

**ALL ABOUT REVERSE CHARGE AND
JOINT CHARGE MECHANISM**

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REVERSE CHARGE AND JOINT CHARGE MECHANISM – A BREIF ANALYSIS

REVERSE CHARGE AND PARTIAL REVERSE CHARGE MECHANISM

INTRODUCTION

One of the main sources of revenue for any government is indirect tax collection. Normally this tax is imposed on the ultimate end user of the product or services. However the end user does not pay the tax to the government directly. Instead the manufacturer (excise duty) / seller (VAT) / service provider (service tax) collects the tax from the buyer or service receiver. After collection the same is remitted to the government. However, when the government feels inconvenient to make the seller or service provider to collect the tax, because, they are in unorganized sector or evasion prone sector, it makes the buyer or service receiver to pay the tax directly to the government. Hence, as per provisions of the statute if the service receiver has to pay the tax directly to the government instead of paying through the service provider it is called reverse charge mechanism or method of tax shift (because responsibility of paying the tax is shifted from provider to receiver).

Background of Reverse Charge Mechanism in India

The concept of reverse charge in service tax was introduced in India for Clearing and forwarding agents in 1997 wherein the users were made to pay tax. However the same was struck down by the Supreme Court in the case of “Laghu Udyog Bharati Vs Union of India (112) E.L.T. 365 (SC) stating that the provision of reverse charge was ultra vires the Act itself. Finance Act (No. 2) 2004, levied payment of service tax on reverse charge basis for Goods Transportation Service. As per FM’s budget Speech the levy was for booking agents and not for truck owners or truck operators.

Section 66A of Finance Act 2006, made specific provision of service tax under reverse charge for import of services with effect from 18.04.2006. Constitutional validity of this reverse charge tax was upheld in the case of Orient Crafts Ltd Vs UOI (2006) (4) STR 81 (Del). This provision continued to form part of the Act up to 30th June, 2012.

In Finance Act 2012, sub-section 2 to section 68 was amended to empower central government to notify any taxable service for which service tax shall be paid by prescribed person (service receiver). Hence, the central government has issued Notification no 20/2012-ST dated 20.06.2012, notifying several services for which service receivers were made to pay tax (Full reverse charge) and several services where in both service providers and service receivers were made to pay tax (Partial reverse charge / Joint charge).

List of specified services under Reverse Charge Mechanism

1. Services provided by Insurance Agents to Insurance companies

Services provided by insurance agents to any person carrying on insurance business are covered by reverse charge. Hence, for commission or any other charges received by insurance agents, service receiver i.e. insurance companies are liable to pay service tax. Normally, typical example of applicability of this service would be in automobile industry wherein authorized dealers / sale centers of two wheelers and four wheelers provide business to insurance companies. Amount of commission and other charges received by them, the dealers are not liable to pay service tax.

2. Services provided by Goods Transport Agency to Specified persons

GTA service has been excluded from the applicability of negative list and hence they are kept within the ambit of service tax. However, when they provide services to specified persons who are liable to pay freight shall pay service tax under reverse charge basis.

2.1. Who is a GTA?

As per section 65B(26), “Goods Transport Agency” means any person who –

- Provides service in relation to transport of goods by road and
- Issues **consignment note**, by whatever name called;

2.2. What is Consignment note?

As per explanation to Rule 4B of the Service Tax Rules, 1994, a consignment note means –

- A document, issued by a goods transport agency
- Against the receipt of goods
- For the purpose of transport of goods by road in a goods carriage (as defined in Motor Vehicle Act, 1988),
- Which is serially numbered, and
- Contains the names of the consignor and consignee, registration number of the goods carriage in which the goods are transported, details of the goods transported, details of the place of origin and destination, person

REVERSE CHARGE AND JOINT CHARGE MECHANISM – A BREIF ANALYSIS

liable for paying service tax whether consignor, consignee or the goods transport agency.

A GTA shall issue consignment note containing above particulars to the service recipient.

2.3. Who are all specified persons?

As per Rule 2(1)(d) of the Service Tax Rules, 1994 read with Notification no 30/2012-ST, where the person liable to pay freight is any of one of following persons then service tax shall be paid by such person.

- a. Any factory registered under or governed by Factories Act, 1948;
- b. Any society registered under the Societies Registration Act, 1860 or under any law for the time being force;
- c. Any co-operative society established by or under any law;
- d. Any dealer of excisable goods, who is registered under the Central Excise Act 1944 or the rules made there under;
- e. Any body corporate established by or under any law; or
- f. Any partnership firm whether registered or not under any law including association of persons;

However, it is important to note that where any of above persons is located in a non-taxable territory then person providing the service shall be liable to pay service tax i.e. the GTA. **[Proviso to Rule 2(1)(d)]**

On the total value of the service, as per notification no 26/2012, SI No 7, 75% is allowable as abatement. Service tax is payable on 25% of 12.36%. For taking this abatement condition of non-availment of cenvat credit is not applicable to service receiver liable to pay freight as per notification no 08/2014 dated 11th July, 2014.

