

STATE OF MINNESOTA
COUNTY OF HENNEPIN

TAX COURT
REGULAR DIVISION

Knutson Construction Services
Rochester, Inc.,

Appellant,

vs.

Commissioner of Revenue,

Appellee.

**FINDINGS OF FACT,
CONCLUSIONS OF LAW, AND
ORDER FOR JUDGMENT**

Docket No. 8997-R

Filed: July 16, 2018

This matter came before The Honorable Joanne H. Turner, Judge of the Minnesota Tax Court, for trial.

Matthew T. Collins and Gordon Heinson, Fabyanske, Westra, Hart & Thomson, P.A., Minneapolis, Minnesota, represent appellant Knutson Construction Services Rochester, Inc.

Kristine K. Nogosek, Assistant Minnesota Attorney General, represents appellee Commissioner of Revenue.

At issue in this case is whether Minnesota use tax applies to payments made by Knutson Construction Services Rochester, Inc. (Knutson Rochester), to Knutson Construction Services, Inc. (Knutson Minneapolis), a related corporation, for the use of construction equipment. We conclude that the transactions between Knutson Rochester and Knutson Minneapolis, although “leases” for purposes of Minn. Stat. ch. 297A (2016), are not subject to use tax because they did not occur within the “normal course of business” of Knutson Minneapolis.

The court, having heard the testimony of witnesses and the arguments of counsel, having reviewed the exhibits, and deeming itself advised on the premises, now makes the following:

FINDINGS OF FACT

1. Knutson Construction Services, Inc. (Knutson Minneapolis), Knutson Construction Services Rochester, Inc. (Knutson Rochester), and Knutson Holdings, Inc., are separate legal entities organized under the laws of the State of Minnesota.¹ Knutson Minneapolis and Knutson Rochester are wholly-owned subsidiaries of Knutson Holdings.²

2. Knutson Minneapolis and Knutson Rochester are commercial building contractors.³ Knutson Rochester performs commercial construction services in and around Rochester, Minnesota.⁴

3. As a matter of corporate policy, both Knutson Minneapolis and Knutson Rochester use their own employees, rather than sub-contractors, to do such things as masonry, concrete, concrete finishing, and carpentry work on construction projects.⁵

4. To facilitate its masonry, concrete, concrete finishing, and carpentry work, Knutson Minneapolis purchases, owns, and maintains numerous items of construction equipment, such as fork lifts, Bobcats, cranes, concrete mixers, which are housed in an equipment yard in Blaine,

¹ Stip. Material Facts ¶ 1 (filed Feb. 5, 2018).

² Stip. Facts ¶ 1.

³ Stip. Facts ¶ 5.

⁴ Stip. Facts ¶ 6; Tr. 11 (Paul Essler, Chief Financial Officer of Knutson Rochester, Knutson Minneapolis, and Knutson Holdings, testifying).

⁵ Tr. 12-14 (Mr. Essler testifying).

Minnesota.⁶ Knutson Minneapolis employees are responsible for maintaining the equipment and transporting it to construction projects as needed.⁷

5. By owning, rather than renting, equipment, Knutson Minneapolis ensures that the equipment is properly maintained and readily available when needed.⁸

6. At the time of purchase, Knutson Minneapolis paid the appropriate sales or use tax on its equipment purchases,⁹ rather than use exemption certificates to avoid payment of sales tax. Between 2009 and 2011, Knutson Minneapolis paid approximately \$485,000 in sales tax on equipment purchases.¹⁰

7. When a particular piece of construction equipment is needed for a construction project, the manager on the project (whether a project of Knutson Minneapolis or Knutson Rochester) sends a request by e-mail to the yard manager.¹¹ The yard manager is responsible for transporting the equipment to the project when needed.¹² If Knutson Minneapolis does not own the particular piece of equipment requested, or if the equipment is being used at another project, the project manager is instructed to rent it from a third party.¹³

⁶ Stip. Facts ¶ 8; Tr. 14 (Mr. Essler testifying).

⁷ Tr. 14-15 (Mr. Essler testifying).

⁸ Tr. 15-16 (Mr. Essler testifying).

⁹ Tr. 51 (Mr. Essler testifying).

¹⁰ Tr. 51 (Mr. Essler testifying).

¹¹ Tr. 18-19 (Mr. Essler testifying).

¹² Tr. 14-15 (Mr. Essler testifying).

¹³ Tr. 19 (Mr. Essler testifying).

8. When Knutson Rochester uses Knutson Minneapolis's equipment, it takes possession of the equipment.¹⁴

9. There are no written lease agreements between Knutson Minneapolis and Knutson Rochester relating to Knutson Rochester's use of equipment.¹⁵

10. Knutson Minneapolis bills Knutson Rochester for the use of equipment¹⁶ based on a percentage of average market rates for that equipment in the United States and Canada, as reported in the Associated Equipment Distributors Green Book.¹⁷ The rate charged depends on whether the equipment is to be used on a project with a "hard bid" (at a lump-sum price) or a negotiated cost-plus contract.¹⁸ On a project with a "hard bid," where Knutson Rochester has offered to complete the work for a single fixed price, the equipment rate is 50% of the AED Green Book rate.¹⁹ On a negotiated cost-plus contract, the equipment rate is 75% of the AED Green Book rate.²⁰ Knutson Rochester uses these rates to formulate its bids and contracts.

11. Similarly, the equipment rates Knutson Minneapolis uses to formulate its lump-sum bids are 50% of the AED Green Book rates, and the equipment rates Knutson Minneapolis uses to negotiate cost-plus contracts are 75% of the AED Green Book rates.²¹

¹⁴ Stip. Facts ¶ 10.

¹⁵ Stip. Facts ¶ 11.

¹⁶ Tr. 31-32 (Mr. Essler testifying); Ex. 2 (documentation of equipment usage); Exs. J3 (2009 invoices), J4 (2010 invoices), J5 (2011 invoices).

¹⁷ Tr. 20-22 (Mr. Essler testifying); Exs. J6 (2009 rates), J7 (2010 rates), J8 (2011 rates).

¹⁸ Tr. 30-31 (Mr. Essler testifying).

