

MINNESOTA • REVENUE

February 2013

Budget for a Better Minnesota Sales Tax Reform

***20% rate reduction + broader base = Fair and
Sustainable***

Contents

Sales Tax Reform Overview	3
Sourcing – Buyer and Seller in MN.....	4
Sourcing – Buyer in MN, Seller in Another State.....	5
Sourcing – Seller in MN, Buyer in Another State.....	6
How Sales Tax Reform Will Affect Specific Industries.....	7
Manufacturing	8
Contractors and Labor	9
Agricultural Production	10
Nonprofits	11
How Does It Add Up?.....	12
A Sales Tax for Today’s Economy	13
Affiliate Nexus – Minnesota E-Fairness.....	15
Resources	16

Sales Tax Reform Overview

Governor Dayton's budget proposes the largest cut to the sales tax rate in state history. By broadening the base and lowering the rate, Governor Dayton's budget makes our tax system fairer, modern and sustainable. It helps put Main Street businesses on equal footing with online retailers and aligns our sales tax rate with neighboring states.

- 20% sales tax reduction for everyone, dropping the state rate to 5.5%
- Our sales tax rate drops from 7th - to 27th -highest among states
- A modern tax code for the 21st century – today, services account for 67% of consumer spending (up from 31% in 1950), so our tax code should reflect that
- Stabilize and balance revenues for the long term

Examples of What Is and Isn't Taxed in Governor Dayton's Proposal

Still Exempt (no sales tax) <i>Examples</i>		
<ul style="list-style-type: none"> • Agricultural items (some) • Capital equipment • Clothing items under \$100 • Daycare services • Food • Funeral services 	<ul style="list-style-type: none"> • Medical services • Mining production materials • Nonprofit purchases • Personal care attendants • Public safety items • Prescription drugs 	<ul style="list-style-type: none"> • Renewable energy systems • Residential heating fuels • Textbooks, computers for school use • Veterans organizations memberships

Currently Taxed (rate cut 20% to 5.5%) <i>Examples</i>		
<ul style="list-style-type: none"> • Appliances • Artwork • Auto parts/repair parts • Books, CDs, magazines • Candy bars • Cats and dogs • Cleaning service • Cleaning supplies 	<ul style="list-style-type: none"> • Electronics • Furniture • Housewares • Jewelry • Lawn care service • Lawn and garden • Linens • Lodging 	<ul style="list-style-type: none"> • Lumber, paint, tile • Outdoor recreation items • Personal care items • Pet grooming • School supplies • Sporting goods • Toys • Utility bills

Newly Taxed (at new, lower 5.5% rate) <i>Examples</i>		
<ul style="list-style-type: none"> • Accounting services • Admission events/memberships • Advertising services • Architectural and engineering services • Auto repair 	<ul style="list-style-type: none"> • Bank charges • Investment counseling • Clothing items over \$100 • Computer services • Consulting services • Design services • Digital products 	<ul style="list-style-type: none"> • Legal services • Over-the-counter drugs • Personal instruction • Personal services • Publications • Transport/travel services • Veterinary services

View a complete list at www.revenue.state.mn.us/tax_reform.

Sourcing

When does sales tax apply, who collects?

Goods and services are taxed the same way in Minnesota, both under current law and in the governor's proposal. The basic rule is that when a customer (or client) receives goods or services in Minnesota, the purchase is subject to our sales and use tax – no matter where the seller is located. (The seller's location may affect how the tax is collected or paid.)

Buyer and Seller Both in Minnesota – Taxable Good or Service

Taxable. The seller must collect sales tax on the purchase and pay it to the state.



Examples of a business making these types of transactions:

