribute rules for the administration and enforcement of . . . state tax laws." Under this statute, the Department has the necessary authority to adopt the proposed rule.

REGULATORY ANALYSIS

As required by *Minnesota Statutes*, section 14.131, the Department consulted with the Commissioner of Finance "to help evaluate the fiscal impact and fiscal benefits of the proposed rule changes on units of local government."

As required by *Minnesota Statutes*, section 14.127, the Department looked at the cost of compliance within the first year after the rule changes take effect and determined that the cost will not exceed \$25,000 for any business that has less than 50 full time employees or for any one statutory or home rule charter city that has less than 10 full time employees.

Minnesota Statutes section 14.131, sets out seven factors for a regulatory analysis that must be included in the SONAR. The Department's response to these seven factors follows:

"(1) a description of the classes of persons who probably will be affected by the proposed rule, including classes that will bear the costs of the proposed rule and classes that will benefit from the proposed rule"

The proposed rule will likely affect any person or business who sells property or a service on an occasional basis and not in the normal course of business. A list of the specific types of groups that would be especially interested in this rule is included in the introduction. These classes of persons will benefit from having a clearer interpretation of the law, a better understanding of the types of sales that are considered occasional, and having a better understanding of the different terms used in the law. This rule also clarifies the distinction between the isolated and occasional sales exemption as it applies to individuals and the exemption for the sale of property that is used in a trade or business, but is not made in the normal course of business. The department does not expect any costs to be incurred by the general public. There may be some cost imposed on retailers who need to adjust their records in order to adequately separate taxable tangible property that is not subject to tax from items that are taxable.

"(2) the probable costs to the agency and to any other agency of the implementation and enforcement of the proposed rule and any anticipated effect on state revenues."

The Department of Revenue does not anticipate any additional administrative costs incurred by the agency or by other state agencies, due to the promulgation of this proposed rule. The proposed rules will clarify how the sales tax applies to the sale of tangible personal property or services in different situations, thus tending to increase the efficiency with which this tax is administered. The promulgation of the rule will ensure better compliance with current tax law because of the guidance provided to taxpayers on the proper collection of sales tax when isolated and occasional sales are made by an individual and when sales by a business are not made in the normal course of business.

"(3) a determination of whether there are less costly methods or less intrusive methods for achieving the purpose of the proposed rule"

The Department is not aware of any less costly or less intrusive methods by which the purpose of the proposed rules could be achieved. Because the law in this area includes different terms that need further interpretation, the Department believes that a rule would be the most effective method to reference all statutory provisions related to this area, explain the various terms, and give examples illustrating when

property or services are excluded from tax under the two exemptions dealing with isolated sales made by an individual or a business.

“(4) a description of any alternative methods for achieving the purpose of the proposed rule that were seriously considered by the agency and the reasons why they were rejected in favor of the proposed rule”

The Department decided to promulgate this rule because of the interplay between different provisions of the law. Legislation could not appropriately explain the different terms and situations that arise when isolated sales are made. The Rule can more appropriately illustrate how these exemptions apply to different types of businesses and situations. The Department has also published a number of revenue notices and fact sheets that deal with occasional sales, farm machinery, and selling events. However, since revenue notices and fact sheets do not bind taxpayers, a rule is needed in this area.

“(5) the probable costs of complying with the proposed rule, including the portion of the total costs that will be borne by identifiable categories of affected parties, such as separate classes of governmental units, businesses, or individuals”

The rule may result in some compliance costs because of the need to change accounting systems in order to separate taxable sales from non-taxable sales. However, these changes are a direct result of the law changes that have been made in this area since the rule was last modified and are only indirectly related to the amendment of the rule.

“(6) the probable cost or consequence of not adopting the proposed rule, including those costs or consequences borne by identifiable categories of affected parties, such as separate classes of governmental units, businesses, or individuals”

If this proposed rule is not adopted, the current rule dealing with isolated and occasional sales will reflect obsolete law because of the numerous law changes that have taken place since the rule was promulgated. Individuals and business that make occasional sales, as well as buyers who may be affected by this rule, will be unaware of their responsibilities and available exemptions under the sales tax law.

“(7) an assessment of any differences between the proposed rule and existing federal regulations and a specific analysis of the need for and reasonableness of each difference”

There are no applicable federal laws in this area.

PERFORMANCE-BASED RULES

Minnesota Statutes, sections 14.002 and 14.131, require that the SONAR describe how the agency, in developing the rules, considered and implemented performance-based standards that emphasize superior achievement in meeting the agency’s regulatory objectives and maximum flexibility for the regulated party and the agency in meeting those goals.

