

STATE OF MINNESOTA
IN TAX COURT

SAP Retail, Inc.,

Appellant,

vs.

Docket No. 8345-R

Commissioner of Revenue,

Appellee.

Dated: September 19, 2013

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

This matter was heard in the Minnesota Tax Court on April 22 and 23, 2013.¹ After the parties filed proposed findings of fact and conclusions of law and post-trial memoranda, closing arguments were held on June 19, 2013.

Walter A. Pickhardt and Martin S. Chester, Attorneys at Law, represented appellant SAP Retail, Inc.

Mark B. Levinger and Jeremy D. Eiden, Assistant Minnesota Attorneys General, represented appellee Commissioner of Revenue.

Masha M. Yevzelman and Thomas R. Muck, Attorneys at Law, represented intervenor Best Buy Co., Inc.

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

¹ This matter was originally heard by The Hon. George W. Perez, Judge of the Minnesota Tax Court. After Judge Perez's departure from the court, the parties agreed that the undersigned could render a decision on the basis of the existing record. *See* Tr. 4-5 (May 28, 2013).

FINDINGS OF FACT

1. Appellant SAP Retail, Inc. (now known as SAP Industries, Inc.), is a Delaware corporation headquartered in Newtown Square, Pennsylvania. Stip. ¶ 1.

2. SAP Retail is a subsidiary of SAP America, Inc., which in turn is a subsidiary of SAP AG, a publicly traded company headquartered in Germany. Stip. ¶¶ 5, 4, 2.

3. SAP Retail produces and licenses enterprise resource planning software and provides related services. Stip. ¶¶ 3, 5.

SAP'S ENTERPRISE RESOURCE PLANNING SOFTWARE

4. SAP's enterprise resource planning software is a suite of computer modules, each module consisting of a set of computer programs representing a particular business function. Tr. 53-54. For example, SAP's software includes modules for sales and distribution, materials management, and production planning. SAP Ex. 1 at 11. Each module, in turn, represents a collection of software programs written to work together as an integrated whole. SAP Ex. 1 at 11. The SAP modules are accessed by codes or "transactions." In the sales and distribution module, for example, there are codes that allow the software to perform such business functions or transactions as creating a sales order and creating a sales invoice. SAP Ex. 1 at 12. Each program, in turn, involves several (or many) sub-programs. SAP Ex. 1 at 12-13. In processing a sales order, for example, the system may check to see if the item is available, schedule its delivery, and check the customer's credit. SAP Ex. 1 at 12.

5. The modules in SAP's enterprise resource planning software rely on a shared data set, meaning the same underlying database. Tr. 56.

6. The modules in SAP's enterprise resource planning software are integrated with one another. Tr. 53-54; SAP Ex. 1 at 12-13. Because the software's modules are already

integrated, the licensee does not have to do anything to assemble the modules so that they work together. Tr. 57-58; SAP Ex. 1 at 13-14.

7. A licensee need not purchase a license for all of the modules in the SAP software. When a licensee buys a license for fewer than all available modules, all of the modules of the software are nevertheless included. The licensee simply cannot access the modules for which no license was purchased. T. 19-20.

8. SAP's enterprise resource software has various "configuration" options built into it. The software can be configured to the specifications of the particular user by selecting from the various configuration options, and configuration does not require writing additional software code. Stip. ¶ 52; SAP Ex. 1 at 12 (noting that changing the configuration of the software after installation does not alter any program), 47 (noting that SAP's configuration parameters and settings are stored in underlying databases).

9. SAP's enterprise resource software is commonly installed on a group of computer servers known as an "environment." Stip. ¶ 47. Taken together, all of a customer's SAP environments are termed a "landscape." Stip. ¶ 48.

10. An SAP software landscape commonly has at least three environments or systems: a development system (known as DEV); a quality assurance system (known as QA or QAS); and a production system (known as PROD). Stip. ¶ 49.

11. Specific functionalities within each system or environment are referred to as a "client." Stip. ¶ 50. Users of the software log into a specific functionality or client. Stip. ¶ 50.

12. The development system commonly has at least four "clients" or functionalities: the sandbox (in which configuration settings are made and first tested); the unit test client (also

used to test configuration settings); the development client; and the golden client (in which final configuration settings are stored). Stip. ¶¶ 51, 53.

INSTALLATION AND IMPLEMENTATION OF SAP SOFTWARE: THE GENERAL PROCESS

13. To install software means to place software in a location from which it can be executed. *See* Tr. 62 (“Installation makes the software available for use, and primarily deals with setting the application and the software up on the hardware.”); SAP Ex. 1 at 23. SAP considers its software fully installed once the user is able to log onto the software or a license key can be entered. Tr. 74, 76-77. This definition of installation is consistent with industry practice, under which installation is understood to be complete once the application is placed on the customer’s computer hardware and is available for use. Tr. 77. Software installation may require configuring the software to suit the licensee’s computer hardware. SAP Ex. 1 at 23.

14. Implementation, in contrast, determines how the software will be used after it has been installed. Tr. 62. In implementing software, the software is configured to perform the business functions that are necessary to carry out the customer’s particular processes and business activities. Tr. 77-78.

15. Implementation of the SAP software begins with project preparation, during which the scope of the project is defined or refined and the customer determines which business processes or activities the software will address. Tr. 78-79; SAP Ex. 1 at 38.

16. During project preparation, “functional” consultants meet and correspond with the customer to investigate the customer’s business practices or functions in detail and, on the basis of that investigation, diagram or map the customer’s business process. Tr. 79. The diagrams and maps developed during this step are termed a “blueprint,” and are used to determine how the

SAP software is configured, that is, how the various switches and parameters of the SAP software are to be set. Tr. 79-80.

17. The initial configuration of the software is typically done in the DEV environment. Tr. 69.

18. Once the various modules of the SAP software have been configured, they are separately installed (as configured) in the QA environment. *See* Tr. 88. The QA environment is generally used for testing and training. Tr. 89. More specifically, the main purpose of the QA environment is testing the integration of the various SAP modules. Tr. 204. In addition, the QA environment is also used in training key users of the system. Tr. 204. If problems are found during testing, corrections and adjustments are first made in the DEV environment, then made and tested in the QA environment. Tr. 89.

