

ISD & CROSS CHARGE

1

CA ASHOK BATRA
M/S A. K. BATRA & ASSOCIATES NEW DELHI

Input Service Distributor

2

- Applicable to supplier of services only
- Applicable to such supplier of services having more than one registration under the same PAN
- 2 (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;

Concept of ISD

3

- ISD is an office of supplier of goods and services. A supplier may have number of establishments located in different States, however, as regards input services, a supplier may insist for obtaining invoices in the name of its one central location, irrespective of which establishment has actually received the services. The purpose could be centralized accounting, centralized payment system, master agreement with head office or for any other reason.
- **Example:** ABC Ltd may have **head office in Mumbai** and **establishments in Delhi, Chennai and Kolkata**. Although certain services are received at Delhi, an invoice may be issued in the name and address of Mumbai Head Office. Let's say a supplier P in Delhi makes an intra-State supply (CGST+SGST) and supplier Q of Gujarat makes an inter-state supply (IGST) **to Delhi** establishment, however, invoices are raised in the name of corporate office at Mumbai.

Concept of ISD

4

- Objective was different in service tax regime though concept is borrowed from service tax i.e. to avoid a situation where refund arises in one office and tax payable in another office
- The provisions of **section 16** of CGST Act provides that, no registered person shall be entitled to a credit in respect of any supply of goods or services or both to him **unless, he is in possession of a tax invoice or debit note** issued by a supplier registered under this Act, or such other taxpaying documents as may be prescribed. Therefore, in such case, although the services are received by various establishments (ex: Delhi), **it would not be possible for such establishments to claim the credit**, as the invoice will be issued in the name of central office of such person (i.e. Maharashtra). **The head office also cannot avail the credit as they are not actual recipient of such inward services.**
- Thus, in the above example, ABC's head office at Maharashtra if obtains registration as ISD, it will be allowed to take credit on the basis of invoices issued by P and Q **and immediately distribute such credit to Delhi establishment, by issuing ISD invoice to Delhi.** Delhi can thereafter be able to claim credit on the basis of ISD invoices issued by head office. Although, concept of ISD allows distribution of credit, such distribution is required to be made in certain manner.

Relevant provisions and Rules

5

- **Separate Registration for ISD - Section 24** of the CGST Act (read with **rule 8** of CGST Rules, 2017), requires an office of the supplier which intends to act as Input Service Distributor (ISD), to separately obtain registration as ISD. In other words, a registration number of an establishment as an ISD is different from regular registration number of such establishment u/s 22 of the Act.
- **Document for distribution of credit - Rule 54** of the CGST Rules, 2017 deals with the **prescribed document to be issued by ISD** for the **purpose of distribution of credit**.
- **Manner of distribution of credit - Section 20** of the CGST Act (read with **Rule 39** of GST Rules), contains **provisions relating to manner of distributing the credit** by ISD.
- **Filing of Return - Section 39(4)** of the CGST Act read with **Rule 65** of the CGST Rules, provides **for filing of return** by ISD, for every calendar month, within 13 days after the end of such month.

Relevant provisions and Rules

6

- **25(4)** A person who has obtained or is required to obtain more than one registration, whether in one State or Union territory or more than one State or Union territory shall, in respect of each such registration, be treated **as distinct persons** for the purposes of this Act.
- **Sec 16 (1)** Every **registered person (not entity/establishment)** shall, subject to such conditions and restrictions as may be prescribed and in the manner specified in section 49, be entitled to take credit of input tax charged on any supply of goods or services or both to him which are **used or intended to be used in the course or furtherance of his business** and the said amount shall be credited to the electronic credit ledger of such person.

