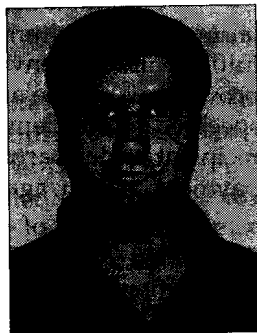


"REVERSE CHARGE MECHANISM" — AN ANALYSIS

By

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In the Financial Budget 2012 Finance Minister had introduced a partial reverse charge mechanism, which is newly developed concept of generating revenue in the shape of tax charged at source.

The basic concept of introducing the reverse charge mechanism by the Government was that the number of registrants collect the tax but do not pay the same to the department. This was a serious loss of the revenue even though the compliant section at the recipient end is often not benefited. To ensure proper collection, while not inconveniencing small business, a new scheme is proposed and introduced in Finance Budget 2012 in the name of Partial Reverse Charge Mechanism.

That in this new regime service provider and service recipient are liable to pay service in compliance to their percentage according to table mentioned under Notification No. 30/2012-S.T., dated 20-6-2012 with effect from 1-7-2012.

Although under Section 68(1) of the Finance Act, 1994 states that every person providing taxable service shall pay Service Tax at the prescribed rate specified in Section 66B but under Reverse Charge Mechanism, most of the services under Notification No. 30/2012-S.T., dated 20-6-2012, service provider, i.e. person who is providing taxable service is liable to pay Service Tax. However, in few services as per said notification, exceptions have been made and the service receiver is made liable to pay Service Tax.

As there is no provision like Income-tax Act, to deduct tax at source in case of Service Tax, and in absence of such provision, the service receiver is not required to deduct tax and deposit/pay the same to department.

Any service whose point of taxation has been determined and whole liability affixed before 1-7-2012 the new provisions of reverse charge mechanism will not applicable on such services. Merely because payments are being made after 1-7-2012 will not add any additional liability on the service receiver in respect of such services.

It is also clarified by the Government that any service provided in the State of J & K will not be liable to tax. The Place of Supply Rules, 2012 will determine whether a service is being provided in J & K. Moreover wherever the service provider is located in J & K but the service is being provided in taxable territory, in terms of the stated rules, the tax will be collected from the service receiver under Partial Reverse Charge Mechanism.

The liability of the service provider and service recipient are different and independent of each other. Thus in case the service provider who is availing exemption owing to turnover being less than ₹ 10 lakhs, he will not be obliged to pay any tax. However, the service recipient is liable to pay Service Tax which he is obliged to pay under the partial reverse charge mechanism.

Although service provider is allowed Cenvat credit of tax paid by him on input services under partial reverse charge mechanism subject to conditions fulfilled under Cenvat Credit Rules, 2004. The credit of tax paid by the service provider would be available on the basis of the invoice subject to the conditions specified in the Cenvat Credit Rules, 2004. The credit of tax paid by the service recipient under partial reverse charge would be available on the basis on the tax payment challan, again subject to conditions specified in the said Rules.

Analysis of some important services as per Notification No. 30/2012-S.T., dated 20-6-2012 under reverse charge mechanism is discussed with short explanation for understanding in easy manner as under :-

• **Goods Transport by Road Service :-** the person liable to pay freight to the transporter or service provider who provides service in connection to goods transport of goods by road in such service receiver are liable to pay Service Tax under reverse charge mechanism as per following table :-

Description of a service	Percentage of Service Tax payable by the person providing service	Percentage of Service Tax payable by the person receiving the service	Status of Service Provider	Status of Service Receiver
In respect of services provided or agreed to be provided by a goods transport agency in respect of transportation of goods by road. Tax is to be paid on 25% of the gross amount after availing abatement	NIL	100%	Goods Transport Agency	<ol style="list-style-type: none"> Any factory registered Society Registered Co-operative Society Dealer of excisable goods body corporate established partnership firm

Following service provided by goods transport agency to the service receiver are covered under negative list or out of preview of Service Tax therefore not liable to Service Tax.

Services provided by a goods transport agency by way of transportation of -

- (a) fruits, vegetables, eggs, milk, food grains or pulses in a goods carriage;
- (b) goods where gross amount charged on a consignment transported in a single goods carriage does not exceed one thousand five hundred rupees; or
- (c) goods, where gross amount charged for transportation of all such goods for a single consignee in the goods carriage does not exceed rupees seven hundred fifty.