19. After the software has been tested as fully configured, final preparations are made for the system to receive the customer's data. Tr. 87, 89. Customer training and any changes in management activities are also done at this stage, typically in the QA environment. Tr. 87, 89.

20. The software as configured is again installed, this time in the PROD environment, is loaded with the customer's master data, and begins to be used to process actual transactions. Tr. 89.

SAP'S SALE OF THE SOFTWARE TO BEST BUY

21. In August 2007, SAP Retail entered into a software license agreement with Best Buy Enterprise Services, Inc., a wholly-owned subsidiary of Best Buy Co., Inc. Stip. ¶¶ 11, 7, 6; Jt. Ex. 4.

22. Under the terms of the license agreement, SAP Retail granted Best Buy Enterprises Services a non-exclusive, fully paid, and perpetual license to use SAP Retail's

software and documentation in its international and emerging businesses, starting with Best Buy's planned expansion into China, Mexico, and Turkey. Stip. ¶¶ 11, 9; Jt. Ex. 4.

23. Appendix 1 to the License Agreement (Jt. Ex. 5) lists the particular software licensed by Best Buy and enumerates the fees to be paid by Best Buy to SAP Retail as and for license fees. Under Appendix 1 to the License Agreement, SAP Retail agrees to provide "governance and consultative executive support for SAP projects and activities" to Best Buy's "Executive Management" for a period of three years. Jt. Ex. 5 at 8. Such services are to be provided "at no additional cost." Jt. Ex. 5 at 8. Appendix 1 is "annexed to and made a part of" the Software License Agreement. Jt. Ex. 5 at 1. No other services are referenced in Appendix 1.

24. Licensees of SAP Retail software have the option to purchase the software without implementation services. Stip. ¶ 10. SAP Retail's software and its consulting services are separate, are not sold together, and are not bundled together in any way. Tr. 21. Although licensees can purchase implementation services from SAP, they may also contract with other companies for software implementation services. Stip. ¶ 10. A number of companies provide such implementation services. Tr. 60-61. SAP is not among the 10 largest providers of implementation services for the enterprise resource planning software it sells. Tr. 61-62.

SAP'S CONSULTING AGREEMENT WITH BEST BUY

25. At the same time that SAP Retail entered into the License Agreement with Best Buy, it agreed to provide Best Buy with consultants "to perform, at [Best Buy's] direction, consulting and professional services including support of installation and implementation of the applicable SAP Software." Jt. Ex. 6 (Professional Services Schedule); Stip. ¶ 13. The services performed under the Professional Services Schedule were provided on a time and expense basis at rates agreed to by the parties in a separate Statement of Work. Jt. Ex. 6 at 20.

26. On August 27, 2007, SAP Retail and Best Buy entered into a Statement of Work covering the “International Scoping Phase” of Best Buy’s software project. Stip. ¶¶ 33, 34; Jt. Ex. 16. According to the August 2007 Statement of Work, SAP consultants were to “assist in the implementation of the SAP Software and assist [Best Buy] in gaining a better understanding of the SAP Software applications.” Jt. Ex. 16 at 1. Thus, according to the August 2007 Statement of Work,

The scope of the Project is to provide supplemental consulting support to the Best Buy/Accenture project team during the initial activities of the International Scoping Phase. The Scoping phase will focus on building a common global conceptual design for the Best Buy international (excluding North American U.S. operations) and emerging businesses (Pacific Sales).

Jt. Ex. 16 at 1. In addition, the scope of the project included support for enumerated consulting activities, such as analysis of “technical requirements” and “hardware requirements and sizing.”

Jt. Ex. 16 at 1-2.

27. The August 2007 Statement of Work gave SAP “consulting and primary responsibility for the development of the project deliverables for the Merchandising/Supply Chain business area,” which were defined to include documentation of “high level business requirements,” configuration of “Conference Room Pilot scenarios,” confirmation of Conference Room Pilot and blueprint materials, and creation of Final Blueprint Documents for the Merchandising/Supply Chain. Jt. Ex. 16 at 2. In addition, SAP consultants were to “assist with and contribute to, but [] not have primary responsibility for the comparable deliverables to be created by the Financials, Human Resources or Technical infrastructure teams.” Jt. Ex. 16 at 2.

28. Nothing in the August 2007 Statement of Work, the Professional Services Schedule, the Software License Agreement, or Appendix 1 to the License Agreement called for SAP Retail consultants to actually install the SAP software. Jt. Exs. 16, 6, 4, 5.

29. SAP Retail's software license agreement with Best Buy and SAP Retail's agreement for consulting services, although signed at the same time, are two distinct agreements.

ACCENTURE'S SOFTWARE INSTALLATION AGREEMENT WITH BEST BUY

30. Although Best Buy maintains a data center in Bloomington, Minnesota, at the time that Best Buy licensed the SAP software in August 2007, it had not yet purchased the servers on which the SAP software would be installed. Stip. ¶¶ 78, 79.

31. In September 2007, Best Buy and Accenture (to whom Best Buy had previously outsourced most of its information technology functions) agreed to a Statement of Work for "installation and support for 4 SAP development systems" to be hosted through the Cincinnati Bell Technology Services Data Centre facility in Cincinnati, Ohio. Conf. Jt. Ex. 44 at 4.²

32. Under the September 2007 Statement of Work, Accenture specifically agreed to install 4 "instances" of the SAP software. Conf. Jt. Ex. 44 at 10.

33. The September 2007 Accenture Statement of Work made configuration of the SAP software the responsibility of Best Buy itself. Conf. Jt. Ex. 44 at 13.

34. Accenture was the prime implementation partner on the Best Buy project, and was solely responsible for the installation and implementation of the SAP software. Tr. 137-38.

35. Accenture employees in Cincinnati, including Jeremy Rogers and Steve Toms, performed services described in the Accenture Statement of Work. Stip. ¶ 57. More specifically, Accenture employees installed the SAP software on Accenture's servers in Cincinnati. Tr. 142. The software was fully installed—meaning that it was loaded onto

² Confidential Joint Exhibit 44 is captioned "Statement of Work Between Best Buy and Accenture IO—Draft 1.0." However, a footer on the Statement of Work indicates it is a "final" document, and the parties are unaware of the existence of a later version. Stip. ¶ 54. Accordingly, we find that Joint Exhibit 44 is a copy of the operative agreement between Best Buy and Accenture.