This proposed rule supports the Department’s strategic plan. The Department’s main objective in this rule is to repeal outdated information. By providing additional clarity and certainty in this area of the law, the proposed rule will promote the principle that everyone is paying the right amount of tax, no more and no less. The additional clarity and certainty provided by the proposed rule will also help improve the degree to which these particular tax laws are easy to understand and easy to administer.

ADDITIONAL NOTICE

In order to provide notice to all persons who may be affected by the proposed rules, the Additional Notice Plan consists of:

- (1) Posting the Request for Comments, Notice of Intent to Adopt Rules, and SONAR to the Department website at <http://www.taxes.state.mn.us>.
- (2) Mailing a copy of the Notice of Intent to Adopt Rules and a copy of the proposed rules to the following:
 - The Tax Section of the Minnesota State Bar Association
 - Minnesota Auctioneer Association
 - The Minnesota Bankers Association;
 - Minnesota Business Partnership;
 - Minnesota Council of Nonprofits;
 - Minnesota Farm Bureau; and
 - Minnesota Retailers Association.
 - And others who specifically requested copies

Our Notice Plan also includes giving notice required by statute. We will mail the rules and Notice of Intent to Adopt to everyone who has registered to be on the Department's rulemaking mailing list under Minnesota Statutes, section 14.14, subdivision 1a. We will give notice to the Legislature as required by Minnesota Statutes, section 14.116.

LIST OF WITNESSES

If these rules go to a public hearing, the Department does not anticipate calling any witnesses. Department of Revenue employees may be called to testify in support of the rules.

RULE ANALYSIS

Minnesota Statutes, chapter 14, requires the Department to explain the facts establishing the need for and reasonableness of the rules as proposed. "Need" means that a problem exists, which requires administrative attention. "Reasonableness" means that there is a rational basis for the Department's proposed action. The need for and reasonableness of the proposed amendment to the rule is explained in this section. It is necessary and reasonable to amend the rule to make it easier and more efficient for the Department to administer the laws related to the sales tax when isolated sales are made by individuals or businesses and to make sure that taxpayers are informed of their rights and obligations in this area.

Part 8130.5800 – Amendments and Repealers

Subpart 1. Subpart 1 modifies the current subpart 1 by providing a general background, referencing the applicable laws and correcting the obsolete statutory references related to isolated or occasional sales of tangible personal property made by a person who is not engaged in selling such property in the normal course of business, as well as the laws applicable to the sale of tangible personal property that is primarily used in a trade or business. The subpart also references isolated sales of services by individuals. Section 297A.67, subdivision 23, deals with isolated and occasional sales of services and property. The amendment of subpart 1 is necessary because the old rule did not deal with the sale of property used in a trade or business. The exemption for occasional sales, as well as the exemption for the

sale of property used in a trade or business, has gone through numerous changes since the rule was promulgated. Under Laws of Minnesota for 2001, First Special Session, Chapter 5, Article 12, Section 53, the sale of tangible personal property used in a trade or business is exempt under certain circumstances. The old rule deals only with sales by individuals. There was no distinction between sales by individuals and sales by businesses. In the new rule, item A deals with sales by individuals, while item B deals with sales by businesses, to explain the law changes made since the old rule was promulgated. The definitions of the terms "isolated" and "occasional" have been moved to subpart 1a because that subpart deals with other definitions that are relevant to this rule. This subpart is reasonable because it provides a statutory framework to the rule as a whole, an explanation of key terms used in the rule, and references to relevant statutory provisions.

Subpart 1a. Subpart 1a is a new subpart which provides definitions for various terms that appear in the law. Some of the definitions were moved from the existing subpart 1 to this subpart since subpart 1 is meant only to provide general background. This subpart is necessary because definitions of these terms are not provided within Chapter 297A.

The definitions in items A and C of "isolated" and "occasional" are reasonable as they are identical to the definitions originally in subpart 1. The example in item C regarding garage sales is needed to clarify the meaning of occasional. An annual garage sale is considered occasional, as opposed to other sales that occur more frequently.