Service tax under reverse charge is not applicable if the goods being transported is exempt by virtue of notification no 25/2012 (SI. No. 21)

3. Sponsorship Services

The term sponsorship has not been defined in the Finance Act. But, the same was defined in the erstwhile section 65(99a) of Finance Act, 1994.

REVERSE CHARGE AND JOINT CHARGE MECHANISM – A BREIF ANALYSIS

Sponsorship includes

- Naming an event after the sponsor;
- Displaying the sponsor company's logo or trading name;
- Giving the sponsor exclusive or priority booking rights;
- Sponsoring prizes or trophies for competition
- But DOES NOT INCLUDE financial or other support in the form of donation or gift where in service provider is under no obligation to provide anything in return to such donators.

In order to attract service tax by reverse charge under sponsorship, service receiver should either be a body corporate or partnership firm **located in a taxable territory**. However service provider can be any person.

In case service receiver is a person other than a body corporate or partnership firm OR body corporate or partnership firm located in a non-taxable territory, service provider (person receiving the amount towards sponsorship) shall be liable to collect service tax and remit to the government.

4. Legal service and Arbitral tribunal

As per Rule 2(1)(cca) "Legal Service" means any service provided in relation to advice, consultancy or assistance in any branch of law, in any manner and includes representational services before any court, tribunal or authority.

When individual lawyers or firm of lawyers or arbitral tribunal are providing legal services to any person **who is a business entity**, service tax under reverse charge is applicable.

Non-applicability of reverse charge for legal services in certain cases

- This entry is not applicable when legal services are received by charitable / religious institutions, schools; government etc., Also charges paid for personal litigation is not covered.
- This is the only one entry which enjoys small service exemption. When service receiver's turnover in the preceding financial year is less than Rs. Ten lakhs then he is not liable to pay service tax under reverse charge mechanism.

REVERSE CHARGE AND JOINT CHARGE MECHANISM – A BREIF ANALYSIS

- When advisory or consultancy services or representational services are received from other professionals like Chartered accountant, cost accountant or company secretary reverse charge mechanism is not applicable.

5. Services of a Director to a body corporate

Where a director of a company receives any sum towards provision of any services from a body corporate (public, private companies and other body corporate like RBI, LIC etc.) the service receiver i.e. the body corporate has to pay service tax under reverse charge basis.

Coverage

The director receiving any sum not in the capacity of employee shall alone be taxable under this head. Hence whole time directors / executive directors when they receive remuneration, commission, sitting fee or other similar payments shall not be covered by this entry.

Independent directors / part time directors / non-executive directors are generally not considered as employees and hence any sum paid to them shall be covered by this entry.

6. Support services received from Government or local authority

In respect of *support services* received from government or local authority, service receiver has to pay service tax under reverse charge mechanism. However following services received from government or local authority are not subject to reverse charge.

- Renting of immovable property service
- Services by the department of post by way of speed post, express parcel post, life insurance and agency services provided to a person other than Government;
- Services in relation to an aircraft or a vessel, inside or outside the precincts of a port or an airport;
- Transport of goods or passengers; or
- Services received from government by a person which is not a business entity. Examples charitable trusts, schools, colleges etc.,

Support services have been defined in section 65B (49) of the Act as follows

REVERSE CHARGE AND JOINT CHARGE MECHANISM – A BREIF ANALYSIS

"support services" means infrastructural, operational, administrative, logistic, marketing or any other support of any kind comprising functions that entities carry out in ordinary course of operations themselves but may obtain as services by outsourcing from others for any reason whatsoever and shall include advertisement and promotion, construction or works contract, renting of immovable property, security, testing and analysis;

All the above services except renting of immovable property are kept under reverse charge mechanism. Services of police, fire etc., are typical examples of services received from government or local authority.

7. Import of Services

Any payment made for receipt of taxable services from a non-taxable territory is subject to service tax on reverse charge basis. Examples of such services would be royalty, technical know-how, fee for overseas consultancy etc., As per Place of Provision of Service Rules, 2012, if the services are rendered in taxable territory but the service provider is located in a non-taxable territory then service receiver has to pay service tax on reverse charge basis.