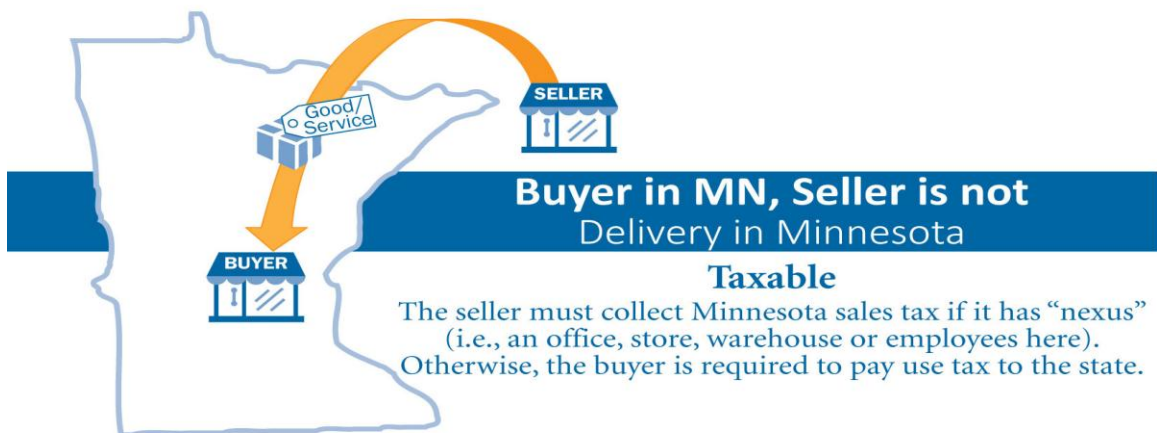
A Minnesota company is contemplating expanding its facility. It hires a Minnesota architectural firm to draw the plans for its new building. The architectural firm is responsible for collecting sales tax when it bills the company for its work. However, the Minnesota company would pay 20% less in sales tax on the construction materials for the expansion due to the Governor's proposed sales tax rate reduction to 5.5%.

Sourcing

When does sales tax apply, who collects?

Buyer in Minnesota, Seller in Another State – Taxable Good or Service

Taxable. The seller must collect sales tax if they have “nexus” in Minnesota – that is, if they have a physical presence such as an office, warehouse or employees here. If the seller doesn’t collect sales tax, the buyer is required to pay use tax to the state.



Examples of a business making these types of transactions:

A Minnesota company hires legal counsel from a law firm located in Hudson, WI. The law firm provides legal advice and produces a memo for the company which is delivered to the company’s Minnesota office. Because the law firm does not have nexus in Minnesota, the Minnesota company is responsible for paying Minnesota use tax.

Affiliate Nexus – Minnesota e-Fairness – see page 15

Sourcing

When does sales tax apply, who collects?

Seller in Minnesota, Buyer in Another State – Not Taxable in Minnesota

Not taxable in Minnesota. The good or service is not subject to Minnesota's sales tax when delivered in another state. The good or service may be taxable in the buyer's state, depending on that state's laws.



Examples of a business making these types of transactions:

A large company, whose corporate headquarters are in New York, has hired a Minneapolis advertising agency to develop an advertising campaign on behalf of its new product. The advertising agency delivers its advertising pitch and final product to executives at their offices in New York. The advertising agency's services are not subject to Minnesota sales tax.

How Sales Tax Reform Will Affect Specific Industries

*Many goods and services that are currently exempt
will remain exempt from sales tax*

Manufacturing

Still Exempt (no sales tax) – Examples

- Materials used or consumed to produce products for sale
- Input purchases like chemicals, ingredients, electricity, materials, oil, packaging, and tools
- Repair of manufacturing equipment
- Sales of tangible personal property to others solely for the purpose of resale
- Buying or leasing capital equipment used for manufacturing, fabrication, mining or refining (Governor's budget recommends capital equipment sales tax exemption at time of purchase rather than a refund after the fact.)

Currently Taxed (rate cut by 20% to 5.5%) – Examples

- | | |
|--|---|
| • Batteries | transportation or storage before/after the manufacturing process |
| • Bearings | |
| • Collets | • Janitorial cleaning materials or services |
| • Conveyor belts | • Machinery, equipment, fixtures, implements |
| • Drill chucks | |
| • Gears | • Materials to make one's own tools |
| • Grinding wheels | • Materials used to construct or remodel real property |
| • Power hand tools | |
| • Pulleys | • Office supplies and equipment |
| • Seals | • Protective safety clothing |
| • Shafts | • Taxable advertising materials and point of sale displays |
| • Soldering irons | |
| • Chemicals and cleaning agents used to clean: production tools and equipment, areas around food processing equipment, building and structures | • Tools purchased to create tools or special tooling used in the production process |
| • Computer hardware, supplies, canned or packaged software, and software maintenance agreements | • Training materials and supplies |
| • Furniture | • Utilities for heating and lighting and other nonproduction functions |
| • Items used primarily to facilitate loading, unloading, handling, | • Installation labor by manufacturer |
| | • Delivery charges by manufacturer |
| | • Some equipment sales |