Item B is needed to define the term "normal course of business." Stating that inventory is considered to be sold in the normal course of business is reasonable since it is consistent with Minnesota Statutes, Section 297A.61, subdivision 21, which defines 'normal course of business' as continuous and consistent business activities. Inventory is merchandise sold for the purpose of producing income, as provided in subdivision 21. The position on the sale of inventory is consistent with other department publications. Revenue Notice #1991-06, issue and conclusion #4, states that "business inventory was never subject to the isolated/occasional sale exemption since the inventory was sold in the regular course of business. The seller must either charge sales tax, or accept an exemption certificate from the buyer." Item B also states that the lease of tangible personal property is subject to tax. Leasing of business equipment is never exempt under Minnesota Statutes, section 297A.68, subdivision 25, which deals with the sale of property used in a trade or business. A lease is made during the normal course of business since the title to the property does not change hands and the activity demonstrates a commercial continuity under Minnesota Statutes, section 297A.61, subdivision 21. Items that are leased have the potential of being re-leased and thus, leasing demonstrates a commercial continuity or consistency of making sales, as provided in the definition of "normal course of business" under Minnesota Statutes, section 297A.61, subdivision 21.

Example 1 deals with repossession of secured property. It is necessary to demonstrate the meaning of inventory. It is reasonable because banks deal with the repossession of items. This position is consistent with Revenue Notice #1991-06 as well as Sales Tax Fact Sheet #132. Revenue Notice #1991-06, issue and conclusion #11, deals with tax consequences when a bank or similar lender repossesses secured property primarily used in a trade or business. It states that the "transfer to the bank is treated as a sale for resale as long as the bank will be reselling the item. The bank or other lender must collect and remit tax when it resells the items, since repossessed items are considered to be inventory in the possession of the financial institution."

Example 2 deals with a company that leases excavating and hauling equipment to another business. The example is necessary to demonstrate that leases of tangible personal property in the normal course of business are subject to tax. This example is reasonable because under Minnesota Statutes, section 297A.61, subdivision 4, retail sales include leases. If the lease of equipment is conducted in the normal course of business, the lease of equipment does not qualify for the exemption under Minnesota Statutes, section 297A.68, subdivision 25. Even if substantially all of the assets of the business are leased, that would meet the definition of "normal course of business" since the leasing would demonstrate commercial continuity.

Example 3, dealing with the sale of luxury boats, is necessary to explain the meaning of "isolated and occasional sale" in the context of a sale in the normal course of business. As explained in subpart 2, the exemption for isolated or occasional sales of tangible personal property is available only when a person does not sell tangible personal property in the normal course of business. The example is reasonable because while the business sells only one or two boats a year, the sales are conducted by a trade or business in the normal course of business.

The definition of "trade or business" in item D is necessary because the exemption under section 297A.68, subdivision 25, is available to a trade or business only under certain specified circumstances. The definition is needed to supplement the explanation of the term in Minnesota Statutes, section 297A.68, subdivision 25, paragraph (b), clause (2), which deals with the assets of a separate division or branch, but does not further define the meaning of "trade or business." The definition of trade or business is reasonable because it represents the department's long standing position and is provided in department publications such as Revenue Notice #1991-06, and Fact sheet # 132. Revenue Notice #1991-06 states that "trade or business" includes any activity carried on for the production of income from selling goods or performing services, but that "organizations exempt from federal taxation under *Internal Revenue Code*, subchapter F, are only considered to be engaged in a trade or business to the extent the activity is unrelated to their exempt purposes."

The rule also incorporates the U.S. Supreme Court position that "to be engaged in a trade or business, the taxpayer must be involved in the activity with continuity and regularity and that the taxpayer's primary purpose for engaging in the activity must be for income or profit. A sporadic activity, a hobby, or an amusement diversion does not qualify." Comm'r v. Grotzinger, 408 U.S. 23 (1987). Under this definition, government entities are not considered to be engaged in a trade or business since all of their activities are conducted to further a public purpose, rather than for generating profit.

Government entities that periodically sell equipment in the normal course of business are considered to be in a trade or business since the government in this case performs a continuous and regular activity carried on for the production of income. Under Minnesota Rules, Part 8130.9300, subp. 4, such sales are not isolated or occasional sales.

The examples in Item D of a trade or business, such as apartment buildings or other rental property and law offices, are reasonable as they are of businesses whose activities are carried on continuously for the production of income. The examples of entities that are not considered to be engaged in a trade of business, such as the American Red Cross and Churches, are reasonable as they are entities that are exempt from federal taxation and the purpose of their activities is not generating income or profit. The example given of an exempt organization that is engaged in a taxable activity is reasonable, since a nonprofit hospital, while it may be exempt from federal taxation, is engaged in selling for the production of income when it operates a gift shop and the sale of items used by the gift store is taxable.

