

STATE OF CALIFORNIA
BOARD OF EQUALIZATION

120.0564

In the Matter of the Petition)
for Redetermination Under the) DECISION AND RECOMMENDATION
Sales and Use Tax Law) OF HEARING OFFICER
)
C--- I--- CORPORATION)
)
) Account No. SR -- XX XXXXXX-010
Petitioner)

The above entitled matter came on regularly for hearing on Monday, September 24, 1979, in Sacramento, California. James E. Mahler, Hearing Officer.

Appearing for Petitioner: None

Appearing for S---
C--- E---: Mr. J--- W. E---
Assistant Counsel

Mr. F--- C. R---
Tax Accountant

Mr. E. R. Y---
Computer Operations Manager

Appearing for the Board: Mr. Francis Jordan
Auditor

PROTEST

Petitioner protests a determination of sales tax deficiency for the period October 1, 1975 through December 31, 1978. The protested taxes are measured by:

	<u>State, Local and County</u>
Taxable fabrication labor charges to S--- C--- E--- not reported.	\$1,002,272

CONTENTIONS

1. Petitioner provided "special employees" to its customer.
2. The employees performed "transcription services" and not "fabrication labor".

3. Even if some tax is due, charges where no supervisor was provided or where the employees worked on the day shift should be deleted from the audit.

SUMMARY

Petitioner is a corporation operating a keypunching and keystroking business. It owns no equipment and all work is done on its customer's equipment. This is its first sales and use tax audit.

In April 1973 petitioner entered into a three-year contract to do keystroking for the S--- C--- E--- Company (S---). The contract was renewed and extended for another three years in April 1976. Insofar as they are relevant here, the terms of the renewed contract are as follows.

Petitioner agreed to "provide a second shift data entry staff complete with supervision". Payment was to be at a monthly rate for data coordinators, data controllers and operators, plus hourly overtime for operators, the total not to exceed a specified amount. Petitioner agreed to "perform this work and services as requested and directed by" an S--- employee, and also that "the performance of work and services...shall meet the productivity standards for comparable work used and achieved by S---". The agreement state that neither petitioner nor its employees would be considered employees of S---.

A memo on petitioner's letterhead dated July 19, 1976, provided that the second shift supervisor was responsible for the "direct supervision of all personnel and production scheduled on the shift". Specifically, the supervisor was to assist S---'s manager in setting up work schedules for the shift, "control" incoming work and assign it to operators and examine and release completed work. The duties also included the directing, counseling and coordination of all operators on the shift and the keeping of performance records.

After consulting the Board's legal staff, the auditor determined that petitioner's keystroking activities consisted of fabricating tangible personal property and were therefore subject to tax. The contention that petitioner merely provided "special employees" was rejected, primarily because petitioner had contracted to provide supervisory personnel along with the data entry staff.

At the preliminary hearing, S---'s representatives presented a more detailed explanation of the contract with petitioner. They explained that the work done under the contract consisted of transcribing or keystroking data from source documents to magnetic computer discs. Most of this work was done by petitioner's own employees on the day shift. However, the amount of work fluctuated greatly, and there was always some overflow which the day shift could not handle. S--- did not want to hire additional personnel directly to do the overflow work, since the keystroking workload was expected to diminish in the future and S--- would then have to lay off the extra personnel. Therefore, S--- contracted with petitioner to provide the necessary personnel on a temporary basis.

Each morning S---'s manager of computer operations would assign tasks for both the day and night shifts. He also allocated additional work to the night shift in case they finished the assigned tasks early. Depending on the workload, petitioner supplied from 3 to 25 operators for the night shift. In addition, petitioner sometimes provided operators for the day shift on a fill-in basis.

Petitioner provided a supervisor for the night shift only if 6 or more operators were provided. The supervisor received the work assignment from S---'s manager, ensured that enough operators were available to do the work, and parceled the work out to individual operators. She also reviewed the operator's work to make sure it was done correctly.

The auditor regarded amounts derived from such contracts under the guise of charter membership charges and annual account maintenance charges as receipts attributable to petitioner's sales of goods which were subject to sales tax. As petitioner did not report or pay sales tax with respect thereto, those amounts were established as the taxable measures of Item B.

ANALYSIS AND CONCLUSIONS

The fabrication of customer furnished property for a consideration is defined as a "sale" under Revenue and Taxation Section 6006(b). However, in certain limited situations where a taxpayer performs labor on the customer's premises, the Board has recognized that a "sale" might not occur even though the labor would otherwise be regarded as taxable fabrication. This is the so-called "special employee" doctrine, where the transaction is regarded as a furnishing of services rather than as a fabrication sale.

The Board has previously ruled that recording information on magnetic tapes or discs supplied by the customer is a fabrication sale. (See Sales & Use Tax Reg. 1502(c)(2).) Therefore, petitioner's keystroking activities are subject to tax, unless petitioner was only furnishing special employees.

The distinction between a fabrication sale and a special employee situation depends upon the contractual relationship between the taxpayer and its customer. Basically, if the taxpayer contracts to create or produce tangible personal property, the transaction is a fabrication sale. But if the taxpayer contracts only to provide personnel who will work under the direction and control of the customer, the transaction has special employee status.

In this case, petitioner contracted to do keystroking work for SCE. This work was normally done by S---'s own employees, and petitioner was only hired for the overflow work. Although petitioner agreed to provide a supervisor, the contract expressly stated that the work would be performed "as requested and directed by" an S--- employee. In fact, all work was assigned by S---'s manager of computer operations. Petitioner provided a supervisor only when the number of operators exceeded a certain amount. The supervisor was generally responsible for seeing that the work was done, but did not determine what work was done or the specific details of how the work was done. Accordingly, it is concluded that petitioner provided special employees to S--- and did not make fabrication sales.

Recommendation

Delete the protested item from the measure of tax. Necessary adjustments are to be initiated by Headquarters Petition Unit.

JAMES E. MAHLER, HEARING OFFICER

12/19/79

Date