

Mr. R. Sekar, IAS
Joint Secretary
Department of Revenue (TRU)
Ministry of Finance
New Delhi.

25th October, 2005

Dear Sir,

Subject: Request for review of Service Tax Applicability on Gross Revenues of Manpower Services

Reference: i) Amendments to Service Tax vide Finance Act, 2005
ii) Circular F.No.B1/6/2005 (TRU) dated 27th July 2005, Page 11 Para No.22.4

We thank you for taking the time to meet with us and in continuation of the personal interaction on 29th September, 2005, Executive Recruiters Association (ERA), would like to request an urgent review of the above mentioned circular that requires staffing / manpower services companies to charge service tax on gross revenues rather than their service fees.

We seek this review principally on two grounds; one based on the underlying basis of Service Tax Statute, which should tax only the service fee and the other based on the fact that Temp Staffing industry last few years in which it has come into an organized existence in this country could play a significant role in mitigation of Unemployment in this country particularly in semi urban and rural areas. The large five players in this industry in the last three years have managed to create more than 100,000 jobs predominantly in semi urban centers. Service Tax as sought to be levied by the referred circular, could prove to be more than a dampener for the growth of the industry particularly in the non-metro areas of the County.

We have in the following annexure detailed on the above and request you to

1. Kindly review your order and revert back to the earlier scenario of changing service tax on the service – fee – changed, only.
2. Monitor the trend over the next 10 – 24 months and take a review – call.
3. There could be periodic interaction between MOF and the industry body to assess the performance and take corrective measures.
4. The temp staffing industry, on its part would stand up and deliver results, give us a chance.

Yours sincerely,
For Executive Recruiters Association

B.R. Muralidharan
Executive Director

Temp Staffing and the basis Service Tax Statute:

1. When Service Tax was first introduced by the Finance Act 1994, it was built on the following edifice :
 - a. Service Tax is essentially a tax on "the service".
 - b. Wherever any goods, commodity or any material is involved, it cannot form part of the taxable service and value thereof.
 - c. Similarly expenses of reimbursable nature, when identifiable, cannot attract the levy, as there is no element of service therein.

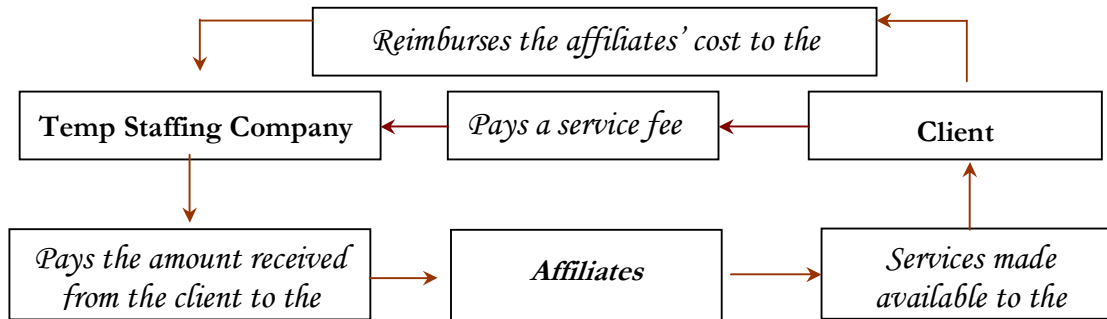
2. Consequently, service tax is applicable to :
 - a) **An advertising company** - only on the fee it receives and the payment made by the advertising company to a publishing house is excluded, being a reimbursed amount.
 - b) **Air Travel agents** - on commission received from the airlines and excludes the ticket value.
 - c) **Cargo handling agents** - on the gross fee charged for services rendered. The transportation costs, being a reimbursement & financially quantifiable in nature, are excluded.

There are many more such examples, which clearly indicate that Service Tax is sought to be levied on the **gross service fee only**. Similarly as demonstrated below Service Tax shall be levied only on service fee in Temp Staffing industry too.

3. Basis and Logic of Service Tax Calculation and Applicability on Temp Staffing:

Gross revenues of Manpower / Staffing companies have two distinct and verifiable components, salary reimbursement and service charges. The first component is a flow-through or a "raw material" (therefore we plead exemption from service tax) while the second component is clearly taxable.

The modus – operandi of Temp Staffing companies is as under :



The origin of this transaction is the Client. The actual chronology of events is as under.

The client decides:

- a. The exact profile & the skill – set of the personnel he needs.
- b. The CTC (Cost to Company) that he is willing to pay for these set of people.
- c. The fee that he is agreeable to pay to the staffing co.
- d. The client & the staffing co. then work together on freezing the final set of people.
Here again the final veto is with the client. In essence, the client calls the shots, all the way & takes the decision at every stage.

4. Therefore it is amply clear that the Temp Staffing Company's service essentially is in managing the Human Resource Management of the temp staff and all other aspects such as the CTC payable and the profile are client's decision. Therefore the Gross CTC payable to the Temp Staff is clearly a cost of service and should not be subject to Service Tax.