¹⁹ Tr. 29 (defining "hard bid"), 31 (Mr. Essler testifying).

²⁰ Tr. 29-30, 31 (Mr. Essler testifying).

²¹ Tr. 31, 39 (Mr. Essler testifying).

12. Knutson Minneapolis has bid its jobs this way since before the incorporation of Knutson Rochester.²²

13. The rate charged by Knutson Minneapolis for use of a particular piece of equipment is a percentage (50% or 75%) of the average national cost of renting that piece of equipment, rather than the actual cost to Knutson Minneapolis of purchasing and maintaining it.²³

14. Knutson Minneapolis bills Knutson Rochester monthly for the use of equipment.²⁴ Knutson Rochester pays Knutson Minneapolis's invoices with an intercompany transfer of cash.²⁵

15. Knutson Minneapolis bills Knutson Rochester for only the days on which Knutson Rochester actually uses the equipment.²⁶ If Knutson Minneapolis mistakenly bills Knutson Rochester for a day on which Knutson Rochester did not have the equipment, Knutson Minneapolis credits Knutson Rochester on a later bill for the overcharge.²⁷

16. In years in which Knutson Minneapolis did not cover the cost of purchasing and maintaining its equipment, Knutson Minneapolis did not raise equipment rates.

17. Knutson Minneapolis does not advertise its construction equipment for rent to third parties, and does not lease or otherwise make its equipment available to third parties, even when not in use by either Knutson Minneapolis or Knutson Rochester.²⁸

²² Tr. 31 (Mr. Essler testifying).

²³ See Exs. J6, J7, J8.

²⁴ Tr. 40; Exs. J3, J4, J5.

²⁵ Tr. 59 (Mr. Essler testifying).

²⁶ Tr.49-50 (Mr. Essler testifying).

²⁷ Tr. 50 (Mr. Essler testifying).

²⁸ Tr. 18, 50 (Mr. Essler testifying).

18. Knutson Minneapolis does not separately track the profitability of the equipment yard.²⁹

19. Knutson Rochester does not solicit bids from third parties for equipment rentals unless the equipment is not available from Knutson Minneapolis, and regardless of whether the same equipment may be available from third parties at lower cost.³⁰

20. Knutson Holdings, Knutson Minneapolis, and Knutson Rochester are each Subchapter S corporations.³¹ In addition, for the years at issue, Knutson Holdings elected to treat Knutson Minneapolis and Knutson Rochester as Qualified Subchapter S Subsidiaries (“QSSSs”) of Knutson Holdings under IRC § 1361(b)(3)(B).³²

21. Because of their QSSS status, Knutson Minneapolis and Knutson Rochester were not treated as separate corporations for federal or state income tax purposes during the period at issue.³³ The income and expenses of Knutson Minneapolis and Knutson Rochester were treated as earned or incurred by Knutson Holdings.³⁴

22. Minnesota Statutes ch. 297A (2016) requires Knutson Minneapolis and Knutson Rochester to have separate Minnesota sales and use tax identification numbers and to file separate sales and use tax returns.³⁵

²⁹ Tr. 66-67 (Mr. Essler testifying).

³⁰ Tr. 19 (Mr. Essler testifying).

³¹ Stip. Facts ¶ 2.

³² Stip. Facts ¶ 2.

³³ Stip. Facts ¶ 3.

³⁴ Stip. Facts ¶ 3.

³⁵ Stip. Facts ¶ 4.

23. The Minnesota Department of Revenue conducted a sales and use tax audit of Knutson Rochester for the period December 2009 to December 2011.³⁶ On November 16, 2015, the Commissioner of Revenue issued a Notice of Change in Sales and Use Tax assessing Knutson Rochester \$64,837.85 in additional state and local sales and use tax, including (on Schedule 2) additional state and local use tax of \$54,162.01 on intercompany payments for equipment.³⁷

24. On January 13, 2016, Knutson Rochester administratively appealed the assessment on Schedule 2 of sales and use tax on payments it made to Knutson Minneapolis for the use of equipment.³⁸ Knutson Rochester paid the tax due with respect to the balance of the Commissioner's order.³⁹

25. On September 20, 2016, the Commissioner affirmed her assessment of use taxes in the amount of \$54,162.01 (plus interest) on the payments to Knutson Minneapolis identified in Schedule 2 of the November 16, 2015 Order.⁴⁰

26. On November 18, 2016, Knutson Rochester timely appealed the Commissioner's Order to this court.⁴¹

³⁶ Stip. Facts ¶ 15.

³⁷ Notice Change Sales Use Tax (dated Nov. 16, 2015) (Ex. J1).

³⁸ Letter from Gordon P. Heinson to Minnesota Department of Revenue, Appeals & Legal Services Division (Jan. 13, 2016); Stip. Facts ¶ 16 (“[Knutson] Rochester administratively appealed only Schedule 2 of the Notice.”).

³⁹ See Notice Determination Appeal 2 (dated Sept. 20, 2016).

⁴⁰ Notice Determination Appeal.

⁴¹ Notice Appeal (filed Nov. 18, 2016).

CONCLUSIONS OF LAW

1. There is sufficient credible evidence in the record to rebut the prima facie validity of the Commissioner's Order.
2. The transfers of possession of construction equipment from Knutson Minneapolis to Knutson Rochester constitute "the leasing of . . . tangible personal property" within the meaning of Minn. Stat. § 297A.61, subd. 3(b)(2) (2016).
3. The leases of construction equipment by Knutson Minneapolis to Knutson Rochester were not made within the normal course of business of Knutson Minneapolis, as defined by Minn. Stat. § 297A.61, subd. 21 (2016).
4. The leases of construction equipment by Knutson Minneapolis to Knutson Rochester are exempt from both sales and use tax under Minn. Stat. § 297A.68, subd. 25 (2016).

ORDER FOR JUDGMENT

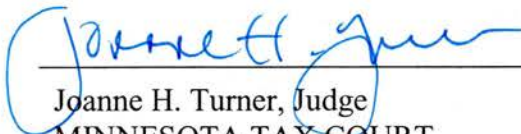
1. The Commissioner's Order dated September 20, 2016, is reversed with respect to the amounts assessed on Schedule 2, along with any associated interest.
2. Any amounts paid by Knutson Rochester to the Commissioner with respect to Schedule 2 shall be refunded with interest.