• **Sponsorship service :-** any service provider involved in providing sponsorship service to body corporates or firms involved business or commerce sponsor events with an intent to obtain commercial benefit or bringing their name or products or services in public image to public attention by associating with a popular or successful event. This is an alternate form of advertisement. Consideration is normally paid in return for naming of the event after the sponsor or displaying the sponsoring company's logo or trading name or giving the sponsor exclusive or priority booking rights, such service receiver are liable to pay Service Tax under reverse charge mechanism as per following table :-

Description of a service	Percentage of Service Tax payable by the person providing service	Percentage of Service Tax payable by the person receiving the service	Status of Service Provider	Status of Service Receiver
in respect of services provided or agreed to be provided by way of sponsorship	NIL	100%	Any Person	1. Anybody corporate 2. Partnership firm located in the taxable territory

• **Individual advocate or a firm of advocates providing legal services :-**
An individual advocate or a firm of advocates providing services to service receiver by way of support services in connection with any consultancy, advice or technical assistance provided in any discipline of law are liable to be subjected to Service Tax such service receiver are liable to pay Service Tax under reverse charge mechanism as per following table :-

Description of a service	Percentage of Service Tax payable by the person providing service	Percentage of Service Tax payable by the person receiving the service	Status of Service Provider	Status of Service Receiver
in respect of services provided or agreed to be provided by individual advocate or a firm of advocates by way of legal services	NIL	100%	1. Individual advocate 2. A firm of advocates	Any Business Entity located in taxable territory

• **Services provided by Director of the Company to said Company :-**

Service Tax is payable under reverse charge on services provided by non-executive, nominee and independent Directors to the Company w.e.f. 7-8-2012 vide Notification No. 45/2012-S.T., dated 7-8-2012 and not from 1-7-2012. Service Tax is not payable in case of Managing Director or whole time Director or Executive Director, if the Director is in full time employment of the company. Service Tax will be payable on sitting fees paid to directors for attending meetings of Board and Committees of Board, travelling expenses and incidental expenses for attending meetings of Board and their Committees, Commission or other remuneration paid, such service receiver are liable to pay Service Tax under reverse charge mechanism as per following table :-

Description of a service	Percentage of Service Tax payable by the person providing service	Percentage of Service Tax payable by the person receiving the service	Status of Service Provider	Status of Service Receiver
in respect of services provided or agreed to be provided by a director of a company to the said company, It is effective from 7-8-2012 and not from 1-7-2012	NIL	100%	Director of a Company	Business Entity registered as body corporate located in taxable territory

• **Service Provided by Government or local authority by way of support services :-** services provided or agreed to be provided by Government or local authority by way of support services excluding :-

- (1) Renting of immovable property, and
- (2) Services specified in sub-clauses (i), (ii) and (iii) of clause (a) of Section 66D of the Finance Act, 1994.

Therefore such service receiver is liable to pay Service Tax under reverse charge mechanism as per following table :-

Description of a service	Percentage of Service Tax payable by the person providing service	Percentage of Service Tax payable by the person receiving the service	Status of Service Provider	Status of Service Receiver
in respect of services provided or agreed to be provided by Government or local authority by way of support services excluding, (1) renting of immovable property, and (2) services specified in sub-clauses (i), (ii) and (iii) of clause (a) of Section 66D of the Finance Act, 1994	NIL	100%	Government or local authority	Any Business Entity located in taxable territory

• **Transport of passengers service :-** Services provided by transport of passengers vehicle by service provider for transporting of passengers on renting of a motor vehicle designed to carry passengers and transport of passengers in a contract carriage or hire for the transportation of passengers are taxable, but excluding metered cabs, radio taxis or auto rickshaws. Therefore such service receiver or service provider is liable to pay Service Tax under reverse charge mechanism as per following table :-

Description of a service	Percentage of Service Tax payable by the person providing service	Percentage of Service Tax payable by the person receiving the service	Status of Service Provider	Status of Service Receiver
(a) in respect of services provided or agreed to be provided by way of renting of a motor vehicle designed to carry passengers on abated value to any person who is not engaged in the similar line of business. Tax is to be paid on 40% of the gross amount as availing abatement	NIL	100%	1. Individual, 2. Hindu Undivided Family 3. Partnership firm 4. Whether re-registered or not 5. Including association of persons	Business Entity registered as body corporate located in taxable territory

Description of a service	Percentage of Service Tax payable by the person providing service	Percentage of Service Tax payable by the person receiving the service	Status of Service Provider	Status of Service Receiver
in respect of services provided or agreed to be provided by individual advocate or a firm of advocates by way of legal services	NIL	100%	1. Individual advocate 2. A firm of advocates	Any Business Entity located in taxable territory