Newly Taxed (at new, lower 5.5% rate) – Examples

- | | |
|--|-----------------------------------|
| • Legal services | • Management consulting services |
| • Accounting and bookkeeping services | • Packaging and labeling services |
| • Process, physical distribution and logistics management consulting | • Environmental consulting |

Current Law Industrial Production – Sales Tax Fact Sheet 145:

www.revenue.state.mn.us/businesses/sut/factsheets/FS145.pdf

Contractors and Labor

Still Exempt (no sales tax) – Examples

- Construction labor for construction, remodeling or improvement of real property remains exempt. Construction labor includes services such as wiring, welding steel beams, carpentry, laying bricks, cement finishing, pipe installation and plumbing.
- Repair, installation and replacement of real property such as furnaces, garbage disposals, built-in dishwashers and stovetops, water heaters and softeners, and central air conditioning, or when you work on plumbing or electrical wiring also remains exempt.

Currently Taxed (rate cut by 20% to 5.5%) – Examples

- All materials, supplies and equipment to complete the construction contract (i.e., lumber, pipe, wiring, etc.)
- Cleaning including duct cleaning
- Disinfecting
- Exterminating
- Fabrication labor (i.e., crushing gravel, pipe cutting or threading, custom sawing or milling lumber and rolling, cutting or forming metal)
- Delivery (hauling) of aggregate materials (except for road construction) and concrete block
- Ready-mixed concrete including transportation and delivery
- Equipment and machinery used for construction (some items may qualify for a capital equipment refund or farm machinery exemption)

Newly Taxed (at new, lower 5.5% rate) – Examples

- Repair labor to restore tangible personal property so it can be used for its original purpose, such as: furniture reupholstery, electronics repair, and refrigerator repair,
- Architectural services
- Engineering services
- Environmental consulting services

Current Law Contractors – Sales Tax Fact Sheet 128:

www.revenue.state.mn.us/businesses/sut/factsheets/FS128.pdf

Current Law Labor – Sales Tax Fact Sheet 152:

www.revenue.state.mn.us/businesses/sut/factsheets/FS152.pdf

Agricultural Production

Agricultural activities that result in a product that will be sold at retail

Still Exempt (no sales tax) – Examples

- Farm machinery
- Replacement parts for farm machinery
- Petroleum products used to improve agricultural land
- Feed, seed, etc. used in farm conservation programs
- Horses
- Feed, feed supplements, hay and medications
- Chemicals to fertilize or control weeds, disease and insect infestations
- Fuels, electricity, gas and steam used or consumed in agricultural production
- Soil preparation
- Mechanical harvesting
- Veterinary services for livestock and work animals, as well as other animals kept for economic reasons (i.e., laboratory animals, sports animals, and animals sold at retail)
- Custom or contract farm work

Currently Taxed (rate cut by 20% to 5.5%) – Examples

- Other equipment, such as trucks, trailers and storage bins that do not qualify for the farm machinery exemption
- Materials and supplies used to construct, repair or maintain farm buildings, residences, and greenhouses that are real property
- Feed for agricultural animals that are raised for your own consumption, except poultry raised for human consumption
- Detergents or other chemicals used to clean any animal dwellings
- Chemicals used for odor control
- Fuels, electricity, gas and steam used for general space heating, lighting farm buildings that do not house agricultural animals or to operate a yard light
- Tree seedlings purchased for windbreaks (taxable unless part of a federal program)

Newly Taxed (at new, lower 5.5% rate) – Examples

- Agronomy services
- Crop consultants
- Feed consultants
- Farm machinery repair labor (but farm machinery parts remain exempt)

Current Law Agricultural Production – Sales Tax Fact Sheet 100:

www.revenue.state.mn.us/businesses/sut/factsheets/FS100.pdf

Nonprofits

Many nonprofits organized for a charitable, religious or educational purpose are tax exempt and may purchase some items without paying sales tax. Qualifying nonprofits must have their “sales tax-exempt status” authorized by the Department of Revenue. This exemption applies only to purchases made by qualifying nonprofit organizations. These nonprofits currently collect sales tax when they sell taxable items and they would continue to do so. Nonprofit grant money will not be affected.

