



## INFORMATION MEMO

# City Sales Tax Exemptions in Construction Contracts

*Learn how cities may use purchasing agent agreements with contractors and subcontractors to make sales tax-exempt purchases of materials for construction projects. This memo links to a sample purchasing agent agreement.*

### RELEVANT LINKS:

[2013 Minn. Laws ch. 143, art. 8, sec. 29 amending Minn. Stat. § 297A.70, subd 2.](#)

[Minnesota Department of Revenue Notice #95-05, July 17, 1995.](#)

For information on competitive bidding generally see LMC information memo, [Competitive Bidding Requirements in Cities](#).

## I. A new, limited sales tax-exemption

In 2013, the Legislature granted a limited sales tax exemption to cities, which takes effect Jan. 1, 2014. One of the more complicated parts of the tax exemption relates to construction projects. Materials for a city's construction projects are generally tax exempt if the city purchases them directly. However, if the city contracts out the labor and purchase of materials, the tax exemption is not automatically available.

First, the sales tax exemption is not available if a city or its contractor purchases construction materials to be used in constructing buildings or facilities that will not be used principally by the city.

Second, the tax exemption does not apply to sales of materials if purchased by a contractor or subcontractor for building, construction, or reconstruction if part of a lump-sum contract or similar type of contract with a guaranteed maximum price covering both labor and materials for use in the construction, alteration, or repair of a building or facility. The Department of Revenue interprets this "lump-sum" requirement to apply to contracts with both contractor and subcontractor. Therefore, no combined labor and materials or similar guaranteed maximum contract may be made with either contractors or subcontractors, according to the Department of Revenue, or else the tax exemption is not available on the materials.

The solution to the second problem is to solicit bids on two separate contracts—one for materials and one for labor—and to designate a purchasing agent or agents for the city. If done properly, the city will not have to pay sales or use tax on the materials for the contracted project.

## II. Soliciting bids on two contracts

The Department of Revenue has strict requirements on how a city must separately bid the two contracts (materials and labor). Those requirements are as follows.

This material is provided as general information and is not a substitute for legal advice. Consult your attorney for advice concerning specific situations.

**RELEVANT LINKS:**

[Minnesota Department of Revenue Notice #95-05, July 17, 1995.](#)

[Minnesota Department of Revenue Factsheet #111 – Schools: Sales and Purchases.](#)

[Minnesota Department of Revenue Factsheet #128 – Contractors.](#)

[Minnesota Department of Revenue Factsheet #142 – Sales to Governments](#)

[Minn. R. 8130.1200, subp. 3 D.](#)

[Minnesota Department of Revenue Notice #95-05, July 17, 1995.](#)

[Minn. R. 8130.1200, subp. 3 D.](#)

- The city initially advertises for separate bids for materials and labor.
- The city reserves the right to accept only one bid without accepting both bids from any one contractor.
- Separate contracts are awarded for materials and labor.

Again, the Department of Revenue extends this separation of labor and materials requirement to contracts with subcontractors as well.

**III. Purchasing agent agreements**

In addition to bidding separate contracts, to receive the tax exemption, the city must formally authorize the contractor providing the materials as its purchasing agent. Because schools and towns and their contractors have had the sales tax exemption before now, the Department of Revenue has fact sheets on contractors, school purchases, and government purchases that provide information related to designating a purchasing agent.

Using a proper form for designating a purchasing agent agreement is important because using an improper form could deprive a city of its intended sales tax exemption. The purchasing agent agreements have many requirements, which are described below.

**A. Agreements for contractors**

The purchasing agent agreement between the city and the city’s materials contractor must specify that:

- The appointment of purchasing agent has been made.
- Title to all materials and supplies purchased pursuant to such appointment shall immediately vest in the city at point of delivery.
- The risk of loss with respect to such materials and supplies is that of the city.
- The city, and not the purchasing agent, shall have responsibility for all defective materials and supplies, including those incorporated into realty purchased in such manner.

State administrative rule also requires the designated purchasing agent to “furnish adequate notification” to all vendors and suppliers of the agency relationship with the city and to make it clear to the vendors and suppliers that the city is the one responsible for paying and not the contractor-agent. This must be included in the purchase order between the purchasing agent and the retail vendor.

**RELEVANT LINKS:**

Minnesota Department of Revenue, [Certificate of Exemption Form ST3](#), July 2013.

Minnesota Department of Revenue, [Certificate of Exemption Form ST3](#), July 2013.

LMC Model [Purchasing Agent Agreement](#).

This is re-emphasized when the contractor checks the box on a completed Certificate of Exemption Form ST3, indicating it has been appointed as a purchasing agent. The contractor-agent should provide the completed form, along with the purchase order, to the seller before the sales tax-exempt transaction is completed.

**B. Agreements for subcontractors**

Subcontractors can also make purchases tax-free as the city’s purchasing agent if the subcontractor has also provided separate bids on materials and labor, and at the time of sale, the subcontractor:

- Has a copy of the completed Certificate of Exemption Form ST3 showing the city is exempt from sales and use tax.
- Has a document appointing the subcontractor as purchasing agent for the city. This is usually provided by the primary purchasing agent whom the city has authorized to appoint subagents.
- Secures separate contracts for materials and labor (avoiding the lump-sum contract or similar guaranteed maximum contract for both materials and labor), or only obtains a materials contract.

**C. Sample purchasing agent agreement**

The League of Minnesota Cities has prepared a sample purchasing agent agreement that follows the requirements outlined above. The League thanks Stephen Melcher, of the law firm Fabyanske, Westra, Hart & Thomson, P.A., for generously supplying both the basis for the sample agreement and consultation in its modification.