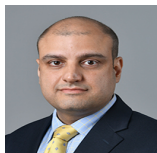


## The Curious Case of Cross Charges Under GST-resolved?

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Multi-locational businesses are prevalent in India, with companies having a head office ('HO') supported by branches/offices ('BO') across Indian States. This set up entails incurring common expenses by the HO for the benefit of the organization, as a whole. Similarly, it is conventional practice that business functions like finance, human resources, IT, legal departments are housed centrally in HO of the Company. In this background, allocation of common expenses and availment of input tax credit ('ITC'), has garnered immense debate, since the introduction of the GST law in July 2017; the moot points being:

***-Whether it is mandatory to allocate common credits through ISD mechanism?***

***-Whether it is mandatory to cross charge costs (including employee costs) for central functions?***

This piece delves into various aspects of the matter to analyze these points. GST is a destination-based consumption tax, it is imperative that ITC shall accrue to the offices (GST registrations) which have used/availed the underlying services. Therefore, admittedly there is a need for apt allocation of ITC among the different offices of a legal entity since it benefits more than the paying registration.

To this end GST law has an enabler in form of ISD (input service distributor mechanism) which allows allocation of ITC on common input services to the beneficiary registrations. Simultaneously, allocation of ITC can well be achieved by using cross charge mechanism, wherein the common costs are invoiced from office, which had incurred the expense. On the other hand, with respect to allocation of costs pertaining to central functions (internal activities, not involving a third-party vendor), there are no explicit provisions in the GST law that mandate such allocation.

The GST law has a deeming fiction which treats different offices of same legal entity having different GST registration as "distinct person". Additionally, Entry 2 of Schedule 1 of Central Goods and Services Tax Act 2017, declares supply between distinct person to be taxable even if made without any consideration. The combined reading of Entry 2 of Schedule 1 and the concept of distinct persons gives rise to perceived mandate that costs associated with central functions shall be allocated among different GST registrations of a legal entity-taxpayer.

The GST authorities, across jurisdictions, endorsed the view that both distribution of common ITC through

ISD mechanism and cross-charging for central functions is mandatory. Accordingly, several taxpayers are sitting with demand notices and litigation on these issues.

These issues started trending with rulings of Authority for Advance Ruling ('AAR') and Appellate Authority for Advance Ruling ('AAAR') across different States. The forerunner being the ruling in case of **Columbia Asia Hospitals Private Limited**<sup>[1]</sup>, which held that the services of employees at head office in so far as they are benefitting other registered branches, will be treated as supply between distinct persons, and hence the same is liable to tax. While delivering the said ruling, AAAR also observed that there is a fundamental difference between the concept of ISD and that of cross charge. In the ISD concept, only ITC on input services which are attributable to other distinct entities are distributable. Whereas, in case of cross charge mechanism, all expenses incurred by a distinct person for the purpose of carrying out activities which benefits other distinct persons is required to be cross charged. In case of cross charge, there is an element of service rendered by person who cross charges to the other units even though they belong to same legal entity whereas in case of ISD, there is no element of service at all, but a mere distribution of ITC.

This debate intensified by the ruling in case of **Cummins India Limited**<sup>[2]</sup> wherein the Maharashtra AAAR held that activity of HO availing ITC for common input supplies on behalf of BOs does qualify as supply and would attract the levy of GST. The AAAR also held that the HO is not entitled to avail the ITC of such common input supplies and it must register itself as an ISD as per Section 24 of the CGST Act, 2017 and distribute such availed common ITC to the company's branch offices/ units. Similar view was echoed in case of **B.G. Shrike**<sup>[3]</sup> by Maharashtra AAR.

These views created concerns among trade and industry, which had adopted diverse positions, viz.:

- Companies that have followed neither ISD nor cross-charge mechanism
- Companies that have followed ISD mechanism, but not cross-charged for central functions
- Companies that have addressed common ITC through cross-charge mechanism, but not levied GST on costs for central functions.

