

Minnesota Income Tax Withholding on Payments to Independent Contractors in the Construction Trades

18

Withholding Tax Fact Sheet 18

Fact Sheet

This fact sheet explains the new law and the responsibilities for employers who are required to withhold the 2 percent Minnesota withholding tax on independent contractors in the construction trades. If you need more information, send an email or call us (see our email and telephone numbers at the bottom of this page).

The law

Beginning January 1, 2009, a construction contractor who makes payments to an individual construction contractor carrying on a trade or business as a sole proprietorship must deduct and withhold 2 percent (.02) of the payment(s) as Minnesota income tax withholding. Payments are subject to 2 percent withholding only if the work was performed in the state of Minnesota and the total payments during the year exceed \$600. (*M. S. 290.92, subd. 31*)

Difference between a construction contractor and an individual construction contractor

A **construction contractor** (payer) is any individual or business entity carrying on a trade or business described in industry code numbers 23 through 238990 of the North American Industry Classification System (NAICS).

An **individual construction contractor** (payee) is any individual carrying on a trade or business as a sole proprietorship described in industry code numbers 23 through 238990 of the NAICS. A single member Limited Liability Company (LLC) is not a sole proprietorship for purpose of this law.

Trades covered by this law

All construction trades described in North American Industry Classification System (NAICS) codes 23 through 238990 are subject to 2 percent (.02) withholding.

Examples of construction trades covered by this law include:

- residential and commercial building construction
- residential remodeling
- framing and finish carpentry
- masonry
- roofing and siding
- electrical contracting
- plumbing and HVAC
- drywall and insulation
- painting and wall covering

- flooring
- other specialty trades

The above list is not all inclusive. For a complete listing of applicable construction trades, go to www.naics.com/naics23.htm.

Carrying on a trade or a business

The term “carrying on a trade or business” generally includes any activity conducted for the production of income from selling goods or performing services. Carrying on a trade or business includes both primary business activity and secondary business activity.

When to withhold 2 percent Minnesota income tax

A construction contractor (payer) is required to withhold 2 percent (.02) of the total payment(s) made to an individual construction contractor (payee) when payments to that individual construction contractor exceed \$600 in a calendar year. If the payments exceed \$600, all of the payments, even the first \$600, are subject to income tax withholding.

What are total payments?

Total payments are gross payments to the individual construction contractor including the cost of materials, subcontracted labor and the personal services of the individual construction contractor.

Examples

In the four examples below the word “you” is defined as construction contractor.

Example 1. In February 2009, you contract with an individual construction contractor to install a stained glass window in a house you are remodeling. The total payment for the installation is \$500. Since you are not aware of any future business with this individual construction contractor, you are not required to withhold 2 percent because the payment is less than \$600.

Example 2. In August 2009, you contract with the same individual construction contractor who installed the stained glass window in February 2009. This time the total payment for the installation is \$400. Because the total you will pay the individual construction contractor for the calendar year is over \$600, you are required to withhold 2 percent of the total payments, or \$18 [$\$900 \times 2\% (.02)$].

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Withholding Tax Division, Mail Station 6501, St. Paul, MN 55146-6501
Phone: 651-282-9999 or 1-800-657-3594
Minnesota Relay 711 (TTY)
Fax: 651-556-5152
Email: withholding.tax@state.mn.us

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This fact sheet is intended to help you become more familiar with Minnesota tax laws and your rights and responsibilities under the laws. Nothing in this fact sheet supersedes, alters or otherwise changes any provisions of the tax law, administrative rules, court decisions or revenue notices. Alternative formats available upon request.

Example 3. In May 2009, you contract with an individual construction contractor to perform carpentry work on homes in a small housing development. The contract specifies that the individual construction contractor will return in July 2009 to perform additional work. The contract states you will pay the company twice, \$500 in May and \$1,000 in July. You must withhold 2 percent on both payments starting at dollar one.

