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# Reverse Charge Mechanism of GST in India: A Socio-Legal Analysis

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**Abstract** The power to tax is the sole prerogative of the sovereign with at least two modalities at the command *i.e.* forward charge and the reverse charge. Reverse Charge Mechanism (RCM) is based on the principle “Respondent Superior” and constitutes as one of the prominent features of the GST (Goods and Services Tax) worldwide. In this mechanism, the obligation to pay the taxes lies with the recipient instead of the supplier, thus shifting the tax burden upon the recipient. It can be argued that the process assures timely and accurate collection of GST by the governments while also ensuring compliance of the taxation rules as prescribed for the businesses. The purpose of RCM is to broaden the base of tax collection in various unorganised sectors while also exempting specific class of suppliers<sup>1</sup>. While using an interpretivist paradigm, this paper intends to evaluate the impact of the RCM on administrative machinery and its effect on the entrepreneurs. Tax evasion is by its very nature difficult to measure and reaction of tax evasion to policy changes even more so. For its investigation and deeper analysis, the paper largely draws upon the Baconian inductive methodologies.

**Key Words-** Reverse Charge Mechanism (RCM), Respondent Superior, Goods and Service Tax (GST), Tax Burden, Inductive reasoning

<sup>1</sup> Anger Lehner Structural and civil Engineering Company V. Municipal Corporation of Greater Mumbai (2022)103 GSTR336-346 para 14

## 1. Introduction

Reverse charge mechanism is considered to be a specific mechanism when applying the tax. The liability to declare and pay the output tax is transferred to the recipient of the fulfilment within the reverse charge mechanism (Ledvinkova, 2012). Although the value added tax has attributed feature of the protection against the tax evasions, there was a weak resistance of this tax against the tax evasions for some commodities or services. A possible solution in order to fight the frauds in this field is the implementation of the reverse charge mechanism (also known as National Reverse Charge in EU regions) (Markova, 2011). In general, to combat the unlawful practice of tax evasion which might occur in every international trade flow, the RCM can be used as a powerful mechanism where each importer is expected to pay the applied customs duties and tax on the imported goods upon their arrival at the destination border (Gradeva & Katerina, 2014). Under the ambit of destination principle (which applies almost universally)<sup>2</sup>, the supplier, as taxable person, is generally required to register and remit the GST due on their supplies in each jurisdiction in which they have customers, and in accordance with the local rules and requirements of that jurisdiction (Lamensch, 2012). This results in a non-negligible compliance burden. Until recently, the question attracted only limited attention because cross-border transactions remained relatively limited. In fact, most services used to be 'non-transportable' and their international supplies would traditionally occur through the geographical movement of one or the other party to the transaction, either the customer would travel to the country of the supplier or the supplier would have a commercial presence or send a representative to the country of the customer<sup>3</sup>. In addition, cross-border supplies of goods mostly concerned products that could not be obtained from domestic suppliers or that could be

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<sup>2</sup> Except in some cases of interstate trade within federations or within an integrated economic area such as the EU (e.g. intra-Community supplies to private consumers are in principle taxed at origin, an intra-Community supply taking place between a supplier and a customer established in two different Member States of the EU).

<sup>3</sup> United Nations, Manual on Statistics of International Trade in Services (2010), p 9.

obtained abroad at a more competitive price (including transport costs). Finally, where there would effectively be a cross-border supply, it would traditionally take place between neighbouring jurisdictions, which usually shared similar tax traditions (the *gravity model* of trade in international economics)<sup>4</sup>. As a consequence, those engaging in cross-border trade were actually required to register in only a limited number of familiar jurisdictions till recently. Although the scope of the present study is limited to the RCM in GST in India, it is with this reason in view that an attempt has been made to investigate the contribution of this taxation mechanism in the wider context of the world. Similarly, the opposite of the RCM -- the forward charge principle, which is accepted worldwide wherein the taxes are paid by the supplier, has been observed to carry certain inherent flaws which further allows escape of government taxes particularly in the case where there is a trade between the registered and the unregistered enterprises. To overcome the same lacuna, the principle of RCM has gained unprecedented favour with the governments of the world. The principle of putting certain services under reverse charge mechanism is based upon the concept of the maxim "Respondent superior"<sup>5</sup> which implies that the superior/ bigger corporate should be made responsible for payment of tax as it is not possible for the government to run after small/unregistered service providers. In this regard, however, the reverse charge mechanism is also aimed to give relief to small business entities who usually do business through proprietorship/partnership firms or in individual constitution. After the seven years of the implementation of GST in India, there still exists a great deal of confusion on the reverse charge mechanism of tax collection. Reverse charge actually subscribes to the idea that the liability to pay tax lies with the recipient of

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<sup>4</sup> On the gravity model of trade see eg Céline Carrère, 'Revisiting the Effects of Regional Trade Agreements on Trade Flows with Proper Specification of the Gravity Model' (2006) 50 *European Economic Review* 223; JH Bergstrand, 'The Gravity Equation in International Trade: Some Microeconomic Foundations and Empirical Evidence' (2005) 67 *Review of Economics and Statistics* 474; Robert C Feenstra, James R Markusen and Andrew K Rose, 'Using the Gravity Equation to Differentiate among Alternative Theories of Trade' (2001) 34 *Canadian Journal of Economics* 434

<sup>5</sup> Respondent superior is a legal doctrine, most commonly used in tort, that holds an employer or principal legally responsible for the wrongful acts of an employee or agent, if such acts occur within the scope of the employment or agency

services/supply<sup>6</sup>. During the situation of normal supply, the burden to pay tax rests upon the supplier of the service/supply. In the earlier service regime, there were a number of services like manpower supply, works contract, GTA, legal etc. (as notified by notification no. 30/2012 of the service Tax) were placed under reverse charge mechanism either partial reverse charge or complete reverse charge. It is how ever pertinent to mention that a higher VAT rate is associated with lower compliance (Ali & Haughton, 1999).

