STATE OF CONNECTICUT
DEPARTMENT OF REVENUE SERVICES
25 Sigourney Street
Hartford CT 06106-5032

PS 2007(7)

POLICY STATEMENT

Taxation of Services by Employment Agencies and Agencies Providing Personnel Services

Purpose: This Policy Statement provides Department of Revenue Services (DRS) guidelines for imposing sales and use taxes on services by employment agencies and agencies that provide personnel services under Conn. Gen. Stat. §12-407(a)(37)(C).

It defines the term employee, provides more detail about determining whether a contract is for personnel services or for another service, and discusses the exclusion for professional employee organizations, which is in addition to the exclusion for leased employees.

It explains the terms leased employee and professional employer organization and other requirements for excluding from gross receipts and sales price certain amounts paid with respect to leased employees and employees of professional employer organizations.

Effective Dates: Effective when issued and applicable to all open tax periods except that:

- The exclusion of certain amounts paid for leased employees described in this publication applies only to sales of services occurring on and after July 1, 1997; **and**
- The exclusion of certain amounts paid to professional employer organizations described in this publication applies only to sales of services occurring on and after July 1, 2000.

Statutory Authority: Conn. Gen. Stat. §§12-407(a)(2)(I); 12-407(a)(1), (8), (9), (31) through (33); 12-407(a)(37)(C); and Conn. Agencies Regs. §12-426-27(b), (g), and (h).

Agencies Defined: The term ***agencies***, as used in Conn. Gen. Stat. §12-407(a)(37)(C), includes but is not limited to service providers generally recognized as employment agencies and temporary help agencies. Any person, as defined in Conn. Gen. Stat. §12-407(a)(1), providing services that fit the descriptions of taxable services described in this Policy Statement is an agency for purposes of Conn. Gen. Stat. §12-407(a)(37)(C).

Employee Defined: The criteria for determining whether staff is an employee or an independent contractor for federal tax purposes also apply for Connecticut tax purposes. Whether a Form W-2 or a Form 1099 is supplied to an individual therefore does not control. Internal Revenue Service Publication 15-A, Employer's Supplemental Tax Guide, summarizes the criteria for determining whether an individual is an employee as defined under the common law and these criteria apply when reviewing an individual's status for purposes of the Connecticut sales and use taxes on personnel services. The existence of an employer-employee relationship is determined by the substance of the relationship, not the label, and all information that provides evidence of the degree of control and the degree of independence must be considered.

Services by Employment Agencies: Conn. Agencies Regs. §12-426-27(b)(3)(b) describes taxable services by employment agencies as follows:

> ***Employment services*** mean and include the procurement or offer to procure for a consideration: Jobs or positions for those seeking employment, or employees for employers seeking the services of employees.

Two common employment agency services occur when an agency attempts to:

- Obtain a job for a job seeker; **or**
- Find an employee for an employer.

Employer-employee relationship: To provide a taxable service, an employment agency must procure or offer to procure an actual employee with the intention of creating a permanent employer-employee relationship between the service recipient (the employer) and the person seeking the job. Similarly, when an employment agency procures or offers to procure jobs or positions for those seeking employment, to be taxable the service must result in or be intended to result in a permanent employer-employee relationship between the service recipient (the job seeker) and an employer.

Agents for independent contractors: Agencies that assist musicians, entertainers, or others in any way (as agents, brokers, or otherwise) in the procurement of jobs, typically on a short-term or one-time basis, when the job seekers are and will remain independent contractors, are not performing taxable employment agency services. These services are not intended to create a permanent employer-employee relationship.

Taxable charges of employment agencies: The amount subject to sales and use taxes for services by employment agencies is the total fee or commission charged by the service provider for procuring or offering to procure a job for a service recipient either an employer or a job-seeker, whether the amount is ultimately paid by the service recipient, a third party, or both.

Agencies Providing Personnel Services: Conn. Agencies Regs. §12-426-27(b)(3)(c) describes taxable personnel services as follows:

> ***Personnel services*** mean and include furnishing temporary or part-time help to others by means of employing temporary and part-time help directly.

Personnel services are different from employment agency services. Personnel services involve placing a service provider's own employee with a service recipient and having that employee act as the employee of the service recipient during the time the employee is placed. Typically, the temporary employees are provided to support or supplement a service recipient's workforce. However, even if a service recipient has no workforce of its own, it may purchase taxable personnel services.

Necessary elements of a personnel service: The two necessary elements of a taxable personnel service are:

- A service provider must directly employ employees who will furnish temporary or part-time help to a service recipient; **and**
- While an employee is with the service recipient, the service recipient must have control over the work the employee does as well as how the work is done within the general parameters of the type of personnel service contracted for (for example, clerical or accounting).