Manner of distribution of credit by Input Service Distributor – Sec. 20

7

- **20(1)** The Input Service Distributor shall distribute the credit of **central tax** as **central tax** or **integrated tax** and **integrated tax** as **integrated tax** or **central tax**, by way of **issue of a document** containing the amount of input tax credit being distributed in such manner as may be prescribed.
- **Similar provision in State/UT GST Act/s also.**
- **20(2)** The Input Service Distributor may distribute the credit **subject to the following conditions**, namely :—
 - **(a)** the credit can be distributed to the recipients of credit **against a document** containing such details as may be prescribed;
 - **(b)** the amount of the 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**;

Manner of distribution of credit by Input Service Distributor – Section 20

8

- (d) the credit of tax paid on input services attributable **to more than one recipient** of credit shall be distributed amongst such recipients to whom the input service is attributable and such distribution shall be *pro rata* on the **basis of the turnover in a State** or turnover in a Union territory of such recipient, **during the relevant period**, to the **aggregate of the turnover of all such recipients** to whom such **input service is attributable and which are operational** in the current year, during the said relevant period;
- (e) the credit of tax paid on input services attributable **to all recipients of credit** shall be distributed amongst such recipients and such distribution shall be pro rata on the basis of the turnover in a State or turnover in a Union territory of such recipient, during the relevant period, to the aggregate of the turnover of all recipients and which are operational in the current year, during the said relevant period.

Procedure for distribution of input tax credit by Input Service Distributor - Rule 39

9

- (1) An Input Service Distributor shall distribute input tax credit in the manner and subject to the **following conditions, namely, -**
- 1(a) the input tax credit available for **distribution in a month shall be distributed in the same month** and the details thereof shall be furnished in **FORM GSTR-6** (Return form for ISD) in accordance with the provisions of Chapter VIII (Contain Rules for Returns) of these rules;
- 1(b) the Input Service Distributor shall, in accordance with the provisions of clause (d), **separately distribute the amount of ineligible input tax credit** [ineligible under the provisions of sub-section (5) of section 17 or otherwise] and the amount of eligible input tax credit;
- 1(c) the input tax credit on account of **Central tax, State tax, Union territory tax and integrated tax shall be distributed separately** in accordance with the provisions of clause (d);

Procedure for distribution of input tax credit by Input Service Distributor - Rule 39

10

- 1(d) the input tax credit that is required to be distributed in accordance with the provisions of clauses (d) and (e) of sub-section (2) of section 20 to one of the recipients 'R₁', whether **registered or not**, from amongst the total of all the recipients to whom input tax credit is attributable, including the recipient(s) who are engaged in making exempt supply, or are otherwise not registered for any reason, shall be the amount, "C₁", to be calculated by applying the following formula -
- $C_1 = (t_1 \div T) \times C$
- where,
- "C" is the amount of credit to be distributed,
- "t₁" is the turnover, as referred to in section 20, of person R₁ during the relevant period, and
- "T" is the aggregate of the turnover, during the relevant period, of all recipients to whom the input service is attributable in accordance with the provisions of section 20;

Procedure for distribution of input tax credit by Input Service Distributor - Rule 39

11

- 1(e) the input tax credit on account of **integrated tax** shall be distributed as input tax credit of **integrated tax** to every recipient;
- 1(f) the input tax credit on account of **Central tax and State tax** or Union territory tax shall -
 - (i) in respect of a **recipient located in the same State or Union territory** in which the Input Service Distributor is located, be distributed as input tax credit of **Central tax and State tax or Union territory tax** respectively;
 - (ii) in respect of a recipient located in a State or Union territory **other than that of the Input Service Distributor, be distributed as integrated tax** and the amount to be so distributed shall be equal to the aggregate of the amount of input tax credit of Central tax and State tax or Union territory tax that qualifies for distribution to such recipient in accordance with clause (d);

Procedure for distribution of input tax credit by Input Service Distributor - Rule 39

12

- 1(g) the Input Service Distributor shall issue an **ISD invoice**, as prescribed in sub-rule (1) of rule 54, clearly indicating in such invoice that it is issued **only for distribution of input tax credit**;
- 1(h) the Input Service Distributor shall issue an **ISD credit note**, as prescribed in sub-rule (1) of rule 54, **for reduction of credit** in case the input tax credit already distributed gets reduced for any reason;
- 1(i) any additional amount of input tax credit **on account of issuance of a ISD debit note** to an Input Service Distributor by the supplier shall be distributed in the manner and subject to the conditions specified in clauses (a) to (f) and the amount attributable to any recipient shall be calculated in the manner provided in clause (d) and such credit shall be distributed in the month in which the debit note is included in the return in **FORM GSTR-6**;