Accenture's servers—in December 2007, at which point users could log on to and use the software. Tr. 146-47, 149.

SAP'S SERVICES UNDER THE CONSULTING AGREEMENT WITH BEST BUY

36. Many SAP consultants worked on the Best Buy project at one time or another. Stip. ¶ 61; Jt. Ex. 56.

37. SAP employs "basis" consultants, who may handle system administration tasks such as installing and upgrading software, transporting development and configuration objects from one SAP system to another, monitoring system performance, and system security. Stip. ¶ 58.

38. SAP basis consultant Jeff DePianta worked on the Best Buy project in Minnesota between September 2007 and February or mid-March 2008, providing advisory support to the Accenture and SAP technical infrastructure teams. Stip. ¶ 59; Tr. 136-37.

39. During the time Mr. DePianta worked on the Best Buy project, only the DEV system had been installed, and that had been installed in Cincinnati. Tr. 160-61.

40. Administrative privileges were required to install SAP software on Accenture's servers in Cincinnati. Tr. 142. Mr. DePianta did not have administrative privileges on Accenture's servers, Tr. 142, and did not have direct access to any of Accenture's servers in Cincinnati, Tr. 158-59, 160-61. Mr. DePianta did not install any software on the Best Buy project. Tr. 156.

41. Rakesh Walekar, an SAP basis consultant, worked on the Best Buy project from late January 2008 to June 2010. Stip. ¶ 79; Tr. 172.

42. When Mr. Walekar began work on the Best Buy project in January 2008, the SAP software had already been installed on Accenture's servers in Cincinnati. Tr. 177, 209.

43. The QA system installed on Best Buy's servers in Minnesota in April or May 2008 was configured in the same way as the DEV system installed in Cincinnati in late 2007. Tr. 188, 204, 205, 240.

44. Accenture's database team used the software again to install the production (PROD) system on Best Buy's servers in Minnesota in August or September 2008. Tr. 188, 206, 254.

45. Eventually, the DEV system that had first been installed on Accenture's servers in Cincinnati was copied and moved to Best Buy's servers in Minnesota. Tr. 207. Mr. Walekar assisted the basis team in planning the move of the DEV system to Minnesota, but because Mr. Walekar lacked authorization or administrative access he did not physically move the DEV system. Tr. 210-11.

46. Mr. Walekar neither installed any software, nor did Mr. Walekar have authorization to install any software. Tr. 188-89, 206-07.

47. There is no evidence in this record that anyone from SAP Retail installed the software licensed from SAP by Best Buy. No employee of SAP Retail testified that he or she installed the SAP software. No witness identified any SAP Retail employee as having installed the software. Nor is there any evidence that any SAP consultant had authority to install the licensed software on either the Best Buy or Accenture servers.

48. Most of these consultants on the Best Buy project were "functional" consultants, who had skills relating to specific business functions (such as procurement or warehousing) and relating to the configuration of the settings in SAP's software pertaining to those business functions. Stip. ¶ 62.

49. SAP's functional consultants prepared a blueprint for each of Best Buy's functional areas and, in some cases, blueprints for specialties within each of those functional areas. Tr. 307.

50. Sara Rutherford, a specialist in warehouse and materials management, was one of the functional consultants on the Best Buy project. Tr. 286, 295. Ms. Rutherford prepared a blueprint of Best Buy's warehouse management function, documenting Best Buy's detailed requirements for the management of its warehouse and indicating how the SAP software should be configured to satisfy those requirements. Tr. 307-08; Conf. Jt. Ex. 75.

51. After Best Buy agreed to the blueprint of the warehouse management function, Ms. Rutherford began to configure the SAP software. Tr. 311-12. Ms. Rutherford began in the "golden" client, a system containing no client transactional or master data. Tr. 313. The SAP software module for warehouse management contains "every possible function" available for warehouse management. Tr. 314. To configure the SAP warehouse management module, Ms. Rutherford first eliminated those functions that Best Buy did not require, and set parameters for the remaining functions to reflect Best Buy's needs. Tr. 314-15. Ms. Rutherford then documented the system as it had been configured. Tr. 315. Finally, Ms. Rutherford created a graphical representation of the particular business process underlying the SAP module, including a narrative of the process to be followed. *See, e.g.*, Conf. Jt. Ex. 85 (example of the process of completing home delivery of a product order).

52. Without configuration, the SAP software as delivered would have met some—but not all—of Best Buy's requirements. Tr. 329-30.

53. Once the "golden" client was configured, Ms. Rutherford copied the configuration of the SAP warehouse management module to a unit test client for testing individual functions of

the software. Tr. 319-20. For example, Ms. Rutherford tested the way in which the software had been configured for inventory storage. Tr. 320.

54. A separate team of Best Buy employees and Accenture consultants, led by SAP senior consultant Sankar Ramanathan, created a blueprint for the management of inventory at Best Buy's retail stores, similarly documenting Best Buy's detailed requirements and indicating how the SAP software should be configured to meet those requirements. Tr. 337-39; Conf. Jt. Ex. 76.

55. Mr. Ramanathan then configured the SAP software for management of inventory at Best Buy's retail stores, Tr. 342, and documented that configuration, Conf. Jt. Ex. 86. For example, Best Buy employees had indicated during the blueprinting process that a particular document should be the "default" screen view at a particular step of the process; Mr. Ramanathan configured the SAP software accordingly. Tr. 346-47.

56. Once the individual SAP software modules were configured, the configurations were transferred to the quality assurance (QA) client to test their integration. Tr. 321-22. During integration testing, consultants executed a series of "scripts" that tested particular business processes from start to finish across multiple software modules. Tr. 322. For example, the consultants confirmed that a reduction in a particular item in Best Buy's physical inventory was also reflected in the proper account in Best Buy's accounting system. Tr. 322.

57. Best Buy employees then executed the same test scripts to confirm that the system, as configured, met their requirements. Tr. 324.

58. Finally, the system was loaded with Best Buy's master data and went "live." Tr. 327.

SAP RETAIL'S BILLINGS TO BEST BUY

59. In September 2007, SAP Retail billed Best Buy for the licensed enterprise resource planning software, but did not charge Minnesota sales tax. Stip. ¶¶ 14; Jt. Ex. 7. Best Buy paid the invoice. Stip. ¶ 14.

