

The Minnesota Sales Tax Base

Most tangible goods and some services and digital goods are subject to the tax

The sales tax is a tax on final retail sales. Items purchased for resale (i.e., goods bought by a retailer from a wholesaler) are exempt. In Minnesota, the rule of thumb is that tangible personal property is taxable unless specifically exempted, and services are not taxable unless specifically included. Digital goods, which are nontangible versions of tangible goods, such as e-books, streaming music, and online video games, are not taxable unless specifically included. Intangible personal property, such as stocks and bonds, are not subject to the sales tax. Real property (i.e., land and buildings) and improvements to real property, such as home remodeling, are also exempt from the sales tax.

Minnesota excludes food, clothing, and certain other “necessities” from the sales tax

Minnesota excludes both food for home consumption and clothing from the sales tax base. Of the 45 states and the District of Columbia that impose a sales tax, 32 exempt food for home consumption while seven tax food for home consumption at a reduced rate. Only three other states exempt clothing: New Jersey, Pennsylvania, and Vermont.

The rationale often given for exempting food and clothing from the sales tax base is that these items are basic necessities. Other items that are excluded from the sales tax base for the same reason include home heating fuels, prescription drugs, certain medical devices, and caskets and funeral urns.

Minnesota excludes a number of business purchases from the sales tax

The other major types of tangible goods exempted from the sales tax are business purchases. Minnesota excludes from the tax many items used *directly* in the production of taxable goods and services and some of the taxable services. It also excludes capital equipment used in manufacturing, machinery used in farming, and mining equipment. The rationale for these exemptions is that if both the inputs and outputs of a good are taxed, the result is tax “pyramiding” or double taxation. Items purchased by a business but not used directly in production of the good or service, such as office equipment and supplies, are still taxable.

Although many inputs to taxable goods and services are exempt, businesses that provide nontaxable services, intangible property, and improvements to realty pay taxes on their purchases since they are considered the final user of those items. For example, a printer may buy paper exempt as an input to its taxable output but a law firm will pay sales tax on the paper. Although there is no sales tax on home remodeling, the contractor will pay sales tax on all the materials it buys to use in the project. A little over 40 percent of sales taxes are paid by businesses.

Minnesota taxes a limited number of services

Minnesota only taxes services specifically listed under the definition of a taxable sale in statute ([Minn. Stat. § 297A.61](#), subd. 3). The major taxable services include the following:

- lodging
- admission to places of amusement and recreation
- parking
- laundry and drycleaning
- motor vehicle washing, rustproofing, and towing
- building cleaning services
- detective and security services
- pet grooming, care, and boarding
- lawn, garden, and tree care, maintenance, and removal
- massage (except for medically provided or necessary massage)

Minnesota now taxes a number of digital goods

Beginning July 1, 2013, the state began including a number of digital goods in the sales tax base. Digital goods now subject to the sales tax include online movies and television, streaming music, audio books, e-books, greeting cards, and interactive video games. Educational instruction and materials delivered digitally or via the Internet (i.e., online classes and most online seminars) remain exempt from the sales tax.

The sales tax base is eroding over time

Two major trends are eroding the sales tax base over time: (1) the continuing movement to a more service-based economy, and (2) the increasing amount of remote sales over the Internet. A number of services such as legal, financial, medical, and personal care services remain exempt from the sales tax. As this portion of the economy continues to grow faster than the rest of the economy, the share of total final consumption subject to the sales tax will continue to decline. Because the state cannot require a business to collect the sales tax unless the business has a physical presence in this state (the legal term is “nexus”), the increase of sales made by out-of-state sellers via the Internet also reduces the tax base over time. Congress has the ability to regulate interstate commerce and could impose the duty to collect state sale taxes on out-of-state sellers. Although bills have been introduced several times to accomplish this, to date, none have passed.

Although a purchaser owes a complementary use tax if the sales tax is not collected by the seller, it is hard for the state to collect the use tax. Estimates of business compliance with the use tax range from 50 percent to 95 percent depending on the industry, type of product purchased, and the size of the business. Virtually no use tax is collected from private consumers.

For more information: Contact legislative analyst Pat Dalton at 651-296-7434. For specific information on goods and services subject to Minnesota sales tax, or on how to pay the tax, please call the Minnesota Department of Revenue at 651-296-6181.

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