IT IS SO ORDERED. THIS IS A FINAL ORDER. ENTRY OF JUDGMENT IS STAYED FOR 15 DAYS. LET JUDGMENT BE ENTERED ACCORDINGLY.⁴²

⁴² In 2017, Minn. Stat. § 271.08, subd. 1, was amended to extend from 15 to 30 days the time for filing motions for rehearing. Act of May 30, 2017, ch. 1, art. 8, § 3, 2017 Minn. Laws 1017, 1185. The extended time period applies only to notices of appeal and petitions filed after June 30, 2017. *Id.* Because the appeal in this matter was filed before July 1, 2017, the deadline for motions for rehearing remains 15 days after the mailing date of the decision of the court.



BY THE COURT:


Joanne H. Turner, Judge
MINNESOTA TAX COURT

DATED: July 16, 2018

MEMORANDUM

At issue in this case is whether appellant Knutson Construction Services Rochester, Inc. (“Knutson Rochester”) must pay use tax on amounts it paid to Knutson Construction Services, Inc. (“Knutson Minneapolis”) for the use of various items of construction equipment. Use tax applies only if the transactions in question are made “in the normal course of business of [leasing] that kind of property.” Minn. Stat. § 297A.68, subd. 25 (2016). We conclude, after careful review of the record, that the transactions at issue here were not made “in the normal course of business of [leasing] that kind of property” because they were not initiated “for the purposes of attaining profit or producing income,” *see* Minn. Stat. § 297A.61, subd. 21 (2016), from the leases themselves.

We first briefly review the Minnesota statutes applicable to this dispute, then summarize the relevant facts. We determine that the transactions between Knutson Minneapolis and Knutson Rochester were “leases” under the applicable statute. We further determine, however, that the payments from Knutson Rochester to Knutson Minneapolis are not subject to use tax because the equipment was not made available to Knutson Rochester in the normal course of Knutson Minneapolis’s business.

I. BACKGROUND

Minnesota's sales and use tax regime "embodies a comprehensive tax system created to impose an excise tax on the sale, use, storage, or consumption within Minnesota of tangible personal property and certain other commodities and services." *Color-Ad Packaging, Inc. v. Comm'r of Revenue*, 428 N.W.2d 806, 806 (Minn. 1988). Minnesota sales tax is imposed "on the gross receipts from retail sales . . . made in this state or to a destination in this state." Minn. Stat. § 297A.62, subd. 1 (2016). Minnesota use tax is imposed on "the purchase price of retail sales" of "tangible personal property or taxable services purchased for use, storage, distribution, or consumption" in Minnesota. Minn. Stat. § 297A.63, subd. 1(a) (2016). Because Minnesota use tax is imposed at the same rate as Minnesota sales tax, *id.*, and because no Minnesota use tax is imposed if Minnesota sales tax was paid on the sales price, *id.*, subd. 1(b), the sales and use taxes "are mutually exclusive, but complementary." *Color-Ad Packaging*, 428 N.W.2d at 806.

The broad scope of Minnesota's sales and use tax regime notwithstanding, the sale and use of certain "business" items is "specifically exempted" from tax. Minn. Stat. § 297A.68, subd. 1 (2016). The dispute in this case focuses on the exemption for transactions involving "tangible personal property primarily used in a trade or business":

The sale of tangible personal property primarily used in a trade or business is exempt if the sale is not made in the normal course of business of selling that kind of property and if . . . (2) the sale is between members of a controlled group as defined in section 1563(a) of the Internal Revenue Code.

Id., subd. 25. Exemption under subdivision 25 therefore requires three things: (1) that the tangible personal property at issue be "primarily used in a trade or business"; (2) that the sale "is not made in the normal course of business of selling that kind of property"; and (3) that the sale be "between members of a controlled group," as defined by I.R.C. § 1563(a). If the sale is exempt from sales tax under subdivision 25, the transaction is also exempt from use tax. Minn. Stat. § 297A.68,

subd. 25. Moreover, a “sale” under chapter 297A includes “the leasing of . . . tangible personal property.” Minn. Stat. § 297A.61, subd. 3(b)(2) (2016).

In this case, there is no dispute that the property involved—construction equipment—is both tangible personal property and primarily used in a trade or business. In addition, there remains no dispute that Knutson Rochester and Knutson Minneapolis are members of a controlled group, as defined by I.R.C. § 1563(a).⁴³ The parties dispute, however, whether the transactions between Knutson Minneapolis and Knutson Rochester were “leases” and whether they occurred “in the normal course of business.”

With that background, we turn to a review of the facts of the case, as adduced at trial.

A. FACTUAL BACKGROUND

Appellant Knutson Rochester and Knutson Minneapolis are wholly-owned subsidiaries of Knutson Holdings. All three corporations have elected Subchapter S status under the Internal Revenue Code. Additionally, for the months at issue here, Knutson Holdings elected to treat Knutson Rochester and Knutson Minneapolis as qualified Subchapter S subsidiaries (Qsubs or QSSSs). By electing QSSS status, Knutson Holdings treats the assets, liabilities, revenues, and expenses of both Knutson Rochester and Knutson Minneapolis as its own for income tax purposes. Nevertheless, Knutson Minneapolis and Knutson Rochester have separate Minnesota sales and use tax identification numbers and file separate sales and use tax returns.

Knutson Rochester and Knutson Minneapolis are general commercial building contractors, with Knutson Rochester acting in and around Rochester, Minnesota. Unlike some other general contractors, both Knutson Rochester and Knutson Minneapolis use their own employees for a variety of construction work, including masonry, concrete work, concrete finishing, and carpentry.

⁴³ Tr. 49 (Jan. 18, 2018).

Also unlike some other general contractors, Knutson Minneapolis owns (rather than rents) the equipment needed for this work, such as forklifts, Bobcats, cranes, and concrete mixers. By owning (rather than renting) this equipment, Knutson Minneapolis ensures that it is properly maintained and readily available when needed. Knutson Minneapolis pays the appropriate sales or use tax on the equipment when purchased. Between 2009 and 2011, Knutson Minneapolis paid approximately \$485,000 in sales tax on equipment purchases.

