

## **Reverse Charge Mechanism under Service Tax**

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## Reverse Charge Mechanism under Service Tax

### I Introduction:

Worldwide all indirect taxes are borne by buyers or service receivers and the tax liability is discharged by sellers or service providers. Indian service tax is no exception to this. Service tax being an indirect tax, is collected by the service provider from the service recipient. The obligation of remittance and reporting is cast upon service provider. This is the normal modus operandi. This normal process is known as Direct Charge.

However, Indian Service Tax law departed from this general practice for specified services in certain situations and made the service receiver liable to remit service tax to the Government. This is known as Reverse Charge Mechanism (RCM). Though, the Government not reasoned out for such departure, it appears that the same could be introduced primarily to facilitate tax administration by reducing the number of tax assesseees, for effective collection of tax and for reducing tax evasion. This mechanism is similar to the concept of "Tax Deduction at Source" in Income Tax Law. This reverse charge mechanism was first introduced from 01-01-2005 on 4 services namely telecommunication service, general insurance business, insurance auxiliary service, Goods Transport Agency services.

Subsequently, with the introduction of negative list Service Tax regime in the year 2012, together with increasing the number of services covered under the reverse charge mechanism, the Government from 01-07-2012 added one more category of reverse charge, Partial Reverse Charge or Joint Charge (PRCM / JCM).

Reverse Charge Mechanism is now, classified into two categories.

- A. Full Reverse Charge: In this Mechanism, the Service receiver alone is liable to pay Service Tax
- B. Partial/Joint Reverse Charge: In this Mechanism, both the service receiver and the service provider are liable to pay service tax at specified percentage of the value of taxable service.

Service receiver is liable to discharge his obligation irrespective of any mention of his liability in the service invoice. Further, absence or short charge of service tax by service provider do not reduce or enhance the liability of the service receiver.

Applicability of reverse charge is dependent on the following factors:

1. Type of service
2. Status of the service provider and the receiver
3. Place of provision of Service

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1. Type of Service: Reverse charge is primarily applicable on the following specified services:
  - a. Insurance Services.
  - b. Services by a recovery agent to an NBFC.
  - c. Good Transportation Agency Services
  - d. Sponsorship Services.
  - e. Arbitral Services
  - f. Legal Services
  - g. Services by a director to a Company or a Body Corporate.
  - h. Services received from the Government.
  - i. Supply of Manpower Services.
  - j. Mutual Fund Services.
  - k. Lottery Services.
  - l. Import Services.
  - m. Aggregator Services.
  - n. Rent-A-Cab Services.
  - o. Works Contract Services.
  
2. Status of service provider and service receiver: The secondary factor for the applicability of reverse charge is the status of service provider and the service receiver. Though a service is specified for RCM, for the applicability of RCM the service provider shall be of a specified type. In other words, both the service and the status of service provider shall be specified. Similarly, though a service is specified for RCM, for the applicability of RCM the service recipient shall be of a specified type.  
E.g: In Manpower supply services, reverse charge is applicable only if the status of the service receiver is a body corporate and the status of the service provider non-corporate.
  
3. Place of provision of Service: Another important criteria to determine the applicability is the place of provision of service. If services are provided in taxable territory (India excluding J&K) by a service provider located outside the taxable territory, all such services whether or not a specified service, will get covered under reverse charge. In general parlance, it is known as Import of services. In all such cases, every service receiver, irrespective of the status, will get covered under RCM.

In other words, if service provider is not located in taxable territory (J&K and Outside India), service receiver is liable to pay service tax.

### **II No Threshold exemption:**

Small Service providers are generally entitled to threshold exemption of ₹ 10 Lakhs on satisfaction of certain conditions. Such exemption is not applicable to service receivers under reverse charge Mechanism.



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Even if service provider does not charge service tax in the invoice, being a small service provider having taxable turnover less than ₹ 10 lakhs, the service receiver is still liable to pay service tax.

### **III Registration and filing of periodic returns**

Under reverse charge, service receiver has to seek registration within 30 days of occurrence of taxable event indicating the category of services.

Service tax returns have to be filed half-yearly. Return for April to September should be filed by October 25 and for October to March by April 25.

Service tax assessee having turnover beyond a certain threshold (amount yet to be notified) shall be required to file an annual return apart from the two half-yearly returns being filed now.

### **IV Point of Taxation (POT) and Due date**

Where a service recipient is liable to pay tax, the point of taxation, i.e. timing, shall be the date of payment against such services. This includes advance payments.