60. In 2007 and in 2008, Best Buy licensed additional software from SAP Retail, which was not enterprise resource planning software. Stip. ¶¶ 15, 17; Jt. Ex. 8. SAP Retail billed Best Buy for the additional software, but did not charge sales tax. Stip. ¶¶ 16, 18; Jt. Exs. 9, 11.

61. SAP Retail did not bill Best Buy for Minnesota sales tax for the software licenses because it had received a resale certificate (Jt. Ex. 15) from Best Buy Purchasing, LLC, another Best Buy affiliate. Stip. ¶ 23.

62. The Commissioner of Revenue later determined that the resale certificate given by Best Buy Purchasing did not apply to the software licenses because the licenses were not issued to Best Buy Purchasing. Stip. ¶ 24. Best Buy paid sales taxes to the Department of Revenue of \$521,240.46 for sales or use tax on the two software licenses. Stip. ¶ 25.

63. Services performed in accordance with the Professional Services Schedule were provided by SAP Retail on a time-and-expense basis at agreed-upon rates. Stip. ¶ 32. Disbursements by SAP Retail for accommodations, meals, and public transportation for its consultants were to be billed to Best Buy at cost. Stip. ¶ 32.

64. Of the services for which Best Buy paid SAP Retail, and with respect to which the Commissioner assessed sales and use tax, the record shows only 32 hours (totaling less than \$10,000) were performed before August 27, 2007, the date of the Software License Agreement. Jt. Ex. 18 at 4. There is no evidence in the record that those services were necessary to

determine the price of the software licenses, and the services performed before August 27, 2007, are not included on the invoices that are the subject of the sales tax assessments at issue here.

See Stip. ¶ 61.

65. The August 2007 SAP Statement of Work estimated a completion date for SAP's consulting services of October 26, 2007. Jt. Ex. 16 at 1. Changes orders to the Statement of Work, however, extended that completion date. Stip. ¶ 36. Change Order # 1 extended the completion date to February 1, 2008. Stip. ¶ 36; Jt. Ex. 17 at 1. Change Order # 3 further extended the completion date to June 1, 2008. Jt. Ex. 30. (Change Order # 2 added additional SAP consultants to the project but did not extend the completion date. Jt. Ex. 25).

66. SAP Retail billed Best Buy, at an hourly rate that varied by consultant, for services performed by SAP Retail consultants pursuant to the August 2007 SAP Statement of Work and Change Orders # 1, #2, and # 3. Stip. ¶42; Jt. Exs. 18-24, 26-29, 31-39.

67. In addition, SAP consultants incurred travel expenses in connection with their work for Best Buy. Those travel expenses included, among other things, airfare, hotels, ground transportation, and meals. Stip. ¶ 43. SAP's consultants paid for these expenses and were reimbursed by SAP Retail. Stip. ¶ 43. SAP Retail then billed Best Buy for the expenses at cost (that is, without any mark-up). Stip. ¶ 43.

68. SAP Retail billings to Best Buy for consulting services and travel expense reimbursement were separate from its billings to Best Buy for software license fees. *Compare* Jt. Exs. 7, 9, 11, 13 *to* Jt. Exs. 18-24, 26-29, 31-39.

COMMISSIONER ORDERS

69. By order dated May 17, 2010, the Commissioner gave SAP Retail notice of \$721,159.56 in additional sales and use taxes for the period September 1, 2007, through September 30, 2008. Jt. Ex. 124.

70. By letter dated August 10, 2010, SAP Retail administratively appealed the May 17, 2010 order in its entirety. *See* Jt. Ex. 1 at 2.

71. By letter dated March 17, 2011, SAP Retail notified the Commissioner that it was withdrawing its appeal of the taxes calculated on Schedules A, B, D, and E of the Commissioner's May 17, 2010 order. *See* Jt. Ex. 1.

72. On March 23, 2011, the Commissioner issued a Notice of Determination on Appeal, which affirmed in its entirety the Commissioner's May 17, 2010 assessment. Jt. Ex. 1. The Commissioner included in his March 2011 notice a separate summary of interest on the conceded taxes. Jt. Ex. 1.

73. On April 5, 2011, SAP Retail filed with this court its notice of appeal.

74. SAP Retail paid the taxes calculated on Schedules A, B, D, and E of the Commissioner's May 17, 2010 order (Schedules A, B, F, and G of the March 22, 2011 Order) and interest thereon. Stip. ¶ 30. Only the taxes assessed on Schedule C, D, and E of the March 23, 2011 order remain at issue.

CONCLUSIONS OF LAW

1. The consulting services performed by SAP Retail for Best Buy are not among those services specifically subject to sales or use tax under Minn. Stat. § 297A.61 (2012).
2. SAP Retail's consulting services are not subject to sales tax as fabrication labor.

3. The payments received by SAP Retail for consulting services performed for Best Buy, and as reimbursement for travel expenses incurred by SAP consultants, are not part of the sales price of the license for SAP's enterprise resource planning software.

4. SAP's consulting services were not necessary to complete the agreement between SAP Retail and Best Buy for the license of SAP's software.

5. SAP's consulting services do not constitute "installation charges."

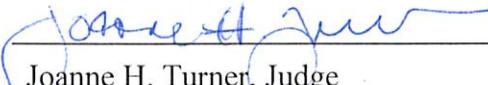
ORDER FOR JUDGMENT

The Order of the Commissioner dated March 23, 2011, is reversed as to the amounts shown on Schedules C, D, and E.

IT IS SO ORDERED. THIS IS A FINAL ORDER. ENTRY OF JUDGMENT IS STAYED FOR A PERIOD OF 30 DAYS FROM THE DATE OF THIS ORDER. LET JUDGMENT BE ENTERED ACCORDINGLY.

BY THE COURT:




Joanne H. Turner, Judge
MINNESOTA TAX COURT

DATED: September 19, 2013

MEMORANDUM

The dispute in this matter is whether services performed by appellant SAP Retail, Inc., to assist in the configuration of its proprietary software for use in the operations of intervenor Best Buy, Inc., are subject to Minnesota sales taxes. We conclude they are not.