Procedure for distribution of input tax credit by Input Service Distributor - Rule 39

13

- 1(j) any input tax credit **required to be reduced** on account of issuance of a credit note to the Input Service Distributor by the supplier **shall be apportioned to each recipient in the same ratio** in which the input tax credit contained in the original invoice was distributed in terms of clause (d), and the amount so apportioned shall be -
 - (i) reduced from the amount to be distributed in the month in which the credit note is included in the return in **FORM GSTR-6**; or
 - (ii) **added to the output tax liability of the recipient** where the amount so apportioned is in the **negative** by virtue of the amount of credit under distribution being less than the amount to be adjusted.

Procedure for distribution of input tax credit by Input Service Distributor - Rule 39

14

- (2) If the **amount of input tax credit distributed by an Input Service Distributor is reduced later on** for any other reason for any of the recipients, including that it was distributed to a wrong recipient by the Input Service Distributor, the process specified in clause (j) of sub-rule (1) shall apply, *mutatis mutandis*, for reduction of credit.
- (3) Subject to sub-rule (2), the Input Service Distributor shall, **on the basis of the ISD credit note** specified in clause (h) of sub-rule (1), issue an Input Service Distributor invoice to the recipient entitled to such credit and include the Input Service Distributor credit note and the Input Service Distributor invoice in the return in **FORM GSTR-6 for the month in which such credit note and invoice was issued.**

Procedure for distribution of input tax credit by Input Service Distributor - Rule 39

15

Credit Available with ISD	Recipient unit is located in same state as that of ISD	Recipient unit is located in different state than that of ISD
Central Tax	CGST	IGST
State Tax	SGST	IGST
UT Tax	UTGST	IGST
Integrated Tax	IGST	IGST

Note: Thus it is ensured that there is no loss of credit

Credit Notes / Debit Notes to be issued by ISD

16

- **DISTRIBUTED TO A WRONG ESTABLISHMENT**
- If any credit is **distributed to a wrong establishment**, it can be **rectified by issuing ISD credit note to the recipient** to which it was wrongly issued and issuing an ISD invoice for the said amount to the recipient which is correctly entitled for such credit. Both the documents should be reflected in GSTR-6 of the ISD in the same month.
- **EXCESS CREDIT TO BE RECOVERED FROM THE RECIPIENT**
- **Section 21** provides that, where the Input Service Distributor distributes the credit in contravention of the provisions contained in section 20 resulting in excess distribution of credit to one or more recipients of credit, the **excess credit so distributed shall be recovered from such recipients along with interest.**
- **Case law of PNB**

Special Mention

17

It's important to note that, Section 20 permits distribution of Integrated Tax either as IGST or CGST or SGST. However, Rule 39(1)(e) permits distribution of ITC of integrated tax as IGST only.

It may be noted that, Rule 39 that mandates, distribution of the credit to all the recipients to whom credit is attributable, although such units are not registered under the Act, in spite of the fact that, registration under the Act is a condition for availment of ITC u/s 16.

Besides, it also mandates distribution of “ineligible credit” including ineligible credit under the provisions of section 17(5) or otherwise.

Issues & Case Studies relating to ISD

18

- **HOW TO DISTRIBUTE ITC OF RCM**

- Input Service Distributor is not a supplier of service, but is only a distributor of service. **Instructions appended to Form GSTR-6 provides that, ISD cannot make any payment under RCM and that if it has to make payment under RCM, it will be required to obtain a regular registration.** GSTR-6 also does not provide for showing any particulars for reflecting details of inward supplies on which payment is made under RCM.
- It therefore, appears that, merely **obtaining registration as ISD in a State would not make the assessee “registered person” under that State** for the purposes of payment of GST under section 9(3) or 9(4) of the CGST/SGST Act or as the case may be section 5(3) or 5(4) of the IGST Act.

