

## Service Tax on Service of Manpower Supply—A Scan

**Like any other service that is taxed, the service of manpower supply also has its share of intricacies as far as the issues of exemptions, credit and valuations are concerned. This article looks into the doubts being expressed in quarters about the very nature of the levy of service tax on the service of supplying manpower and probes as to whether this levy covers every service for carrying out any work involving the employment of manpower.**

The service of supplying manpower has recently been subjected to levy of service tax together with manpower recruitment, a service that was already taxed. Taxable service is the service provided or to be provided to a client, by manpower supply agency in relation to the supply of manpower, temporarily or otherwise, in any manner. Manpower recruitment or supply agency has been defined to mean any person engaged in providing any service, directly or indirectly, in any manner for recruitment or supply of manpower, temporarily or otherwise, to a client.

Like any other service that is taxed, this also has its share of intricacies as far as the issues of exemptions, credit and valuations are concerned. The issue of valuation has specific relevance to this service. But there are doubts about the very nature of this levy of tax as to whether it covers every service for carrying out any work involving the employment of manpower. Before we look for answer(s), it would be appropriate to examine the definition of the manpower recruitment or supply agency and the charging section. Section 65(68), as substituted by the Finance Act 2005 with effect from 16th June 2005 defined manpower recruitment agency as: "Manpower Recruitment or Supply Agency

means any commercial concern engaged in providing any service, directly or indirectly, in any manner for recruitment or supply of manpower, temporarily or otherwise, to a client". The first of the pre-requisites of the levy is its provision by the manpower recruitment or supply agency. To fall into this definition, a person essentially has to fulfil conditions like (a) he should be engaged in providing any service, (b) either directly or indirectly, (c) in any manner, (d) service must result in or, the least, be incidental to supply of manpower, (e) temporary or otherwise, and finally, (f) service should be to the client.

But first let us talk about the term "agency" used in manpower recruitment or supply agency. Does that really mean that though it is defined to mean person engaged in providing any service in manpower supply, such rendering of service of manpower supply should essentially be in the capacity of agent or agency? Does the mention of words "directly" or "indirectly" in the definition signify coverage of both, rendering of service on a principal-to-principal basis (directly) and agent-to-principal basis (indirectly)? In other words, does that mean that "directly" or "indirectly" in the definition of manpower recruitment or supply agency refers to the nature of relationship between the service provider and service recipient or only refers to the manner in which services are provided by the service provider to the client? Is it possible to argue that the word "agency" in the definition sub-merge with what is defined and no special connotation of the term is required to be imputed as it is understood or



— CA. Tilak Chandna

*(The author is a Member of the Institute.  
He can be reached at [tilak\\_chandna2003@yahoo.com](mailto:tilak_chandna2003@yahoo.com))*

defined commercially in Indian Contract Act, 1872? The logical and sound view, of course, would be that no word in the enactment or its provisions is without a meaning and therefore use of the words "agency" has to be given its due meaning. Section 182 of the Indian Contract Act 1872, defines agent as a "person employed to do any act for another or to represent another in dealings with third persons". Under this act, two requisites are to be met to be called an agent. One, doing an act for another or to represent another in dealings with third persons, and two the employment of the agent by another person. It is the condition of employment in doing an act or representing another that is of final criticality to establish agent-principal relationship.

The employment, here, refers to the predominant control or direction vested in the principal with regard to what, how and in which manner the performance of an act or the representation is to be made by the person employed. The existence or otherwise of factor of "employment", so explained, as a matter of fact, in a service contract decides whether the contract is between agent and principal or principal and principal. It safely appears, therefore, that "agency" in manpower recruitment or supply agency is not without significance and only that service of supply of manpower are intended to be covered by the charging section where the service substantially vest the control or direction of the manpower supplied with the recipient. In those cases, where the service may involve supply of manpower but service provider enjoys complete or nearly complete independence in the manner of providing service, it would fall outside the definition of agency and will not be taxable. For example, a person has to travel from place X to place Y. He engages the service of a travel house and is provided with a car and chauffeur to cover the journey. Another alternative is that he engages the service of a chauffeur and uses his own car to travel. In the first case, the service contract would be between two principals. But in the second

case, the relationship between the chauffeur and the person shall be that of principal and agent.