SAP Retail licenses enterprise resource planning software. Stip. ¶ 3. Enterprise resource planning software integrates an enterprise's core business functions, such as finance, logistics, and human resources, into a single system with a shared database. SAP Ex. 1 at 10. In addition, SAP Retail provides consulting services, including implementation of its software. SAP Retail, however, is not among the ten largest providers of implementation services for its own software. Tr. 61-62.

In 2007, Best Buy Co., Inc., selected SAP Retail to provide it with enterprise resource planning software for its international and emerging businesses, starting with Best Buy's planned expansion into China, Mexico, and Turkey. Stip. ¶ 9. Effective August 27, 2007, SAP Retail granted Best Buy Enterprises Services (a wholly-owned subsidiary of Best Buy Co., Inc.) a non-exclusive, fully-paid, and perpetual license to use SAP Retail's proprietary software, documentation, and other information. Stip. ¶ 11; Jt. Ex. 4.³

There is no dispute that licensees of SAP Retail's enterprise resource planning software can license the software without SAP's implementation services, and can contract with other companies to implement the software. Stip. ¶ 10. Best Buy had previously outsourced most of

³ Relying on a resale certificate issued in the name of Best Buy Purchasing LLC, another Best Buy subsidiary, SAP Retail did not collect Minnesota sales tax for the software licenses. Stip. ¶¶ 23, 14, 16, 18, 21. The Commissioner ultimately determined that the resale certificate issued by Best Buy Purchasing was not valid with respect to the license fees because the software was not licensed to Best Buy Purchasing itself. Stip. ¶ 24. Best Buy Enterprise Services, the actual licensee, paid sales or use tax related to the software licenses themselves, which taxes are not in dispute here. Stip. ¶¶ 25-30.

its information technology functions to Accenture, a global management consulting and technology services company. Stip. ¶ 8. Nevertheless, in addition to licensing the software from SAP Retail, Best Buy contracted with SAP Retail to perform consulting and professional services (on a time and expense basis) in connection with the SAP software, including support of the software's installation and implementation. Stip. ¶ 13; Jt. Ex. 16. Between September 2007 and September 2008, pursuant to its consulting contract, SAP Retail billed Best Buy for consulting services (at hourly rates that varied by consultant) and for SAP Retail's out-of-pocket expenses for its consultants' travel to and from Best Buy's headquarters in Minnesota. Stip. ¶¶ 37, 39, 41, 42.

By notice dated May 17, 2010, the Commissioner gave SAP Retail Notice of Change in Sales and Use Tax totaling more than \$819,000 including interest. Jt. Ex. 124. The Notice of Change encompasses five categories of taxes and transactions.

First, the Commissioner increased SAP's sales tax liability by \$223,764.64 for sales tax on payments made by Best Buy to SAP for the software license itself. Jt. Ex. 124, Sch. A; *see* Minn. Stat. § 297A.61, subd. 3(f) (2012) (defining "sale" and "purchase" to include "the transfer for a consideration of prewritten computer software").

Second, the Commissioner increased SAP's sales tax liability by \$18,071.93 for sales tax on payments made by Best Buy to SAP for software maintenance fees. Jt. Ex. 124, Sch. B; *see* Minn. R. 8130.9910 (2011) (providing that 20% of the charge for a maintenance contract is subject to sales tax if the maintenance contract is optional and the fee for support services is not separately stated from the fee for upgrades or enhancements to the software).

Third, the Commissioner increased SAP's sales tax liability by \$456,866.90 for sales tax on payments made by Best Buy to SAP for consulting services. Jt. Ex. 124, Sch. C. In doing so, the Commissioner asserted the following:

SAP's R/3 system consists of functional modules, which are configured, assembled and organized into software SAP solutions. SAP ERP implementation is the process of combining different software applications (e.g., human resources, inventory control and financial accounting) into one cohesive software system. The implementation of SAP's ERP systems includes elements of both installation and fabrication; both of which are currently taxable under Minnesota law. Installation labor includes, adjusting or programming an item for use (i.e. configuration), while fabrication labor includes, steps in a process resulting in the production tangible personal property for use. This includes the process of setting control parameters that enable the software to properly work with other software applications as part of an ERP system (i.e. configuration).

Minnesota law provides that arranging preprogrammed modules to form a complete program (Minnesota Regulation 8130.9910, Subpart 2., H) is taxable labor and the combining of two or more "prewritten computer software" programs or prewritten portions of the programs does not cause the combination to be other than "prewritten computer software (297A.61 DEFINITIONS, Subd. 17). As such, charges to combine prewritten computer software (modules) into prewritten computer software, represents fabrication labor because the uncombined prewritten computer software is unsuited for its intended use, until combined. Accordingly, fees for assembling software modules, represents arranging and combining pre-written computer software, which results in the production of prewritten computer software, which is taxable as fabrication modules which are unsuited for use by the customer until combined. This would include labor for the purpose of modifying, designing, scoping, and altering pre-written computer software, for a particular use, the application of labor thereto, represents a sale under the provisions of Minnesota law.

Implementation labor is also consistent with taxable installation charges which is considered a part of a taxable sale (M.S. 297A.61, Subd. 3). Installation labor means labor to set an item into position or to connect, adjust or program it for use, or to add something new or different to an item. Like Fabrication Labor, installation labor is taxable whether provided by the seller of the item or a third party. Accordingly, any software applications, not delivered as a module to an ERP system, are installed in the implementation process. The installation labor is taxable in accordance with Minnesota law.

Jt. Ex. 124 at 4 (citations omitted).

Finally, the Commissioner increased SAP's sales tax liability for Hennepin County sales and use tax and for transit improvement sales tax on the payments made by Best Buy to SAP for software license fees, software maintenance fees, consulting services, and for reimbursement of SAP consultants' travel expenses. Jt. Ex. 124, Schs. D, E; *see* Act of May 26, 2006, ch. 257, § 12, 2008 Minn. Laws 517, 527 (Hennepin County sales and use tax); Act of Feb. 25, 2008, ch. 152, art. 4, § 2, 2008 Minn. Laws 37, 51 (transit improvement sales or use tax).

SAP administratively appealed, in its entirety, the May 17, 2010 Notice of Change. *See* Jt. Ex. 1. During the pendency of the administrative appeal, SAP agreed to pay the sales tax on payments made by Best Buy for the software license itself, and for maintenance of the software. *See* Jt. Ex. 1. SAP Retail has paid these amounts. As a result of these payments, only the Commissioner's assessment of sales tax on payments received by SAP for consulting services and on reimbursement of travel expenses remain at issue. Stip. ¶ 31.