However, if such payment is not made within three months from the date of invoice, POT shall be the date immediately following the said period of three months.

The due date to discharge service tax is 6<sup>th</sup> of the following month from the date of POT. For transactions having March as POT, the due date is March 31<sup>st</sup>.

### **V Services specified under Mega Exemption and Negative List:**

Reverse charge provisions will not apply to the service recipient, if the service is exempt under mega exemption notification or negative list.

### **VI CENVAT Credit**

Service tax under RCM must be paid directly to the service tax department and not by utilizing CENVAT Credit.

However, service receiver can claim the credit of service tax as and when paid under reverse charge, if it is otherwise qualified as input service under CENVAT Credit Rules, 2004.

### **VII Valuations and Abatements by service provider.**

The tax liability of both service receiver and provider are different and independent of each other. Service recipient can independently avail or forego abatement or may choose a valuation option different from service provider.



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### **VIII Invoicing:**

- Service provider shall issue an invoice indicating the name, address and the registration number of the service provider; name and address of service recipient receiving taxable service; the description and value of taxable service provided or agreed to be provided and the service tax payable thereon.
- Where the service provider is liable to pay part of service tax, he should charge only that part in his invoice and indicate that balance is payable by the service receiver.
- Even if service provider does not charge service tax in the invoice, service receiver is still liable to pay only his portion of service tax.

### **IX. Others**

Service tax is payable on the entire amount paid to the service provider and not by making reverse calculation. Further, no tax is to be deducted at source (TDS) on the service tax portion payable under RCM by the service receiver.

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### **X. Services specified under Reverse Charge:**

**Table A: Full Reverse Charge Service (Service receiver liable to pay 100% of Service Tax).**

S.No	Service Description	Service Provider	Service Receiver	Remarks
1.	<b>Insurance Services</b>	Insurance Agent	Any Person carrying on insurance business	The entire ST liability is to be paid by the service receiver.
2.	<b>Services by a Recovery Agent to a Bank/NBFC</b>	Recovery Agent	Bank / NBFC	The entire ST liability is to be paid by the service receiver. (w.e.f. 11-07-2014)
3.	<b>Transportation of Goods by Road</b>	Goods Transport Agency	<p><b>Any Factory</b> registered under the Factory Act.</p> <p><b>Society</b> Registered under Society Reg. Act.</p> <p><b>Co-op. Society</b> established by or under any law</p> <p><b>Dealer</b> of excisable goods registered under the Central Excise Act.</p> <p><b>Body corporate</b> established under any law</p> <p><b>Partnership Firm/Association of Person</b></p>	<p>1. Liability to pay tax is on person paying freight to GTA.</p> <p>2. Tax is leviable on 30% of the freight value, if CENVAT Credit is not availed by GTA. It is advisable to obtain a declaration from GTA. Otherwise, service tax will be leviable on 100% of the freight value.</p> <p>3. No service tax under reverse charge if any one condition is satisfied: (i) Amount charged on all the consignments transported in a goods carriage in a particular trip does not exceeds Rs.1, 500.</p> <p>(ii) Amount charged on individual consignment transported in a goods carriage in a particular trip does not exceed Rs.750.</p> <p>(Note: Above Exemption is available <b>per trip.</b>)</p>

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S.No	Service Description	Service Provider	Service Receiver	Remarks
4.	<b>Sponsorship</b>	Any person	<b>Any Body corporate or partnership firm</b> located in the taxable territory	Person receiving the sponsorship money is the service provider
5.	<b>Arbitral Services</b>	Arbitral Tribunal	<b>Any business entity (*)</b> located in the taxable territory with a turnover of more than Rs. 10 lacs in the preceding FY.	“Business entity” means any person ordinarily carrying out any activity relating to industry, commerce or any other business or profession.
6.	<b>Legal Service</b>	Individual Advocate or Firm of Advocates	<b>Any business entity (*)</b> located in the taxable territory with a turnover of more than Rs. 10 lacs in the preceding financial year.	Meaning of business entity is same as above.
7.	<b>Services by director of a company/body corporate</b>	Director of a company/body corporate	<b>Said company or the body corporate</b>	Sitting fees, incidental expenses for attending Board meetings and commission paid to directors are taxable. Executive or Independent directors offering services not in capacity of the employee of the company are taxable.
8.	<b>Any Service</b>	Government or Local Authority.	Business entity	All services provided by the Government or local authority to a business entity, except the services that are specifically exempted, or covered by any another entry in the Negative List. <b>(Applicable from 01-04-2016).</b>

