

Reverse Charge Mechanism under service tax – an updated Guide – Aug 16, 2012

1. Please provide a general note on the reverse charge mechanism?

With effect from July 1, 2012, the Reverse Charge Mechanism ('RCM') has come into effect. Under RCM, the service receiver is required to pay service tax, either partly or fully, in respect of certain specified input services received by him, under certain specified circumstances. The service receiver is required to discharge his service tax liability on cash basis and cenvat credit cannot be used for discharging this liability. Cenvat credit would be available to the service receiver, who has discharged the service tax liability under RCM, subject to the provisions. service tax liability fastened on the service provider.

2. Under what statutory provision is this levied?

The enabling provision has been provided by insertion of Proviso to [Section 68](#) in the Finance Act as per which Central Government may notify the service and the extent of service tax which shall be payable by such person and the provisions of Chapter V shall apply to such person to the extent so specified and the remaining part of the service tax shall be paid by the service provider. Under this clause the Central government has issued [notification No. 30/ 2012](#) dated 20.6.2012 notifying the description of specified services when provided in the manner so specified where part of the service tax has to be paid by the service receiver. The extent to which tax liability has to be discharged by the service receiver has also been specified in the said notification.

3. What are the services on which RCM is applicable and at what rates?

In some cases, under the RCM, the service tax liability is to be partially discharged by the service provider and the service receiver on three services, viz, vehicle hire services, manpower supply services and works contract services. In other services, specified, below, the service receiver, being a business entity, is liable for service tax to the extent of 100% of the liability.

4. Is service tax payable on import of services also?

Yes. While, in the case of RCM operating in respect of activities transacted within the taxable territory, the service provider's liability arises only in respect of services received from non-corporates (individuals, partnership firms, AOPs and LLPs), in the case of import of services, any person importing services from any person, is liable to discharge the service tax liability, subject to exemptions given under the Mega Exemption Notification.

5. Can a chart be given for the service tax liability arising under the RCM?

The following chart will possibly be helpful:

Sl. No.	Provider of Service	Recipient of Service	Service provider's liability	Service recipient's liability
A.	Services provided by insurance agents to persons carrying on insurance business	Persons carrying on insurance business (Insurance Companies)	Nil	The entire service tax liability shall be discharged by the service recipient, i.e. the Insurance company
B.	Services provided by Goods Transport Agency	If the Consignee or Consignor is:-a) Factory;	Nil	The entire service tax liability shall be discharged by the person paying the freight. It is clarified that as per Notification 13/2012, ST is payable only on 25 % of freight. Such

	b) Any registered society;		liability on 25 % of freight amount shall be discharged in full by the service recipient.	
	c) Any co-operative society;			
	d) Any dealer registered under CE;			
	e) Any body corporate;			
	f) Any partnership firm.			
C.	Services provided by Sponsors of events etc. to those sponsoring.	1. Body Corporate;2. Partnership firm	Nil	The entire service tax liability shall be paid by the service recipient.
D.	Services provided by Arbitral Tribunal	Business entity	Nil	The entire service tax liability shall be discharged by the service recipient
E.	Legal Services provided by Individual Advocate	Business entity	Nil	The entire service tax liability shall be discharged by the service recipient
F.	Support services provided by Government or Local Authority	Business entity	Nil	The entire service tax liability shall be discharged by the service recipient.
G.	Services by way of renting or hiring of passenger vehicles, provided by Individual; or HUF; or Proprietary firm; or Partnership Firm (whether registered or not including the association of persons); Services by way of renting or hiring of passenger vehicles, provided by	1. Any company formed or registered under Companies Act; or2. Business entity registered as a body corporate.	Nil	As per Notification 13/2012, ST is payable on 40 % of value. Hence, the entire service tax on 40 % of the value shall be discharged by the service recipient.
H.	1. Individual; or 2. HUF; or 3. Proprietary firm; or 4. Partnership Firm (whether registered or not including the association of persons);	1. Any company formed or registered under Companies Act; or2. Business entity registered as a body corporate.	If the service provided does not intend to claim abatement, he has to pay 60% of the total service tax liability. In the above given example, the ST liability on Rs.10,000 @ 12 % is Rs.1,200, out of which the service provider has to pay 60 % of Rs.1,200, i.e. Rs.720	The service recipient shall pay 40 % of the total liability, i.e. Rs.480. It may be noted that in both the cases, the service recipient's liability is same.
I.	Manpower supply or security agency services provided by	1. Any company formed or registered under Companies Act; or2. Business entity	25% of the Service tax liability shall be paid by	75 % of the ST liability shall be paid by the service recipient.