Example 4. In March 2009, you contract with an individual construction contractor who is a resident of Iowa to install sheet-rock in a building located in Minnesota. The contract specifies that the work must be completed by the end of May 2009. The total payment for the installation is \$6,000 and will be paid in two separate payments of \$3,000 each. Tax must be withheld even though the total amount paid is less than the Minnesota individual income tax filing threshold. Because the payment will be more than \$600, you must withhold 2 percent on the entire amount of each payment.

Minnesota tax ID number required

If you are required to withhold Minnesota tax, you must have a seven-digit Minnesota tax ID number.

If you already have a Minnesota tax ID for other Minnesota taxes for the same business, you can use the same number for withholding tax. Go to our website at www.taxes.state.mn.us and click "Update business info" on the e-Services menu.

If you do not have a Minnesota tax ID number, you must apply for one. Go to www.taxes.state.mn.us and click "Register for a Minnesota tax ID number" on the e-Services menu. If you do not have Internet access, contact our Registration Services office at 651-282-5225 or 1-800-657-3605.

How to pay and report withholding

The same payment and reporting rules for regular employee withholding apply to the 2 percent withholding. If you withhold both employee and individual construction contractor income tax, add the totals together for the first three quarters.

Please review the following instructions, then see Fact Sheet 14 for a step-by-step guide for filing and paying (if you are a quarterly filer) or Fact Sheet 16 (if you are an annual filer).

For the first, second and third quarter 2009 returns:

- On the wage line, include the payments made to individual construction contractors who qualify for the 2 percent income tax withholding.
- On the number of employees line, include the number of individual construction contractors from whom you withheld 2 percent Minnesota income tax.
- On the tax withheld line, include the total 2 percent tax you withheld from all individual construction contractors who qualify for the 2 percent income tax withholding.

For the 2009 fourth-quarter/year-end reconciliation return:

You will enter annual withholding information specific to individual construction contractors.

If you currently pay employees and individual construction contractors, keep the individual construction contractor in-

formation separate from employee information, so you have it available to report correctly at the end of the year.

Information a construction contractor needs to retain

A construction contractor must retain the:

- name of each individual construction contractor paid
- address of each individual construction contractor paid
- Social Security number of each individual construction contractor paid
- amount paid to each individual construction contractor
- amount withheld for each individual construction contractor
- federal Form W-9* for each individual construction contractor

*Federal Form W-9 allows the payee to provide an FEIN in lieu of a Social Security number. However, you are required to furnish a Social Security number for the purpose of this law.

Form W-2 or Form 1099-MISC

Issue a Form 1099-MISC to report payments of \$600 or more to an individual construction contractor. Enter the payee's Social Security number in the box labeled "RECIPIENT'S identification number." Enter the 2 percent (.02) withholding tax in the box labeled "State Tax Withheld."

Forms 1099-MISC with Minnesota withholding tax are required to be sent to the Minnesota Department of Revenue by February 28 of the following year. See Fact Sheet 2a for the Minnesota specifications for submitting Forms W-2 and 1099.

Need forms or information?

Go to www.taxes.state.mn.us to:

- download forms, instructions, tax tables, fact sheets, Revenue Notices, frequently asked questions, reports, etc.
- file and pay Minnesota taxes, and view payment and return histories
- change existing business information
- register your business for a Minnesota tax ID number

If you don't have Internet access, you may call:

- 651-282-9999 or 1-800-657-3594 for withholding tax questions
- 1-800-570-3329 to file and pay withholding tax
- 651-282-5225 or 1-800-657-3605 to update your business information or to apply for a Minnesota tax ID number

Or send questions by e-mail to withholding.tax@state.mn.us.

Independent Contractor Exemption Certificate (ICEC)

Effective January 1, 2009, a new state law requires individuals who work as independent contractors in the building construction industry to obtain from the Department of Labor and Industry an Independent Contractor Exemption Certificate (ICEC). For more information, go to www.doli.state.mn.us/ic.html.

Important: Having an ICEC from the Minnesota Department of Labor does not exempt an individual construction contractor from the 2 percent Minnesota tax.