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Mechanism of Reverse Charge under GST

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Reverse Charge Mechanism, popularly known as RCM is well known to the Service tax assesses whereas this would be the new concept for a person engaged in trading activity and was not liable to discharge service tax as a receiver of service.

RCM is a mechanism wherein the liability to pay the tax (GST) on a transaction is shifted from supplier to receiver. In other words, in the specified cases, the obligation to pay the GST would be on the recipient of goods and/ or services rather than the supplier.

Following could be few reasons behind the idea of Reverse Charge Mechanism:

- a) To enable small entrepreneurs to develop without hassles in early days and later they would grow and contribute to exchequer.
- b) To avoid loss of revenue from grey (unbilled, underbilled) unorganised sector,
- c) To avoid compliance complications to the small players.
- d) To tax every transaction though specified persons are exempted to pay tax due to small scale exemption,
- e) To avoid difficulties in monitoring/assessing persons from unorganised sector.
- f) To provide a level playing field between the tax compliant and the non-compliant, also between service providers outside India and those in India.

Provisions Under Existing Law:

Provisions of The Finance Act 1994, read with Notification 30/2012-Service Tax amended from time to time, provided for service receivers to pay service tax when the specified services like man power supply/security, GTA, rent a cab, sponsorship services etc are received from specified persons, mostly other than companies.

Apart from Reverse charge mechanism, Service tax law also provided for Joint Charge Mechanism, wherein both provider of service and the receiver was made liable to pay service tax to the extent of certain percentage of liability specified in the said notification. Ex: Works contract services.

Further, most of the state VAT laws had a provision to levy VAT on the procurement of goods from the persons not registered under the respective VAT laws (Popularly known as URD purchase).

Under Central Excise law, where molasses are produced in a Khandsari sugar factory, the person who procures such molasses for use in manufacture of any commodity was liable to pay the excise duty.

In most of the cases, the recipient was eligible for Cenvat Credit /ITC of the tax paid under RCM unless specifically restricted in the law.

Changes in the Mechanism under GST:

Following major changes could be observed in the Reverse charge mechanism under GST vis a vis the system under earlier indirect tax laws:

- a) No concept of Joint Charge Mechanism (as on date). i.e. in case of all the specified supplies, the recipient of supply alone liable to pay the GST and not jointly with the supplier.
- b) The RCM is made applicable for both goods as well as services.

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- c) Separate provision introduced to impose the liability to pay GST when the goods and services received by a registered person from any persons who are not registered under GST. [Sec 9(4) of the CGST/SGST Act]. Relaxation given for procurements not exceeding Rs.5000/- in a day.
- d) The list of services on which RCM is applicable is reduced under GST compared to the service tax law. i.e. few of the services covered under reverse charge earlier are now under forward charge and the vice versa.

Provisions governing Reverse Charge under GST:

Following provisions require the recipient of goods or services as the case may be, to pay GST instead of supplier.

- a) Sec 9(3) specifies certain categories of supply of goods or services, the tax on which shall be paid on reverse charge basis **by the recipient of such goods or services** or both. All the provisions of this Act shall apply to such recipient as if he is the person liable for paying the tax in relation to the supply of such goods or services.
- b) Sec 9(4) provides that in respect of the supply of **taxable goods or services** or both by a supplier, **who is not registered**, to a registered person shall be paid by such person on reverse charge basis shall apply to the recipient as if he is person liable and all the provisions of this Act shall apply to such recipient as if he is the person liable for paying the tax in relation to the supply of such goods or services.
- c) Further, Sec 9(5) requires that in case of specified categories of **services (goods not covered)** the tax on such supplies shall be paid by the electronic commerce operator if such services are supplied through it, and all the provisions of this Act shall apply to such electronic commerce operator as if he is the supplier liable for paying the tax in relation to the supply of such services.

Registration: It is mandatory to obtain registration under GST for the persons who are liable to pay tax under reverse charge mechanism. In other words, irrespective of turnover, whether under the exemption threshold limit or not, whether taxable or not, the persons who are liable to pay GST as a recipient of goods or service, such person has to mandatorily register under GST and comply with the law.