Burden of proof. The Commissioner's orders are considered "prima facie valid." Minn. Stat. § 271.06, subd. 6 (2012). The taxpayer bears the burden of demonstrating that the challenged order is incorrect. *Wybierala v. Comm'r of Revenue*, 587 N.W.2d 832, 835 (Minn. 1998).

A. SAP RETAIL'S CONSULTING SERVICES ARE NOT AMONG THOSE SERVICES SPECIFICALLY SUBJECT TO TAXATION UNDER MINN. STAT. § 297A.61, SUBD. 3(g).

Minnesota assesses a sales tax of 6.5 percent on "the gross receipts from retail sales as defined in [Minn. Stat. § 297A.61, subd. 4 (2012)], made in this state or to a destination in this state." Minn. Stat. § 297A.62, subd. 1 (2012). There appears to be no dispute here that the transaction at issue constitutes a "retail sale," as defined in Minn. Stat. § 297A.61, subd. 4(a) ("any sale, lease, or rental for any purpose, other than resale, sublease, or subrent of items by the purchaser in the normal course of business"). "Gross receipts" is defined as "the total amount

received, in money or by barter or exchange, for all sales at retail as measured by the sales price.” Minn. Stat. § 297A.61, subd. 8 (2012). “Sales price” is defined as: “the total amount of consideration, including cash, credit, personal property, and services, for which personal property or services are sold, leased, or rented,” without deduction for (among other things) “delivery charges” and “installation charges.” Minn. Stat. § 297A.61, subd. 7(a) (2012).

The Commissioner contends that because SAP’s consulting services “are not specifically exempted from taxation by Minn. Stat. [ch] 297A” they are subject to tax. Appellee’s Post-Trial Reply Br. at 2. But we have observed that “[a] limited number of services are enumerated in the statute as taxable.” *D’Amico Catering, Inc. v. Comm’r of Revenue*, Nos. 7488, 7489, 2004 WL 192955, at * 3 (Minn. T.C. Jan. 20, 2004) (observing that the Legislature can “add[] to the list of services to which sales tax applies,” but declining to “read such services as taxable into the statute.”). We similarly decline here to expand the list of taxable services beyond those enumerated in statute. Accordingly, we consider whether the consulting services provided by SAP Retail to Best Buy are among any of the services specifically made subject to sales tax under Minn. Stat. § 297A.61. We conclude they are not.

1. SAP Retail’s consulting services were not used to “fabricate” the SAP software.

“Sale” and “purchase” under Minn. Stat. § 297A.61, subd. 3(c) (2012), includes “the production, *fabrication*, printing, or processing of tangible personal property for a consideration for consumers who furnish either directly or indirectly the materials used in the production, *fabrication*, printing, or processing.” (Emphasis added.) Under Minn. R. 8130.9700, subp. 1, fabrication includes “any operation which results in the creation or production of tangible personal property, or which is a step in a process or in a series of operations resulting in the creation or production of tangible personal property.” In assessing sales tax on payments

received by SAP Retail for consulting services and travel expenses, the Commissioner asserted that those consulting services amounted to fabrication of the SAP software. Jt. Ex. 124 at 4 (“charges to combine prewritten computer software (modules) into prewritten computer software, represents fabrication labor because the uncombined prewritten computer software is unsuited for its intended use, until combined.”). SAP Retail asserts that the Commissioner erred, and we agree.

The Commissioner’s post-trial brief elaborates on the Commissioner’s position. According to the Commissioner, the work of SAP’s functional consultants constitutes “fabrication” because SAP’s functional consultants “investigated the business processes of Best Buy, and created blueprint documents that molded the SAP E[nterprise] R[esource] P[lanning] software into something that would be usable by Best Buy.” Appellee’s Post-Trial Br. at 20. The Commissioner further contends that the work of the functional consultants is subject to sales tax because it included, among other things, “the documentation needed to configure the SAP ERP software; and the end-user documentation for training.” Appellee’s Post-Trial Br. at 20.

Although there is no dispute that SAP’s functional consultants created the documentation needed to configure the software, those services are not subject to taxation. Under Minn. Stat. § 297A.61, subd. 3(c), fabrication is taxable only where the consumer (here, Best Buy) “furnish[es] directly or indirectly the materials used in the . . . fabrication” of the tangible personal property. Even if we assume that the work of SAP’s consultants constituted “fabrication” of the software itself, the Commissioner has not identified the “materials” used to do so. Moreover, to the extent anything constitutes such “materials,” they would be the disks on

which the ERP software was provided to Best Buy, and those disks were furnished by SAP Retail itself (not Best Buy).⁴

Alternatively, the Commissioner contends it is the documentation created by the SAP functional consultants—the blueprints of Best Buy’s business processes and the manuals used to train users of the software—that constitute taxable tangible personal property. *See* Appellee’s Post-Trial Br. at 20. Assuming, again without deciding, that the documentation constitutes tangible personal property, there is no evidence that these materials were furnished *by* Best Buy, as the statute requires. Indeed, there appears to be no dispute by the Commissioner that this documentation was specifically created by SAP Retail *for* Best Buy. *See* Appellee’s Post-Trial Br. at 20 (arguing that the reports and forms created by SAP’s consultants “are created specifically for Best Buy”).

We therefore conclude that SAP Retail’s consulting services are not subject to sales tax as “fabrication.”

2. SAP Retail’s consulting services are not subject to taxation under any of the other provisions of Minn. Stat. § 297A.61.

Under Minn. Stat. § 297A.61, “sale” and “purchase” includes the furnishing for a consideration of certain enumerated services, such as admission to athletic events (subd. 3(g)(1)), hotel lodging (subd. 3(g)(2)), nonresidential parking services (subd. 3(g)(3)), and the preparation of food (subd. 3(d)). The consulting services provided by SAP Retail to Best Buy, however, are not among any of those enumerated services.