Nonprofits with “Sales Tax-Exempt Status”

Activity	Current Law	Governor’s Proposal
Purchase of goods/services	Exempt (no tax)	Exempt (no tax)
Sale of goods/services	Collect tax	Collect Tax

Nonprofits will *collect* sales tax on some goods and services.

Still Exempt (no sales tax) – Examples

- Adoption services
- Crisis intervention services
- Drug prevention services
- Day care
- Nursing homes
- Residential care facilities for people with intellectual and developmental disabilities, mental illness or substance abuse problems
- Foster care
- Life skills training
- Emergency and relief services
- Rehabilitation counseling services
- Fees for camps, such as YMCA camps

Currently Taxed (rate cut by 20% to 5.5%) – Examples

- Facility rental at local community center
- Items at the Walker Art Center or Guthrie Theater gift shop

Newly Taxed (at new, lower 5.5% rate) – Examples

- Personal training offered by the YMCA
- Swimming lessons offered by the YWCA
- Music lessons offered by MacPhail Center for Music
- Legal services offered by Access Justice
- Financial counseling offered by Lutheran Social Services financial counseling
- YMCA, YWCA, Jewish Community Center memberships
- Tickets and admissions to artistic events

Current Law Information – Sales Tax Exemption for Nonprofit Organizations:

www.revenue.state.mn.us/businesses/sut/Pages/Nonprofit_ES.aspx.

How Does It Add Up?

We're asking business to pay their fair share to fund investments in education and economic development, take care of our \$1.1 billion deficit, and pay off our \$1.1 billion school debt.

Under the Governor's proposal, some businesses will pay more and some will pay less in sales tax. And many that will pay more sales tax will pay less in other taxes under Governor Dayton's budget. The net impact on individual businesses will vary depending on the company and industry. For example, some businesses in the agricultural and manufacturing industries are little affected by the Governor's budget because many of their exemptions will continue.

The overall tax impact of the governor's plan on each business depends on a range of factors, such as:

- The decrease in sales tax they pay on currently taxable items due to the rate cut
- The reduction in business property taxes
- The reduction in the corporate income tax rate
- The total services purchased

Investments are good for business

Tax policy is one of many factors that businesses consider when they locate or expand in Minnesota. Minnesota's economy has been built on our high quality workforce and infrastructure investments. When considered as a whole, this budget invests in our greatest resource: Minnesotans. Governor Dayton's budget is a package – the critical investments require resources to move Minnesota forward.

Revenue Changes Due to Proposed Rate Cut and Expansion of Sales Tax Base

<i>Business-to-Business Sales</i>	<i>FY 2014-15 Revenue Change (thousands)</i>
Added tax due to base expansion at 5.5%	+ \$2,884,180
Reduced tax due to rate reduction on currently-taxable goods	- \$ 655,000
Net increase in tax on B-to-B sales	+ \$2,229,180
<i>Consumer Sales</i>	<i>FY 2014-15 Revenue Change (thousands)</i>
Added tax due to base expansion at 5.5%	+\$ 687,565
Reduced tax due to rate reduction on currently-taxable goods	- \$ 833,700
Net decrease in tax on consumer sales	-\$ (146,135)
Total Change in FY 2014-15 (B-to-B + Consumer)	+\$2,083,045

Full List of Investments: www.mn.gov/governor/images/budget_at_a_glance.pdf

A Sales Tax for Today's Economy

Updated Sales Tax makes us more in line with other states

By modernizing our sales tax to include more goods and services, Minnesota would be following the lead of other states, including our neighbors. The exact mix varies, but at least some services – often including business services – are taxable in nearly every state with a sales tax.