On the other hand, government has given relaxation from obtaining registration for the persons who are only engaged in making supplies of taxable goods or services or both, the total tax on which is liable to be paid on reverse charge basis by the recipient.

RCM Liability on Services:

Notification 13/2017-Central Tax (Rate) and 10/2017 -Integrated Tax (Rate), both dated 28.06.2017 have been issued to specify the following list of services where the service recipient is liable to pay GST under RCM. Subject to some exceptions, the list of services covered under earlier service tax regime are made subject to RCM under GST as well.

1. **Import of Services:** Any service supplied by any person who is located in a non-taxable territory (outside India) to any person located in India. Like earlier service tax provisions, the recipient of service is liable to pay tax as far as the place of provision of service (now place of supply under GST) is in India.

However, SEZs are given exemption from payment of GST in case of import of services [18/2017-Integrated Tax (Rate)].

2. Goods Transport Agency (GTA) Services: Supply of services by a GTA in respect of transportation of goods by road is subject to RCM. Following specified persons are required to pay GST when such persons are received transportation of goods by road from a Goods Transport agency:

- a) Any factory registered under Factories Act.
- b) Any Society registered under society registration Act/ or any other law for time being in force.
- c) Any Co-operative society established by or under any law,
- d) Any person registered under CGST/SGST/IGST/UTGST Act.
- e) Any body corporate established by or under any law,
- f) Any partnership firm whether registered or not (including AOPs)
- g) Any casual taxable persons located in taxable territory.

The rate of GST prescribed for GTA services is 5% (IGST) and same shall be discharged by the above specified recipient of service.

When the GTA services are provided to persons other than above specified persons, then the liability to pay GST would be on GTA itself under forward charge.

The person who pays or is liable to pay freight for the transportation of goods by road in goods carriage, located in the taxable territory shall be treated as the person who receives the service for the purpose.

3. Legal Services by advocates: In case of services supplied by an individual advocate including a senior advocate by way of representational services before any court, tribunal or authority, directly or indirectly, to any business entity located in the taxable territory, including where contract for provision of such service has been entered through another advocate or a firm of advocates, or by a firm of advocates, by way of legal service, to a business entity, the liability to pay GST would be on the business entity under RCM.

A writ petition was filed in Hon. Delhi High Court as the entry is not clear whether it covers only the representation services or even other legal services like consultancy, opinion, drafting services etc provided by the advocates. Further it was also questioned whether the advocates would be liable to get registered towards the services other than representation services and pay GST in such cases.

The Delhi high Court has passed an interim-order dated 12.07.2017 directing the government to issue clarification in this regard and the benefits of such clarifications shall not be denied to advocates who have already obtained registration voluntarily. Accordingly, a press release has been released by the Government dated 15.07.2017 clarifying that all legal services provided by advocates/firm of advocates to business entity are subject to reverse charge and being a recipient of supply, the business entity shall be liable to discharge GST under RCM and not the advocates/firm of advocates.

The legal services provided by advocates to other than business entities with more than 20 Lakhs turnover are exempted vide notification 09/2017- Integrated Tax dated 28.06.2017.

4. Services by Arbitral Tribunal: Any business entity located in taxable territory would be liable to pay GST on the services received from an arbitral tribunal.

5. **Sponsorship Services:** Services provided by way of sponsorship to any body corporate or partnership firm is covered under reverse charge. i.e. the body corporate/firm being a receiver of services shall be required to pay GST on the amount so contributed towards sponsorship.
6. **Services by Government:** Where services are received by a business entity located in India from Central Government, State Government, Union territory or a local authority, the liability to pay GST would be on such business entity.