- **IS IT NECESSARY TO HAVE MORE THAN ONE ISD?**

- Input Service Distributor is defined as an office of the supplier of goods and services and it appears that it can distribute the credit to all the offices of the entity which are covered under Single PAN. It therefore appears that, it's enough for any supplier to take only one ISD registration in respect of all its units located across the India. If a supplier needs to distribute credit from more than one office as it may have regional office where it is receiving invoices for distributing the credit it can have ISD registration in each regional office>

Conclusion

19

- The manner of **distribution of ITC through ISD is very much rigid**, as ISD is required to **distribute the ITC in the same month** or that, **credit note of ITC should be given in the same proportion in which original ITC was distributed.**
- An ISD is required to file the return on **13th of the next month**, hence he will be required to undertake the reconciliation of ITC in respect of inward supplies between 11th to 13th.
- **Unless, ISD files its return, other units will not be able to get the ITC.** These complexities contained in the Act, make the concept of ISD prone to implementation challenges.

Conclusions

20

- **CAN ISD REGISTRATION BE AVOIDED - ISD is applicable only in respect of input services.** Services identifiable to units should be billed to such unit/s directly by supplier of service, in such case ISD will be required to distribute only common credits like audit fees of Statutory Audit. Cost of compliance need to be compared with amount of tax credit on common services or possibility of taking credit at HO/regional office level as the case may be or charging certain amounts on monthly/quarterly basis be entering into an agreement with distinct person.
- **No consequences except for loss of credit**

Cross Charge

21

- **What's the concept of Cross Charge?**
- Generally, ISD is a concept used for 'distribution' of ITC to one or more supplying units, whereas cross charge is the concept for **'accumulation' of ITC scattered at different location to a central location.**
- **Example of Cross Charge:** ABC India has a plant at Maharashtra, but representative offices at Delhi, Chennai, Kolkata and Tamil Nadu which is only engaged in marketing activities. All supplies are happening directly from Plant at Maharashtra to customers across India. In this case, ITC of local taxes (CGST+SGST) in respect of services obtained at local offices at Delhi, Chennai and Kolkata shall be accumulated at those respective offices unless the cross charging is not adopted. If cross charging is adopted, then such offices will do cross charge on their plant at Maharashtra for business support services and consequently, accumulated ITC at those offices will be used effectively.

Cross Charge

22

- Applicable to both supplier of goods or services or both
- There are more than one registration under the same PAN
- Offices of an organization in different States are regarded as distinct persons, hence, what is taxable under GST is supply of goods and services by the HO to its branch office/s and vice versa when made in the course or furtherance of business even if the same is without consideration in terms of section 7 of CGST Act read with Schedule I
- **ITC Available to the Recipient**

Any tax charged on such supplies is available to the recipient as input tax credit subject to the provisions of Chapter V of CGST/SGST Act

Cross charge – Legal Prospective

23

- Different units of a same entity functioning in different States are treated as “distinct persons” under the GST law and supply of goods or services or both between such “distinct persons”, even if made without consideration are treated as supply, as per Schedule I of the CGST Act. **This deeming fiction was created, so that the Input Tax Credit chain is maintained in tact. Explain How - ?**
- **This purpose would have been well achieved if only supply of goods without consideration alone are considered as deemed supply**, but knowingly or unknowingly, supply of services without consideration are also deemed to be supplies, which has led to challenging difficulties to the trade.
- Major cause for future litigation

ISD vs Cross Charge

24

- **Distinction between ISD & cross-charge**
- Only ITC on input services which are attributable to other distinct entities are distributable : No element of service, but mere distribution
- In a cross-charge mechanism, expenses incurred by a distinct person for the purpose of carrying out activities the outcome of which benefits other distinct persons is required to be cross charged as there is an element of service.

Legal Provisions

25

- 25(4) A person who has obtained or is required to obtain more than one registration, whether in one State or Union territory or more than one State or Union territory shall, in respect of each such registration, be treated **as distinct persons** for the purposes of this Act.
- 25(5) Where a person who has obtained or is required to obtain registration in a State or Union territory in respect of an establishment, has an establishment in another State or Union territory, then such establishments shall be treated as establishments **of distinct persons** for the purposes of this Act.
- **Schedule III - Para 1.** Services by an **employee** to the **employer (not person)** in the course of or in relation to his employment- None of the three terms defined in GST
- **Schedule I - Para 2.** Supply of goods or services or both between related persons or between distinct persons as specified in section 25, when made in the course or furtherance of business