The definition of “primarily used” in item E is necessary because it is a term used in statute and in this rule, both in the exemption for occasional sales and also in the exemption for sales of property used in a trade or business. Defining the term as an item that is used at least 50 percent of the time in a trade or business is reasonable as this has been the department’s long standing position as represented in publications such as Revenue Notice #1991-06, and Fact Sheet #132. Revenue Notice #1991-06 states that “when an item is used for purposes other than trade or business use, the owner must determine what the primary use is when deciding whether or not to charge tax on the sale of the item.” “Primarily used” means that the item is used at least 50 percent or more of its operating time, in the trade or business. If it is used less than 50 percent of the time in the trade or business, it will be considered not to be primarily used in the trade or business, and the sale of the item is eligible for the isolated or occasional sale exemption.” This is similar to the definition used in other states. For example, Indiana’s definition for “primarily used” is an “item or service that is used more than fifty (50%) of the time.” 45 IAC 2.2-5-55. Item E provides an example of a lawn mowing business. Since the owner uses the lawnmower mostly to mow his own lawn, it is not considered to be used primarily in a trade or business.

The definition of “substantially all of the assets of a trade or business” in item F is necessary because it is used in Minnesota Statutes, section 297A.68, subdivision 25, paragraph (a), clause (5). While subdivision 25, paragraph (b), clause (3), states that the sale must occur within one year, the law does not further define the term. The definition of “substantially all of the property sold” is necessary because it is used in Minnesota Statutes, section 297A.68, subdivision 25, paragraph (b), clause (1), in defining the meaning of farm auction. It is reasonable to adopt a “90 percent or more” standard for “substantially all” because this term has been interpreted similarly by various courts. The term “substantially all” generally means “all but a few,” or “all except a negligible minority” (*Burnet v. Bank of Italy*, 46 F.2d 629 (1931)). In *Strong v. Commissioner of Internal Revenue*, T.C. Summ.Op. 2007-48, 227 WL 895 131 (U.S. Tax Ct. 2007), the court analyzed the meaning of section 448(d)(2) of the Internal Revenue Code, which dealt with qualified personal services corporations. The court sustained the determination by the Internal Revenue Service that petitioner was not a personal service corporation because under Temporary Income Tax Regulations, 52 Fed.Reg. 22768 (1987), as amended by T.D. 8329, 56 Fed.Reg. 485 (1991), “the term ‘substantially all’ means an amount equal to or greater than 95 percent.” In *Suzy’s Zoo v. Commissioner of Internal Revenue*, 114 T.C. No.1, 2000 WL 5257 (U.S. Tax Ct. 2000), the Tax Court held that the taxpayer did not qualify for the small reseller exception to the Uniform Capitalization rules since, for purposes of the exception to the rules, “the term “substantially all” means 95 percent or more of the value of the corporation’s stock.”

The example about the business that owns the retail hardware business as well as a construction divisions is necessary to demonstrate that the term “substantially all of the assets of a trade or business” refers to the assets of a separate division as well. In the example, one division closes so all the assets (more than 90 percent) of that division are sold. The sale is exempt even though the construction division continues to exist. The example can also be found in Fact Sheet #132: “For example, a company has a retail hardware business and also does construction work. The records of the businesses are kept separately. The retail hardware business closes, but the construction work continues. The sale of all the assets of the hardware business is exempt from the tax.”

Subpart 2. Subpart 2 is amended to deal with the exemption for isolated and occasional sales of property or a service by an individual. New subparts 3a, 3b, 3c, and 3d deal with such sales by businesses. It was necessary to deal with individuals and businesses separately because the statutory requirements under Minnesota Statutes, section 297A.67, subdivision 23, dealing with isolated and

occasional sales by individuals are different from the requirements under Minnesota Statutes, section 297A.68, subdivision 25, dealing with sales of property used in a business. Previously, the exemption included sales of tangible personal property made by a person or business who did not normally sell such items in the regular course of business. Beginning July 1, 1991, sales of items used in a trade or business are eligible for exemption if they meet the requirements under section 297A.68, subdivision 25. Subpart 2 is reasonable since it is based on the statutory definition of occasional sales by individuals that are not made in the normal course of business.

Example 1 of what constitutes isolated and occasional sales was included in the old rule, and is simply updated to be generic. Example 2 about mowing a neighbor's lawn is needed to demonstrate a sale of a nonrecurring nature. It is reasonable since the neighbor being on vacation is an example of a non-recurring activity. Examples 3 and 4 of what constitutes isolated and occasional sales were also included in the old rule (as item A, examples 2 and 3, in old rule), and are amended so they only describe isolated and occasional sales of property or a service by an individual.

Item B is deleted since it deals with sales by a business, addressed in subpart 3a.