Now we come to explaining the other elements embedded in the definition of manpower recruitment or supply agency to properly understand its scope and field.

### Engagement of the Person

To qualify for being a manpower recruitment or supply agency, the most fundamental condition is that the person should be engaged in the provision of service specified. There can be two ways of looking at it. One could be that whenever a person provides service of supply of manpower, that provision itself makes him a manpower supply agency and thus becomes taxable under the act. The other view could be that it is the service of supply of manpower by that person only who is ordinarily engaged in the provision of that service which is taxable. In the former it is the service first and the agency follows. In the latter case, agency is first and the service follows. Of the two approaches, the latter looks to be more plausible in view of the language. The words used in the definition are "person is engaged...." That means engagement should exist beforehand.

Engage means to take part, to devote attention and effort, to employ one's self, to conduct, to agree with or bind by contract, to promise. Engagement, in the definition, refers to a kind of systematic, regular and organised activity done in the ordinary course. One may safely say that service involving manpower supply by a person whose ordinary engagement is not provision of service of supply of manpower is not intended to be taxable under this clause.

### Directly or Indirectly

The use of the words "directly" or "indirectly" theoretically can be open to two interpretations. One, these words relate to engagement and two, to provision of service. How do the two interpretations affect the taxability under the

act is explained. If these two words qualify "engagement" that would mean person not directly engaged in provision of supply of manpower but engaged in provision of any other service which indirectly results in service of supply of manpower would get covered in the definition of the manpower supply agency. But if the two words qualify "provision of service" then to qualify manpower supply agency the engagement has to be direct but the provision of service can be direct (i.e. by that person only) or indirect, (i.e. through somebody else). But if one looks at the definition carefully, it appears that the second view looks more sound, precisely because the words "directly" or "indirectly" appear after "providing of service". If the law intended the first view to apply then the two words would have been used immediately after or in the company of engagement.

### In Any Manner

The use of this phrase in the definition has a widening effect of the scope. But an interpretation problem as in the case of "directly" or "indirectly" may also arise with the interpretation of the phrase "in the manner". Does it refer to manner of engagement or manner of service provision? Taking a cue from what is stated for interpreting directly or indirectly, "in any manner" should refer to the providing of service. This should further get clear from its general dictionary meaning; which means mode of action, way of performing or affecting anything, method, style; the way of managing, the way of doing a thing, the method of procedure; general method. It is held to mean power to control the work, not only as to its character, but also as to the particular means used to accomplish it. The objective that is intended to be served by the inclusion of this phrase in the definition is to cover all kinds and types of service arrangement of supply of manpower with wide variances as to employer-employee relationship, liability and manner of discharge of compensation, terms and conditions governing manpower supply under the agreement and so on. But does the

use of this phrase in the definition extend its meaning to cover also part of the services in the whole series of activities in providing service of manpower supply? The possible answer would be yes when we read this phrase used in conjunction with the phrase "directly" or "indirectly".

### Temporarily or Otherwise

The use of these words, in the definition, in all probability, signifies the nature of supply and not the nature of engagement or nature of service. Obviously speaking "temporarily" refers to the time element in supply and "otherwise" would refer to supply being linked to anything other than time.

### DEPARTMENT'S CLARIFICATION

After enacting this amendment, the department has also issued a circular number F.N B1/6/2005-TRU dated 27th July 2005 explaining the intent and scope of the levy. The same should also help in understanding the issues discussed above.

