

**STATE BOARD OF EQUALIZATION**

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November 30, 1987

Mr. F--- H---  
XXX --- --- Ave.  
--- ---, CA XXXXX

Dear Mr. H---:

Your letter regarding special employees to Assistant Chief Counsel Gary Jugum dated September 30, 1987, has been referred to me for response. You state:

“A contract staffing agency has indicated to me that a concern exists at to potential tax liability on their part. The firm has taken over all employees of the art department of a multi-national company and in effect ‘leases’ them back to the use company, charging the payroll rate plus a small percentage to cover profit and overhead.

“The user company may hire and fire at will, set the hourly salary rates for the employees, and directs, supervises and controls the product and output of the personnel. The contract staffing agency merely acts as a payroll processing company, but treats the employees as its own for state and federal payroll taxes, withholding, FICA, etc. purposes.

The purpose of this scheme is to enable the user company to escape including highly paid artistic personnel in pension, profit sharing, and benefit plans. In addition, if there is little or no need for the art department in the future, the use company would be under no obligation to give severance pay to the ‘leased’ personnel.

“I would appreciate having your guidance in this area concerning any potential sales tax liability on the part of the employee-leasing company.”

As Mr. Jugum explained in his letter to you dated June 1, 1987, when a “customer provides the premises where the work is done, tools used, and the raw materials, and if the charge is at an hourly rate, the person performing the [fabrication] work may qualify as a ‘loaned employee.’” If the “lease” arrangements satisfy these requirements, including the requirement that the user company pays the contract staffing agency an hourly rate for the “leased” employees, the person

performing the work might qualify as a "loaned employee." However, the charges made by the contract staffing agency with respect to fabrication labor for a consumer will be treated as taxable gross receipts unless 1) the customer has other persons who clearly are employees performing similar work, or 2) the customer employs persons who are capable of giving meaningful direction to the "loaned employees" beyond describing only the result desired.

If you have further questions, feel free to write again.

Sincerely,

David H. Levine  
Tax Counsel

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