To determine whether an employee functions as the employee of a service recipient, it is necessary to examine who controls the means and method of the employment during the time the employee is with the service recipient. The element of control over what is done and how it is done differentiates between a service recipient that receives the services of a temporary or part-time employee (such as to support or supplement the service recipient's workforce), and a service recipient that receives a specific predetermined service or task that will be performed by an employee of the service provider. In making this determination, service providers and service recipients should not rely only on the fact that the service recipient exercises control over superficial aspects of the employee's work, such as days or hours of attendance and other rules of general conduct in the workplace.

Although there are no invariable guidelines in this area, the more control the service recipient has over the service provider's employee's duties while the employee is with the service recipient, and the less that employee's duties are related to a predetermined task or project, the more likely the services are personnel services. Conversely, the more the duties performed by the employee fulfill a project or task predetermined by the service provider and the service recipient, and the more control the service provider has over the employee's duties while the employee is with the service recipient, the less likely the service is a personnel service.

Example 1: A medically incapacitated individual engages a nursing agency to provide a nurse to care for and assist in the individual's recovery. The nurse is an employee of the agency. The duties, of which light housekeeping and meal preparation are relatively small components, are prearranged between the agency and the individual. The nurse's responsibilities and conduct are prearranged and are prescribed and controlled by the agency not by the individual. The agency is rendering nontaxable nursing services, not taxable personnel services.

Example 2: A bank hires a service provider to merge two computer systems by converting all the files of an old system onto the new system. The bank and the service provider have predetermined the scope of this project. The service provider places several of its

employees at the bank to perform the conversion project. These employees work alongside the bank's employees, work the same hours as the bank's employees, and often take their breaks and lunch periods with the bank's employees. The service provider is rendering computer and data processing services taxable at the current rate for those services, not taxable personnel services.

Employee leasing: ***Leased employees*** are temporary employees supplied to supplement, and often to replace, all or part of a service recipient's workforce. Sometimes leased employees were former employees of the service recipient and have become employees of the employee leasing company without changing work locations. Employee leasing is a taxable personnel service and providers of leased employees are agencies providing personnel services under Conn. Gen. Stat. §12-407(a)(37)(C). An employee leasing company may be a professional employer organization (PEO) if it meets certain statutory criteria as described in the following section.

Taxable charges of agencies providing personnel services: In general, the amount subject to sales and use taxes for agencies providing personnel services is the entire charge by the service provider to the service recipient. It includes compensation of the employee and all expenses related to the compensation whether or not separately stated by the service provider in its contract or on its bill or invoice to the service recipient. However, there are limited statutory exclusions from sales and use taxes on charges for leased employees and worksite employees of PEOs.

Exclusions for Leased Employees and PEO Worksite Employees: Two special provisions in Conn. Gen. Stat. §12-407(a)(8)(B)(viii) and (9)(viii) exclude some of the charges of a personnel service provider from sales and use taxes. Charges for all separately-stated compensation, fringe benefits, workers' compensation and payroll taxes (payroll-related expenses) paid to or on behalf of leased employees and worksite employees of a PEO are excludible from the tax on personnel services. Any administrative fees or other charges by a service provider (other than payroll expenses), whether or not they are separately stated, and the markup or profit portion, if any, of a service provider's charges for leased employees or PEO worksite employees are subject to tax.

Separately-stated requirement: To qualify for either of the payroll-related expense exclusions, the charges for payroll-related expenses must be clearly separately stated in the contract when services are first provided or on the periodic bills or invoices from the service provider to the service recipient. If a service provider fails to clearly separately state payroll-related expenses as required, these charges do not qualify for the exclusions and are subject to sales and use taxes.

Leased employee exclusion: For sales and purchases of leased employees **on and after July 1, 1997**, separately-stated, payroll-related expenses of a leased employee may be excluded from sales and use taxes.

For this exclusion, a ***leased employee*** is:

- An employee provided to a service recipient at the beginning of a contract by a service provider under which at least 75% of the employees under the initial contract qualify as leased employees under Internal Revenue Code (I.R.C.) §414(n), as amended; **and**
- Any employee added to the service recipient's workforce by the service provider after the initial qualifying contract begins.

To be a leased employee under I.R.C. §414(n), an employee must have completed at least one year of continuous service for the service recipient (or for the service recipient and related persons) on a substantially full-time basis. The year of full-time continuous service may be met by the employee's direct employment by the service recipient, the employee's employment by the service provider, or by a combination of both at the service recipient's workplace during the year immediately before the initial employee leasing contract begins.