It is in this context that the legalese involved in the definition of the RCM becomes significant, and with the same in view, we have analysed the intricacies of the definition of the RCM as defined in the Central Goods and Services Act 2017 in the passage below:

*S 2(98)- "reverse charge" means the liability to pay tax by the recipient of supply of goods or services or both instead of the supplier of such goods or services or both under sub-section (3) or sub-section (4) of section 9 of Central Goods and Services Tax (CGST) Act 2017, or under sub-section (3) or sub-section (4) of section 5 of the Integrated Goods and Services Tax(IGST) Act2017. The two requirements of the reverse charge mechanism are that the recipient must be a person as defined under section 2(84) of CGST Ac and the liability to pay tax be notified either by categories of supplies or by identifying the class of recipients<sup>7</sup>.*

Though the basic fundamental principle of reverse charge mechanism is meant to encourage and facilitate the business of micro, small and medium enterprises yet it has become a complex system leading to large amount of revenue leakage and confusion among the business entities

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<sup>6</sup> <https://www.ato.gov.au/businesses-and-organisations/gst-excise-and-indirect-taxes/gst/in-detail/rules>

<sup>7</sup> Union of India v. Mohit Minerals Private Limited, [2022] 101 GSTR 262, 348 para 85(SC).

as well as the tax administration. In Indian context, the benefit which was envisaged for the MSME (Micro, Small and Medium Enterprises) sector could not be materialized due to certain weaknesses in the taxation system itself. The prevalent business practice under reverse charge mechanism has been found nearly ineffective in dealing with the unregistered firms, which is contrary to the basic principle of the reverse charge mechanism. It has been noticed big business entities prefer to deal with registered corporates who do not fall under the ambit of reverse charge mechanism as it suits their business interests as no big business entity wants unnecessary complexity and tax burden under the reverse charge mechanism (Allingham & Sandmo, 1972).

In Indian context, the principle of RCM has been engraved within the service tax in the country and the legislature has put certain services like Goods transport agencies and legal services by advocates under the ambit of RCM but in practice it actually ran parallel to the international experience of taxation—internationally, the VAT/GST is one of the most important tax revenues of the European states, yet it suffers from excessive tax evasion. Carousel frauds that abuse the current VAT/GST treatment of cross-border supplies of goods in the EU represent the most serious type of VAT/GST evasion (Arltová *et al*, 2020).

In Indian GST regime, the reverse charge mechanism is based on the supplies between registered and unregistered persons for specific goods and services. Goods and Services Tax is a crucial component of the modern taxation system, aiming to bring about a uniform tax structure across the supply chain. The principle of GST is supposed to be based on the postulation that the tax burden should be always borne by the end consumer, rather than being accumulated or distorted at various stages of the supply chain of the goods, services or both. It is achieved by the input tax credit mechanism, where supplier claims a credit for the GST paid on their inputs, by offsetting the input tax from their output Tax. (Shandilya, 2013). It has been

also argued by the scholars like [Keen and Smith \(2007\)](#) that the reverse charge mechanism is burdensome and confusing for suppliers and may create new gaps within the GST system. Furthermore, it has been also argued that the reverse charge mechanism is not so efficient since it increases the input cost of the supplier ([Baker et al,2022](#)). The RCM under GST in India is a system where the recipient of the goods or services, instead of the supplier, becomes actually liable for the taxes. This phenomenon differs from the usual process where the supplier collects and deposits the tax. One of the main reasons why the RCM has been put in practice is to address the challenge of collecting tax from the unregistered suppliers or those in the unorganized sector. Since they might not be compliant with tax procedures, the burden of paying GST shifts to the registered recipient. This ensures the government receives its due tax revenue in time, and adequately.

However, it can also be argued that the RCM needs to be given some critical introspection in the context of tax adjudication with the administrators and planners not very keen on chasing down potentially non-compliant and small suppliers thus focussing on the registered recipients alone who are already within the GST ambit. The reverse charge mechanism in principle is same as 'Output Tax but its definition as defined in S.2(82) of the CFST Act 2017 does not consider it as an "output tax" in relation to a taxable person which practically implies that the tax chargeable under this Act on taxable supply of goods or services or both made by him or by his agent, excludes the tax payable by him on reverse charge basis.

It is pertinent to mention that as per S.9(3) of the CGST Act 2017, GST is usually paid by the supplier of goods or services. This sub section enables the government (on the recommendation of the GST Council) to notify categories of supply where the recipient (instead of the supplier) will be liable to pay GST. An investigation reveals that the purpose of reverse charge mechanism is to widen the scope of levying of taxes on various unorganised sectors and to

exempt specific classes of suppliers in the favour of social norms like, exemption to the farmers. Similarly, the measurement of the felled trees and supervision of the auctions are separate services rendered by the government timber depot to the coffee plantation company falls under the RCM<sup>8</sup>. A business entity is liable to pay tax under the reverse charge mechanism on legal fees paid to an individual advocate or a firm of advocates<sup>9</sup>.

## **2. Analysis of the statutory provisions of RCM in GST Act 2017**

Payment of GST is normally made by supplier of goods and services<sup>10</sup>. However this established rule is subjected to three exceptions-

Firstly, specified categories of supplies may be notified in respect of which the recipient pays the tax *[sub section (3)] of S.9 of CGST Act 2017*.

Secondly, specified categories of registered persons may be notified in relation to specified categories of supplies where the recipient pays the tax *[sub section (4) of S.9 of CGST Act 2017]*.

Thirdly, electronic commerce operators are liable to pay GST on intra-State supplies specified categories of services *[sub section (5) of S.9 of CGST Act 2017]* excepting electronic commerce operators to pay the tax. This type of transaction contemplates payment of tax by a person who is neither a, supplier nor a recipient.

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<sup>8</sup> Tata Coffee Ltd. In re, [2020] 82 GSTR 472, 480 para 8, 481 para 9 (4) (AAR, Karnataka) affirmed in [2020] 82 GSTR 482, 495 para 16 (AAAR, Karnataka).

<sup>9</sup> Indian Institute of Management, Tiruchirappalli, In re, [2021] 102 GSTR 467, 478 para 7.2, page 483, para 8.4 (AAR-Tamil Nadu).