Individual; or registered as a body corporate. the service provider.

2. HUF; or

3. Proprietary firm; or

4. Partnership Firm (whether registered or not including the association of persons);

Works Contract services provided

by

1. Individual; or

2. HUF; or

3. Proprietary firm; or

4. Partnership Firm (whether registered or not including the association of persons);

J.	1. Any company formed or registered under Companies Act; or 2. Business entity registered as a body corporate.	50 % of the service tax liability shall be paid by the service provider.	50 % of the Service tax liability shall be paid by the service recipient.
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K.	Services provided by non-Executive Directors	Companies	100% of the service tax liability to be paid by the service receiver	Nil
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L.	Any service provided by a person located outside the taxable territory (non taxable territory).	Any person located in the taxable territory , including an individual	Nil	The entire service tax liability shall be paid by the service recipient. Exemption is available in respect of import of services by an individual for non-commercial or non-business uses.
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6. How is a business entity defined

As per Section 65B(17) – ‘Business Entity’ means any person ordinarily carrying out any activity relating to industry, commerce or other business or profession. Hence, the term ‘Business Entity’ includes individuals running businesses or individual professionals other than, partnership firms, companies, etc.

It is very important to fully comprehend the meaning of a ‘Business Entity’, as even individuals running businesses or professionals can be covered under the Reverse Charge Mechanism.

7. What does a service provider need to indicate on the invoice when he is liable to pay a part of the liability under the partial reverse charge mechanism?

The service provider shall issue an invoice complying with [Rule 4A](#) of the [Service Tax Rules 1994](#). Thus the invoice shall indicate the name, address and the registration number of the service provider; the name and address of the person receiving taxable service; the description and value of taxable service provided or agreed to be provided; and the service tax payable thereon. As per [clause \(iv\) of sub-rule \(1\) of the said rule 4A](#) “the service tax payable thereon’ has to be indicated. The service tax payable would include service tax payable by the service provider.

8. If the service provider is exempted being a SSI (turnover less than Rs. 10 lakhs), how will the reverse charge mechanism work?

The liability of the service provider and service recipient are different and independent of each other. Thus in case the service provider is availing exemption owing to turnover being less than Rs. 10 lakhs, he shall not be obliged to pay any tax. However, the service recipient shall have to pay service tax which he is required to pay under the partial reverse charge mechanism, notwithstanding the fact that the service provider is not liable to pay service tax.

9. Will the credit of such tax paid be available to the service recipient?

Normally, the credit of the entire tax paid on the service received by the service receiver would be available to the service recipient subject to the provisions of the [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.

10. What shall be the point of taxation for the service recipient? When will he need to pay the service tax in respect of his liability?

Both the service provider and service recipient are governed by the [Point of Taxation Rules 2011](#) in respect of the service provided or received by him. Usually it is the invoice or date of receipt of payment which is the point of taxation for the service provider. However for the service recipient, in terms of rule 7 of the said rules, point of taxation is when he effects payment to the service provider, provided that the payment is made within 6 months of the date of the invoice of the service provider. Thus in the case where the invoice is issued in, say, July 10, 2012 and the service recipient pays for the same in December 1, 2012, the point of taxation for the service provider will be the date of issue of invoice, i.e July 10, 2012. The point of taxation for the service recipient shall, however, be the date of payment, i.e. December 1, 2012. The service provider would be required to pay service tax (to the extent, the liability is fixed on him, under RCM) on or before by 5th/6th January, 2013. Assuming that the service receiver has not effected the payment to the service provider within six months of the date of the invoice, the service tax liability would swing back to the date of the invoice of the service provider.