For example:

- » Iowa, Wisconsin and South Dakota each currently tax 10 to 20 personal services
- » 5 states tax legal services, including South Dakota
- » 5 states tax accounting and bookkeeping services, including South Dakota
- » 6 states tax architectural and engineering services, including South Dakota
- » 17 states tax some computer services; 13 states tax custom software as a service and 11 tax mainframe computer access and processing services, including South Dakota
- » 11 states tax advertising agency services, including South Dakota; 30 states tax sign construction and installation, including Iowa, South Dakota and Wisconsin
- » 10 states tax employment services, including Iowa and South Dakota
- » 19 states tax telephone answering services, including Iowa, South Dakota and Wisconsin; 13 states tax credit information and credit bureaus, including South Dakota

Lower rate makes us more competitive

Lowering our rate to 5.5% (a 20 percent cut) drops Minnesota's sales tax ranking to 27th-highest in the nation and makes us more competitive with our neighbors:

Sales Tax Rankings – Current			Sales Tax Rankings – Proposed		
Rank	State	Rate	Rank	State	Rate
7	Minnesota	6.875%	15	Iowa	6%
16	Iowa	6%	27	Minnesota	5.5%
31	North Dakota	5%	31	North Dakota	5%
31	Wisconsin	5%	31	Wisconsin	5%
39	South Dakota	4%	39	South Dakota	4%

Minnesota a leader in sales tax modernization and reform

Three other Governors have released proposals this year to broaden their sales tax bases to include business services and inputs.

State	Proposed Sales Tax Changes
Ohio	Lower rate, broader base under Gov. John Kasich's tax reform plan which will extend sales tax to more personal and business services (management consulting, advertising, legal services, engineering, investment consulting, etc.)
Nebraska	Broader base under Gov. Dave Heineman's tax reform plan by eliminating some business sales tax exemptions (manufacturing machinery, ingredient/component parts, agricultural machinery and chemicals, medical equipment and medicine, etc.)
Louisiana	Increase rate, broaden sales tax base. Specifics TBA in April, but Gov. Bobby Jindal says his tax reform plan is modeled on Texas, which taxes a range of business services.

Sales Tax Reform a Wash for Consumers

Under Governor Dayton's plan, the typical consumer will pay sales tax on some items and services that were not previously taxed, but they will also see a 20% lower sales tax rate on currently taxable purchases. Here's how a shopping trip might look like for an average Minnesota consumer before and after the Governor's proposal:

Current Sales Tax Rate

ABC Retail Store	

Non-taxable items	
Milk	2.99
Bread	2.29
Bananas	1.34
Kid's t-shirt	10.00
Cold Medicine (OTC)	8.69
Subtotal	25.31
Taxable items (6.875%)	
Light bulbs	3.65
Dog food	34.99
Candy bar	.89
Justin Bieber CD	13.99
Laundry detergent	7.99
Greeting card	2.99
Ice scraper	6.99
Bath tissue	7.99
Toothpaste	2.99
Hockey stick	49.99
Subtotal	132.46
Tax (6.875%)	9.12
Total	166.89

Governor Dayton's Proposal

ABC Retail Store	

Non-taxable items	
Milk	2.99
Bread	2.29
Bananas	1.34
Kid's t-shirt	10.00
Subtotal	16.62
Taxable items (5.5%)	
Cold Medicine (OTC)	8.69
Light bulbs	3.65
Dog food	34.99
Candy bar	.89
Justin Bieber CD	13.99
Laundry detergent	7.99
Greeting card	2.99
Ice scraper	6.99
Bath tissue	7.99
Toothpaste	2.99
Hockey stick	49.99
Subtotal	141.15
Tax (5.5%)	7.75
Total	\$165.52

**YOU SAVE
\$1.52**

Affiliate Nexus – Minnesota E-Fairness

Minnesota and other states lose millions of dollars each year in tax that is owed on sales from out-of-state sellers, such as Amazon and other Internet or catalog retailers.

If the governor's E-Fairness proposal is adopted, Amazon and other out-of-state retailers with affiliates or sponsors who sell on their behalf in Minnesota would have nexus here. As a result, they would have to collect and pay sales tax when they sell taxable items to Minnesota residents or businesses.

This proposal would generate about \$5 million a year in revenue and take an important step toward a level playing field for Minnesota retailers. To fully address the issue, we need Congress to enact the Marketplace Fairness Act. This legislation would require all sellers in the U.S. to collect and pay sales tax based on the destination of the product.

Resources

Governor's Budget Toolkit: www.mn.gov/governor/budget/toolkit/

Minnesota Management and Budget: www.mmb.state.mn.us/gov-rec1415

Department of Revenue Materials: www.revenue.state.mn.us/tax_reform