Analysis Entry I to Schedule III

26

- Services by an **employee** to the **employer** in the course of or in relation to his **employment**
- None of the three terms defined in GST
- Employer can be any legal entity and employee is an individual.
- “employer” and “employee” referred to under Entry No. 1 of Schedule III would constitute a legal person.
- This entry uses the word “employer” and not “person”
- It provides that is all the services by an employee “in the course of or in relation to his employment” and **is not limited/restricted to his place of work.**

Supplies provided by HO to another distinct person

27

- (i) **Procuring goods at HO centrally located for distribution to units across the country** : In this scenario the goods are procured by the HO for the purpose of use by the units. The goods either first come to the HO, and thereafter transferred to the units or the goods are directly delivered to the units. **One such case can be where the HO procures laptops in bulk directly from the manufacturer to be used by the employees at units located in different States of India – GST Leviable**
- (ii) **Procuring services at HO centrally for utilization by the units across the country**: In this scenario the HO enters into a service contract with the supplier of services wherein the services are used by other units. Such types of services are **Centralized Consultancy services, Statutory Audit services, IPR services, etc. – ISD registration required**
- (iii) **Procuring goods and services for utilization in the course of strategic operations of HO** : The HO also procures goods and services for use in the course of carrying out the strategic operations. HO procures goods like furniture, consumables, etc. and avails services of employees, renting of premises, etc. and use such goods and services for carrying out its operations. **Such operations carried out by the HO include accounting, marketing, management and other administrative functions. – Business Administrative and Support Service – Subject matter of litigation**

Karnataka AAAR in Columbia Asia Hospitals

28

- Ruling : India Management Office (IMO) is providing services to its other distinct units by way of carrying out activities such as accounting, administrative work, etc. with the use of the services of the employee working in the IMO, the outcome of which benefits all the other units and such activity is to be treated as a taxable supply
- The employee-employer relationship is to be viewed separately for every registered unit of the business entity, cost of employees working in the IMO is an integral part of the cost of services rendered by IMO

Draft Circular – Cross Charge dated 5.10.2019

29

- 2.1. Let us assume that there is a **business entity** which has **Head Office (HO) at Mumbai (HO)** and **two branch offices at Kolkata (BO-1) and Chennai (BO-2)**, as shown in the matrix above. The **HO procures security service (IS – 1)** for the entire organisation from a security agency located in Delhi, which deploys **10 security guards at HO and 5 each at BO-1 and BO-2**.
- 2.2. The HO has a **Personnel Department** which looks after the personnel administration such as maintenance of leave record, performance evaluation, and promotion of all the employees posted at HO, BO-1 and BO-2. **The activity performed by the personnel department of HO is marked as C-1.** The **Technical Maintenance Department of the HO** does the maintenance of all the machines installed at HO, BO-1 and BO-2. The activity performed by the Technical Maintenance Department of the HO is **marked as C-2**.
- 2.3. Head Office as well as branch offices undertake software development projects for their clients. In a software development project **undertaken for a client by BO-2, two engineers posted at BO-1 assisted BO-2**. The activity performed by the two engineers of BO-1 for the software development project undertaken by BO-2 is marked as B-1 in the matrix above, depicting the flow of the above services within the three distinct persons of the same organisation.

Draft Circular – Cross Charge

30

- **3.1. Question**– Is it mandatory to distribute input tax credit (hereinafter referred to as ‘ITC’) in respect of input services (IS-1), procured by HO but attributable to both HO and BOs, following the Input Service Distributor (ISD) procedure?
- **Answer** -Yes, it is **mandatory to follow ISD procedure** laid down in Section 20 of CGST Act read with rule 39 of the Central Goods and Services Tax Rules, 2017 (hereinafter referred to as ‘the CGST Rules’) for distribution of ITC in respect of input services procured by HO from a third party but attributable to both HO and BO or exclusively to one or more BOs.

Draft Circular – Cross Charge

31

- **3.2. Question**–Will the input service (IS-1) procured by HO from a third party for use by the BOs, the ITC of which is distributed in accordance with the ISD procedure, be treated as a supply by HO to the BOs and will it be taxable in the hands of HO.
- **Answer – No**, the services procured by HO from a third party for use at HO and BOs, or exclusively for use by BOs, the ITC of which is distributed in accordance with the ISD procedure laid down in Section 20 of the CGST Act read with rule 39 of the CGST Rules, would not be separately treated as supply by the HO to the BOs.