Exceptions: RCM is not applicable when the business entity receives the following services from the government:

- a) Renting of immovable property,
 - b) Services by the Department of Posts by way of speed post, express parcel post, life insurance, and agency services provided to a person other than Central Government, State Government or Union territory or local authority,
 - c) services in relation to an aircraft or a vessel, inside or outside the precincts of a port or an airport,
 - d) transport of goods or passengers.
7. **Director Services:** In case of Services supplied by a director of a company or a body corporate to the said company or the body corporate, the liability to pay GST would be on the company/body corporate. Ex: Sitting fees, Commission etc received by directors.
However, it shall be noted that the remuneration received by the wholtime directors who are in payroll of the company (employees) do not get covered here as such services are treated as neither supply of goods nor supply of services under GST.
 8. **Insurance Agent service:** Insurance company located in India shall be liable to pay GST under RCM on the consideration say commission paid to insurance agents. Hence, Insurance agents not require to get registered under GST unless they are into taxable supply other than agency services.
 9. **Services of Recovery Agent:** The liability to pay GST is on a banking company or a financial institution or a non-banking financial company, located in the taxable territory who receives services of recovery agent.
 10. **Transportation of goods by vessel by a person located in non taxable territory up to the Custom Station clearance in India:** In such cases the importer is liable to pay GST under RCM.
 11. **Services by way of transfer or permitting the use or enjoyment of a copyright:** The new entry introduced under RCM where in Publisher, music company, producer or the like, located in the taxable territory would be liable to pay GST when they receive services by way of transfer or permitting the use or enjoyment of a Copyright relating to original literary, dramatic, musical or artistic works from an author, music composer, photographer, artist or the like.

In short,

Supplier of Service: Author, Music Composer, Photographer, Artist or the like.

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Recipient of Service: Publisher, Music company, Producer or the like.

Description of service: services by way of transfer or permitting the use or enjoyment of Copy right relating to original literary, dramatic, musical or artistic works.

Liability to Pay GST: By Recipient of service under RCM.

Condition: Such Copy right shall be registered covered under clause (a) of sub-section (1) of section 13 of the Copyright Act, 1957.

Services not subject to RCM:

All the supply of services which are not covered above are subject to forward charge. However, it is important to list out the cases which were subjected to reverse charge under service tax regime but not under GST:

- a) Rent a cab services
- b) Man Power Supply Services
- c) Security services
- d) Works contract Services

In all the above cases, the liability to collect and pay GST would be on the Supplier of service and not the recipient under reverse charge.

RCM Liability on Goods:

Government has issued notification 04/2017 Central Tax (Rate) and Notification No. 4/2017 Integrated Tax (Rate), both dated 28.06.2017 to notify the goods which are subjected to RCM. The same is given in the below table. The person mentioned in the recipient column would be liable to pay GST on procurement of specified goods from the person mentioned under supplier column.

SI No	HSN	Description of Goods	Supplier	Recipient
1	0801	Cashew nuts, not shelled or peeled	Agriculturist	Any Registered person
2	1404 9010	Bidi Wrapper leaves (tendu)	Agriculturist	Any Registered person
3	2401	Tobacco leaves	Agriculturist	Any Registered person
4	5004 to 5006	Silk Yarn	Any person who manufactures silk yarn from raw silk or silk worm cocoons	Any Registered person
5	-	Supply of Lottery	State Government, Union Territory or any local authority	Lottery Distributor or selling agent
6	All	Import of Goods	Person Outside India	Person in India

Procurements from Unregistered Persons:

The unregistered purchases are subject to RCM where in the purchaser being a registered person is liable to Pay GST. Government has given a relaxation vide notification No.08/2017-Central Tax dated 28.06.2017 where in it is clarified that GST is required to be paid by the recipient only where the aggregate value of such supplies of goods or service or both received

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by a registered person from any or all the suppliers, who is or are not registered, exceeds five thousand rupees in a day.