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S.No	Service Description	Service Provider	Service Receiver	Remarks
9.	<b>Import of Service</b>	Any person located in a non-taxable territory <i>i.e.J&amp;K and outside India.</i>	Any person located in the <b>taxable territory(#)</b>	If both service provider and service receiver are located in non-taxable territory, there no question of service tax in India.
10.	<b>Supply of Manpower for any purpose or security services (See Note 1 Below)</b>	Individual, HUF, Partnership Firms including LLP's, AOP, located in taxable territory.	Any business entity registered as body corporate, located in taxable territory.	Control and Supervision plays a key role. This service is w.e.f - 01.04.2015. Earlier it was covered under Partial Reverse Charge
12.	<b>Lottery Services</b>	Agents of lottery distributors	Lottery-Distributor or selling agent of lottery.	This service is w.e.f- 01.04.2015
13.	<b>Aggregator Services.</b>	Service provider using the brand name of the aggregator.	Aggregator	Aggregator is defined to mean “a person, who owns and manages a web based software application, and by means of the application and a communication device, enables a potential customer to connect with persons providing service of a particular kind under the brand name or trade name of the aggregator” .Eg: Web-based Taxi service providers, Hotel Services Providers.



## **Reverse Charge Mechanism under Service Tax**

### **Note 1: Supply of Manpower for any purpose or security services**

#### **Manpower Services:**

“Supply of manpower” means supply of manpower temporarily or otherwise, to another person to work under his superintendence or control.

In this case, services should be provided under command of principal employer. If the agreement is for any specific work for which contractor is responsible for quality of work by manpower, there will not be any liability under reverse charge.

Hence, terms of agreement between the parties plays a key role to determine the taxability.

#### **Security services:**

“Security services” means services relating to the security of any property, whether movable or immovable, or of any person, in any manner and includes investigation, detection or verification any fact or activity

In this case, irrespective of whether the contract is for supply of security guard or for provision of security services, service receiver shall become liable.

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**Table B: Partial Reverse Charge or Joint Charge**

Status of service provider			(i) Individual, (ii) HUF (iii) Partnership Firms including LLP's (iv) AOP, located in taxable territory.					
Status of service receiver			Any business entity registered as body corporate, located in taxable territory.					
S#	Description of Service		Service Provider			Service Receiver		
			Taxable portion of gross value	Effective rate (Before 01.06.2015)	Effective rate (from 01.06.2015 onwards) (see Note 3)	Taxable portion of gross value	Effective rate (Before 01.06.2015)	Effective rate (from 01.06.2015 onwards) (see Note 3)
1	<b>Renting of any motor vehicle designed to carry passengers</b>	If Abatement is claimed by Service Provider	Nil	Nil	Nil	100%	4.94 %	5.60 %
		If abatement is not claimed by Service Provider	50%	6.18 %	7.00 %	50%	6.18 %	7.00 %
		Exception: Service provider will be liable for service tax where the service receiver is in a similar line of business.						
2	Service portion in execution of works contract (See Note 2)	Actual Value Method	50%	6.18 %	7.00 %	50%	6.18 %	7.00 %
	Notional Value Method	For Services mentioned in Note 2 (b)(A)	20%	2.472%	2.80%	20%	2.472%	2.80%
		For Services mentioned in Note 2 (b)(B)	35%	4.326%	4.90%	35%	4.326%	4.90%

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### **Note 2: Works Contract Services:**

Value of service portion under works contract can be determined at the option of service receiver by either of the following methods irrespective of the option availed by service provider.

#### a) Determination of value on Actual Value Method:

Value of works contract service = Gross Amount charged – Value of material – Value Added Tax paid on material transferred.

#### b) Determination of Value on Notional Basis:

In case of works contract	Taxable Value of service portion (% of total amount charged)
(A) Entered into for execution of original works	40%
(B) In case of works contract not covered in (A) above, Including works contract entered into for (i) Maintenance, repairs, reconditioning, restoration or servicing of goods. e.g AMC (ii) Maintenance, repairs, completion & finishing service such as glazing, plastering, floor and wall tiling etc.	70%

**Note 3: The above rates are excluding Swachh Bharat Cess and Krishi Kalyan Cess.**

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