Knutson Minneapolis stores and maintains its equipment at an equipment yard in Blaine, Minnesota, where Knutson Minneapolis employees are responsible for keeping it in good repair. When Knutson Minneapolis or Knutson Rochester needs a particular piece of equipment for a construction project, the project manager sends an e-mail request to the yard manager. If the equipment is available, the yard manager arranges for it to be transported to the job site.

There are no written agreements between Knutson Minneapolis and Knutson Rochester for the use of equipment. Knutson Minneapolis bills Knutson Rochester for equipment based on a percentage of average market rates for that equipment in the United States and Canada, as reported in the Associated Equipment Distributors Green Book. The rate charged to Knutson Rochester depends on whether the equipment is to be used on a construction project with a "hard bid" (that is, a lump-sum price typically presented in a sealed bid) or a negotiated cost-plus contract. On a project with a hard bid, the equipment rate is 50% of the AED Green Book rate. On a negotiated cost-plus contract, the equipment rate is 75% of the AED Green Book rate. Knutson Minneapolis uses the same rate structure to formulate its lump-sum bids and negotiated cost-plus contracts.

If Knutson Minneapolis does not own the necessary equipment, or if it is being used at another project, the yard manager instructs the project manager to rent it from a third party. Even if it might be obtained for less, Knutson Rochester does not rent equipment from third parties

unless it is not available from Knutson Minneapolis. Knutson Minneapolis does not advertise its construction equipment for rent to third parties, and does not lease or otherwise make its equipment available to third parties, even when it is not in use. Knutson Minneapolis does not separately track the profitability of the equipment yard.

B. PROCEDURAL HISTORY

The Minnesota Department of Revenue conducted a sales and use tax audit of Knutson Rochester for the months at issue (December 2009 to December 2011). In November 2015, the Commissioner assessed Knutson Rochester state and municipal (Rochester) use taxes totaling \$64,837.85 on a variety of items, including delivery charges (Schedule 1), intercompany equipment transfers (Schedule 2), and purchases on which no sales taxes were paid (Schedule 3).⁴⁴

1. KNOTSON ROCHESTER'S ADMINISTRATIVE APPEAL

Knutson Rochester filed an administrative appeal, challenging only the assessments on Schedule 2.⁴⁵ In September 2016, the Commissioner denied Knutson Rochester's administrative appeal.⁴⁶

⁴⁴ Notice Change Sales Use Tax (dated Nov. 16, 2015) (Ex. J1).

⁴⁵ Letter from Gordon P. Heinson to Minnesota Department of Revenue, Appeals & Legal Services Division 2 (Jan. 13, 2016) (Ex. 4 to Comm'r's Return & Answer filed Dec. 28, 2016).

⁴⁶ Notice Determination Appeal (dated Sept. 20, 2016) (Ex. J2).

2. KNUTSON ROCHESTER'S APPEAL TO THIS COURT

On November 18, 2016, Knutson Rochester timely appealed to this court,⁴⁷ contending that the transactions at issue are exempt from sales and use tax under Minn. Stat. § 297A.68, subd. 25(2) (2016).⁴⁸

3. THE PARTIES' CROSS-MOTIONS FOR SUMMARY JUDGMENT

In November 2017, Knutson Rochester and the Commissioner each filed a motion for summary judgment based in part on stipulated facts.⁴⁹ Knutson Rochester argued that the payments it made to Knutson Minneapolis “have no actual economic substance” and were nothing more than “cost allocation bookkeeping entries” that “cannot reasonably be consider[ed] an attempt to attain profit or produce income.”⁵⁰ The Commissioner asserted that the arrangements between Knutson Rochester and Knutson Minneapolis amounted to “leases” and argued that the facts to which the parties had stipulated “establish that the leases were made by Knutson Rochester in the normal course of business and are therefore not exempt from taxation.”⁵¹

The court heard arguments on the parties' cross-motions on January 18, 2018.⁵² With trial set for March 5, 2018, and with pretrial submissions due starting on February 8, 2018, we denied

⁴⁷ Notice Appeal (filed Nov. 18, 2016).

⁴⁸ Notice Appeal Attach. at 5.

⁴⁹ Appellant's Notice Mot. Mot. Summ. J. (filed Nov. 30, 2017); Comm'r's Notice Mot. Mot. Summ. J. (filed Nov. 30, 2017).

⁵⁰ Appellant's Mem. Law Supp. Mot. Summ. J. 1 (filed Nov. 30, 2017).

⁵¹ Mem. Law Supp. Comm'r's Mot. Summ. J. 1 (filed Nov. 30, 2017).

⁵² Tr. (Jan. 18, 2018).

the parties' cross-motions with just a brief order. Order Denying Cross-Motions Summ. J. (filed Jan. 26, 2018). We now explain our denial of the parties' motions.

Under Minn. R. Civ. P. 56.03, summary judgment is proper when the pleadings, depositions, answers to interrogatories, admissions, and affidavits on file “show that there is no genuine issue as to any material fact and that either party is entitled to a judgment as a matter of law.” Our function in ruling on a motion for summary judgment is, first, to determine whether there is an issue of fact to be tried. *Anderson v. Twin City Rapid Transit Co.*, 250 Minn. 167, 186, 84 N.W.2d 593, 605 (1957). Only disputes over “material” facts can defeat a motion for summary judgment. Minn. R. Civ. P. 56.03. A fact dispute is “material” for summary judgment purposes if its resolution will affect the outcome of the case. *O'Malley v. Ulland Bros.*, 549 N.W.2d 889, 892 (Minn. 1996) (citing *Zappa v. Fahey*, 310 Minn. 555, 556, 245 N.W.2d 258, 259-60 (1976)). The substantive law determines which facts are material. *Bond v. Comm'r of Revenue*, 691 N.W.2d 831, 836 (Minn. 2005) (citing *Anderson v. Liberty Lobby*, 477 U.S. 242, 248 (1986)).