11. How is the service recipient required to calculate his tax liability under partial reverse charge mechanism? How will the service recipient know which abatement or valuation option has been exercised by the service provider, in the case of rent-a-cab / taxi hire services?

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. (In the case of works contracts, value of the free of cost materials supplied and out of pocket expenses reimbursed or incurred on behalf of the service provider would need to be included in the assessable value in terms of Valuation Rules). The invoice raised by the service provider would normally indicate the details of 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.

This problem would arise only in the case of certain specified input services like rent-a-cab services. In this case, the service receiver is required to discharge service tax liability on 40% of the gross amount charged, irrespective of whether the service provider has taken abatement or not and hence, there should be no issues.

12. Is the reverse charge applicable on services provided and completed before 1.7.2012 though payments were made after 1.7.2012?

Unfortunately, full clarity is not available on this subject matter. In terms of Circular No. 162/13/2012-ST dated July 6, 2012, for any service whose point of taxation has been determined and whole liability affixed before 1.7.2012, the new provisions will not apply. *Per se*, in terms of this Circular, if the invoice is raised with a date on or after July 1, 2012, the Reverse Charge Mechanism would apply, even if the service has been rendered prior to July 1, 2012.

However, in our view.... since Notification No.30/2012-ST dated 20-6-2012 has come into effect only from July 1, 2012, the RCM can cover activities which happen on or after July 1, 2012 and consequently, services which were rendered or completed on or before July 1, 2012 may not be covered under RCM.

This issue, however, is not free from doubt.

13. Can cenvat credit can be utilized by the service receiver to discharge his liability under the RCM?

No. Despite the decision of the Karnataka High Court in the Aravind Fashions case **2011-TIOL-748-HC-KAR-ST**, the benefit of utilizing cenvat credit for paying service tax under RCM is not available, in terms of the amendment carried out to rule 3(4) of the Cenvat Credit Rules, 2004 with effect from 1-7-2012. Accordingly, the service tax liability has to be discharged by the service recipient in cash, which of course, can be availed as cenvat credit, subject to restrictions contained in the Cenvat Credit Rules, 2004.

14. When does the liability to pay service tax under RCM arise... is it, on the date of receipt of the invoice of the service provider or on the date, the service received makes the payment to the service provider? Are the rules different if the service provider happens to be an 'associated enterprise'?

In the case of services where the recipient is liable to pay tax on reverse charge basis, similar obligation vis-à-vis payment of service tax has been cast on the service recipient, though the invoices are issued by the service provider. It is clarified that the date of provision of service shall be determined in terms of Point of Taxation Rules, 2011. In the case of persons liable to pay tax on reverse charge basis, the date of provision of service shall be the date of payment except in the case of associated enterprises receiving services from abroad where the date shall be earlier of the date of credit in the books of accounts or the date of payment. Thus the service receiver, liable to pay tax on reverse charge basis is required to ensure that the invoice is available at the time the payment is made or at least received within 30 days thereafter and in the case of associated enterprises, invoice should be available with the service receiver at the time of credit in the books of accounts or the date of payment towards the service received.

15. Will the services provided by Police or security agencies to PSUs or corporate entities or sports events held by private entities covered under RCM?

Yes. 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, in these cases.

16. What are the services on which such partial reverse charge mechanism shall be applicable?

In terms of Serial Nos. 7(b), 8 and 9 of the table in [Notification No. 30/2012](#) dated 20.6.12, the new partial reverse charge mechanism is applicable to services provided or agreed to be provided by way of

(a) renting of a motor vehicle designed to carry passengers on non-abated value to any person who is not engaged in a similar business, or

(b) supply of manpower for any purpose, or security agency service

(c) service portion in execution of a works contract;

by any individual, Hindu Undivided Family or partnership firm, whether registered or not, including association of persons, located in the taxable territory to a business entity registered as a body corporate located in the taxable territory. Thus the nature of the service and the status of both the service provider and service receiver are important to determine the applicability of partial reverse charge provisions.