⁴ The Commissioner cites Minn. R. 8130.0700, subp. 1 (2013), for the proposition that “producing, fabricating, printing, and processing include any operation which results in the creation or production of tangible personal property, or which is a step in a process or in a series of operations resulting in the creation or production of tangible personal property.” But Rule 8130.0700 is, by its terms, limited to “retail consumers who furnish directly or indirectly the materials used in the production, fabrication, printing, or processing,” just as the underlying statute is.

In summary, we conclude that SAP Retail's consulting services are not among those services specifically made subject to sales tax under Minn. Stat. § 297A.61 or its accompanying administrative rules.

B. PAYMENTS RECEIVED BY SAP RETAIL FOR CONSULTING SERVICES AND TRAVEL EXPENSES ARE NOT PART OF THE SALES PRICE OF THE SOFTWARE LICENSE ITSELF.

Under Minn. Stat. § 297A.62, subd. 7(a) (2012), sales price is defined as “the total amount of consideration, including cash, credit, personal property, and services, for which personal property or services are sold, leased, or rented.” Although not one of the bases on which the Commissioner originally increased SAP’s sales tax liability, *see* Jt. Ex. 124, the Commissioner now asserts through counsel that the amounts received by SAP from Best Buy for consulting services are subject to sales tax because they “are part of the taxable sales price” of the license agreement. Appellee’s Post-Trial Br. at 13. We disagree.

Under the terms of SAP’s Software License Agreement, license fees were enumerated on Appendix 1 to the license agreement itself. Jt. Ex. 4 (Software License Agreement), ¶ 4.1 (“Licensee shall pay to SAP license fees for the Software and Maintenance fees on the terms in Appendices hereto.”); *see* Jt. Ex. 5 (Appendix 1 to Software License Agreement). Fees for professional services were set forth in a separate Professional Services Schedule. Jt. Ex. 4, ¶ 4.1 (“Fees for Services will be paid as set forth in the Professional Services Schedule hereto.”); *see* Jt. Ex. 6 (Professional Services Schedule). Nothing in either the Software License Agreement or the Professional Services Schedule describes the fees to be paid for professional services as license fees. Rather, the two categories of fees are separately described and separately scheduled. We conclude that payments received by SAP Retail for consulting services and reimbursement for travel expenses are not part of the sales price (i.e., the license fee) of the software itself.

The Commissioner bases his argument here on the fact that the Professional Services Schedule, which enumerates the consulting services to be provided by SAP Retail, is annexed to and made part of the License Agreement. More specifically, the Commissioner contends as follows:

The Services Schedule outlines what services, in general terms, [SAP Retail] would provide and how [SAP Retail] would be compensated. The terms of the Services Schedule are a continuation from the License Agreement. . . .

The Services Schedule states that the [Statement of Work], of which a template is attached to the contract, will “more fully describ[e] the project assumptions, scope, duration and fees for the Services shall reference this Schedule.” [sic] The [Statement of Work] executed the same day states that the Services Schedule is “incorporated by reference.” The [Statement of Work] is therefore incorporated into the Services Schedule, which in turn is incorporated into and supersedes the provisions of the License Agreement. It is clear from the terms of the schedules themselves, and the timing of the executions, that the schedules (including the Services Schedule) and the License Agreement were negotiated together and that the Services Schedule was necessary to complete the sale consummated on August 27, 2007.

Appellee’s Post-Trial Br. at 16-17 (citations omitted).

We agree that, by its terms, the Professional Services Schedule is specifically “annexed to and made a part of” the License Agreement. Jt. Ex. 6 at 1. Nor does there appear to be any dispute that the Professional Services Schedule and the License Agreement were, as the Commissioner contends, “negotiated together.” Appellee’s Post-Trial Br. at 17. We further agree that where the Professional Services Schedule and the License Agreement conflict, the provisions of the Professional Services Schedule “shall prevail and govern.” Jt. Ex. 6 at 1. But the Commissioner points us to nothing in either agreement that makes the fees paid under the Professional Services Schedule part of the consideration paid for the licensed software itself.⁵

⁵ Fees paid for professional services could, in different circumstances, be part of the consideration paid for the licensed software. For example, a software developer could require the licensee purchase its services as well, or could discount its software license for customers

Indeed, the testimony of Ronald Kile, SAP Retail’s bid manager, that software and consulting services are “two very separate contracts” and are not discounted even if purchased together, T. 21, was uncontradicted.

Moreover, even if SAP’s software and consulting services had been purchased as a package, SAP’s consulting services would be rendered taxable only if they were “sold for one nonitemized price.” *See* Minn. Stat. §§ 297A.61, subd. 4(m) (2012) (providing that “[a] sale of a bundled transaction in which one or more of the products included in the bundle is a taxable product is a retail sale”), 38(a) (2012) (defining a “bundled transaction” to mean “the retail sale of two or more products when the products are otherwise distinct and identifiable, and the products are sold for one nonitemized price”). In this case, there is no dispute that the two agreements between SAP Retail and Best Buy separately itemize software license fees and professional services fees.

We conclude that payments received by SAP Retail from Best Buy for consulting services and travel reimbursements were not part of the software license fee.

D. OTHER ISSUES RAISED BY THE PARTIES

The parties’ pre- and post-trial briefs address several other issues.

1. SAP Retail’s consulting services were not necessary to complete the license of the software.

The Commissioner contends that because the license and professional services agreements were negotiated at the same time, SAP’s professional services were “necessary to complete the sale” and are therefore part of the sales price of the license under Minn. Stat. § 297A.61, subd. 7(a). Appellee’s Pre-Trial Br. at 6; Appellee’s Post-Trial Br. at 12. We disagree, for several reasons.

who also purchase services and recoup the difference. But neither of these scenarios reflects the facts of this case.