In this case, genuine issues of material fact precluded entry of judgment for either party.⁵³ In particular, there was no information before the court indicating how yard charges (that is, the price that Knutson Minneapolis charged Knutson Rochester for the use of its equipment) were calculated, including (for example) whether those yard charges included a markup of any kind. As a result, we could not determine from the record before us whether the transactions between Knutson Minneapolis and Knutson Rochester were “leases” within the meaning of Minn.

⁵³ The record before the court on summary judgment was limited to a stipulation of facts (different from the stipulation of facts filed by the parties before trial), the declaration of Paul Essler (the chief financial officer of Knutson Construction Services, Inc.), and a report from Mr. Kalen Karnowski of Malloy, Montague, Karnowski, Radosevich & Co., P.A.

Stat. § 297A.61, subd. 14a (2016), or whether they were, as Knutson Rochester argued, merely cost-sharing arrangements.⁵⁴ Similarly, we could not determine from the record before us whether Knutson Minneapolis made its equipment available to Knutson Rochester “for the purposes of attaining profit or producing income,” as required under Minn. Stat. § 297A.61, subd. 21, for a sale “in the normal course of business” under Minn. Stat. § 297A.68, subd. 25.

II. GOVERNING LAW

Having reviewed the facts of the case and its procedural status, we turn to a further explanation of the applicable law and, in particular, to when sales occur “in the normal course of business of selling that kind of property.” Minn. Stat. § 297A.68, subd. 25(a). As we have explained, exemption under subdivision 25 requires three things: (1) that the tangible personal property sold be “primarily used in a trade or business”; (2) that the sale “is not made in the normal course of business of selling that kind of property”; and (3) that the sale be “between members of a controlled group,” as defined by I.R.C. § 1563(a). If a sale is exempt under subdivision 25, then “[t]he use . . . of tangible personal property acquired as a result of [the] sale . . . is also exempt.” Minn. Stat. § 297A.68, subd. 25(a).

A “sale” under chapter 297A includes “the leasing of or the granting of a license to use or consume, for a consideration in money or by exchange or barter, tangible personal property.” Minn. Stat. § 297A.61, subd. 3(b)(2) (2016). The dispute in this case focuses on whether the transactions between Knutson Minneapolis and Knutson Rochester (1) constituted “leases” and (2) occurred in “the normal course of business.”

⁵⁴ The record on summary judgment established that Knutson Minneapolis treated the payments made to it by Knutson Rochester for the use of equipment as reductions in or offsets against the cost of purchasing, repairing, and operating the equipment, rather than as “profit” or “income.” Declaration of Paul Essler ¶ 9 (dated Nov. 30, 2017).

A. LEASES

For purposes of chapter 297A (and, by extension, section 297A.68), the legislature has provided a specific definition of “lease”:

“Lease or rental” means any transfer of possession or control of tangible personal property for a fixed or indeterminate term for consideration.

Minn. Stat. § 297A.61, subd. 14a(a). “This definition must be used for sales and use tax purposes regardless if a transaction is characterized as a lease or rental under generally accepted accounting principles, the Internal Revenue Code, chapter 336, or other provisions of federal, state, or local law.” *Id.*, subd. 14a(d). We use this definition to determine whether Knutson Minneapolis “leased” its equipment to Knutson Rochester or whether, as Knutson Rochester contends, the two companies merely “shared” the equipment and its costs.

B. NORMAL COURSE OF BUSINESS

For purposes of chapter 297A (and, by extension, section 297A.68), the legislature has also provided a specific definition of the phrase “normal course of business.”

“Normal course of business” means activities that demonstrate a commercial continuity or consistency of making sales or performing services for the purposes of attaining profit or producing income.

Minn. Stat. § 297A.61, subd. 21 (2016). Moreover, the legislature has provided a *nonexclusive* list of “[f]actors that indicate that a person is acting in the normal course of business,” including:

- (1) systematic solicitation of sales through advertising media;
- (2) entering into contracts to perform services or provide tangible personal property;
- (3) maintaining a place of business; or
- (4) use of exemption certificates to purchase items exempt from the sales tax.

Id. We use this definition to determine whether in making its equipment available to Knutson Rochester, Knutson Minneapolis was acting in the normal course of its business.

III. ANALYSIS

Having reviewed the governing law, we apply that law to the facts of the case. We conclude that the transactions between Knutson Minneapolis and Knutson Rochester were “leases” within the meaning of Minn. Stat. § 297A.61, subd. 14a. But we further conclude that the transactions between Knutson Rochester and Knutson Minneapolis did not occur in the normal course of business of Knutson Minneapolis, within the meaning of Minn. Stat. § 297A.61, subd. 21, and therefore are exempt from both sales and use tax under Minn. Stat. § 297A.68, subd. 25.

A. THE COMMISSIONER CONCEDED THE PRIMA FACIE VALIDITY OF HER ORDER.

As a threshold matter, the Commissioner’s counsel conceded at the hearing on the parties’ cross-motions for summary judgment that the Commissioner’s Order overstated Knutson Rochester’s use tax liability.⁵⁵ In particular, the Commissioner’s Order double-counted Knutson Rochester’s payments to Knutson Minneapolis for December 2009 by \$6,600 and, by extension, overstated Knutson Rochester’s alleged liability for Minnesota and Rochester use taxes.⁵⁶ In addition, during the audit the Commissioner was not provided with copies of the invoices from Knutson Minneapolis to Knutson Rochester for the months of January 2009, February 2010, and May 2010.⁵⁷ Those invoices were admitted at trial, showing that for those months Knutson Rochester paid Knutson Minneapolis a total of \$17,709.49.⁵⁸ As a result of those omissions, the

⁵⁵ Tr. 47-48 (Jan. 18, 2018).

⁵⁶ See Ex. J1 at 13 (Nov. 16, 2015 Order).

⁵⁷ Tr. 88-89 (Ms. Lisa Lencowski, Revenue Tax Specialist, Minnesota Department of Revenue, testifying); see Ex. J1, at 13-14.

⁵⁸ See Ex. J3, at 2; Ex. J4, at 16 & 62.

Commissioner's Order understated Knutson Rochester's alleged liability for Minnesota and Rochester use taxes. Accordingly, we conclude that the Commissioner's Order is not prima facie valid. We must therefore determine the amount of Knutson Rochester's liability for Minnesota use tax, if any, based on the evidence presented by both parties.