Following aspects shall be kept in mind as far as purchases from Unregistered Persons (URPs) are concerned:

1. Procurement from all the unregistered vendors shall be taken into account while arriving the aggregate value of such inward supplies to see whether it has crossed Rs.5000/- in any given day.
2. The liability arises both in case of goods as well as services. Hence, aggregate value shall include both.
3. The GST is applicable on procurement from URPs irrespective of mode of payment like cash, Cheque, NEFT etc.
4. Petty cash expenses such as stationery, onetime repairs etc i.e. expenses charges to P&L shall be observed to identify the liabilities for compliance.
5. Applicable GST i.e. CGST and SGST shall be discharged for all the liable cases. IGST is unlikely as it is mandatory for the persons making interstate taxable supply to get registered under GST.

Exceptions:

Cases where RCM is not applicable when goods/services procured from Unregistered persons:

- a) Where the aggregate value of procurements from all the unregistered persons put together does not cross Rs.5000/- in a day,
- b) Where the goods or services procured are exempted from payment of GST including non taxable items.
- c) Where the supply is not made in the course or furtherance of business. Ex: in case of purchase of jewellery from the individuals, the jeweller (Buyer) need not discharge GST as individual is not supplying the jewellery in his course of business. (Confirmed by press release dated 13th July 2017).
Most of the exchange offers in the retail sales could be excluded from RCM liability to the extent of old items received by the retail shops.
- d) When buyer is not liable and not taken registration under GST.
- e) Second hand goods received by a registered person who is dealing in buying and selling of second hand goods and who pays GST on the value of outward supply of such second hand goods – Exempted vide notification No.10/2017-Central Tax (Rate).

Major challenge for compliance could be identification of all taxable supplies from unregistered suppliers and applying the rate of taxes. There could be procurements such as biscuits, coffee or tea for employees, gift items, stationary items etc., all of which could be liable for GST. There could be miscellaneous services such as electrical maintenance, plumbing, carpentry etc. The assessee needs to identify all such procurements and ascertain rate of taxes for payment which could be a tedious exercise. There could be lot of expenses which are incurred by the employees travelling at other places. Even these expenses need to be screened every month to discharge liability under reverse charge.

GST liability on E- Commerce Operators

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'Electronic Commerce Operator' means any person who owns, operates or manages digital or electronic facility or platform for electronic commerce.

"Electronic commerce" means the supply of goods or services or both, including digital products over digital or electronic network.

Government has notified that in case of the following categories of services, the tax on supplies (GST) shall be paid by the electronic commerce operator and not by the supplier of such service. {Notification 14/2017- Integrated Tax and 17/2017- Central Tax dated 28.06.2017}.

- a) Services by way of transportation of passengers by a radio-taxi, motorcab, maxicab and motor cycle,
- b) Services by way of providing accommodation in hotels, inns, guest houses, clubs, campsites or other commercial places meant for residential or lodging purposes, except where the person supplying such service through electronic commerce operator is liable for registration under GST.

It shall be noted that, where the above services are not supplied through the e commerce platform, then the liability to pay GST would still be on the supplier and not anyone else.

Further in case of accommodation services mentioned above is provided by the registered person and then such registered supplier is liable to pay GST and not the e commerce operator.

Time of Supply:

Point of time at which GST liability would be recognised is provided in Time of Supply provisions.

For Goods:In case of supplies in respect of which tax is paid or liable to be paid on reverse charge basis, the time of supply shall be the earliest of the following dates:

- (a) the date of the receipt of goods; or
- (b) the date of payment as entered in the books of account of the recipient or the date on which the payment is debited in his bank account, whichever is earlier; or
- (c) the date immediately following **thirty days** from the date of issue of invoice or any other document, by whatever name called, in lieu thereof by the supplier:

For Services:

- (a) the date of payment as entered in the books of account of the recipient or the date on which the payment is debited in his bank account, whichever is earlier; or
- (b) the date immediately following **sixty days** from the date of issue of invoice or any other document, by whatever name called, in lieu thereof by the supplier:

In case of both goods and services, where it is not possible to determine the time of supply under any of the above clauses, the time of supply shall be the date of entry in the books of account of the recipient of supply.

Payment:

All the input tax credits are routed through electronic credit register maintained in GSTN. The amount available in the electronic credit ledger may be used for making any payment towards output tax under this Act or under the Integrated Goods and Services Tax.