Employees added to the workforce by the service provider after the contract begins need not have worked for the service provider or service recipient for one year and need not work full-time. These employees may replace existing employees under the initial contract or may supplement the number of employees provided under the initial contract.

Example 1: On July 1, 1995, a service provider contracted with a service recipient to provide 50 leased employees to the service recipient. At the beginning of the contract, 40 (80%) of the employees had worked full-time for the service recipient for over one year. The other ten employees either had worked for the service recipient for less than one year or had worked only part-time. On and after July 1, 1997, the

service provider can exclude the separately-stated charges for payroll-related expenses paid to or on behalf of all 50 contract employees from sales and use taxes. The separately-stated, payroll-related expenses of any additional employees hired under the contract by the service provider qualify for the exclusion as soon as they are hired or on and after July 1, 1997, whichever is later.

Example 2: On July 1, 1995, a service provider contracted with a service recipient to provide 50 employees to the service recipient. At the beginning of the contract, 30 (60%) of the employees had worked full-time for the service recipient for over one year. The other 20 employees either had worked for the service recipient for less than one year or had worked only part-time. During the next two years, the other 20 employees and 10 ten replacement employees qualified as leased employees by completing one year of substantially full-time employment. On and after July 1, 1997, **none** of the employees under the 1995 contract qualify for the exclusion because at the beginning of the contract in 1995 fewer than 75% of the employees qualified as leased employees. On July 1, 1999, the service provider entered into a new contract (not merely an automatic renewal of the old contract) with the service recipient involving the same employees. All the employees and any additional employees hired under the new contract qualify as leased employees on and after the date of the new contract because at the beginning of the new contract at least 75% of the employees qualified as leased employees. On and after July 1, 1999, the service provider can exclude the separately-stated charges for payroll-related expenses paid to or on behalf of all of these employees from sales and use taxes.

In summary, if at the beginning of an employee leasing contract at least 75% of the employees provided under the contract qualify as leased employees (having completed at least one year of continuous employment on a substantially full-time basis for the service recipient, the service provider, or both), then **all** the employees provided under that initial contract and any full-time or part-time replacement or supplemental employees qualify for the exclusion from tax on separately-stated, employee-related expenses for sales of leased employees on or after July 1, 1997, even if the contract began before that date. A service provider need not call itself an employee leasing company to qualify for this exclusion.

PEO worksite employee exclusion: For sales and purchases of worksite employees of a PEO **on and after July 1, 2000**, separately-stated charges for payroll-related expenses of the employees may be excluded from sales and use taxes.

For this exclusion, a ***worksite employee*** of a PEO is an employee who is provided by a PEO under a professional employer agreement at premises owned or operated by the service recipient including campus type facilities.

Example 1: A manufacturer's sales and administration divisions are located in one building in Town A and its manufacturing plant is located in Town B. Each of these locations is a separate worksite.

Example 2: A manufacturer owns a five-acre campus containing a number of buildings for its various divisions. The entire campus is one worksite.

A ***professional employer agreement*** is a written contract between a PEO (service provider) and a service recipient where the PEO agrees to provide at least 75% of the employees at the service recipient's worksite. The contract must provide that the worksite employees are intended to be permanent employees at the worksite and that the employer responsibilities will be allocated between the PEO and the service recipient. However, the employees remain the employees of the PEO. For the exclusion to apply, at least 75% of the employees at the service recipient's worksite must be provided by the PEO throughout the term of the contract. To be a PEO, a service provider need not call itself a PEO, but needs only to have a written contract with a service recipient that meets these requirements.

Unlike the leased employee exclusion, the PEO worksite employee exclusion does not require any employees to be leased employees as defined in the Internal Revenue Code. The only requirement is a contract between a PEO and a service recipient to provide at least 75% of the employees at the service recipient's worksite, as more fully described above. If this requirement is met, all employees provided under the professional employer agreement qualify for the exclusion on and after July 1, 2000, even if the contract began before that date. If a PEO hires additional employees to replace or supplement the initial worksite employees provided under the contract, then the additional or replacement employees qualify for the exclusion for the duration of the contract, as long as the contract continues to provide at least 75% of the total employees at the service recipient's worksite.

