

ISD and Budget 2024 proposal -GST

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Introduction

In the past years under GST regime, one of the issues bothering the tax payers, was understanding on opting between Input service distributor/ISD and cross charge. There are many tax payers who have not complied with ISD concept on the common third party expenditures incurred such as audit fees, IT accounting expenses incurred centrally[such as at Head office/HO]. This was due to confusion whether credit on common expenses has to be compulsorily distributed through ISD route or not? Adding to this, ISD registration woes were also there in the beginning when GST was introduced. The credit distribution has to be done in the same month and invoices should be addressed to ISD registration to enable distribution of credits. Many would have got the invoices addressed to regular GST registration due to ignorance. To address this issue, Rule 54(1A) of CGST Rules 2017 was inserted providing option for the registered person to raise internal invoice from regular registration to ISD registration and then pass on the credits.

Those tax payers who had not obtained the ISD registration at all to distribute the common credits were apprehending denial of credit claim citing it pertains to other recipient branches/locations. Therein the only option being adopted was to cross charge to other locations. It would do well to recollect at this juncture that in Schedule I to GST law, it sets out at entry 2 that the supplies between distinct persons would be deemed to be supplies, even when done without consideration. Examples of distinct persons are branch offices in different states or being different GSTINs in same PAN. As per this entry, even when the offices of same legal entity bearing different GST registrations, make supplies of goods/services to each other, these are liable to GST on the supplies made between them. To the extent there are supplies between establishments of a distinct person, the value declared in the invoice could be considered as open market value when the recipient unit is able to take full credit.

The 50th GST Council meeting had recommended to clarify through a circular that Input Services Distributor (ISD) mechanism is not mandatory for distribution of input tax credit of common input services procured from third parties to the distinct persons as per the present provisions of GST law, and also to clarify issues regarding taxability of internally generated services provided by one distinct person to another distinct person[such as branch offices of same entity]. The **Council also recommended that amendment may be made in GST law to make ISD mechanism mandatory prospectively** [for future] for distribution of input tax credit of such common input services procured from third parties.

Accordingly in circular 199/11/2023 it was clarified under current provisions of GST, it is not mandatory for the HO to distribute ITC by ISD route. Such distribution of the ITC in respect common input services procured from a third party vendor can be made by the HO to a branch office/BO through ISD only if the said input services are attributable to the said BO or actually been provided to the said BO.

In this background, the Budget 2024 has proposed amendment to make distribution of common credit mandatorily by ISD route. This proposal is yet to be notified.

The paper writer has examined the ISD concept and the implications of the latest proposals.

Concept of ISD-in current GST law

Input service distributor: -

As per section 2(61) of the CGST Act, Input Service Distributor” (ISD) has the following characteristics,

(61) "Input Service Distributor" means an office of the supplier of goods or services or both which receives tax invoices issued under section 31 towards the receipt of input services and issues a prescribed document for the purposes of distributing the credit of central tax, State tax, integrated tax or Union territory tax paid on the said services to a supplier of taxable goods or services or both having the same Permanent Account Number as that of the said office;

Section 20

The manner for distributing credit



Conditions

- a. Tax invoice shall be issued to the recipient of the credit containing such details prescribed u/r 54(1) of CGST Rules.
- b. The amount of credit distributed shall not exceed the amount of credit available for distribution.
- c. The credit of tax paid on input services attributable to a recipient of credit shall be distributed only to that recipient,
- d. The credit of tax paid on input services attributable to more than one recipient of credit shall be distributed amongst eligible recipients and distribution shall be on the basis of the turnover in as State during the relevant period to the aggregate turnover of all such eligible recipients.
- e. ITC to eligible branch= (Turnover in that State/ Aggregate Turnover)*Common ITC.