<sup>10</sup> Ibid Mohit Minerals case

**2.1** However, in some of the cases parties can shift the GST liability from the recipient to the supplier like goods and the transport agency which falls under forward as well as to reverse charge mechanism. In such type of the cases, the recipient can deduct the GST amount from the total amounts payable to the supplier, such reverse payment of GST by the recipient is popularly called the reverse charge mechanism<sup>11</sup>. The Draft Model GST Law did not have a corresponding sub section. However it was, suggested to the GST Council that the reverse charge mechanism should be applied on supplies from unregistered persons reason being that , it would be beneficial to buy goods or services from an unregistered person on acceptance of the suggestion, the GST Council decided to tax GST with respect to unregistered person on reverse charge basis. The fundamental of this logic involved all commodities supplied by an unregistered person to a registered person if the supplies are otherwise chargeable to tax<sup>12</sup>.

**Section 8(4)** of the draft GST Act was as follows-

*The central tax 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 registered 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 of such goods or services or both<sup>13</sup>. The present sub section was substituted by the Central Goods and Services*

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<sup>11</sup> Agenda for the 5th GST council meeting, pages 48-49.

<sup>12</sup> Minutes of the 5th GST Council meeting pages 11-12, paragraph xvi, page 19 para xvi: Agenda for the 10<sup>th</sup> GST Council meeting, agenda item 3, page 32, item 15: Minutes of the 10th GST Council meeting, page 28 para 10: minutes of the 11th GST Council meeting, page 33, para-Levy and Collection of Tax, sub-para. 2.

<sup>13</sup> CGST Bill 2016, Notes on clauses, clause 9(iii) explains the purpose of the sub section: See Gazette of India Extraordinary, part II, section 2 issue no 12 dated 27.03.2017, page 110.



(Amendment Act 2018)<sup>14</sup>. The sub section *originally covered all taxable supplies by any unregistered supplier to any registered person*. More ever this sub section was substituted to restrict its ambit to specified classes of registered persons receiving specified categories of supplies from unregistered suppliers as may be notified by the central government<sup>15</sup>.

## **2.2 Special provision to pay tax by a Person who is neither Supplier nor a Recipient**

### **Sub section (5) of S.9 of CGST Act 2017**

The above cited sub section i.e. Sub section (5) of S.9 of CGST Act 2017 historically corresponds to section 8(4), of Draft Model GST Law. Here it is very interesting to know that this sub section is a solitary instance throughout the GST statute where it requires the payment of taxes by a person, who is not a supplier nor a recipient of services<sup>16</sup>. It targets, electronic commerce operators (popularly called aggregators) where the services are supplied through them<sup>17</sup>. This sub section enables the government to notify categories of services supplied through an electronic commerce operator in such cases the operator shall pay the tax on the intra-State supplies of the services. The sub section covers only intra-state (with in state) supplies<sup>18</sup> of the services *but does not cover the supply of goods through electronic commerce operators*.

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<sup>14</sup> Substituted by section 9, Central Goods and Services (Amendment) Act 2018, Gazette of India Extraordinary issue no 44 dated 30.08.2018-part II section 1 page 1; with effect from 01.02.2019 by Notification No. 2/2019-Central Tax, dated 29.01.2019 section 3(i) page 1.

<sup>15</sup> This sub section corresponds to section 8(4), Draft Model Law. The sub section is a solitary instance requiring payment of taxes by a person who is not a supplier or a recipient of services.

<sup>16</sup> Mohit Minerals Private Limited v. Union of India, [2020] 74 GSTR 134, 192 para 140 Gazette of India Extraordinary issue no 16 dated 07.08.2018-part II section 2 page 12. (Guj) (DB) The judgment is under IGST Act but the ratio applies equally to the CGST Act.

<sup>17</sup> Agenda for the 5th GST council meeting, pages 48-49.

<sup>18</sup> The interstate supplies are covered under sub section 5(5) of IGST Act 2017

**2.3** However, Sub section (5) of S.9 of CGST Act 2017 the does not address supplies falling within sub section (1) of S.9 of CGST Act 2017(Alcoholic liquor for human consumption). GST cannot be levied on supplies of the alcoholic liquor for human consumption. The exclusion follows from Article 366 (12A), Constitution of India which define Goods and Service Tax as “Any Tax on supply of goods or services or both except on taxes on supply of the alcoholic liquor for human consumption”. Thus, GST cannot be levied on an alcoholic substance like beer which is consumed by humans without further processing. However, GST can be levied on the owner or by contract brewing units<sup>19</sup>. “Supply of services relating to alcoholic liquor for human consumption i.e. job work relating to the supply of beer<sup>20</sup> or payments for the use of liquor brands. GST is not payable on the license fee for the grant of liquor license as it is not a supply of goods or service under section 7(2)(b)<sup>21</sup>. There may be instances where the suppliers providing services through their own online platforms fall within sub section (5) having regard to the wide definition of electronic commerce and electronic commerce operators. These suppliers are also governed by sub section (1). There will be a taxation impact if the rates of taxes are different for sub section (1) and (5). Since taxation statutes are to be strictly construed, these suppliers are entitled to take advantage of the rate more favourable to them which may lead to revenue loss to the government.

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<sup>19</sup> United Breweries Ltd. In re, [2019] 67 GSTR 83, 94, para 11.1 (AAR Karnataka).

<sup>20</sup> . Crown Beers India Private Limited In re, [2019] 67 GSTR 102, 126, 127 (AAR Maharashtra).