#### 22. Manpower Recruitment Service

22.1 "Prior to 16th June 2005, service tax was leviable on services provided by manpower recruitment agencies in relation to recruitment of manpower. Amendments have been made to levy service tax on temporary supply of manpower by manpower recruitment or supply agencies."

22.2 "A large number of business or industrial organisations engage the services of commercial concerns for temporary supply of manpower which is engaged for a specified period or for completion of particular projects or tasks. Services rendered by commercial concerns for supply of such manpower to clients would be covered within the purview of service tax."

22.3 "In these cases, the individuals are generally contractually employed by the manpower supplier. The supplier agrees for use of the services of an individual employed

by him to another person for a consideration. The terms of individual's employment may be laid down in a formal contract or letter of appointment or on a less formal basis. What is relevant is that the staff is not contractually employed by the recipient but come under his direction."

22.4 "Service tax is to be charged on the full amount of the consideration for the supply of manpower, whether full time or part time. The value includes recovery of staff costs from the recipient e.g. salary and other contributions. Even if the arrangement does not involve the recipient paying these staff costs to the supplier (because the salary is paid directly to the individual or contributions are paid to the respective authorities) these amounts are still part of the consideration and hence form part of the gross amount."

The clarification given in the circular underlines and clarifies many of the doubts but at the same time raises a few new ones particularly with regard to valuation.

After having analysed the prescribed elements of manpower or supply agency in the definition, one can usefully look into elements comprising 'service taxed'. The essential elements are (a) service provided or to be provided, (b) in relation to supply of manpower, (c) temporarily or otherwise, and (d) in any manner.

### Service Provided or to be Provided

The expression "provided or to be provided" has been substituted for the expression "provided" by the Finance Act, 2005 with effect from 16th of June 2005. To throw light on the impact of this amendment, it is apt to refer to department circular number B1/6/2005-TRU dated 27th July 2005, explaining the import of this amendment.

Clause 27 of the circular states "amendments have been made in section 65(105), section 67 and rule 6 of the service tax rules, 1994, linking payment of service tax with receipt of payment

for the taxable service provided or advance payment received towards taxable services to be provided in future. When payments relating to taxable services are received during the course of provision of service, service tax is liable to be paid to the extent of receipt of payment. In other words, a person is liable to pay the tax as soon as the consideration towards the taxable service is received."

Clause 27.1 of this circular further states: "In case of continuous supply of services (such

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as construction services) which are provided over a period of time and the consideration (payment), the whole or part of it, is determined as payable, periodically from time to time, the services are treated as provided separately and successively each time the payment is due or each time the payment is received by the service provider."

Clause 27.2 of the circular explains one more significant aspect of the term when it states: "However, when advance payment is received for a service which is non-taxable at the time of receipt of payment but becomes taxable during the course of provision of service, such payment would have to be apportioned appropriately between the two periods and that part of service provided on or after the service becomes taxable service, is only liable for service tax. Similarly, when payment is received in advance for services to be provided but subsequently the services are not actually provided, then in such cases service tax paid is

liable to be refunded.”

The amendment makes services taxable at three stages. The first two stages are (i) advance payments received and (ii) completion of services; whichever is earlier. The concept is similar to what is generally well understood and applied in the case of Tax deduction at source. It is the third stage of taxability that is a little novel and has to be fairly understood and kept in mind by the service providers and tax practitioners. The third stage of liability now being provided is the one where neither the payment has been received nor the service has been completed. But if under the contract or agreement or arrangement the consideration becomes payable at various states of services being rendered, the service tax liability would also arise corresponding to such stages of services being achieved deeming it completion of services, irrespective of the date of actual receipt or billing.

### In Relation To

This phrase used in the charging clause is quite significant and in fact widens the scope of the service under tax net. This makes not only the actual service of supply of manpower taxable but also the whole array of services provided in relation to supply of manpower.