17. How is a 'body corporate' defined?

The term 'body corporate' is not defined under the Finance Act, 1994.

As per section 2(7) of the Companies Act, 'body Corporate' or 'corporation' includes a company incorporated outside India, but does not include – (a) Corporation Sole (b) Registered Co-operative Society (c) Any other body corporate (Except a company defined under Companies Act) as may be notified by the Central Government.

A "Cooperative Society" is body. A partnership firm is not a body corporate." A society is not a body corporate. An AOP or a Trust, is not a body corporate.

18. Are import of services by individuals exempt?

Import of services by individuals, for non-commercial or non-business services continues to be exempt even under the new law. However, if the individual imports services for purposes of commercial uses, service tax is payable under the RCM. When individual employees pay for imported services and then claim reimbursement from their employers, RCM could get attracted as the employer would be treated as having imported the services.

19. On what basis can cenvat credit be taken by the service provider, who has paid service tax under the RCM?

The service provider can avail of cenvat credit on the basis of the GAR-7 challan, evidencing the payment of service tax by him, under the RCM. From a practical perspective, it is better to use a separate GAR-7 challan for payment of service tax under RCM,

20. Are software AMC services rendered by non-corporates to be treated as works contract services, requiring the corporate service receiver to pay service tax under RCM?

It is not that all AMCs are to be treated as works contracts. In many cases, software maintenance contracts are pure services contracts. Whether the input service is a works contract or a pure services contract, can be identified from the bill / invoice of the service provider. If the service provider has charged VAT, it would be a works contract, requiring the service receiver to pay service tax under the RCM.

21. An employee of a software company has hired a taxi from a non-corporate for official purposes and claims a reimbursement. Is the RCM attracted in this case?

In our view, the transaction involving the reimbursement of the conveyance / taxi hire charges will still attract RCM, so long as the bill is booked by the Company, irrespective of whether the bill is raised in the name of the Company or in the name of the employee.

22. Are there any exemptions in respect of taxi hire charges?

Yes. Payments made to Metered Cabs, Radio Taxis and Auto Rickshaws are exempted, by virtue of the Mega Exemption. Metered Cab has been defined as under:

Metered cab" means any contract carriage on which an automatic device, of the type and make approved under the relevant rules by the State Transport Authority, is fitted which indicates reading of the fare chargeable at any moment and that is charged accordingly under the conditions of its permit issued under the Motor Vehicles Act, 1988 (59 of 1988) and the rules made thereunder;

Radio Taxi is not defined.

Since, services provided by Metered Cabs, Radio Cabs and Auto Rickshaws are exempted from the levy of service tax, the Reverse Charge Mechanism is also not attracted.

23. As a software company, we understand that, we are liable to pay service tax on input services such as, taxi hire charges, etc. if taken from non-corporate service providers. Is cenvat credit on these services, in respect of which, we are liable to pay service tax under RCM?

To have a liability to discharge service tax under the RCM, is no guarantee to ensure that, cenvat credit is available, which is still governed by the Cenvat Credit Rules, 2004. In the instant case, cenvat credit would not be available on taxi hire charges.

24. We understand that, we are liable for service tax on maintenance services, under RCM, assuming that, these maintenance services are works contracts and the services are provided to us by non-corporates. What are the service tax rates that are applicable for maintenance services that are considered as works contracts? How will the service receiver's liability be computed in this case, as a typical example?

VAT is to be charged @ 5% on 75% of the value while service tax is to be charged @ 12.36% on 70% of the value. No service tax is to be charged on the VAT element and vice versa.