B. KNUTSON MINNEAPOLIS LEASED CONSTRUCTION EQUIPMENT TO KNUTSON ROCHESTER.

The parties dispute whether the transactions between Knutson Minneapolis and Knutson Rochester were "leases" within the meaning of chapter 297A. Because the definition of "lease" for purposes of chapter 297A is broad, we conclude that the transactions were leases.

Minnesota Statutes § 297A.61, subd. 14a, defines "lease" to mean "any transfer of possession or control of tangible personal property for a fixed or indeterminate term for consideration." Section 297A.61 further provides: "This definition must be used for sales and use tax purposes regardless if a transaction is characterized as a lease or rental under generally accepted accounting principles, the Internal Revenue Code, chapter 336, or other provisions of federal, state, or local law." *Id.*, subd. 14a(d). There is no dispute that Knutson Minneapolis transferred possession of construction equipment to Knutson Rochester, nor that the equipment was tangible personal property, nor that possession was transferred for a fixed or indeterminate term. The parties dispute whether those transfers were "for consideration."

Although Minn. Stat. chap. 297A provides specific definitions for many words and phrases used in the chapter, it does not provide a specific definition of "consideration." We construe words and phrases "according to their common and approved usage." Minn. Stat. § 645.08(1) (2016). We construe "technical words and phrases and such others as have acquired a special meaning . . . according to such special meaning." *Id.*

“Consideration requires that one party to a transaction voluntarily assume an obligation on the condition of an act or forbearance of the other party.” *U.S. Sprint Commc'ns Co., Ltd. v. Comm'r of Revenue*, 578 N.W.2d 752, 754 (Minn. 1998). In this case, Knutson Rochester voluntarily assumed the obligation to pay Knutson Minneapolis on condition that Knutson Minneapolis make its construction equipment available for use; similarly, Knutson Minneapolis voluntarily assumed the obligation to make its construction equipment available for use on condition that Knutson Rochester pay. We therefore conclude that the transactions between Knutson Rochester and Knutson Minneapolis were leases for purposes of Minn. Stat. ch. 297A.

Knutson Rochester argues that its “payment of the equipment costs was a cost allocation and does not represent consideration supporting a lease transaction.”⁵⁹ We disagree. The rates that Knutson Minneapolis charged Knutson Rochester for the use of equipment were not based, in any respect, on the cost to Knutson Minneapolis of the equipment itself. Rather, they were based on a percentage (either 50% or 75%) of the standard rate *nationwide* for *rental* of that type of equipment, as published by the Association of Equipment Dealers. In addition, Knutson Rochester paid Knutson Minneapolis only if it used the equipment and only for the period (typically, days) during which it used it. In other words, Knutson Rochester was charged for, *and only for*, the *actual use* of equipment. Indeed, testimony at trial established that if Knutson Minneapolis charged Knutson Rochester for the use of equipment for more days than Knutson Rochester actually used it, Knutson Minneapolis credited Knutson Rochester for the overcharge in a later month. Accordingly, if Knutson Rochester never used a particular piece of equipment, it was not “allocated” a portion of the cost of that equipment.

⁵⁹ Appellant’s Post-Trial Br. 8 (filed Apr. 11, 2018).

Under the circumstances, Knutson Rochester's payments to Knutson Minneapolis were payments under leases as defined in chapter 297A.

C. ALTHOUGH KNUTSON MINNEAPOLIS LEASED CONSTRUCTION EQUIPMENT TO KNUTSON ROCHESTER, IT DID NOT DO SO IN THE NORMAL COURSE OF BUSINESS.

Having concluded that the transactions between Knutson Rochester and Knutson Minneapolis were "leases" within the meaning of Minn. Stat. § 297A.61, we must then consider whether Knutson Minneapolis leased equipment to Knutson Rochester in the "normal course of business," for purposes of Minn. Stat. § 297A.68. We conclude that it did not. The payments from Knutson Rochester to Knutson Minneapolis are therefore exempt from sales tax and, under section 297A.68, are also exempt from use tax.

1. STATUTORY DEFINITION OF "NORMAL COURSE OF BUSINESS"

For purposes of chapter 297A (and, by extension, the exemption under section 297A.68), the legislature has provided a specific definition of the phrase "normal course of business."

"Normal course of business" means activities that demonstrate a commercial continuity or consistency of making sales or performing services for the purposes of attaining profit or producing income.

Minn. Stat. § 297A.61, subd. 21. For a sale to be made in the "normal course of business," it must have been made to "attain[] profit or produc[e] income." Such "commercial" sales must also have been made continually or consistently. For our purposes here, a sale of tangible personal property otherwise subject to sales tax under Minn. Stat. § 297A.62 is exempt if it was *not* made to "attain[] profit or produc[e] income" and if such sales are not made continually or consistently. Because "sale" includes "lease," *see* Minn. Stat. § 297A.61, subd. 3(b)(2), a lease of tangible personal property otherwise subject to sales tax under Minn. Stat. § 297A.62 is also exempt if it was *not*

made to “attain[] profit or produc[e] income,” and if such leases are not made continually or consistently.

In this case, even though Knutson Minneapolis made its equipment available to Knutson Rochester both continually and consistently, there is no evidence that Knutson Minneapolis sought to “attain[] profit or produc[e] income” from doing so. As we have already explained, the rate that Knutson Minneapolis charged Knutson Rochester for a particular piece of equipment was far below market rates for that particular piece of equipment. Nor did Knutson Minneapolis ever lease equipment to third parties.⁶⁰

The Commissioner argues that in leasing equipment from Knutson Minneapolis, Knutson Rochester was acting to “attain[] profit or produc[e] income,” *particularly* (in the Commissioner’s view) because Knutson Minneapolis charged below-market rates.⁶¹ But we must evaluate the motives of the seller/lessor (Knutson Minneapolis), not the buyer/lessee (Knutson Rochester, a separate legal entity). If Knutson Minneapolis were truly trying to generate income or profit, it would have leased its equipment to third parties at market rates, rather than allow it to remain idle or to lease it to Knutson Rochester at 75% or less of the going rate.⁶²

⁶⁰ Tr. 18 (Mr. Essler testifying).