<sup>21</sup> Para 4 ,5, Circular No 121/14/2019-GST dated 11-10-2019

### 3. Rule of Necessity under RCM in the GST

It can be argued that during usual circumstances, the supplier collects GST on behalf of the government from the buyer and pays it back to the government itself periodically as prescribed by the statute. Moreover, in certain specific circumstances it has been noticed that there is no provision for the supplier to collect the GST. In such cases, the burden of payment of taxes lies with the buyer / purchaser who purchases the goods and services from unorganised sector or from unregistered suppliers where the revenue of the government is at stake and thus the RCM comes in force to prevent the leakage of the revenue. To collect tax from the unregulated and unorganized sectors on which Government has little control, is a cumbersome task to collect the tax proceeds from entities like the transporters, Lawyer firms, unregistered businesses, Goods and Transport Agency. Therefore, the government transfers the burden to collect & pay GST on recipient instead of the supplier. *Section 9(3) and 9(4) of CGST Act, 2017* deals with GST Reverse Charge (RCM), where *section 9(3) of GST ACT 2017* deals with the nature of supply or supplier whereas *section 9(4) of GST Act 2017* deals with, where taxable supply provided by the unregistered dealer to Registered person. As per *Section 7 of IGST (Integrated Goods and Service Tax) Act 2017*, the IGST deals with the location of supplier and place of supply. If it is within the same state, then it would be considered as intrastate supply in such case CGST and SGST would be applicable, when the location of supplier and place of supply are in different state in India then it would be an interstate supply and consequently IGST shall be applicable.

**3.1 Role of Taxable person in RCM:** As per *section 24 of the CGST Act 2017*, if a person receiving a supply which falls under the ambit of RCM then the taxable person shall be compulsory required to register himself irrespective of his turnover in the preceding financial year. As per *section 31(3)(f) of CGST Act 2017*, for RCM Supply, if the supplier is not

registered, *the registered* recipient shall issue self-invoice. As per section 35 of the CGST Act, 2017, the *registered person* who is liable to pay RCM shall maintain all the records of supply attracting *the GST*. Further as per Section 49(4) of CGST Act, 2017, when GST is payable under RCM, it should be paid in cash *from Electronic Cash Ledger*. The tax under RCM cannot be paid by utilizing Input Tax Credit the reason being for this is that the tax liability under RCM is not an Output tax and ITC under GST can be utilized only against output tax settlement. Further, the recipient can avail the RCM as an ITC on output tax payable only after making the payment of that RCM in the electronic cash ledger. However, in exceptional cases, the GST legislation stipulates that the liability under the GST Act shall be discharged by recipient instead of supplier of goods or services.

#### **4. The Cardinal Legal Principles relating to the RCM**

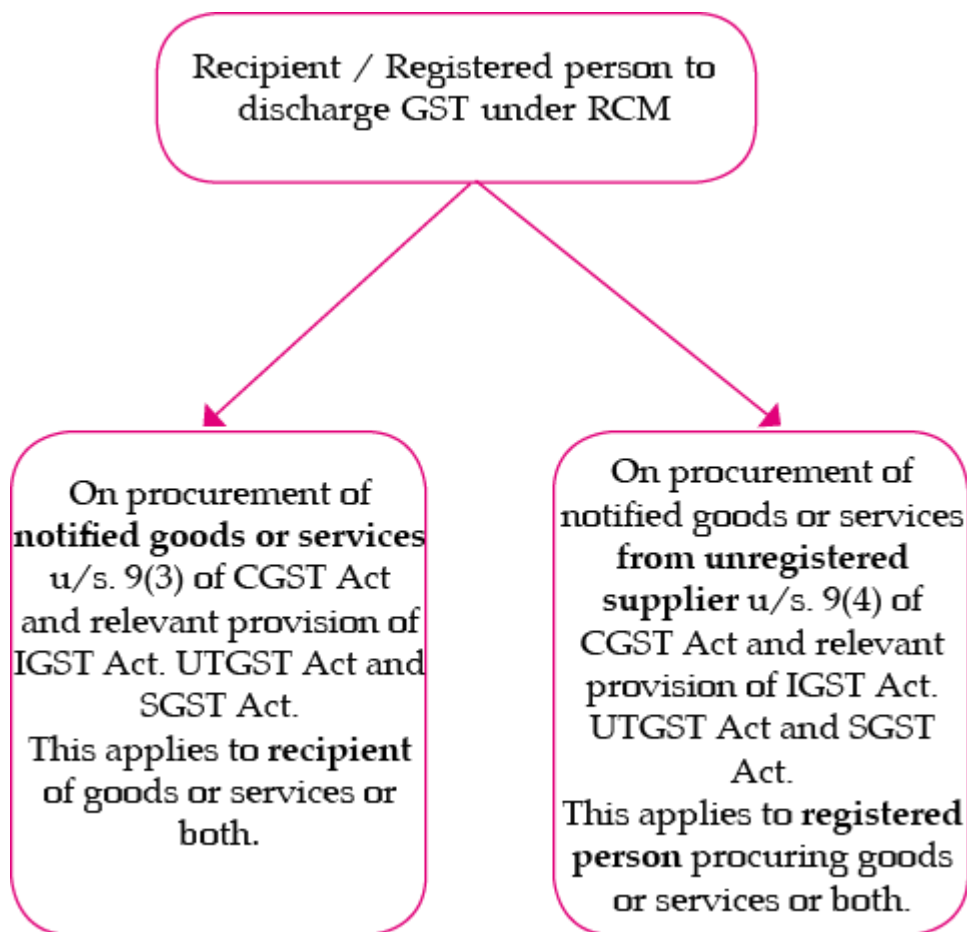
Reverse charge applies only when there is a taxable supply made to the purchaser. In the cases where supply is exempted, nil rated or non-taxable, the RCM does not apply. The recipient of goods or the services acts in the same way as the supplier, and discharges the tax liability under the existing provisions of the RCM itself. The recipient is the only person liable for paying the tax on supply procured by him. The provisions of the GST Act 2017 which includes the collection, recoveries and penal apply to the recipient in same way as it applies to the supplier in forward charge cases. The tax liability does not need to be discharged by the supplier under the RCM at applicable rate of tax. In such cases, a recipient makes payment on his own account under the recipient's GSTIN number if registered and is declared in his GST Returns as taxable supplies on which tax liability is discharged. Once the tax is paid under RCM by the recipient, it becomes an input tax of the recipient and the recipient (payer of tax under RCM) is entitled to avail ITC thereof, subject to other provisions contained in

*Chapter V (Input Tax Credit) of CGST Act and Input Tax Credit Rules.* Globally it is common to define ITC benefit eligibility for small business by implementing policies and restrictions on tax registration of the entrepreneurs. The study done by (Onji & Kazuki, 2009) suggests that the masquerading behaviour for tax evasion by entrepreneurs are commonplace in other settings of taxation system. The study however cited above is useful to globally to understand behavioural pattern of the tax evaders.