• **Services provided by Director of the Company to said Company :-**

Service Tax is payable under reverse charge on services provided by non-executive, nominee and independent Directors to the Company w.e.f. 7-8-2012 vide Notification No. 45/2012-S.T., dated 7-8-2012 and not from 1-7-2012. Service Tax is not payable in case of Managing Director or whole time Director or Executive Director, if the Director is in full time employment of the company. Service Tax will be payable on sitting fees paid to directors for attending meetings of Board and Committees of Board, travelling expenses and incidental expenses for attending meetings of Board and their Committees, Commission or other remuneration paid, such service receiver are liable to pay Service Tax under reverse charge mechanism as per following table :-

Description of a service	Percentage of Service Tax payable by the person providing service	Percentage of Service Tax payable by the person receiving the service	Status of Service Provider	Status of Service Receiver
in respect of services provided or agreed to be provided by a director of a company to the said company, It is effective from 7-8-2012 and not from 1-7-2012	NIL	100%	Director of a Company	Business Entity registered as body corporate located in taxable territory

• **Service Provided by Government or local authority by way of support services :-** services provided or agreed to be provided by Government or local authority by way of support services excluding :-

(1) Renting of immovable property, and

(2) Services specified in sub-clauses (i), (ii) and (iii) of clause (a) of Section 66D of the Finance Act, 1994.

Therefore such service receiver is liable to pay Service Tax under reverse charge mechanism as per following table :-

Description of a service	Percentage of Service Tax payable by the person providing service	Percentage of Service Tax payable by the person receiving the service	Status of Service Provider	Status of Service Receiver
in respect of services provided or agreed to be provided by Government or local authority by way of support services excluding,— (1) renting of immovable property, and (2) services specified in sub-clauses (i), (ii) and (iii) of clause (a) of Section 66D of the Finance Act, 1994	NIL	100%	Government or local authority	Any Business Entity located in taxable territory

• **Transport of passengers service :-** Services provided by transport of passengers vehicle by service provider for transporting of passengers on renting of a motor vehicle designed to carry passengers and transport of passengers in a contract carriage or hire for the transportation of passengers are taxable, but excluding metered cabs, radio taxis or auto rickshaws. Therefore such service receiver or service provider is liable to pay Service Tax under reverse charge mechanism as per following table :-

Description of a service	Percentage of Service Tax payable by the person providing service	Percentage of Service Tax payable by the person receiving the service	Status of Service Provider	Status of Service Receiver
(a) in respect of services provided or agreed to be provided by way of renting of a motor vehicle designed to carry passengers on abated value to any person who is not engaged in the similar line of business. Tax is to be paid on 40% of the gross amount as availing abatement	NIL	100%	1. Individual, 2. Hindu Undivided Family 3. Partnership firm 4. Whether re-registered or not 5. Including association of persons	Business Entity registered as body corporate located in taxable territory

(b) in respect of services provided or agreed to be provided by way of renting of a motor vehicle designed to carry passengers on non abated value to any person who is not engaged in the similar line of business.	60%	40%	6. Located in the taxable territory	
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• **Supply of Manpower Service :-** The manpower supply is defined in Rule 2(g) of the Service Tax Rules, 1994 which means "supply of manpower temporarily or otherwise to another person under his superintendence or control".

Thus the essence of the service is that the service provider shall only be responsible for supply of manpower. The manpower will work under the supervision and control of the service receiver.

The said supply of manpower service provided by individual, HUF, Firm, AOP or service provider located in the taxable territory provided to body of corporate is covered under reverse charge w.e.f. 1-7-2012 vide Notification No. 30/2012-S.T., dated 20-6-2012.

• **Security Service :-** "security agency" means any commercial concern engaged in the business of rendering services relating to the security of any property, whether movable or immovable, or of any person, in any manner and includes the services of any investigation, detection or verification, of any fact or activity, whether of a personal nature or otherwise, including the services of providing security personnel. The service provided by individual, HUF, Firm, AOP or service provider located in the taxable territory provided to body of corporate is covered under reverse charge w.e.f. 7-8-2012 vide Notification No. 45/2012-S.T., dated 7-8-2012 and not from 1-7-2012.

The Board had clarified in his educational guide that Services provided by Government security agencies are covered by the main portion of the definition of support service as similar services can be provided by private entities. In any case it is also covered by the inclusive portion of the definition. However the tax will be actually payable on reverse charge by the recipient.