The Commissioner contends that the consulting services to be provided by SAP Retail under the Professional Services Schedule are analogous to the measuring services we found subject to sales tax in *Artistic Drapery Services, Inc. v. Commissioner of Revenue*, No. 7954 R, 2009 WL 1585854 (Minn. T.C. June 3, 2009). Appellee's Post-Trial Br. at 15-16. We disagree. In *Artistic Drapery*, the appellant was "a drapery and reupholstery business." 2009 WL 1585854, at * 2. When Artistic Drapery was hired for a project, it provided the customer with "a written Estimate and Measure Sheet." *Id.* at * 2. Our decision does not specifically describe what was reflected in the Estimate and Measure Sheet but, given the nature of the business and the fact that the amount eventually billed to the customer always "match[ed] exactly the amount due on the Estimate," *id.*, it is apparent that the Estimate and Measure Sheet reflected, for example, the cost of the chosen fabric and the amount of fabric required for the job. The amount of fabric required could be determined only by measuring the customer's windows or the item to be reupholstered. Put another way, Artistic Drapery could not have given the customer an Estimate and Measure Sheet that reflected the precise cost of the project without first taking measurements. We concluded that "measuring charges [were] necessary to complete the sale." *Id.* at * 6. By that, we meant only that measuring charges were necessary to determine the sales price and, thereby, the terms of the contract between Artistic Drapery and its customer. See *id.* at * 5 (finding that Artistic Drapery's "sale to the purchaser" occurred "when the customer received the Estimate.").

Of all the consulting services for which SAP Retail billed Best Buy, only a single consultant (John Behn) appears to have provided any services (32 hours) before the License Agreement was signed. Jt. Ex. 18. There is no evidence in this record that Mr. Behn's services—or the services of any other SAP consultant—were necessary to determine the price of

the software licenses. Nor is there any evidence that any of the consulting services provided by SAP Retail were necessary to determine the cost or terms of the License Agreement itself.

Moreover, it is undisputed that licensees of SAP's software can contract with other companies for implementation services. Stip. ¶ 10. In fact, given that SAP is not among even the ten largest providers for implementation services for its own software, contracting with SAP itself is necessarily the exception, rather than the rule; the testimony of Mr. Kile that SAP's software and consulting services are not sold together is undisputed.

Further, given that Best Buy desired SAP to provide consulting services during Accenture's installation of the SAP software, it is hardly surprising that Best Buy and SAP negotiated the license and consulting agreements at the same time. Contemporaneous negotiation, however, does not render the consulting agreement part of the license agreement. Again, Best Buy could have contracted with another firm for consulting services, or done without such services entirely. We find that the license agreement and consulting agreement are distinct, albeit contemporaneous.

2. SAP's consultants did not install the software.

Similarly, the parties argue at length over whether SAP Retail's consultants installed the SAP software. According to the Commissioner, the cost of installation labor is part of the sales price "when that labor is part of a taxable sale." Appellee's Pre-Trial Br. at 6. Accordingly, the Commissioner asserts, "[i]nstallation charges are part of the sales price, even if separately stated." Appellee's Pre-Trial Br. at 6. But we have already concluded that the payments received by SAP Retail for consulting services are not part of the sales price of the software itself.

Moreover, even if installation charges are part of the sales price, SAP's consultants did not install the software. It is undisputed that Best Buy contracted with Accenture, not with SAP, for installation of the software. It is further undisputed that Accenture consultants physically installed the software, and it is undisputed that SAP's consultants lacked the system authorizations necessary to have installed the software.

The Commissioner contends that what SAP's consultants did amounted to installation of the SAP software, citing testimony of Mr. Walekar that the Best Buy and Accenture consultants with the necessary system authorizations lacked the knowledge to install the software on their own. Appellee's Post-Trial Br. at 18 (arguing that “[t]he database team's contribution was its security clearance only” and that only SAP's basis consultants had the “level of knowledge and expertise necessary to the installation of the software.”). Mr. Walekar testified that the SAP consultants “would take the installation guide with us, and the installation guide would tell all the detailed steps in there, and we would basically stand next to [the basis consultant] and tell them what to click on a screen . . .” T. 213. In other words, there is no evidence that the assistance provided by SAP's consultants amounted to anything more than the installation assistance provided in the SAP installation guide. We do not find this to be “installation” within the meaning of Minn. Stat. § 297A.61, subd. 7(a).

The Commissioner further asserts that, when it comes to software, “installation includes tasks such as loading parameters to initialize program settings and arranging preprogrammed modules of the [] software to form a complete program.” Appellee's Pre-Trial Br. at 7 (citing Minn. R. 8130.9910, subp. 2.H. (2013)). We read Rule 8130.9910, subp. 2.H., differently.

Subpart 2 of Rule 8130.9910 distinguishes between “canned or prewritten” software programs (subp. 2.A.) and “custom” computer programs (subp. 2.B.). The former is subject to sales tax, the latter is not. Rule 8130.9910, subp. 2.H. then provides, in pertinent part:

Examples of services that do not result in custom software include loading parameters to initialize program settings and arranging preprogrammed modules to form a complete program.

No tax results when the modifications to existing prewritten software are required to meet the customers’ specific needs. These modifications are considered to be custom programming.

We find nothing in Rule 8130.9910 that defines “loading parameters to initialize program settings and arranging preprogrammed modules to form a complete program” as “installation.” Nor do we find anything in Rule 8130.9910 that itself makes “loading parameters to initialize program settings and arranging preprogrammed modules to form a complete program” otherwise taxable services.⁶ Rather, we read the rule as saying only that services such as “loading parameters to initialize program settings” and “arranging preprogrammed modules to form a complete program” do not make otherwise “canned” or “prewritten” software nontaxable as custom software. There is no dispute here that SAP Retail’s software is itself subject to sales tax. In other words, SAP Retail does not contend here that its software is custom software not subject to sales tax.

3. Issues we do not reach.

Finally, because we conclude that SAP Retail’s consulting services and reimbursements received for travel expenses are not subject to sales tax, we need not (and do not) address

⁶ In contrast, as we noted earlier, Minn. R. 8130.9910, subp. 2.K., specifically provides that “[p]rogramming changes to a canned or prewritten computer program to adapt it to a customer’s equipment . . . are in the nature of fabrication labor and are taxable.” In other words, the drafters of the Rule could have explicitly provided that “loading parameters to initialize program settings and arranging preprogrammed modules to form a complete program” are “in the nature of fabrication labor and are taxable,” but did not.

whether SAP Retail's consulting services were properly sourced to Minnesota; whether a multiple points of use (MPU) certificate relieved SAP Retail of the obligation to charge sales tax; and whether imposing sales tax on payments made by Best Buy to reimburse SAP Retail for airfare violates 49 U.S.C. § 40116 (2006).

In summary, then, we conclude that the consulting services performed by SAP Retail's consultants are not subject to sales tax, whether as part of the license fees paid for the SAP software or independently.

J.H.T.