## 5. Interpretivist paradigm of Reverse Charge Mechanism (RCM)

The diagram illustrated below explains the universally phenomenon of the RCM-

Table 1Source <https://www.bcasonline.org/Referencer> 2011



**5.1** It can be argued that the reverse charge applies in case of notified supplies of goods and services or in the case of supplies by a specified category of suppliers. A recipient of notified goods or services or both is liable to pay CGST under RCM on supply of notified goods or services *u/s. 9(3) of CGST Act 2017*. Where the recipient is liable to discharge GST liability under RCM irrespective of the recipient being a registered person or an unregistered one; or the supplier of notified goods or services, is a registered person or an unregistered one.

## **6. Baconian inductive methodology in the context of RCM**

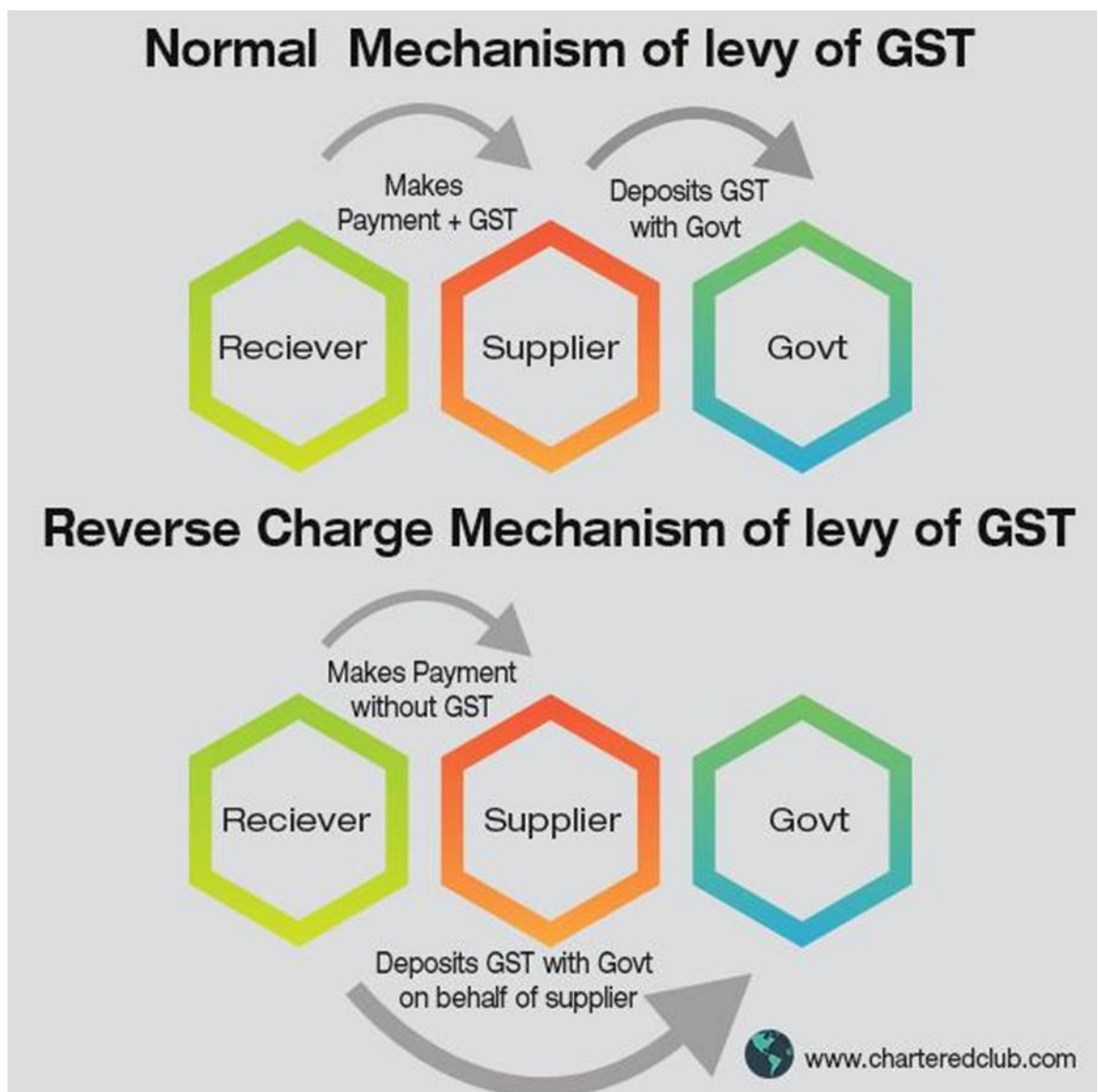
According to the American Psychological Association Dictionary, “the Baconian method<sup>22</sup> involves the inference of general laws or principles from particular instances observed under controlled conditions (i.e., in experiments). To make sure that any such generalization is valid, the observer must seek not only positive instances of an association between things in which one event or state brings about another, but also negative instances in which the event or state fails to occur in the absence of the other). Finally, the observer tries to formulate an explanation for the causal connection so established. Thus, these inductive methodologies are basically concerned with the scientific inquiry and also the construction of facts or knowledge based upon rigorous observations under objective conditions. A survey of RCM reveals that to a significant extent all unregistered or unorganised suppliers do not come under the purview of the RCM which leads to tax leakage, something which is not healthy for any taxation regime. As argued by scholars like Allingham & Sandmo (1972), “The effect of

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<sup>22</sup> <https://dictionary.apa.org/baconian-method> retrieved at 1300 Hrs on 18 -06-2024S

policies, specifically tax policies, on evasion is a subject of considerable policy interest and has been studied extensively. An early theoretical treatment is due to who show that the sign of the elasticity of tax evasion with respect to tax rates is ambiguous, depending on taxpayers' risk aversion and the punishment for evasion". It is also argued by (Mishra, et *all* 2008), that " Increase in tax rates makes evasion more attractive and also reduce taxpayers' wealth (*income effect*)". The phenomenon of *substitution effect* and *income effect* can be illustrated by following diagram-

Table 2Source <https://corpbiz.io/learning/analysis-of-RCM>



**7.1** It is argued that, “The so-called ‘missing trader intra-community’ (MTIC) fraud causes enormous losses in tax revenue. The fraudsters take advantage of the zero-rated cross-border supplies within the country and resell the goods domestically without paying the received tax to the tax authorities” (Ruffles, *et all 2003*). One of the most prominent measures to combat this scheme is RCM that shifts the tax liability from the supplier to the customer in business-to-business transactions. Using asymmetries in international trade data gap, (TDG), in this contest RCM can have fraud-reducing effect.