Example: On July 1, 1999, a service provider calling itself a corporate staffing company contracted with a service recipient to provide 80 employees as permanent employees at the service recipient's worksite. The contract allocated employer responsibilities between the service provider and the service recipient. The service recipient had 100 employees at its worksite including the 80 employees provided under the contract. Thus, the contract provided 80% of the service recipient's total employees at the worksite. As long as the number of employees under the contract remains at least 75% of the total employees at the service recipient's worksite, all of the employees working under the contract and any supplemental or replacement employees qualify for the payroll-related expense exclusion for services provided on and after July 1, 2000, because the service provider is a PEO and the contract is a professional employer agreement. However, if the service recipient hires an additional 30 employees of its own outside the corporate staffing contract with the result that the number of employees provided under the contract falls below 75% of the total worksite employees, the corporate staffing contract no longer qualifies for the payroll-related expense exclusion as of the time the contract fails to meet the 75% threshold.

Leased employee and PEO worksite employee exclusions exist simultaneously: On and after July 1, 2000, the exclusions for leased employees and PEO worksite employees described above are both in effect. Service providers and recipients may avail themselves of whichever of the two exclusions they qualify for. Service providers need not call themselves employee leasing companies or PEOs so long as they meet the statutory requirements for one of the exclusions.

The requirements for the leased employee exclusion and the PEO worksite employee exclusion have an important difference. For the leased employee exclusion to apply, at least 75% of the employees under contract at the beginning of the contract must qualify as leased employees regardless of how many total employees the service recipient has and regardless of what percentage of the employees under the contract remain leased employees. For the PEO worksite employee exclusion to apply, the contract must provide at least 75% of the total employees at the service recipient's worksite for as long as the contract is in effect.

Sourcing of Services: The rules for sourcing employment agency and personnel services in Conn. Agencies Regs. §12-426-27 follow.

Employment agency services: Subsection (g) of the regulation states:

> [E]mployment services are taxable if the agency rendering such services procures a job or position in a Connecticut business for a person seeking employment. If a job or position is procured without the state, such services are not taxable.

For employment agency services, if the location of the job sought is in Connecticut, the service is taxable in Connecticut regardless of where the service provider is located or where the service recipient has its principal place of business. If the location of the job is outside Connecticut, the service is not taxable. If the job is in two or more locations, at least one of which is in Connecticut, the location of the job is considered to be in Connecticut.

Personnel services: Subsection (h) of the regulation states:

> [P]ersonnel services are taxable if the agency rendering such services furnishes temporary or part-time help to a Connecticut business seeking such help. If temporary or part-time help is furnished to a business without the state, such services are not taxable.

For personnel services (including employee leasing and PEO services), if the location of the facility of the service recipient where the temporary or part-time help is furnished is in Connecticut, the service is taxable in Connecticut regardless of where the service provider is located, or where the service recipient has its principal place of business. If the location of the service recipient's facility is outside Connecticut, the service is not taxable. Temporary or part-time employees who work at two or more locations, one of which is in Connecticut, are considered to be working in Connecticut.

Effect on Other Documents: This Policy Statement modifies and supersedes **Policy Statement 93(3.2)**, *Taxation of Services by Employment Agencies and Agencies Providing Personnel Services*.

Effect of This Document: A Policy Statement explains in depth a current DRS position, policy, or practice affecting the tax liability of taxpayers.

For Further Information: Call DRS during business hours, Monday through Friday:

- **1-800-382-9463** (Connecticut calls outside the Greater Hartford calling area only); **or**
- **860-297-5962** (from anywhere)

TTY, TDD, and Text Telephone users only may transmit inquiries anytime by calling 860-297-4911.

Forms and Publications: Forms and publications are available anytime by:

- **Internet:** Visit the DRS website at **www.ct.gov/DRS** to download and print Connecticut tax forms; **or**
- **Telephone:** Call **1-800-382-9463** (Connecticut calls outside the Greater Hartford calling area only) and select **Option 2** from a touch-tone phone, or **860-297-4753** (from anywhere).

Paperless Filing/Payment Methods (fast, easy, free, and confidential):

- **For business returns, tax payments, and electronic bill payments:** Use the ***Taxpayer Service Center*** (***TSC***) to file a variety of tax returns and extensions, as well as to pay taxes or bills over the Internet. Visit the DRS website at **www.ct.gov/DRS** and click on the ***TSC*** logo or on ***File/Register OnLine*** for a complete list of taxes that can be electronically filed and paid.
- **For income tax returns, extensions, estimated payments, and electronic bill payments:** Use the ***Taxpayer Service Center*** (***TSC***) to file personal income tax returns and extensions, or to make estimated payments and electronic bill payments over the Internet. Visit the DRS website at **www.ct.gov/DRS** and click on the ***TSC*** logo or on ***File/Register OnLine***.

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