India's Labour Market and Temp Staffing:

1. India's Labour Market

- Labor force participation is a low 400 million of a 1 billion population
- Organized employment has been stagnant at 30 million for thirty years (22 million in public sector, 8 million in private sector)
- Unorganized employment is the bulk of the labor force (340 million)
- Given that 269 million people are below the poverty line, even the majority of those employed can barely sustain themselves
- 8 million addition to the Labour force
- Given India's employment elasticity (0.15) and ICOR (3.75), the 8 million new jobs needed to freeze unemployment require an impossible annual GDP growth rate of 13.6% and investments of \$125 billion
- The biggest challenge facing India today is to provide jobs to its growing number of young and qualified.

2. Temporary Staffing in India so far

- a. Though the concept is in vogue in the form of contract labour for a long while in the country, It is only in the last 5 years the Temp Staffing as a concept is being offered as a service by organized players. In that period the employment offered by these companies has shot up from a negligible figure to more than a lakh as of today, with the leading players like TeamLease, Adecco People-One, Mafoi, Manpower and Kellys.
- b. Of these lakh plus temp staff the break up of the salary they earn throws up interesting inferences:

Salary Range in INR	% of Temp Staff
Less than 5,000	39
From 5,001 upto 10,000	48
From 10,001 upto 25,000	12
Above 25,000	2

This means that 87% of those employed in temp staffing draw less than Rs.10,000 / month, a clear indication that jobs offered are at the lowest level ideally suited for first time job seekers. The data of the five companies referred to also proves that 60% of these are "First Timers".

- c. Their break up in terms of their presence in the cities across the country as below clearly demonstrates increasingly the employment is generated by these companies in the tier 2,3 cities.:

City Type	Cities Covered	% of Temp Staff
A	Mumbai, Delhi, Chennai, Kolkatta, Bangalore, Hyderabad	55
B	Ahmedabad, Pune, Cochin, Coimbatore,	20

	Trivandrum, Trichy, Lucknow, Madurai and the likes	
C	Mysore, Mangalore, Salem, Vijayawada, Calicut, Trichur and the likes.	15
D	Anantapur, Nagarcoil, Sholapur, Ratnagiri and the likes.	10

This data clearly demonstrates that close to 45% of the jobs that are offered by temp staffing companies are in the tier 2 cities or semi urban areas. This is an increasing trend, with more and more companies moving to these areas would look forward to Temping companies providing manpower support in these areas and the potential is more than 4 millions jobs in these areas in the next five years.

- d. Increasingly temp staffing companies are required by the emerging and fast growing industries like Telecom, infrastructure, IT/ITeS, Financial Services including Insurance, FMCG etc. With their increasing focus on markets away from Metros and Tier 1 cities, the temp staffing in these areas is all set to skyrocket.
- e. The Temp Staffing companies will be able to provide employment to first time job seekers in these areas who will otherwise either be unemployed or looking to migrate to the urban areas looking for work.
- f. Temp staffing companies provide organized employment to such labour market outsiders who will otherwise be employed by in the unorganized sector. This means that such employees get the benefits of social security such Provident Fund, ESIC, and most importantly, staffing companies ensure that always minimum wages is paid.
 - This is borne out by the fact that the five major companies which remitted a total of less than a crore of Rupuees in 2002-03 towards PF, ESIC, TDS etc to the government are certain to remit close to Rs.100 Crores in fiscal 2005-06.
- g. India emerging as an important destination for Temp Staffing – certain facts & figures
 - The top 5 temp staffing players of the world have set – up shops in India, through equity tie – ups. Their global levels of business are as under :

-  **Adecco** : \$ 20.4 Bn
-  **Manpower** : \$ 12.5 Bn
-  **Vedior** : \$ 7.5 Bn



Randstad : \$ 6.6 Bn



Kelly : \$ 4.3 Bn

h. How does Temp Staffing benefit Economic & Society:

From the earlier discussion it is clear that

- i. it has created jobs in the organized sector and helped move jobs from unorganized segment to organized
- ii. Provides jobs with transparent employment practices with assured minimum wages
- iii. Such jobs are created and provided to labour market outsiders, the India's growing number of youth in the small towns.
- iv. It has huge potential to provide additional jobs to the tune of millions in the coming decade

i. The Service Tax on the gross receipts on Temp Staffing Companies and the impact

- i. This has increased the cost of hiring temp staff through such companies expensive for the industry as a whole. With margins ranging from 7 to 12% on the gross receipts, the Service Tax is more than the service fee charged by these companies, at times almost double.

- ii. Even with the Service tax credit available under Cenvat Credit Rules, 2004, the perception of additional burden is already building in.

- iii. **This could prove critical with the fast growing industries being forced to reconsider their decision on temping particularly in their forays into the new markets that is the semi urban and rural areas.**

iv. Impact will be twofold:

- i) **One they might decide to go slow or venture carefully resulting in lower number of job creation**
- ii) **Two, what ever jobs that are created will go to the unorganized sector, making it unattractive for the the youth in these areas**

- v. **The huge potential for job creation through temp staffing rests with the Financial Services sector and the NGOs. But both of them are not eligible for service tax credit. The increased additional burden has already caused concern.**

- i) **A lot of NGOs are working on "manpower intensive projects" and they resort to temping while executing**

“socially relevant Projects”. They have no avenues to “Set off the increased transaction cost”.

- vi. The notification under debate therefore needs to be reviewed and the service tax shall be charged only on the service fee charged by the staffing companies to remove the burden of additional cost of such services to the industry.**

- vii. This will definitely aid and fasten the process set in motion already by the Temp Staffing industry so far of creating millions of jobs for the unemployed youth of this country in the areas where they reside.**