Draft Circular – Cross Charge

32

- **3.3. Question**– If HO considers that procurement, distribution and management of common input services for use by HO and BOs as per ISD provisions leads to an expense, how can it apportion these expenses to the BOs?
- **Answer**–HO may incur certain expenses on procurement, distribution and management of common input services. The HO may or may not apportion and recover such expenses from BOs. Nevertheless, such procurement, distribution and management of services by the HO for the BOs is a separate service provided by the HO to the BOs. It should be invoiced by the HO to the BOs to the extent of expense incurred by the HO. It is a service distinct from those services the ITC in respect of which has been distributed through the ISD procedure. It is for the HO to value the service as per the principles laid down in para 3.6 below.

Draft Circular – Cross Charge

33

- **3.4. Question**– If the HO generates some services internally such as common administration by maintaining common administration team for BOs and HO (C1 in the matrix above), or common IT maintenance through a maintenance team at HO (C2 in the matrix above), where the team members are the employee of the HO, are these employees providing any service to the BOs?
- **Answer** –3.4.1. The offices or establishments of an organisation in different States are establishments of distinct persons under sub-section (4) of section 25 of the CGST Act and Explanation 1 of section 8 of the Integrated Goods and Services Tax Act, 2017 (hereinafter referred to as ‘the IGST Act’). GST law envisages these distinct registered persons to be independent entities, though part of one legal entity, and they can be providing services to each other.
- 3.4.2. Whether employees posted in HO, who look after administration of HO and BOs or maintenance of machines installed in the HO and BOs or perform similar other functions for the organization as a whole or for a particular BO which is a distinct person, are providing service to BOs is not the correct perspective to be determined here. The correct perspective for examining the issue at hand would be to determine whether the HO and BOs are providing services to each other and not whether the employee of HO is providing services to the BOs. In this case, it is the HO which is providing services to BOs

Draft Circular – Cross Charge

34

- **3.5. Question**– What is the legal basis for concluding that HO is providing services to the BOs in the above example?
- **Answer** –HO and BOs are distinct persons in terms of sub-section (4) of section 25 of the CGST Act. They are also related persons as defined in Explanation (a) to section 15 of the CGST Act. It may be noted that the supply of goods or services or both between related persons or between distinct persons, when made in the course or furtherance of business is a supply even if it is made without consideration in terms of para 2 of Schedule I to the CGST Act. **Thus, services produced or generated in HO by its employees and used by or supplied to BOs, with or without consideration, are supplies liable to GST.** The HO should invoice such supplies to the BOs, whether HO charges any consideration for such supplies from BOs or not is immaterial. The same principle would apply for supply of services by a BO to another BO (B1 in the above matrix) or by a BO to the HO.

Draft Circular – Cross Charge

35

- **3.6. Question**– How would these **services provided by one entity to another of a body corporate**, registered as distinct entities (C1 and C2 in the above matrix) **be valued**?
- **Answer-3.6.1.** As regards valuation of such supplies, since HO and BOs located in different States are related persons, value of such supplies cannot be determined under sub- section (1) of section 15 of CGST Act. The same has to be determined under sub-section (4) of Section 15 of CGST Act read with the rules made thereunder. According to rule 28 of the CGST Rules, the value of supply of goods or services between distinct persons or related persons shall, a) be the open market value of such supply; b) if the open market value is not available, be the value of supply of goods or service of like kind and quality; c) if the value is not determinable under clause (a) or (b), be the value as determined by the application of rule 30 or rule 31 of the CGST Rules, in that order.
- **3.6.2.** The rule further provides that where the recipient is eligible for full ITC, the value declared in the invoice shall be deemed to be the open market value of the goods or services.

