

Cross Charge vs. ISD: An Attempt to Settle the Unsettled

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Introduction

In the modern-day business landscape, companies are setting up their Head Office (HO) in one State and set-up various branch offices (BO) all over India to operate their business efficiently. Insofar as the GST law is concerned, such offices at different States are considered as distinct persons and have different GST registrations. In such a model, there exists a concept of cost-centres wherein the common expenditure incurred at HO is expensed and shared to the BOs. Distribution of ITC on such common expenditure is being done either through Input Service Distributor (ISD) mechanism or by way of cross-charge.

Controversy

The industry has been perennially marred with the controversy of distribution of ITC through ISD mechanism vis-à-vis Cross charge with the Revenue authorities questioning the manner of distribution for each route. The GST Advance ruling authorities have also pronounced contradictory rulings further complicating the issue. The AAAR, Karnataka in the case of **Columbia Asia Hospitals Pvt. Ltd.** [\[TS-814-AAAR-2018-NT\]](#) discussed the fundamental difference between the concept of an ISD and the cross-charge mechanism. It was observed that in the case of cross-charge, there is an element of service rendered by the person who cross charges their other units even though they belong to the same legal entity. On the other hand, in the case of ISD, there is no element of service at all, but a mere distribution of credit. Further, it was ruled that internal services provided by HO to BO would be taxable and HO employee cost should be considered for valuation purposes.

However, a contradictory view was taken by AAAR, Maharashtra in the case of **Cummins India Ltd.** [\[TS-747-AAAR\(MAH\)-2021-GST\]](#) which ruled that the Head Office is not entitled to avail and utilize ITC of tax paid for common input services received by it on behalf of branch offices/units and the taxpayer is bound to take ISD registration if it intends to distribute credit of tax paid on such common input services to branch offices/units. In simple words, it was ruled that cross-charge of such expenses was not permitted under GST law and to distribute ITC on common input services to branches/units, taxpayers have to mandatorily register as an ISD.

GST Council Meeting & CBIC Circular

The aforesaid controversy was tabled before the GST Council in its 50th meeting wherein it was decided and recommended to clarify that ISD mechanism is not mandatory for distribution of input tax credit of common input services procured from third parties to the distinct persons and to clarify issues regarding taxability of internally generated services provided by one distinct person to another distinct person. Further, it was recommended that suitable amendment may be made in GST law to make ISD mechanism mandatory prospectively for distribution of input tax credit of such common input services procured from third parties.

To give effect to the same, CBIC issued [Circular No. 199/11/2023-GST dated 17 July, 2023](#) wherein it was clarified that:

- **For third party invoices:** It is not mandatory for the HO to distribute ITC by ISD mechanism. HO can also issue tax invoices to the concerned BOs in respect of common input services procured from a third party by HO but attributable to the said BOs.
- **For internally generated services where full ITC is available:** Value declared on the invoice by HO to the said BO in respect of a supply of services shall be deemed to be the open market value of such services as per Rule 28 of the CGST Rules, irrespective of the fact whether cost of any particular component of such services, like employee cost etc., has been included or not in the value of the services in the invoice. Further, if HO has not issued a tax invoice to the BO in respect of any particular services being rendered by HO to the said BO, the value of such services may be deemed to be declared as Nil by HO to BO and may be deemed as open market value.
- **For internally generated services where ITC is not available:** The cost of salary of employees of the HO, involved in providing the said services to the BOs, is not mandatorily required to be included while computing the taxable value of the supply of such services.

Critical Analysis of the Circular

1. **Welcome clarification:** Amidst the hues and cry of the industry, the Circular comes as a pacifier. The perennial controversy of distribution of ITC via the dual methods stands finally settled with both the methods being clarified as being equally applicable. This clarification would bring an end to the pending litigation on distribution of ITC challenging either of the methods.

2. **Overturning the ruling of Columbia Asia Hospitals Pvt. Ltd. (supra):** The said ruling ruled that in case of internally generated services, cost of employees working in HO should be considered for the purpose of valuation and also drew a distinction with respect to services which can be distributed through cross-charge vis-à-vis ISD route. The said ruling, which complicated the issue further, now stands overturned with the foregoing Circular.

3. **Pick and Choose done for internally generated services :** No logic has been provided as to why the cost of salary of employees of the HO involved in providing services to the BOs is not mandatorily required to be included while computing the taxable value. Further, this raises another question as to why only employee cost has been excluded and not other components for such internally generated services. It seems that CBIC has done arbitrarily a pick and choose as to what should be included and what should be excluded without providing any logical basis.

4. Action points for businesses:

a. In cases where invoices has been raised for such internally generated services which includes cost of HO employees and the time limit for raising Credit notes has not expired, to optimise their working capital, business houses may explore the possibility of raising credit notes in the following situations:

- Where BO has accumulated ITC
- Where ITC is not available to the BO

b. In cases where the taxpayers would still like to transfer higher ITC to their branches to optimise ITC utilization, they can continue to do so, since the Circular mentions that including the cost of HO employees is *“is not mandatorily required to be included while computing the taxable value.”*

While the CBIC clarifications are a welcome step in the right direction, it does raise some questions owing

to the vague language of the Circular. Further, it remains to be seen how the industry reacts to ISD becoming mandatory once the same is notified, which might open another pandora's box.