## 7. RCM On Services under the ambit of GST

GST Council had recommended following services on which tax will be paid as RCM<sup>23</sup>.

• <i>Nature of Service</i>	• <i>Service Provider ('SP')</i>	• <i>Service Recipient ('SR')</i>	• <i>% of GST payable by SR</i>
• Import of Services	• Any person who is located in non-taxable territory	• Any person located in taxable territory other than non-assessee online recipient	• 100%

<sup>23</sup> Notified services under Reverse Charge Mechanism CGST Act 2017



• <i>Nature of Service</i>	• <i>Service Provider ('SP')</i>	• <i>Service Recipient ('SR')</i>	• <i>% of GST payable by SR</i>
		(Business Recipient)	
<ul style="list-style-type: none"> <li>• Goods Transport Agency Services in respect of transportation of goods by road</li> </ul>	<ul style="list-style-type: none"> <li>• Goods Transport Agency</li> </ul>	<ul style="list-style-type: none"> <li>• Factory</li> <li>• Society</li> <li>• Co-operative society</li> <li>• Person registered under GST Act</li> <li>• Body corporate</li> <li>• Partnership Firm</li> <li>• Casual taxable person</li> </ul>	<ul style="list-style-type: none"> <li>• 100%</li> </ul>
<ul style="list-style-type: none"> <li>• Legal Services</li> </ul>	<ul style="list-style-type: none"> <li>• Individual advocate or firm of advocate</li> </ul>	<ul style="list-style-type: none"> <li>• Any business entity</li> </ul>	<ul style="list-style-type: none"> <li>• 100%</li> </ul>

<ul style="list-style-type: none"> <li>• <i>Nature of Service</i></li> </ul>	<ul style="list-style-type: none"> <li>• <i>Service Provider ('SP')</i></li> </ul>	<ul style="list-style-type: none"> <li>• <i>Service Recipient ('SR')</i></li> </ul>	<ul style="list-style-type: none"> <li>• <i>% of GST payable by SR</i></li> </ul>
<ul style="list-style-type: none"> <li>• Arbitration Services</li> </ul>	<ul style="list-style-type: none"> <li>• Arbitral Tribunal</li> </ul>	<ul style="list-style-type: none"> <li>• Any business entity</li> </ul>	<ul style="list-style-type: none"> <li>• 100%</li> </ul>
<ul style="list-style-type: none"> <li>• Sponsorship Services</li> </ul>	<ul style="list-style-type: none"> <li>• Any person</li> </ul>	<ul style="list-style-type: none"> <li>• Body corporate or partnership firm</li> </ul>	<ul style="list-style-type: none"> <li>• 100%</li> </ul>
<ul style="list-style-type: none"> <li>• Services by Government or local authority excluding:</li> <li>• Renting of immovable property</li> <li>• Services by department of posts</li> <li>• Services in relation to aircraft or vessel inside or outside precincts of port/airport</li> </ul>	<ul style="list-style-type: none"> <li>• Government or local authority</li> </ul>	<ul style="list-style-type: none"> <li>• Any business entity</li> </ul>	<ul style="list-style-type: none"> <li>• 100%</li> </ul>

<ul style="list-style-type: none"> <li><i>Nature of Service</i></li> </ul>	<ul style="list-style-type: none"> <li><i>Service Provider ('SP')</i></li> </ul>	<ul style="list-style-type: none"> <li><i>Service Recipient ('SR')</i></li> </ul>	<ul style="list-style-type: none"> <li><i>% of GST payable by SR</i></li> </ul>
<ul style="list-style-type: none"> <li>Transport of goods or passengers</li> </ul>			
<ul style="list-style-type: none"> <li>Director's service</li> </ul>	<ul style="list-style-type: none"> <li>Director of company or body corporate</li> </ul>	<ul style="list-style-type: none"> <li>Company or body corporate</li> </ul>	<ul style="list-style-type: none"> <li>100%</li> </ul>
<ul style="list-style-type: none"> <li>Insurance agency service</li> </ul>	<ul style="list-style-type: none"> <li>Insurance agent</li> </ul>	<ul style="list-style-type: none"> <li>Any person carrying on insurance business</li> </ul>	<ul style="list-style-type: none"> <li>100%</li> </ul>
<ul style="list-style-type: none"> <li>Recovery agency service</li> </ul>	<ul style="list-style-type: none"> <li>Recovery agent</li> </ul>	<ul style="list-style-type: none"> <li>Banking company, financial institution, NBFC</li> </ul>	<ul style="list-style-type: none"> <li>100%</li> </ul>
<ul style="list-style-type: none"> <li>Transportation of goods by a vessel from a place outside India up to</li> </ul>	<ul style="list-style-type: none"> <li>Person located in non-taxable territory to a person located</li> </ul>	<ul style="list-style-type: none"> <li>Importer as defined under Customs Act, 1962</li> </ul>	<ul style="list-style-type: none"> <li>100%</li> </ul>

• <i>Nature of Service</i>	• <i>Service Provider ('SP')</i>	• <i>Service Recipient ('SR')</i>	• <i>% of GST payable by SR</i>
customs station of clearance in India	in non-taxable territory		
• Transfer or permitting use or enjoyment of Copyright relating to original literary, dramatic, musical or artistic works	• Author or music composer, photographer, artist, etc.	• Publisher, Music Company, Producer	• 100%
• Rent-a-cab service through e-commerce operator	• Taxi driver or rent-a-cab operator	• Any person	• 100% by e-commerce operator

### 7.1 RCM On Goods under the ambit of GST

GST Council had recommended following Goods on which tax will be paid as RCM.