Here is the methodology of how the RCM would work, in a typical case:

Assuming that the value of the AMC is Rs 1,00,000/- and is a works contract... the service tax liability is to be shared between the service receiver and the service provider in the ratio of 50:50. In the instant case, the service tax liability of Rs 8,652/- (calculated @ 12.36% on 70% of Rs 1,00,000/-) would have to be discharged by the service provider (who would be a non-corporate) paying Rs 4,326/- and the service recipient, paying Rs 4,326/-.

The above represents the methodology for computation of the liability under the Reverse Charge Mechanism.

25. Is the activity of photocopying or Xeroxing a works contract ?

Yes. The activity of photocopying or Xeroxing is a works contract and payments towards these services would attract service tax, under the Reverse Charge Mechanism.

26. As a company, we have outsourced our housekeeping work to an external agency. Are we liable to pay service tax under RCM?

It would depend on the nature of the contract entered into with the housekeeping agency. If the housekeeping staff work under the superintendence or control of the Company officials, Reverse Charge Mechanism would get triggered under 'supply of manpower' services.

27. We are a company with less than Rs 10 lakhs turnover and hence, have not taken service tax registration. What would happen if we incur Xeroxing expenses of, say, Rs 100/-

The activity of Xeroxing or photocopying is a works contract. In terms of the Reverse Charge Mechanism, you would be required to take registration under the service tax law and pay service tax on the Xeroxing charges, by adopting a suitable valuation methodology.

Hence, the liability under Reverse Charge Mechanism is triggered even when the service recipient is a small service provider having turnover of less than Rs 10 lakhs and is not otherwise liable to pay service on his output services and even in cases, where the service provider is a small scale service provider.

28. Is the service receiver's liability under RCM independent of the service provider's liability?

Yes. The liability of the service provider to pay service tax under the Reverse Charge Mechanism is independent of and notwithstanding the service tax liability of the service provider. Irrespective of whether the service provider has discharged his liability on the service provided or not, the service receiver is required to independently discharge his service tax liability, under the RCM.

In the case of works contracts, it is provided that the service receiver can follow a valuation method, which is independent of the valuation method followed by the service provider.

Hence, in cases involving partial reverse charge, even in cases where the service provider has not charged service tax, due to ignorance or otherwise, the service receiver is required to discharge his liability.

29. Can the same GAR-7 challan be used by the service receiver for discharging his service tax liability under RCM?

Though, the same GAR-7 challan can be used for payment of service tax under RCM along with the service tax liability arising as a service provider, it would be better, from a practical point of view, to have two separate GAR-7 challans, one each for the payment of the liability as a service provider and, as a service receiver, as cenvat credit can be taken on the basis of the GAR-7 challan.

30. I am a service provider covered under the Reverse Charge Mechanism. Assuming that, I am not able to utilize the cenvat credit, given the fact that the service receiver is obliged to discharge a part or the entire service tax liability, am I entitled for a refund of the unutilized credit?

Yes. In terms of Rule 5B of the Cenvat Credit Rules, 2004, introduced with effect from 1-7-2012, the service provider, whose services are covered under RCM, can apply for a refund of the unutilized cenvat credit, subject to the conditions to be specified in the Notification to be issued.

31. I am a small scale service receiver covered under RCM. I am not in a position to utilize the cenvat credit of the service tax paid by me, under RCM, as I am exempted from the payment of service tax. Can I also apply for a refund of the service tax paid by me under RCM?

No. The benefit of Rule 5B of the Cenvat Credit Rules, 2004, as aforesaid, is available only to service providers and not to service receivers. Hence, small scale service receivers, who pay service tax under RCM, are not allowed to claim refund of the service tax paid by them.

32. I am a service receiver covered under RCM. I find that my service provider has fully charged service tax in respect of works contract services, despite that, he is supposed to charge only 50% of the tax. Am I required to pay service tax under RCM, given the fact the service provider has already discharged 100% of the service tax liability?

The service receiver's liability under RCM, is independent of and notwithstanding the service provider's liability. In a typical case like this, the proper course of action would be for the service receiver to discharge his portion of the liability under RCM and have the service provider to issue a revised invoice incorporating the service provider's correct service tax liability.