As for the ISD mechanism - the GST law provisions per se do not compulsorily mandate allocation of common expenses through ISD. Thus, taxpayers have the right in choosing either mechanism (i.e., ISD or cross charge) for allocation of common ITC. Moreover, Central Board of Indirect Taxes and Customs (CBIC) through FAQs<sup>[4]</sup> clarified that ITC availed on services procured at a registration which are used for business in more than one State, should be appropriately invoiced or distributed through ISD mechanism to other States. Hence, giving option between cross charge and ISD.

Similarly, in respect of cross charges for central function, there is a potent argument that performance of central function is not a supply of service by head office to branches, rather it is merely execution of activities by employees of the legal entity in terms of employment contract. Legal precedents<sup>[5]</sup> support the view that employees are employed for carrying out duties under the employment contract for the legal entity as a whole and not for a specific location based on physical presence. Therefore, costs incurred by the HO are towards fulfillment of its legal obligation and not as a part of 'supply' of any service to the BO.

Despite these arguments, given the quandary of the issues, organization having multi-State operations were staring at uncertainty concerning the tax position to be adopted. Particularly, issue of allocation of employee salary expenses by a HO to its BOs has been contentious and is currently sub-judice before the Karnataka High Court<sup>[6]</sup>.

In this background, CBIC has helped dispel confusion on some aspects, through **Circular no. 199/11/2023-GST dated 17 July 2023 ('the Circular')**. This Circular stems from recommendations made by the GST Council in its 50th meeting, held on 11 July 2023.

The Circular clarifies that **ISD mechanism is not mandatory** for distribution of ITC of common input services procured from third parties to the distinct persons as per the present provisions of GST law. Also, that the head office is allowed to avail ITC in respect of common input services procured from third parties but, attributable to both HO and BOs or exclusively for one or more BOs, so long as these costs are cross charged by HO to relevant BOs. In other words, HOs are well within the legal boundaries if they

distribute common ITC through cross charges. This clarification is welcome, and somewhat contrary to early day views expressed by some officials in the higher echelons.

Further, in respect of taxability of internally generated services i.e., the central functions, it has been clarified that where BO is eligible to avail full ITC, then the value declared on the invoice by HO, including nil value shall be deemed to be acceptable value for purpose of levy of GST on central functions. On the other hand, in case BO is not eligible to avail full ITC, then it has been clarified that it is not mandatory to include cost of salary of employees of HO, while computing the taxable value of supply of services attributable to central functions. No rationale is supplied for such clarification; however, it will not be improper to believe that the reason is that employees aren't quite service providers to BOs.

Clarification in respect of ISD mechanism is welcome and will go a long way in resolving tax disputes of legality of cross-charge vs ISD mechanism for the past period, thereby ratifying cross-charges undertaken for common costs. The clarification on taxability of central functions (i.e., internally generated services) is gallant yet appropriate. In a pragmatic effort, the clarification encompasses valuation aspects and specifies that in cases where BOs are eligible for full ITC (i.e., typically branch offices which are engaged in provision of taxable supplies alone), the cross charges for central functions can be made at any value including nil. Therefore, cross charges for central functions has effectively been done away with.

However, in cases where BOs are not eligible to claim full ITC, the dilemma and ambiguity around cross charges ensues. While the Circular clarifies that cost of employees at HO is not required to be added in value of cross charges, the Circular pre-supposes and indirectly endorses need of a cross charge for central functions other than salaries.

Despite this lacuna, now after 6 years of GST in India, it is safe to say that the curious case of cross charges under GST has been all but resolved!

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[1] 2018 (15) G.S.T.L. 722 (A.A.R. - GST)

[2] 2022 (58) G.S.T.L. 549 (App. A.A.R. - GST - Mah.)

[3] 2021 (55) G.S.T.L. 174 (A.A.R. - GST - Mah.)

[4] FAQ issues in respect of on Banking, Insurance and Stock Brokers Sector

[5] Tech Mahindra Limited vs. CCE, Pune - 2016 (44) S.T.R. 71 (Tri. - Mumbai)

[6] In case of Columbia Asia Hospitals Private Limited