

M e m o r a n d u m**120.0563.950**

To: San Jose Auditing (PMS)

Date: November 22, 1977

From: Tax Counsel (GJJ) - Headquarters

Subject: N--- Corporation
XXX --- ---
--- ---, CA XXXXX

SR -- XX-XXXXXX

This is in response to your memorandum of September 27, 1977. A question has arisen during the course of the audit of the referenced taxpayer as to whether taxpayer is making sales of tangible personal property under paragraph (f)(2) of Regulation 1502 concerning automatic data processing services or whether taxpayer is only furnishing "special employees" to its customers.

Regulation 1502(f)(2) provides, in part, that tax applies to the sale of custom programs transferred to the customer in the form of punched cards, or in tape, disc, drum, or similar form. If taxpayer is performing programming services for its customers which result in the production of normal programming media such as cards or tapes, taxpayer is selling tangible personal property. If taxpayer provides technical assistance to its customers, and the programmers provided work under the direction and control of the customers, then taxpayer has not made a sale of tangible personal property notwithstanding the fact that the taxpayer may physically cause to be prepared the programming media.

It is clear that the people employed by taxpayer are not also employees of the customers. However, they may be regarded under appropriate circumstances as "special employees." Generally we have said that where a company provides only workers to an independent business without furnishing the place of work, any supervision of the workers or any materials, tools, equipment, or supplies used in performing the work and the payment for the work is based merely on an hourly rate for the labor, the workers furnished will be considered "special employees" of the business to whom they are furnished, and the furnisher will not be considered as fabricating personal property under Revenue and Taxation Code Section 6006(b).

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Relevant to a consideration of the issues before us is the general distinction drawn between employees (servants) and independent contractors.

An independent contractor is one who renders service in the course of an independent employment or occupation. He follows his employer's desires only in the result of the work, and not in the means whereby it is to be accomplished.

A servant is distinguished from an independent contractor as one who is employed to render personal service to his employer, and who in such service remains entirely under the control and direction of the employer, who is called his master.

In determining whether one who performs services for another is an employee or an independent contractor, the most important factor is the right to control the manner and means of accomplishing the result desired. Other factors that may be considered are whether or not the one performing services is engaged in a distinct occupation or business; whether, in the locality, the work is usually done under the direction of the principal or by a specialist without supervision; the skill required in the particular occupation; whether the principal or the workman supplies the instrumentalities, tools, and place of work; the length of time for which the services are to be performed; the method of payment, whether by the time spent or by the job; whether or not the work is part of the regular business of the principal; and whether or not the parties believe they are creating the relationship of employer-employee.

Of the many factors that enter into determining whether one performing services for another is an independent contractor or the other's servant, the primary one is whether the person for whom the work is done has the legal right to control the activities of the person doing the work. If the employer has the authority to exercise complete control, whether he actually exercises it or not, an employer-employee relationship exists. But if the person employed has the right to control the mode of doing the work, he is an independent contractor.

Ordinarily, whether an employee has or has not the right of control must be determined from the contract of employment. But where no express agreement is shown as to the right of the employer to control the mode and manner of doing the work, the existence or nonexistence of the right must be determined by reasonable inferences drawn from all the circumstances, including the relationship and character of the parties, the nature of the work to be done, the time in which it is to be completed, and the conduct of the parties toward each other with reference to the subject of the contract.

Although the manner of paying one engaged to do work is not decisive of his status, it is an element that has some bearing on the question. Thus, ordinarily, an agreement for the payment of compensation for the performance of work is indicative of an employer-employee relationship when the recompense is made proportionate to the amount of labor involved. If, on the other hand, the compensation is a specific recompense for a designated result, a different conclusion is indicated.

An employer's furnishing of his own servants to one agreeing to perform certain work for him does not conclusively show that the contractor is a servant of the employer, and this is true though the servants so furnished remain in the general employ of the employer.

The fact that the employer remains in possession of premises on which a contractor works does not relieve the independent contractor of his status.

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You have furnished us with five sets of documents which taxpayer has submitted to support claimed exempt transactions.

M--- S--- Corporation

Taxpayer undertook "Development of I--- Interface" and "Digitizing, computer runs, etc." for its customer at an hourly charge. Other billings indicate charges for "support of C--- facility" and "computer expenses" and "computer usage." M--- S--- has furnished us with a letter dated July 5, 1977, stating that "N--- Corporation performed digitizing services at M---'s C--- facility.... The digitization work, as well as a generation of plotting tapes at S--- D--- C--- in [city], were performed on an hourly basis under the direct supervision of M---'s personnel."

It is difficult to determine the proper application of the tax based upon a review of the fragmentary documents available. It would appear that taxpayer undertook to develop a custom program for its customers' use and that taxpayer converted the program into useful machine readable form. The billing suggest to us that taxpayer undertook to furnish a product to its customer and not merely hourly help. Notwithstanding the declaration of the customer as to "direct supervision," we are of the opinion that taxpayer has made a taxable sale of tangible personal property.

M--- Corporation

Taxpayer billed its customer a flat fee of \$186 for programming and testing its customers' "Fixed Assets System to MARS System interface program."

Clearly taxpayer did not undertake to provide technical personnel to work under the direction of its customer but undertook to furnish a completed operating program in machine readable form. The tax applies.

F--- S---, Inc.

Taxpayer billed its customer for "analysis and programming services performed by Mr. R--- W--- for Mr. D--- H---." The charge was on an hourly basis. The customer now alleges that the work was performed "under direct supervision of F--- personnel." The matter is not free from doubt and may bear closer scrutiny, but the billing is consistent here with the claim that

taxpayer undertook to provide no finished product but to provide technical personnel to work at the direction of the customer.

M--- C--- P---

The customer's purchase order provides as follows:

“Contract programming as required by M--- C--- P--- in accordance with the terms, conditions, provisions and specifications of Consultant Agreement dated 9/5/73 between M--- C--- P--- and N--- Corporation.”

Taxpayer billed the customer on an hourly basis for the work performed by three of its employees.

Gross receipts are presumed subject to tax until the contrary is established. Absent taxpayer's providing us with a copy of the consultant agreement there is insufficient evidence to support a necessary conclusion that the transaction is not taxable.

R--- Corporation

Customer's purchase order indicates as follows:

“DESIGN AND IMPLIMENT THE ‘PROJECT MANAGEMENT SYSTEM’ AS DESCRIBED IN THE ATTACHED ‘SERVICES AGREEMENT’ SIGNED 7/18/72.

BASIC SYSTEM

TIME UTILIZATION REPORTING

COST ACHIEVEMENT REPORTING”

The “Services Agreement for Project Management System” provides as follows:

“R--- wishes to purchase and N--- wishes to sell a software package to be developed for R--- by N--- which is a Project Management System, hereafter called ‘System.’”

The agreement further provides that “R--- shall have exclusive title to all documents and programs developed hereunder.”

The programming tasks were performed on an hourly basis “with a not to exceed fee limit.”

Clearly taxpayer undertook to furnish an operating system. It is irrelevant that the work was done at R---'s facilities. R--- Corporation's statement that the work was performed "under R--- direction and supervision is self-serving, is after the fact and is not conclusive.

J:alicetilton