### Valuation Rules

A mention of this was made briefly in the circular explaining the amendment made. The mandate of the circular is that it is the gross consideration, including staff cost and other contributions paid to and on their behalf, whether or not the same are paid to service provider (and paid to individuals employed), which is chargeable to tax. The clarification, it appears, has to be applied with a modification. If the words “in relation to” used in the charging clause are held to mean that even the person providing only a part of the chain of services required to be provided in supply of manpower, then the value of taxable services shall be the consideration for the

services which are actually provided and not any fictional gross consideration including staff cost and contribution made on their behalf as mandated by the circular.

The reason for this view being that every circular has to give way to the provisions of the act that have a final and binding effect. The provision of section 67 of the Finance Act 1994 is quite explicit in this when it provides: “For the purposes of this chapter, the value of any taxable service shall be the gross amount charged by the service provider for such service rendered by him.” Thus, if in pursuance of the arrangement between the service provider and the recipient, the nature of service provided or to be provided and the gross consideration thereof are defined then what is chargeable

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under the act is what is agreed between the parties. The circular will get applied only in those cases where scope of services provided by the service provider include supply of manpower but in discharge of the gross consideration payable for the scope covered, the recipient, on behalf of the service provider, pays for the staff cost and contribution directly to staff or the authorities concerned.

The central Government vide notification number 12 of 2006 dated 19th April 2006 have issued service tax (Determination of Value) Rules 2006 and they shall have overriding effect on the circular. Rule 5 of (Determination of Value) Rules 2006, make a very interesting reading while providing for exclusions in case of pure agents and might have important bearing on the valuation of service of manpower supply agency.

Sub-rule (1) of Rule 5 provides that where any expenditure or costs are incurred by the

service provider in the course of providing taxable service, all such expenditure or costs shall be treated as consideration for the taxable service provided or to be provided and shall be included in the value for the purpose of charging service tax on the said service.

But sub-rule 2 carves out an exception to what is stated in sub-rule 1. It provides: "subject to the provisions of sub-rule (1), the expenditure or costs incurred by the service provider as a pure agent of the recipient of service, shall be excluded from the value of the taxable service if all the following conditions are satisfied namely:

- (i) The service provider acts as a pure agent of the recipient of service when he makes payment to third party for the goods or services provided.
- (ii) The recipient of service receives and uses the goods or services so procured by the service provider in his capacity as pure agent of the recipient of service.
- (iii) The recipient of the service is liable to make payment to third party.
- (iv) The recipient of the service authorises the service provider to make payment on his behalf.
- (v) The recipient of the service knows that the goods and services for which payment has been made by the service provider shall be provided by the third party.
- (vi) The payment made by the service provider on behalf of the recipient of service has been separately indicated in the invoice issued by the service provider to the recipient of service.
- (vii) The service provider recovers from the recipient of service only such amount as has been paid by him to the third party; and
- (viii) The goods and services procured by the service provider from the third party as a pure agent of the recipient of service are in addition to the services he provides on his own account.

***For the purpose of sub-rule (2), pure agent means a person who:***

- (i) Enters into a contractual agreement with the recipient of service to act as his pure agent to incur expenditure or costs in the course of providing taxable service;
- (ii) Neither intends to hold nor holds any title to the goods or services so procured or provided as a pure agent of the recipient of service;
- (iii) Does not use such goods or services so procured; and
- (iv) Receives only the actual amount incurred to procure such goods or services.

The perusal of the rule above, in the context of service of supply of manpower, takes one to a fundamental issue with which we started.

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That is, what is the import of the term "agency" in manpower supply agency? The service of supply of manpower can partake following forms. One, where service is provided as a pure agent. Two, supply of manpower is made as an agency otherwise than as a pure agent but in the course of providing such service some services are provided as a pure agent. Third, service provided may involve manpower, but has no element of agency.

To conclude, the taxability of the service and valuation shall depend on which of the above categories the service provider falls in. Needless to say, the services as a pure agent are going to be a grey area, a breeding ground of lot of muscle flexing from department and taxpayers. □