Subpart 3. A few minor changes update the language of the old rule and eliminate the reference to wholesaler and manufacturer since they sell for resale and are not subject to tax.

Subparts 3a, 3b, and 3c. These new subparts deal with the sale of property used in a trade or business as provided in Minnesota Statutes, section 297A.68, subdivision 25. As stated in the analysis for subpart 2, effective July 1, 1991, sales of tangible personal property primarily used in a trade or business do not qualify for the isolated or occasional tax exemption under Minnesota Statutes, section 297A.67, subdivision 23. However, certain sales of tangible personal property used in a trade or business may qualify for the exemption under section 297A.68, subdivision 25. The provisions dealing with the sale of assets of a separate division, the requirement that the assets be sold within a 12 month period, and the limit of \$1,000 were enacted into law in the 1992 Legislative Session (Laws of Minnesota 1992, Chapter 511, Article 8, Section 16).

Subpart 3a. Subpart 3a deals with the sale of property used in a trade or business, where the sale occurs in a transaction subject to, or is described in, certain provisions of the Internal Revenue Code (IRC), as provided in Minnesota Statutes, section 297A.68, subdivision 25, paragraph (a), clauses (1) and (2).

This subpart is needed to explain that a sale has to be reported to the Internal Revenue Service under one of the listed IRC sections to be eligible for the exemption.

Item A is reasonable as it follows Minnesota Statutes, section 297A.68, subdivision 25, paragraph (a), clauses (1) and (2), as explained in Fact Sheet #132 and in Revenue Notice #1991-06. Revenue Notice #1991-06 states the following: "Does a sale actually have to be reported to the Internal Revenue Service under one of the listed IRC sections in order to be eligible for isolated/occasional sale exemption? Yes, the sale must qualify and be reported as a transaction occurring under one of the listed Internal Revenue Code sections, in order to qualify for the isolated/occasional sale exemption." It also is reasonable since it would be impossible to enforce the law, if the sales were not actually reported under the IRC.

Item B regarding limited liability companies is needed to explain that the exemption in item A is not available to single member limited liability companies unless they elect to be treated as a

corporation. This is reasonable since they are not specifically mentioned in any of the enumerated IRC sections provided under Minnesota Statutes, section 297A.68, subdivision 25, paragraph (a), clause (1). Revenue Notice #2002-10, which deals with single member limited liability companies, also states that single member limited liability companies are subject to the Minnesota sales and use tax law, unless exempted by statute.

Subpart 3b. Subpart 3b is needed to explain the meaning of Minnesota Statutes, section 297A.68, subdivision 25, paragraph (a), clause (5), which deals with the sale of substantially all of the assets of a trade or business. The position taken is reasonable as it is based on the statutory requirements, as provided in subdivision 25, paragraph (b), clause (3). It is also represented in Revenue Notice #1991-06 and Fact Sheet #132. Revenue Notice #1991-06 states the following:

If a trade or business closes and sells off its assets over a period of time (for example, a manufacturer closes down operations and over the next three years sells off the business assets), are these sales still eligible for isolated/occasional sale status? No, these sales are not eligible for isolated/occasional sale status. To qualify for the exemption, the trade or business must sell substantially all of its assets in a single transaction or in a series of related transactions that occur within the 12-month period beginning on the date of the first sale of assets. Any sales occurring after the end of the 12-month period are subject to the sales or use tax.

In item A, it is reasonable to require the buyer to show a statement provided by the seller that the sale is a sale of substantially all of the assets of the business, since the information is only known to the seller. The statement by the seller will excuse the buyer from a duty to pay the tax, in case it is found out later that the sale did not meet this requirement. It is reasonable to require the seller to pay the tax on the total amount since seller is familiar with, and is in control of, the assets being sold and the amount received.

Item B is necessary to explain the meaning of Minnesota Statutes, section 297A.68, subdivision 25, paragraph (b), clause (3). It is reasonable to require substantially all of the assets to be sold within the 12-month period since this conforms with the requirements under subdivision 25, paragraph (b), clause (3), which states that the "sale of substantially all of the assets... must occur ... within the 12-month period..."

Subpart 3c. Subpart 3c is necessary to explain the requirements provided under Minnesota Statutes, section 297A.68, subdivision 25, paragraph (a), clause (6), which deals with the sale of some of the assets of the business, and to distinguish it from subdivision 25, paragraph (a), clause (5), which deals with substantially all of the assets of the business. This subpart is reasonable in part because the language mirrors what is provided in section 297A.68, subdivision 25, paragraph (a), clause (6). It is reasonable to require the buyer to show a statement provided by the seller that the sale does not exceed \$1,000 since the information is only known to the seller. The statement by the seller will excuse the buyer from a duty to pay the tax, in case it is found out later that the sale did exceed \$1,000. It is reasonable to require the seller to pay the tax on the total amount since seller is familiar with, and is in control of, the property sold and the amount received. The example is needed to further emphasize that when the sale is not of substantially all the assets, then the gross receipts from the sale of the property over a period of a year must not exceed \$1,000.