Proposed Budget 2024 amendment wrt ISD

- **Substituted ISD definition section 2(61):** *“Input Service Distributor” means an office of the supplier of goods or services or both which receives tax invoices towards the receipt of input services, including invoices in respect of services liable to tax under sub-section (3) or sub-section (4) of section 9[Reverse charge], for or on behalf of distinct persons referred to in section 25[such as branch offices of same entity under same PAN], and liable to distribute the input tax credit in respect of such invoices in the manner provided in section 20.*
- **Substituted Section 20:** Any office of the supplier which receives tax invoices towards the receipt of input services, including invoices in respect of services liable to tax under Reverse charge, on behalf of distinct persons[such as branch offices], shall be required to be registered as ISD u/s 24 and shall distribute the input tax credit in respect of such invoices.
- ISD shall distribute the credit of CT or IGST charged on invoices received, including the credit of CT/IGST in respect of services subject to levy of tax under reverse charge paid by distinct person[such as branch office] registered in the same State as the said ISD, in such manner, within such time and subject to such restrictions and conditions as may be prescribed.
- The credit of CT shall be distributed as CT or IGST and IGST as IGST or CT, by way of issue of a document containing the amount of input tax credit, in such manner as may be prescribed.

Practical implications

Under present ISD provisions:

It is apposite to note that Section 20(2) of the CGST Act, 2017 provides that ITC through ISD “may” be distributed subject to the following conditions whereas Section 20(1) of the CGST Act, 2017 provides that the ISD shall distribute the ITC of CGST as CGST/IGST and IGST as IGST or CT.

Due to the usage of ‘shall’ under section 20(1) and ‘may’ under section 20(2), there is confusion as to whether the distribution of ITC through the ISD mechanism is optional or compulsory.

It is significant that on similar lines, in the erstwhile Cenvat credit regime, Rule 7 of CCR, 2004 up till 31.03.2016 provided that the input service distributor (ISD) “may distribute” the CENVAT credit in respect of the service tax paid on the input service to its manufacturing units or units providing output service, subject to certain conditions. The said Rule 7 of CCR, 2004 was amended vide Notification No.13/2016-CE(NT) dated 01.03.2016 and the phrase “may distribute” was substituted with “shall distribute” with effect from 01.04.2016.

In this regard, the case of M/s Maini Precision Products Ltd vs. Comm. of Central Tax [2021 (7) TMI 457 - CESTAT Bangalore] order of the Tribunal could be used to contend that the substantive provision for distribution of ITC through ISD is Section 20(2) of the CGST Act, 2017 whereas if one decides to distribute ITC through ISD then, it shall be in accordance with Section 20(1) of the CGST Act, 2017. This decision relied upon the following judgements:

- Commr. of C.T., Pune-I, Commissionerate v. Oerlikon Balzers Coating India P. Ltd. - 2019 (366) E.L.T. 624 (Bom.).
- Hindustan Zinc v. Commissioner of CGST, Udaipur reported in 2019 (4) TMI 475 and 2019 (370) E.L.T. 1582 (Tri. - Del.).
- Gloster Cables Ltd. v. Commissioner of Central Tax, Medchal - 2018 (363) E.L.T. 1197 (Tri. - Hyd.)

Thus, the distribution of ITC through ISD is optional and not mandatory under existing ISD provisions of GST law.

Implication under proposal of Budget 2024:

- Any office receiving the tax invoices towards input services, on behalf of branch offices, including services liable under RCM, is mandated to be registered as ISD u/s 24
- Shall distribute the input tax credit in respect of such invoices.
- Such distribution would be done subject to restrictions and conditions as may be prescribed.
- The credit distribution shall be done by issue of a document containing the amount of input tax credit, in such manner as may be prescribed.

Action points once the proposed change is notified:

- In case of common expenses, it would be suggested to obtain the ISD registration and distribute the credits to the respective locations.
- The vendors alternatively, could be instructed to issue separate invoices to respective locations instead of consolidated invoices which could reduce the ISD compliance.

This could be preferred option to avoid compliance of ISD.

- In case of support services provided from one location to another location, cross charging can still be opted with valuation options provided in Rule 28 of CGST Rules 2017. When the recipient unit is eligible for full credit, then there would not be major implication on valuation as value of invoice would be treated as open market value. In case the recipient unit is not eligible for full credit, then cost of support + 10% could be considered for issuing tax invoice on the units.

Conclusion

In light of the above proposed amendment, once made effective, Department could contend that credits on common expenses, were compulsorily required to be distributed under ISD mechanism and by cross charging there is excess / short distribution of credits. Therefore, tax payers need to be careful on opting for cross charge. While valuing the cross charges, the turnover ratio could be considered so that it could be proved that there is no excess/ short claim of credit.

Professionals could guide in compliance.

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