Draft Circular – Cross Charge

36

- **3.6.3.** Illustration HO has sent an annual expense budget of Rs 10 lakh for the administrative division looking after the personnel administration of the employees in HO as well as two BOs located in two different States. The value of services supplied by the HO to BO-I may be determined under rule 31 of the CGST Rules using any reasonable means consistent with the principles of valuation contained in the CGST ACT. For example, value “V” of service provided by HO to BO-1 for managing administration of staff can be determined as follows:
 - Value “V” = $(Y/N) \times \text{Rs.}10,00,000/-$
 - Where, Y is the number of employees in BO-1; And N is the total number of employees posted in the HO and two BOs.

Draft Circular – Cross Charge

37

- **3.7. Question**– If there is an input service, clearly attributable to a BO, can it be contracted by the HO and paid for by the HO. How would this credit be transferred to the BO?
- **Answer** – HO can distribute ITC in respect of input services **procured on behalf of BO following the ISD procedure** laid down in section 20 of CGST Act read with rule 39 of the CGST Rules. There is no restriction on HO acting as common procurement centre for all the services required by a business. If a service is specifically attributable to a BO, it shall be distributed to that BO only in terms of clause (c) of sub-section (2) of section 20 of the CGST Act.

Draft Circular – Cross Charge

38

- **3.8. Question**– There are **some services internally generated** which are clearly identifiable as those pertaining to another distinct person, how would these be taxed? For example, if two persons in BO1 do work related to IT development for a project contracted by BO-2 (service B1 in the above matrix), **how would it be taxed?**
- **Answer- 3.8.1.** In this case, BO-1 is providing service to BO-2 by way of assistance in the IT development work undertaken by BO-2. BO-1 should invoice this service to BO-2 and pay GST on it. Value of the service may be determined by using any reasonable means as illustrated below:

Draft Circular – Cross Charge

39

- **3.8.2. Illustration** - Assuming that each of the two engineers of BO-1, who assisted in the software development project undertaken by BO-2 as shown in the above matrix, draws salary and emoluments on cost to the company (CTC) basis of **Rs. 1.00 lakh per month** and puts in, on an average, **200 hours of work per month**, and devoted 50 hours each for the project undertaken by BO-2, the value of service (B1) supplied by BO-1 to BO-2, by way of assistance in a project belonging to BO-2, may be determined using reasonable means under rule 31 of the CGST Rules as under:
 - Value of service B1= Employee cost + Establishment cost of supplying 100 man-hours. Employee cost of 100 man-hours supplied by BO-1 to BO-2 may be calculated in this example as under:
 - = $(100000/200)*50*2$
To this may be added the establishment cost of supplying 100 man-hours following any reasonable method consistent with the generally accepted accounting principles as illustrated in para 3.6.3 above.
- **3.8.3.** It may be noted that the question pertains to clearly identifiable service for which BO maintains record. This does not warrant that activities and services of individual employees are required to be monitored in terms of its usage by various BOs and HO. **Where such accounting is not done in the normal course of business, answer as given for question 3.6 shall apply.**

Draft Circular – Cross Charge - Conclusions

40

- 4. Accordingly, it is reiterated that where a taxpayer, registrant in different States, is a distinct person, then –
 - (i) **An employee of a HO (registered as a separate entity) does not provide any services to a BO, rather it is the HO which provides service to the BO.**
 - (ii) There is a need to **apportion expenses incurred by one office for provision of output services to another office by any reasonable means** consistent with the principles of valuation in the GST law and the generally accepted accounting principles.
 - (iii) Such apportionment/valuation of supply shall be done **on the basis of information maintained by a company in its normal course of working.** There is no need to maintain additional records of activities undertaken by individual employees.
 - (iv) **The only exception** to this principle would be **distribution of ITC in respect of input services procured by one office and distributed to the others for which ISD** provisions apply as the taxpayer is expected to mandatorily obtain ISD registration if he has to distribute ITC on input services.