"Output tax" in relation to a taxable person, means the tax chargeable under this Act on taxable supply of goods or services or both made by him or by his agent **but excludes tax payable by him on reverse charge basis;**

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Therefore, the liability under RCM shall have to be paid in cash though electronic cash ledger and ITC cannot be used to discharge such liability. This provision is in line with earlier service tax law.

Input Tax Credit:

Input tax credit of the GST paid on the goods and services under reverse charge mechanism shall be available subject to their use in the furtherance of business and if it is not covered under restricted goods and services as defined under Section 17 (5) of the CGST Act, 2017 and ITC Rules issued thereunder.

The condition of reversal of ITC when payment is not made to the supplier within 180 days would not be applicable in cases covered under RCM.

Unlike earlier Cenvat credit provisions, GST law doesnot specifically provide to avail the ITC in the subsequent month after making payment. In other words, it is assumed from the given return formats that as far as liability under RCM is paid in a particular month, the eligible ITC could be available in the same month.

Procedural Compliance relating to RCM under GST

Other than the generally applicable provisions of GST like accounting, record maintenance, payment of tax, filing returns, etc, few additional procedures have been prescribed for the RCM compliance which is over and above the other applicable procedures.

a) Tax Invoice: a registered person who is liable to pay tax under reverse charge mechanism shall issue an invoice in respect of goods or services or both received by him from the supplier who is not registered on the date of receipt of goods or services.

Issue of individual tax invoice is not necessary for the procurements made from the URPs.

The recipient of supply in such cases may issue a consolidated invoice at the end of a month for all the supplies made for unregistered persons having aggregate value exceeds rupees five thousand in a day from any or all the unregistered suppliers.

Details of Such invoices shall be disclosed while filing GSTR-2 for the respective month.

b) Payment Voucher: a registered person who is liable to pay tax under RCM shall issue a payment voucher at the time of making payment to the supplier.

As per strict interpretation of provisions it appears that the payment vouchers have to be issued separately for each payment made to each unregistered supplier and no option is provided to issue a consolidated voucher like in case of tax invoice.

c) Records: Every registered person shall keep and maintain an account, containing the details of tax payable including tax payable in accordance with RCM provisions, tax collected and paid, input tax, input tax credit claimed, together with a register of tax invoice, credit notes, debit notes, delivery challan issued or received during any tax period.

The contents of the above documents like tax invoice, payment voucher etc are provided in CGST Rules issued by the government which could be downloaded from GST section under cbec.gov.in. Given contents include c details like description of goods/services, HSN, nature of tax, taxable value, rate of taxes, place of supply etc.

The assessee is free to make own format for each of such document as far as the contents provided in this regard are covered in such formats.

Food for thought:

Sec 9(4) provides that in the GST in respect of the supply of taxable goods or services by a supplier, who is not registered, to a registered person shall be paid by such person on reverse charge basis as the recipient and all the provisions of this Act shall apply to such recipient ***as if he is the person liable for paying the tax in relation to the supply.***

By virtual reading of the provision, whether a view can be taken that in case where supplier is not registered due to threshold exemption of less than Rs.20 lakhs /10 lakhs, even recipient of such supply is not liable - To be resolved by way of representation.

Conclusion:

RCM is applicable on two categories of supplies. One on the specified goods and services and second one is the procurements from the unregistered persons. Procurement of goods or services from unregistered persons would increase the compliance cost in addition to extra manhours. There is a need to identify all unregistered vendors and they should be suggested to register, if beneficial and practical. Otherwise it is expected that businesses who are keen to safeguard their margins would avoid transactions with such unregistered suppliers especially when the values are more than Rs.5000/- in a day. Professionals could keep an eye on such transactions during GST implementation support and suggest assesses to reduce or avoid it. However, this would affect the small businesses badly though government has provided some relaxation by fixing Rs.5,000/- as threshold limit for RCM levy.

Any different views/feedback please mail to nagendra@hiregange.com.

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