Subpart 3d. Subpart 3d is a new subpart. It deals with the exemption for a farm auction sale. This subpart is necessary to clarify the difference between exempt and taxable items. The position taken in this subpart is reasonable because under Minnesota Statutes, section 297A.68, subdivision 25, paragraph (b), clause (1), substantially all of the property sold is required to be property used in farming. Under this section, the property sold is exempt only if it is not primarily used in a trade or business. This position is also represented in Fact Sheet #132 which states: "Farm auction means a public auction conducted by a licensed auctioneer if substantially all of the property sold consists of property used in the trade or business of farming and non-business property, such as household goods."

The example is needed to demonstrate that substantially all of the property sold (as defined in subpart 1a, item F) needs to be used in the business of farming or consist of other personal items. The example also clarifies that property that is used in a trade or business other than farming, remains subject to tax.

Subpart 4. Subpart 4 deals with garage sales. The language about flea markets is deleted as it is no longer needed since the law was changed in 2005 to add Minnesota Statutes, section 297A.87, which deals specifically with flea markets, shows and other selling events. The language about what a garage sale "does not include" is reasonable as it is taken from Minnesota Statutes, section 297A.87, which treats those sales separately. This part is updated to clarify the meaning of garage and personal sales and to provide examples. It is reasonable to include moving sales and estate sales in this part since they involve occasional sales of a variety of personal items rather than the sales identified in Minnesota Statutes, section 297A.87, which involve shows that are generally dedicated to a specific area and are more professional in nature. The subpart is necessary to clarify which types of garage and personal sales are exempt as isolated and occasional sales. This subpart is reasonable as it incorporates positions from Fact Sheet #132, which provides: "Sales of personal belongings are exempt from sales tax if the seller is not in the business of making retail sales, and if no business assets are sold. For example, if an individual sells personal belongings at a garage sale, through word of mouth, notices on a bulletin board, or an advertisement in the classified section of a newspaper, etc., no sales tax applies."

The examples are needed to clarify that the items that were purchased for the purpose of resale are subject to tax, while personal items are not subject to tax, even if they are co-mingled with items that were bought for resale. That is consistent with Minnesota Statutes, section 297A.67, subdivision 23, which states that in order to qualify for the exemption, the items cannot be sold in the normal course of business. A person who holds garage sales regularly meets the definition of making sales in the normal course of business under Minnesota Statutes, section 297A.61, subdivision 21. Also, garage sales cannot be held on a recurring basis since the exemption is available only for isolated and occasional sales. Example 2 demonstrates that a person who sells items that were purchased for the purpose of resale does not qualify for the exemption for occasional sales under Minnesota Statutes, section 297A.67, subdivision 23, since this is a sale of property used in a trade of business. The example also clarifies that while the sale of the items used in a trade or business is subject to tax, the sale of personal items, such as toys, is exempt as an isolated and occasional sale.

Subpart 7: Subpart 7, which deals with admission to places of amusement and athletic events, is repealed since it is no longer accurate. While this subpart stated that these admissions could not qualify for the exemption for isolated or occasional sale since the sale of admissions was not a

sale of tangible personal property, under Minnesota Statutes, section 297A.67, subdivision 23, the sale of property as well as the sale of service may qualify for the exemption. Sales of admissions to places of amusement that meet the requirements under Minnesota Statutes, section 297A.67, subdivision 23, are exempt. However, sales of admissions are generally made in the normal course of business and thus would not qualify for the exemption for isolated and occasional sales.

Subpart 8: Subpart 8 deals with auctions. This subpart is necessary because tangible personal property that is sold in auctions may be owned by third parties that make isolated or occasional sales and the law does not provide guidance on taxability of these sales.