⁶¹ Comm’r’s Post-Trial Br. 9 (filed Apr. 11, 2018).

⁶² The Commissioner sees great significance in the apparent fact that Knutson Rochester and Knutson Minneapolis “documented” the allocation of equipment costs differently.

The evidence shows that when Yard costs were allocated to Minneapolis, the allocation was done on paper only. For Rochester, however, the allocation of costs was not documented on paper only. Rather, the costs were entered into the general ledgers of Rochester and Minneapolis, an invoice was generated on a monthly basis, and Rochester paid Minneapolis for its usage of the equipment. Rochester failed to provide any testimony . . . to explain why the allocation of costs to Rochester and Minneapolis was not documented the same for each entity, if, as Rochester contends, the leases were simply a method to allocate the Yard costs.

In making its equipment available to Knutson Rochester, Knutson Minneapolis was not acting in the normal course of business as defined by Minn. Stat. § 297A.61, subd. 21.

2. CONSIDERATION OF STATUTORY FACTORS

In addition to the statutory definition of “normal course of business,” the legislature has provided a *nonexclusive* list of “[f]actors that indicate that a person is acting in the normal course of business”:

- (1) systematic solicitation of sales through advertising media;
- (2) entering into contracts to perform services or provide tangible personal property;
- (3) maintaining a place of business; or
- (4) use of exemption certificates to purchase items exempt from the sales tax.

Minn. Stat. § 297A.61, subd. 21. The language of these factors, coupled with the provision of Minn. Stat. § 297A.61, subd. 25, making a transaction exempt from use tax if it is exempt from sales tax, makes clear that the “person” to be considered is Knutson Minneapolis. Moreover, subdivision 21 coupled with subdivision 25 limit our consideration of these factors to the specific activity alleged to constitute a “normal course of business.”

Advertising. The “systematic solicitation of sales through advertising media” may indicate that the taxpayer is “acting in the normal course of business.” Minn. Stat. § 297A.61, subd. 21(1). The Commissioner asserts that this factor weighs in favor of taxation because both Knutson Minneapolis and Knutson Rochester advertise their construction services.⁶³ In this case, although Knutson Minneapolis may advertise its construction services, there is no evidence in the record

Comm’r’s Post-Trial Br. 10 (citations omitted). There is a simple explanation: the equipment is owned by, and appears on the books of, Knutson Minneapolis. There is no need to “allocate” equipment costs to the entity on whose books the equipment appears in the first place.

⁶³ Comm’r’s Post-Trial Br. 10.

that Knutson Minneapolis advertised its construction equipment for lease, systematically or otherwise. Indeed, Mr. Essler testified without contradiction that the construction equipment at issue was never used by any third party or entity. This factor weighs against a finding that in making its equipment available to Knutson Rochester, Knutson Minneapolis was “acting in the normal course of business.”

Contracts. That the taxpayer “enter[s] into contracts to perform services or provide tangible personal property” may also indicate that the taxpayer is “acting in the normal course of business.” Minn. Stat. § 297A.61, subd. 21(2). Although Knutson Minneapolis surely enters into written contracts to construct buildings and do other construction work, there is no evidence of written agreements between Knutson Minneapolis and Knutson Rochester spelling out the specific terms under which Knutson Rochester used the equipment. No such written agreements are required. The e-mails between Knutson Minneapolis and Knutson Rochester requesting specific pieces of equipment, coupled with the schedules from which the intercompany rates to be charged for those pieces of equipment were calculated, constitute contracts. *See In re Disciplinary Action Against Riehm*, 883 N.W.2d 223, 230 (Minn. 2016) (“Generally, neither a signature nor a writing is required to make a contract binding.”). This factor weighs in favor of a finding that in making its equipment available to Knutson Rochester, Knutson Minneapolis was “acting in the normal course of business.”

Place of business. That the taxpayer maintains “a place of business” may indicate that the taxpayer is “acting in the normal course of business.” Minn. Stat. § 297A.61, subd. 21(3). The Commissioner argues that this factor is satisfied because both Knutson Minneapolis and Knutson Rochester maintain places of business.⁶⁴ Although Knutson Minneapolis maintains a place of

⁶⁴ Comm’r’s Post-Trial Br. 10-11.

business in Minneapolis for its construction and related services, the equipment at issue was located at Knutson Minneapolis's equipment yard in Blaine, which is separate and far distant from Knutson Minneapolis's corporate headquarters in Minneapolis. Knutson Minneapolis did not separately track the profitability of the equipment yard. As a result, we do not consider this a "place of business" for leasing construction equipment because that was not Knutson Minneapolis's business. This factor weighs against a finding that in making its equipment available to Knutson Rochester, Knutson Minneapolis was "acting in the normal course of business."

Exemption certificates. Finally, the use of exemption certificates to purchase items may indicate that in selling or leasing tangible personal property to others, the taxpayer is "acting in the normal course of business." Minn. Stat. § 297A.61, subd. 21(4). Knutson Minneapolis paid Minnesota sales tax on the equipment it purchased, rather than use an exemption certificate to avoid paying sales tax. This factor weighs against a finding that in making its equipment available to Knutson Rochester, Knutson Minneapolis was "acting in the normal course of business."

The Commissioner argues, contrary to our findings, that the statutory requirements are satisfied here. In particular, the Commissioner argues that the evidence "establishes a commercial continuity and consistence of Rochester leasing Minneapolis' equipment with the goal of attaining profit or producing income on its projects."⁶⁵ The Commissioner further argues that the evidence "establishes that Rochester attained profit and income from the leases," and that "Rochester's overall profitability on each of its projects was increased by the fact that Rochester leased the equipment from Minneapolis at below market rates."⁶⁶

⁶⁵ Comm'r's Post-Trial Br. 8-9.

⁶⁶ Comm'r's Post-Trial Br. 9.

