

Minnesota – Consulting services not subject to sales and use tax

October 4, 2013

In brief

The Minnesota Tax Court found that consulting services relating to the implementation of enterprise software were not subject to sales tax, whether as a separate taxable service (fabrication labor) or as part of license fees paid for the software. Minnesota taxpayers purchasing or providing similar services should consider, consistent with this opinion, that implementation services may be distinct from taxable installation services even when performed by the software vendor. [[SAP Retail, Inc. v. Commissioner of Revenue](#), Minn. Tax Court, No. 8345-R (9/19/13)]

In detail

Facts

During the years at issue, SAP Retail, Inc. licensed enterprise resourcing planning software, which integrates a business's core functions (e.g., finance, logistics, and human resources) into a single system with a shared database. SAP Retail also provided consulting and professional services, including assistance with the implementation of its software (Consulting Services).

In 2007, SAP Retail granted Best Buy Enterprises Services a license (License Agreement) to use SAP's software, documentation, and other information. Best Buy contracted with SAP Retail to perform certain Consulting Services in connection with the SAP software, including support of the software's installation and

implementation. The types of services purchased from SAP Retail were available for purchase from numerous independent service providers that did not sell SAP software. In fact, SAP Retail noted that it was not among the top ten service providers for these services.

On audit, the Minnesota Commissioner of Revenue assessed sales tax on payments SAP Retail received for the Consulting Services. Without going through the administrative appeals process, SAP Retail appealed to the Minnesota Tax Court.

The court ruled that the Consulting Services were not subject to sales tax, either as a separate taxable service or as part of the license fees paid for the SAP software.

Consulting Services are not among those services specifically subject to sales tax

Minnesota imposes a sales tax on the sale of tangible personal property and on the sale of a limited number of services enumerated in Minnesota statutes. One such taxable service is the fabrication of tangible personal property.

The Commissioner asserted that the Consulting Services amounted to fabrication of SAP software because the consultants created documentation needed to configure the software. The court disagreed because fabrication is taxable only when the consumer furnishes the materials used in the fabrication. In this case, there was no evidence that Best Buy

furnished any materials. In fact, the disks containing ERP software were furnished by SAP Retail.

The court found that there were no other statutory enumerated services under which the Consulting Services qualified. Accordingly, the court concluded that the Consulting Services were not among those services made subject to tax under Minnesota law or regulations.

Consulting Services are not 'part of the sales price' of the taxable software license

Minnesota includes the 'total amount of consideration' within the meaning of 'sales price,' on which sales tax is measured. The Commissioner argued that the Consulting Services were subject to sales tax because they were 'part of the taxable sales price' of the License Agreement.

The court disagreed, in part, because the Consulting Services fees were separately itemized in a schedule separate from the License Agreement and there was nothing in either the License Agreement or in the schedule describing the consulting fees as license fees. The consulting service schedule, although 'annexed' to the License Agreement, was a contract separate from the License Agreement. The court reasoned that, even if the

software license and Consulting Services were purchased as a package, the Consulting Services would be rendered taxable only if they were included in a bundled price with the license. Accordingly, the court concluded that the Consulting Services were not part of the taxable software license fee.

Consulting Services were not necessary to complete the license of the software

The Commissioner argued that the Consulting Services were 'necessary to complete the sale' of the License Agreement (and therefore part of the License Agreement's sales price) because the agreement and the Consulting Services were negotiated at the same time. The Commissioner asserted that the Consulting Services were analogous to measuring services performed by a drapery business that used the gathered measurements to complete the sale of drapes. In other words, the measuring charges were necessary to determine the sales price of the taxable drapes and the Consulting Services here were necessary to complete the sale of SAP's software.

The court disagreed for several reasons. First, there was no evidence that the Consulting Services were necessary to *determine the cost* or

terms of the License Agreement. Second, the Consulting Services can be performed by other companies; therefore, SAP's Consulting Services were not necessary for the sale. Finally, contemporaneous negotiation did not render the Consulting Services part of the License Agreement.

The court also specifically noted the Consulting Services performed by SAP did not constitute 'installation charges.'

The takeaway

Minnesota taxpayers purchasing or providing similar consulting or professional services should be aware of the decision as it confirms the position that implementation services are distinct from installation even when performed by the software vendor.

Since the court concluded that the Consulting Services were not subject to tax, it did not address other issues raised by the parties, including the sourcing of the services or the impact of the software's 'multiple points of use.' It is unknown whether the Department will appeal. We will continue to monitor the progress of this decision and report on any significant developments.

Let's talk

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