The definition of an auction in item A is reasonable as it is taken from the definitions provided by Fahey Sales Agency, a Minnesota auctioneer house: <http://faheysales.com/fahey.cfm?pageID=77>. The definition is also reasonable because it is based on the requirements of Minnesota Statutes, Chapter 330, which deals with auctioneers. The definition of an auction does not include consignment sales since unlike auctions, consignment sales are generally conducted in a permanent place of business. Also, under Minnesota Statutes, section 336.9-102, consignment is a transaction in which a person delivers goods to a merchant who is not an auctioneer, for the purpose of sale. The definition of an auction does not include consignment auctions since, unlike auctions, consignment auctions are generally held at a location other than the owner's location. In consignment auctions, the sales price is determined by the owner and the seller, whereas in regular auctions, the price is determined by competitive bidding. Unlike auctions, consignment auctions are regularly held, they are open to all sellers, and they are held at the same location

Under item B, the sale of property that is primarily used in a trade or business is subject to tax. This meets the requirement provided under Minnesota Statutes, section 297A.67, subdivision 23.

Under Item C, property sold at an auction will qualify as an isolated or occasional sale if it would qualify if sold by the owner of the property and if certain other conditions are met. It is reasonable to base qualifying for the exemption on whether or not the sale would qualify if the property were sold by the owner since the auctioneer is an agent for the owner (see explanation under subpart 9, second paragraph, regarding auctioneers and "agency" relationship)

It also is reasonable to require that the sale meet certain conditions in order to qualify as an isolated or occasional sale. The first condition requires the title to be exchanged directly between the seller and the buyer. This requirement is consistent with the decision in *State of Minnesota v. Tysdal*, 228 N.W.2d 230 (Minn.1975). In *Tysdal*, the court considered a number of factors before deciding that *Tysdal* was not subject to tax. One of the factors was: "transfer of title and possession is from the 'owner-seller' to the buyer." Other cases dealing with the issue of whether a sale is an occasional or isolated sale also considered whether title was transferred directly to the seller. See *King's Cove Inc. v. Comm'r of Tax.*, 1972 WL 127 (Docket No. 1670, Minn. Tax) and *Gayle's Marina, Inc. v. Comm'r of Tax.*, 1975 WL 500 (Docket No. 1890, Minn. Tax). The second condition provided in item C states that in order to qualify as an isolated or occasional sale, the auctioneer can not carry insurance on the property. This condition is reasonable because in *King's Cove*, one of the factors the court considered in ruling for the broker was the fact that the broker did not carry insurance for the boats sold. Under the third condition, the auctioneer and the owner of the property are required to enter a written agreement in order for the sale to qualify as an isolated or occasional sale. This requirement is reasonable since under Minnesota Statutes, section 330.10, prior to a sale at a public auction, the auctioneer

and the owner are required to enter into a written contract containing the terms and conditions of the sale.

Item D states that the person receiving the payment is responsible for collecting and remitting the sales tax, when the item sold is subject to tax. This requirement is reasonable since the auctioneer is the person who receives the payment from the buyer and the tax is due on the total amount received. This requirement is also included in Fact Sheet #132 which provides: "The tax must be collected by the person at the auction who is responsible for collecting the sale money." Example 1 is reasonable because the auctioneer sells items owned by a third party and the sale is an isolated sale. The auctioneer does not have title to the property, does not carry insurance on the property, the auction is conducted at a site that is not owned by the auctioneer, and the auctioneer has entered a written agreement with a representative of the estate. Example 2 deals with an auctioneer who purchased the tires. This sale is subject to tax since the auctioneer has title to the tires. The Example 3 is reasonable since the sale is conducted by an insurance company. This is a sale of inventory used in a trade or business and thus the sale is not exempt.

Subpart 9: Subpart 9 is a new subpart that deals with brokered sales. This subpart is necessary because the statute does not provide guidance on when sales by a broker are exempt as isolated and occasional. Sales by auctioneers are similar to brokered sales in some aspects: in both cases the seller is a third party and title to the sold item passes directly between the seller and the buyer. However, this rule distinguishes between brokers and auctioneers because of the following differences: their methods of sale are different, brokers generally make the sale in their own place of business while auctioneers sell the items in the sellers' locations, and Minnesota courts have treated auctioneers differently from brokers.

In *State of Minnesota v. Tysdal*, 228 NW2d. 230 (1975), the Minnesota Supreme Court held that auction proceeds were exempt as occasional sales since the auctioneer acted as an agent for the seller and the seller was not selling tangible personal property in the normal course of business. The buyer made the payment to the auctioneer who kept a portion of the payment as a commission and remitted the rest to the seller. The court saw the transfer of title from the owner-seller to the buyer as the significant factor. Because the Court viewed the relationship between the auctioneer and the item's owner as one of agency, the auctioneer was not seen as being engaged in making sales at retail. In *King's Cove*, the Court found for the taxpayer since the broker did not insure the boat, the payment was not deposited in Appellant's bank account and the broker never had title to the boat. In *Gayle's Marina*, the Court found for the Commissioner since the sales were negotiated solely by the broker and the payments were deposited in the broker's bank account.