The Commissioner's arguments ignore the plain language of the statute. The exemption under Minn. Stat. § 297A.68, subd. 25, requires us to consider not whether the transaction in question is "made in the normal course of business" in the abstract, but whether the transaction in question is "made in the normal course of business *of selling that kind of property.*" In other words, we are restricted by statute to considering whether Knutson *Minneapolis* (not Knutson Rochester) was acting in the normal course of business *of leasing construction equipment.* That, in turn, restricts our consideration of the meaning of "normal course of business" under Minn. Stat. § 297A.61, subd. 21. The question is not whether Knutson Minneapolis's activities *in general* were "for the purposes of attaining profit or producing income." *Id.* Rather, the question is whether Knutson Minneapolis's *leases of equipment to Knutson Rochester* were "for the purposes of attaining profit or producing income." *Id.* As we have explained, they were not.

Consideration of the statutory factors weighs against a finding that the leases between Knutson Minneapolis and Knutson Rochester occurred during the normal course of business of leasing construction equipment.

3. CONSIDERATION OF OTHER FACTORS

Because the language of subdivision 21 is *inclusive*, rather than *exclusive*, we also consider other factors that weigh in favor of or against a finding that in leasing equipment to Knutson Rochester, Knutson Minneapolis was acting in the normal course of business. Those factors further weigh against a finding that in leasing equipment to Knutson Rochester, Knutson Minneapolis was acting in the normal course of business.

First, Knutson Minneapolis set rates for equipment usage based on a percentage of the average market rate for equipment rentals, as published in the AED Green Book, an industry publication listing standard rates for rental of various pieces of construction equipment. The

percentage varied depending on the type of project. For so-called “hard bids” (meaning a lump sum bid, often sealed), Knutson Minneapolis charged Knutson Rochester (and itself) 50% of the AED Green Book rate. For cost-plus work, Knutson Minneapolis charged Knutson Rochester (and itself) 75% of the AED Green Book rate. There is no evidence in our record that equipment rental rates varied from these standards, regardless (for example) of the potential profitability of a particular job or the demand (or lack thereof) for a particular piece of equipment. That Knutson Minneapolis’s equipment rates did not vary with market conditions weighs strongly against a finding that in making equipment available to Knutson Rochester, Knutson Minneapolis was acting in the normal course of business.

Second, when equipment was not being used by either Knutson Minneapolis or Knutson Rochester, Knutson Minneapolis simply allowed it to remain idle, rather than leasing it to third parties at market rates far higher than Knutson Rochester was paying. This weighs strongly against a finding that the equipment yard was operated in the normal course of business.

Third, Knutson Minneapolis does not track the financial performance of the equipment yard. This, too, weighs strongly against a finding that the equipment yard was operated in the normal course of business.

Finally, Mr. Essler testified without contradiction that in operating the equipment yard, Knutson Minneapolis’s only intent was to cover the cost of the equipment, rather than to generate a profit or produce income. This further weighs against a finding that in leasing equipment to Knutson Rochester, Knutson Minneapolis was acting in the normal course of business.

4. CONSIDERATION OF MINN. R. 8130.5800.

Finally, the Commissioner argues that because administrative rules have “the force and effect of law and may not be disregarded unless the rule conflicts with the statute it seeks to

implement,” we are bound by an example in Minn. R. 8130.5800 (2017).⁶⁷ The example reads as follows:

Example 2. A construction company leases excavating and hauling equipment without an operator to another business, when not otherwise in use. The leasing is considered to take place in the normal course of business and is subject to tax.

Minn. R. 8130.5800, subp. 1a(B). We disagree.

Rule 8130.5800 is captioned “Isolated or Occasional Sales and Sales of Personal Property Used in Trade or Business.” The example cited by the Commissioner is found as part of the definition of “normal course of business”:

“Normal course of business” is defined in Minnesota Statutes, section 297A.61, subdivision 21. The sale of inventory is considered to be made in the normal course of business and thus is subject to tax. The lease of tangible personal property is subject to tax.

Minn. R. 8130.5800, subp. 1a.B. Three examples follow, including the example on which the Commissioner relies. Nothing in those examples addresses the particular parts of subdivision 25 at issue here: whether the two businesses are members of the same controlled group and whether the leases were made in the normal course of business. In other words, interpreted as the Commissioner argues, example 2 simply *assumes* that *all* leases of construction equipment “when otherwise not in use” are “in the normal course of business” and therefore subject to use tax, regardless of whether they are made “for the purposes of attaining profit or producing income,” within the meaning of Minn. Stat. § 297A.61, subd. 21, or whether the two businesses are members of a controlled group, as provided in Minn. Stat. § 297A.68, subd. 25. Because example 2 of Minn. R. 8130.5800, subp. 1.a.B., must be interpreted as assuming that all other legal requirements

⁶⁷ Comm’r’s Post-Trial Br. 9.

for taxability are satisfied—an assumption not consistent with the facts of this case—it has no application here.⁶⁸

IV. CONCLUSION

For all of the foregoing reasons, we conclude that the Commissioner erred in assessing use tax on payments made by Knutson Rochester to Knutson Minneapolis for the use of construction equipment.

J.H.T.

⁶⁸ We note, in addition, that an entirely different part of the rule—Minn. R. 8130.5800, subp. 3a—addresses the exemption at issue here under Minn. Stat. § 297A.68. Subpart 3a of the rule includes no examples and appears inconsistent with Minn. Stat. § 297A.68:

The sale of tangible personal property primarily used in a trade or business is exempt if the sale is not made in the normal course of business of selling such property; the sale occurs in a transaction subject to, or described in, section 118, 331, 332, 336, 337, 338, 351, 355, 368, 721, 731, 1031, or 1033 of the Internal Revenue Code, and the following conditions are met:

- (1) the sale must qualify, as well as be reported, as a transaction occurring under one of the Internal Revenue Code sections listed in this item; and
- (2) the transfer must be between partnerships and their partners or between corporations and their shareholders or, if the sale is under section 1563(a) of the Internal Revenue Code, between members of a controlled group.

Minn. R. 8130.5800, subp. 3a.A. Rule 8130.5800, subp. 3a, lists four conditions, all of which must be met. In contrast, Minn. Stat. § 297A.68 lists one condition (that the sale was not made in the normal course of business of selling that kind of property) that must be met, and six other conditions only one of which must be met.