Normally employees of foreign holding companies are deputed in Indian subsidiary companies. A query may arise here whether the payment made by Indian company either to foreign company or its employees are subject to reverse charge mechanism. The issue is settled in Volkswagen India P Ltd Vs CCEX - 2013 (11) TMI 298 - CESTAT Mumbai that if following criteria are met then there are employer – employee relationship exist between Indian company and deputed employee in which case service tax is not attracted since salary paid to an employee is outside the purview of service tax.

- There is an inter company employment agreement
- Employees are relieved from foreign companies and given appointment orders in Indian companies.
- They work closely under the control, supervision and direction of Indian company.

8. Services of Recovery Agents received by banks, NBFCs and other financial institutions:- (with effect from 11th July, 2014)

Recovery agent has not been defined in the Act. However, it would cover recovery agents or enforcement agents appointed under Securities and Reconstruction of Financial

REVERSE CHARGE AND JOINT CHARGE MECHANISM – A BREIF ANALYSIS

Assets and Enforcement of Security Act, 2002 (SARFASE). Services received by banks or financial institutions or non-banking financial companies from recovery agents are subject to service tax under reverse charge. It is worthwhile to mention here services of recovery agents to any person other than banks, NBFCs and other financial institutions are not subject to reverse charge where in recovery agents have to discharge the liability.

9. Supply of Manpower and Security Agency Services

Out of total service tax liability for these two services, 75% of 12.36% (effective rate of 9.27%) shall be paid by service receiver under reverse charge. Balance 25% of 12.36% (effective rate of 3.09%) shall be collected by service provider from service receiver and paid to government.

In order to attract reverse charge for these two services, service provider shall be individual or HUF or partnership firm and the service provider shall be a body corporate.

As per Rule 2(g) “Supply of manpower” means supply of manpower, temporarily or otherwise, to another person to work under his superintendence or control.

Typically following services are covered:

- Payment for services of the staff seconded/deputed with the company under an arrangement where the staff remains on the payroll of the original employer only
- Payment for services of staff (not on payroll of the recipient of service) supplied by an agent/person under an arrangement where it is placed operationally under the superintendence or control of the recipient of service (e.g. housekeeping staff supplied by manpower agency).
- all security/detective services

When services are provided to a business entity payment under reverse charge is not applicable. Hence, Section 25 companies as per Companies Act, 1956 (Section 8 companies as per Companies Act, 2013) are not required to pay service tax under reverse charge basis.

10. Works Contract Services

Works contract service has been defined in section 65B(54) of the Act as follows

REVERSE CHARGE AND JOINT CHARGE MECHANISM – A BREIF ANALYSIS

“Works contract” means a contract wherein transfer of property in goods involved in the execution of such contract is leviable to tax as sale of goods and such contract is for the purpose of carrying out construction, erection, commissioning, installation, completion, repair, maintenance, renovation, alteration of any movable or immovable property or for carrying out any other similar activity or a part thereof in relation to such property”

Payment of service tax under reverse charge is applicable when the service provider is individual or partnership firm or HUF and the service receiver is body corporate. 50% of service tax liability is to be paid by service receiver and 50% of service tax liability is to be paid by service provider by charging from service receiver. Following table exhibits the share of service tax for service provider and service receiver.

Nature of Work	Rate	Percentage of labour portion as per Rule 2A of Valuation Rules	Effective Tax Rate	Share of Service Provider & Service Receiver
Any contract involving the use of labour plus material on which VAT is leviable under any schedule of VAT Act on the material used in execution of works contract and such contract is for any new construction; any addition and alteration to abandoned or damaged structures on land that are required to make them workable; any erection,	12.36%	40%	4.94%	2.472%

REVERSE CHARGE AND JOINT CHARGE MECHANISM – A BREIF ANALYSIS

commissioning or installation of plant, machinery or equipment or structures, whether pre-fabricated or otherwise				
Any other works contract	12.36%	70%	8.65%	4.326%

When services are provided to a business entity payment under reverse charge is not applicable. Hence, Section 25 companies as per Companies Act, 1956 (Section 8 companies as per Companies Act, 2013) are not required to pay service tax under reverse charge basis.

11. Renting of Motor Vehicle designed to carry passengers

Any person who is a body corporate receiving the above service from any individual, partnership firm, HUF then service tax is to be paid on reverse charge basis as follows

Scenario	Rate of Service Tax	Abatement	Effective Rate of tax	Share of Service Receiver	Share of Service Provider
Service Provider does not avail abatement.	12.36%	Nil	12.36%	6.18%	6.18%
Service Provider avails abatement.	12.36%	60%	4.944%	4.944%	Nil

When a body corporate receives services from a person for the service of renting of motor vehicle not covered in Negative list under section 66D or mega exemption notification, it has to pay service tax under reverse charge mechanism.