In item A, the definition of "broker," for purposes of this subpart, is reasonable because it is based on the differences between brokers and auctioneers and on the decisions mentioned above.

Under item B, the sale of property that is primarily used in a trade or business is subject to tax. This meets the requirement provided under Minnesota Statutes, section 297A.67, subdivision 23.

Under Item C, property sold by a broker will qualify as an isolated or occasional sale if it would qualify if sold by the owner of the property and if certain other conditions are met. It is reasonable to base qualifying for the exemption on whether or not the sale would qualify if the property were sold by the owner since otherwise it would fall under item B, and be subject to tax.

The four part test under item C is similar to the test provided in Fact Sheet #132:

Retailers are required to charge sales tax on all sales of new and used taxable items. However, sales of personal items (not used in a trade or business) between individuals may be exempt as an isolated or occasional sale. If a retailer acts as a broker for an individual and receives a brokerage fee or commission for selling the individual's property, the sales tax does not apply if all of the following conditions are met:

1. The property is not business equipment as previously described;
2. The title and money for the sales are exchanged directly between the owner and buyer, and the money does not pass through any accounts of the broker;
3. The broker does not acquire title to the property, does not carry insurance on the property, nor exercises any control over the property, except in respect to leasing or storage arrangements; and
4. The broker's only function is to advertise the property for sale, obtain offers to purchase, and inform the owner of potential buyers. The owner must maintain all rights to accept or reject any offer."

The examples in item D are reasonable because they are based on the decisions mentioned above. The Court in *King's Cove* determined that the boat broker was not liable for tax because appellant "had no title to such brokered boats, carried no insurance for such boats and no money for the sale of boats passed through any account of appellant, payment therefore being made directly from the buyer to the seller." The Court also stated that the "seller of such brokered boats had the sole decision to accept or reject any offer procured by appellant and appellant's only function was to advertise the boats for sale, procure offers of purchase, and transmit the same to the seller for acceptance or rejection."

Subpart 10. Subpart 10 deals with consignment sales and consignment auctions. This subpart is necessary because the statute does not provide guidance on when sales via consignment sales and consignment auctions are exempt as isolated and occasional sales. These types of sales are similar to brokered sales and thus, the conditions for sales to qualify as isolated or occasional sales are the same in subparts 9 and 10. Items A, B, and D, are reasonable as they are consistent with the following conditions identified by the court in *King's Cove Inc. v. Comm'r of Tax.*, 1972 WL 127 (Docket No. 1670, Minn. Tax) and *Gayle's Marina, Inc. v. Comm'r of Tax*, 1975 WL 500 (Docket No. 1890, Minn. Tax): Consignment sales and consignment auctions, like brokered sales, are generally held at a location other than the owner's location. The sales price is determined by the owner and the seller, whereas in regular auctions, the price is determined by competitive bidding. Consignment auctions and consignment sales are similar in that they are regularly held, they are open to all sellers, and they are held at the same location. Brokers and consignees often sell property owned by them, as well as property owned by others.

It is reasonable to treat sales of all items by consignees and brokers the same way since it would be administratively burdensome to collect tax on some items while selling the same items tax free, merely because of the identity of the owner of the items. Such a distinction would also give an unfair advantage to sales where the owner is someone other than the retailer.

Under item C, the sale of property that is primarily used in a trade or business is subject to tax. This meets the requirement provided under Minnesota Statutes, section 297A.67, subdivision 23.

Item E states that the person receiving the payment is responsible for collecting and remitting the sales tax, when the item sold is subject to tax. This requirement is reasonable since the retailer or consignment auctioneer is the person who receives the payment from the buyer and the tax is due on the total amount received. Example 1 is reasonable because the sale violates the fourth condition in item D under which the right to accept or reject the offers is retained by the owner. Example 2 is reasonable because the sale violates the second condition under which the payment should not pass through any accounts of the retailer. Example 3 is necessary to demonstrate the difference between consignment auctions and selling events. Selling events are defined in Minnesota Statutes, section 297A.87, subdivision 1, and since they are different from consignment auctions, the requirements are different. Example 3 is reasonable since under Minnesota Statutes, section 297A.87, subdivision 3, sales at selling events qualify for the occasional sale exemption under section 297A.67, subdivision 23, if the seller participates in the event for three or fewer days.

CONCLUSION

Based on the foregoing, the proposed rule changes are both necessary and reasonable.

10-3-07

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Commissioner of Revenue