Table 3 <https://carajput.com/blog/overview-on-goods-subject-to-reverse-charge-mechanism/>

Sl. No.	Nature of Goods	Supplier of Goods	Recipient of Goods
1	Cashew nuts, not shelled or peeled	Agriculturist	Any registered person
2	Bidi wrapper leaves (tendu)	Agriculturist	Any registered person
3	Tobacco leaves	Agriculturist	Any registered person
4	Silk yarn	Any person who manufactures silk yarn from raw silk or silkworm cocoons for the supply of silk yarn	Any registered person
5	Raw cotton	Agriculturist	Any registered person
6	Supply of lottery	State government, Union territory or any local authority	Lottery distributor or selling agent
7	Used vehicles, seized and confiscated goods, old and used goods, waste and scrap	Central government, state government, union territory or a local authority	Any registered person

It is amply clear from above that there are selective services as well as the selective goods on which the RCM is applicable. The other important aspect of the RCM is time of supply of the services and the time of supply of Goods for the determination of the time of the tax deposition.

## 7.2 Determination of time of supply for RCM under Goods and Services Tax

It is of paramount importance in taxation that there must be the determination of the time of supply of goods and the services under the RCM so that a seamless flow could be maintained towards the process of deposit of tax as well as the ITC under the ambit of the GST.

Table 4 Sec. 12(3) &amp; Sec. 13(3) of CGST Act 2017

**In Case of Goods: Section 12(3) of CGST Act, 2017**

<b>Payment Date</b> <b>Or</b> <b>31 st Date from invoice date</b> <b>Or</b> <b>Book Entry Date</b>	}	..... <b>Whichever is Earlier</b>
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**In Case of Services: Section 13(3) of CGST Act, 2017**

<b>Payment Date</b> <b>Or</b> <b>61 st Date from invoice date</b>	}	..... <b>Whichever is Earlier</b>
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**7.3 Mandatory operational provisions related to RCM under GST**

*Section 24(iii) of CGST Act 2017*, mandates compulsory registration for persons liable to pay tax under RCM. Threshold limit is not applicable to persons liable to pay under RCM. Entrepreneur having less than ₹ 20 lakh turnover or supplier of exclusively exempt or non-taxable goods /services will also be liable for GST registration if he is obliged to discharge his tax under RCM.

*Section 31(3)(f) of CGST Act 2017* mandates registered person liable to pay GST under RCM to issue an invoice in respect of goods and services received by him from unregistered supplier. Such invoices should contain all particulars as prescribed *u/s. 31(1) and 31(2) of CGST Act 2017 read with GST Invoice Rules* to the extent applicable. As this implies that the registered person procuring goods and services and paying tax

under RCM is also obliged to mention HSN Codes and Service Accounting Codes of goods for services procured by him.

Moreover, in terms of *proviso to Rule 46 of CGST Rules 2017*, a registered person may issue a consolidated invoice at the end of a month in respect of purchases from unregistered suppliers exceeding ₹ 5,000 per day. *Rule 1 of Input Tax Credit Rules 2017*, provides that a registered person shall avail input tax credit on the basis of an invoice raised in accordance with provisions of *section 31(3)(f) of CGST Act 2017*. Further also, registered person liable to pay GST under RCM shall issue a payment voucher at the time of making payment to supplier for any taxable supply.

#### **7.4 Statutory compliances for RCM transactions under GST**

It is argued that “A fundamental constraint for taxation is that governments need to be able to observe transactions in order to impose a tax on them. A growing literature therefore further argues that understanding information flows is central to effective taxation. When governments imperfectly observe transactions, important differences emerge between forms of taxation that are equivalent in standard models of taxation but it differs in the information they generate for the government” (Slemrod 2008).

Moreover, where the tax is payable under RCM, it has to be specifically mentioned on such *Tax Invoice* by the Supplier. Similarly, this also needs to be mentioned in receipt *voucher*, if tax is payable on reverse charge. Reverse charge liability cannot be discharged by using input tax credit. However, after discharging reverse charge liability, credit of the same can be availed. Every registered person is required to keep and maintain records of all supplies attracting payment of GST on *reverse charge*. The recipient paying the GST under RCM has to prepare Payment Voucher and keep records. Advance paid for reverse charge supplies in service

transactions are also leviable to GST. The enterprises making advance payment has to pay tax on reverse charge basis in cash from their *electronic cash ledger*.

### **7.5 Process Flow of Mandatory Disclosures for RCM in GST**

In GSTR-3B (summary GST liabilities) the details of supplies on which GST is applicable under RCM needs to be reported by the recipient for the Goods and Services both. In GSTR-1 (summarises all sales (outward supplies), the recipient paying GST under RCM has to report the serial numbers of Payment Vouchers prepared for RCM liability under Document Details. The details of ITC claimed of GST paid under RCM needs to be reported in a separate column provided in GSTR-3B. However, GST under RCM paid on Import of Services is to be reported separately in the given column in GSTR-3B. Invoice level information in respect of all supplies attracting reverse charge, the rate wise data, is to be furnished separately in *column 4B of GSTR-1 (supplies attracting tax on reverse charge basis)* by the supplier.

### **7.6 Importance of Advance ruling relating to RCM under GST**

The Advance Ruling mechanism in taxation laws is not a new concept in India. Advance Rulings, though binding only on the applicant and the authority concerned, offer great insights into the perspectives of the revenue authorities on matters that have not been litigated in courts. The law relating to the *Advance Ruling mechanism* has been in the statute books since 1992, whereby an Advance Ruling Authority (ARA) was set up under the Income Tax Act 1961. The Advance Ruling mechanism was introduced for Customs and Central Excise matters in 1998, and subsequently extended to Service Tax matters in 2003. Initially, only a 'non-resident' applicant was allowed to approach the authority for a ruling, however, the scope of the eligibility for applying was



gradually extended to joint ventures and subsidiaries proposing to set up business in India.