Therefore such service receiver and service provider is liable to pay Service Tax under reverse charge mechanism as per following table :-

Description of a service	Percentage of Service Tax payable by the person providing service	Percentage of Service Tax payable by the person receiving the service	Status of Service Provider	Status of Service Receiver
in respect of services provided or agreed to be provided by way of supply of manpower for any purpose.	25%	75%	1. Individual, 2. Hindu Undivided Family	Business Entity registered as body corporate located in

in respect of services provided or agreed to be provided by way of Security Guard Service for any purpose. It is effective from 7-8-2012 and not from 1-7-2012.	25%	75%	3. Partnership firm 4. Whether reregistered or not 5. Including association of persons 6. Located in the taxable territory	taxable territory
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• **Service portion in execution of works contract Service :-** Works contract has been defined in Section 65B of the Act as 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, fitting out, repair, maintenance, renovation, alteration of any moveable or immovable property or for carrying out any other similar activity or a part thereof in relation to such property. Typically every works contract involves an element of sale of goods and provision of service but excludes the works defined in mega exemption Notification No. 25/2012-S.T., dated 20-6-2012.

Pure Labour Contracts do not fall in the definition of works contract. It is necessary that there should be transfer of property in goods involved in the execution of such contract which is leviable to tax as sale of goods. Pure Labour Contracts are therefore not works contracts and would be leviable to Service Tax like any other service and on full value.

Contracts for repair or maintenance of moveable properties are also works contracts if property in goods is transferred in the course of execution of such a contract. Service Tax has to be paid in the service portion of such a contract. Such as contracts for painting of a building, repair of a building, renovation of a building, wall tiling, flooring be covered under works contract'. In this connection contracts for repair or maintenance of motor vehicles will also be treated as 'works contracts service' if it includes transfer of property and service both.

The service portion can be calculated as per scheme contained in the clause (ii) of Rule 2A of the Service Tax (Determination of Value) Rules, 2006. As per this scheme the value of the service portion, where value has not been determined in the manner as provided in clause (i) of Rule 2A (explained in point 8.2.1 above), shall be determined in the manner explained in the table below -

Where works contract is for...	Value of the service portion shall be...
(A) execution of original works	forty per cent of the total amount charged for the works contract
(B) maintenance or repair or reconditioning or restoration or servicing of any goods	seventy per cent of the total amount charged including such gross amount

(C) in case of other works contracts, not included in serial nos. (A) and (B) above, including contracts for maintenance, repair, completion and finishing services such as glazing, plastering, floor and wall tiling, installation of electrical fittings.	sixty per cent of the <i>total amount charged</i> for the works contract
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Reverse charge Mechanism is applicable on works contract services in which service provider is Individual/Proprietorship/partnership/HUF and service receiver is company registered under the Companies Act, 1956 or business entity registered as body corporate in taxable region.

The service recipient is required to calculate his tax liability under Partial Reverse Charge Mechanism therefore Board had clarified that the service recipient would need to discharge liability only on the payments made by him. Thus the assessable value would be calculated on such payments done (free of cost material supplied and out of pocket expenses reimbursed or incurred on behalf of the service provider need to be included in the assessable value in terms of Valuation Rules). The invoice raised by the service provider would normally indicate the abatement taken or method of valuation used for arriving at the taxable value. However since the liability of the service provider and service recipient are different and independent of each other, the service recipient can independently avail or forgo abatement or choose a valuation option depending upon the ease, data available and economics.

Therefore such service receiver and service provider is liable to pay Service Tax under reverse charge mechanism as per following table :-

Description of a service	Percentage of Service Tax payable by the person providing service	Percentage of Service Tax payable by the person receiving the service	Status of Service Provider	Status of Service Receiver
in respect of services provided or agreed to be provided in service portion in execution of works contract	50%	50%	1. Individual, 2. Hindu Undivided Family 3. Partnership firm 4. Whether reregistered or not 5. Including association of persons 6. Located in the taxable territory	Business Entity registered as body corporate located in taxable territory

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I feel intention of the Government while introducing Partial Reverse Charge Mechanism under Service Tax provisions is to reduce the load of Service Tax on providers of service who are in the unorganized sectors. But coming to the conclusion reverse charge mechanism is confusing to service providers and service recipient to understand calculation of Service Tax liability on their part. On other hand extra tax liability is loaded on the shoulders of service recipient due to reverse charge mechanism, in such a time of inflation.