In 2009, the public sector companies were allowed to apply for advance rulings in India, but it was not till 2011 and 2014, respectively, when both public and private limited companies were allowed to apply. Thus, for most categories of indirect taxpayers, it took 16 years to gain eligibility for applying since the Advance Ruling mechanism was set up. Additionally, the scheme remained restrictive since only questions relating to '*proposed transactions*' were permitted to be put before the Authority. These factors contributed to a limited use of the AAR mechanism under the erstwhile indirect tax regime.

In the erstwhile VAT regime as well, while some States had a formal ARA in place, others like Maharashtra had a mechanism called Determination of Disputed Question (DDQ), and some State like Uttrakhand VAT legislations empowered Commissioners to issue clarifications on specific matters. The introduction of GST in 2017 saw the emergence of the Authority for advance Rulings (AAR) in every state, with two members, one each from the state and central GST formations. GST being a concurrent levy of tax by the state and central governments, the structure cannot accommodate a central AAR, much as the trade would like it, and hence having AARs in every State is a legal necessity. Unlike the ARA under the Customs, Central Excise or Service Tax legislations, which had a Judicial Member (a retired Supreme Court judge), the GST regime is the constitution of the Appellate authority for Advance Ruling (AAAR). AAR which is entirely constituted by members of the tax department. What is unique with the Appellate authority for Advance Ruling (AAAR), is that it adjudicate the appeals against the orders of the AAR, and decides the matter. Where there is a

difference of opinion between the members of the AAR. The AAR, is constituted of members drawn from the respective state and central tax departments, with no representative from the judiciary. Experts have often expressed reservations against the efficacy of a forum comprising members entirely from the tax department, which could have a heavy bias toward revenue. Nevertheless, the AAR mechanism under GST has been put to greater use than the one that existed under the previous regime, perhaps because it is open to all categories of taxpayers, the questions that can be asked of the authority are more expansive, and questions on ongoing activities can also be framed. Appellate authority for Advance Ruling (AAAR) is constituted with a judicial member with tax department officers as members to give adjudication on the matter before it.

## **8. Future Prospectives and Policy Implementation**

The effect of policies, specifically tax policies, on evasion is a subject of considerable policy interest and has been studied extensively (Allingham and Sandmo ,1972). It is observed that to a certain extent, the single market like the EU (European Union) has further encouraged entrepreneurs, households and unregistered business entity's evasive behaviour in paying taxes in the EU Member States, whereas such tax evasive efforts have traditionally been most pronounced in the field of corporate and personal income taxation (Nam *et al* 2001). The size of tax evasion and fraud appears to be increasing steadily in the common markets. Whereas the right of deduction of input tax from output tax is an essential element of the system of indirect tax like GST, it also

prevents the accumulation of ITC available in the economic chain, in which goods or services are going to the customer. ITC chain Starts with the production of certain goods, and adjusted at each stage of the chain of supply from output tax, that is – at any resale of the goods until it is sold to the ultimate consumer (Berger *et all*, 2010). To prevent the tax evasion and to make the goods and services under the supply chain the RCM mechanism was put in force which at times shown that the sign of the elasticity of tax evasion with respect to tax rates when ambiguous, depending on taxpayers' risk aversion and the punishment for evasion: increases in tax rates make evasion more attractive (*substitution effect*) and also reduce taxpayers' wealth (*income effect*). The expected shift of the MTIC fraud from a RCM country (B) to a non-RCM country (C) may even be intensified by the fact that the detection risk in the former country (B) is reduced by the RCM application in this country (B). MTIC fraud in country C is either detected by country A for other evasion related activities (Roger, *et all*, 1997). The studies conducted by Hopland & Ullmann (2019) obvert the facts while still reinforcing that there are certain faults in determining and reporting of tax liability under RCM, especially when it is identified by the GST authorities at the time of scrutiny assessments or audits due mis-statement or mis-reporting in the data system which makes the taxpayer to pay interest or penalty or both for delay in payment or non-payment of GST under RCM. Secondly, the supplier may lose the ITC of tax paid under RCM due to expiry of the time limit to claim such ITC only because of the liability was not determined and discharged at appropriate time.

## 9. Conclusion

It is pertinent to pay closer attention to the basics and applicability of the “RCM under GST”. For separate transactions, for instance, a taxpayer may have to pay forward as well as reverse

charge taxation in course of trade and business activities. It is mandatory for the enterprises to report the RCM liability correctly to claim the ITC timely as also to avoid the burden of interest and penalties for fake reporting during the scrutiny and assessment proceedings. Tax evasion relating to RCM by its very nature, is difficult to observe in normal course of investigation by tax authorities. (Fisman, *et all*, 2004). This phenomenon further aggravates as the problem of tax compliance is as old as the origin of taxes and still persists by way of deliberate and non-deliberate compliances, in both cases it is pertinent to mention here that the government does not get the tax while the phenomenon of *income effect* comes into play . Moreover it further creates a big challenge for the tax administration not to get the proper taxes . To find out a workable solution, the tax administrators would do well to use the tools like characterizing and explaining the observed patterns of tax noncompliance, adopt data mining technique which ultimately, and finally lead the way to reduce the tax evasion in the scope of RCM. Such an strategy is used globally and of obvious importance for all nations around the world (Andreoni, *et all*, 1998). This study shows that RCM under GST is a mechanism designed to bring certain likely to be escaped transactions under the tax net, which will ensure that the government receives its due tax revenue in time and no one is allowed to escape or break the tax chain mechanism . Further, it is of utmost importance for businesses to understand and comply with the RCM provisions timely to avoid interest and penalties to maintain a seamless flow of business operations. The study also establishes that in future, by implementing *Sec.9 Sub Sec 4 of CGST Act 2017* the full potential of RCM can be reached. Since the nature of RCM is dynamic and global in appeal, therefore, a recourse to the AI (artificial intelligence tools) and data mining tools will be useful in detecting the instances of tax evasion specifically with reference to RCM which will in turn make the system more robust, transparent, efficient and more effective.

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