Press Note dated 15/11/2019*

41

- **Services by an employee to the employer in the course of or in relation to his employment is outside the scope of GST**
- Offices of an organization in different States are regarded as distinct persons, hence, what is taxable under GST is supply of goods and services by the HO to its branch office/s and vice versa
- Any tax charged on such supplies is available to the recipient as input tax credit
- Not any additional cost - it is a worldwide practice under the GST laws
- GST charged on prices / charges by any supplier of goods or services from his consumers does comprise of all costs including cost of raw material, capital goods, input services and employee costs, etc.
- This does not mean that salaries paid to the employees by the employer are being taxed under GST

Consequences if cross charge not followed

42

- The view of the Government as evident from the Draft Circular & the Press note seems to be that GST applicable on common functions provided by HO to the branch
- Could result in issuance of SCN and litigation
- Decision of the Karnataka HC against AAAR in the case of Columbia Asia Hospital will be crucial

Legal points for discussion

43

- 1) Whether there is a 'supply' by HO to branches for common functions such as HR, IT, Taxation etc.?
- 2) Whether the value of such supplies will include employee cost?
- 3) The charging mechanism fails and therefore, no tax can be levied

Whether covered under the definition of supply

44

- GST is leviable on 'Supply' of goods or services or both made for a consideration by a person in the course or furtherance of business.
- Schedule I : Supply of goods or services between distinct persons when made in the course or furtherance of business : Liable even if without consideration
- Elements of 'supply' first need to be satisfied,
- Does not fall in the definition of supply as no contractual arrangement / obligation 'to provide' services by a 'supplier of services' to a 'recipient of services'
- Services received by HO and not distributed are consumed by HO / used for own-self for performing its obligations as the HO
- Mere incidental use by branches cannot be treated as an activity of 'supply'
- Legislative intent for introducing the concept of 'distinct persons' was to ensure that credit chain is not broken
- Costs incurred by the HO is towards fulfilment of its legal obligation and not any 'supply' of any service to the branch
- **If not a supply no question of cross charge**

Supply under GST – ‘employee to employer’

45

- ‘Supply’ excludes activities in Schedule III : Services by an employee to employer in the course of or in relation to his employment
- Employee is **employed for carrying out duties under the employment contract for the legal entity as a whole** & not for a specific location based on physical presence – Tech Mahindra Vs. CCE, Pune - 2016 (44) S.T.R. 71 (Tri. - Mumbai)
- “The activity of the head office and branch are thus inextricably enmeshed. Its employees are the employees of the organization itself. There is no independent existence of the overseas branch as a business.” – Agencia Commercial ... vs Custodian Of The Branches [1982 AIR 1268]
- It is **settled law that a body corporate and its branches are not distinct and separate entities from each other**, that the branches constitute mere components through which the corporate entity expresses itself and that all transactions entered into ostensibly with the branches are in legal reality transactions with the corporate body and that it is with the corporate body that a person must deal directly.

Supply under GST – ‘employee to employer’

46

- Terms used are **‘employee to employer’** and not **‘employee to distinct person’**, term ‘employer’ not defined, meaning to be understood in common parlance
- – Oxford Dictionary : “a person or organization that employs people.” –
- Employees’ Provident Funds Act : “employer” means...in relation to an any other establishment, the person who, or the authority, which has ultimate control over the affairs of the establishment or establishment consisting of different departments or branches, whether situated in the same place or not treated as parts of same establishment
- Payment of Gratuity Act, 1972 : the person, who, or the authority which, has the ultimate control over the affairs of the establishment,...company
- **Services are provided by the ‘employees’ to the legal entity (employer) as a whole and there is no separate supply of service by HO to branch**
- The concept of **‘distinct person’ cannot be stretched to tax something (salary cost) by deeming fiction**, which is per se not taxable under the GST Law

Services provided by employee

47

- It may be noted that **any legal fiction created by a Statute is for a specific purpose** and the above deeming fiction is only “for the purposes of this Act”. Otherwise, the fact remains that different units of an entity situated in different States are part of the same entity and hence constitute a single person only.
- **In order to decide whether the employees working in HO are also employees of the units of the entity in different States or not, there is no need to refer to any of the provisions of the CGST Act.**
- Employment is a contract between the employer and employee and is governed by the Contract Act as well as by any other special enactments relating to such employment. By all means the employees of an entity are employees of the entity as a whole as the entity is a single entity. **So, when the employees of HO are catering to the works of all units, they do such works only in their capacity as employees of the entity as a whole** and the fact that different units of such entity are treated as distinct persons under GST law, cannot alter the fact that they are employees of the same entity. Hence, in the author’s view, albeit the decision of the AAR, there is no requirement to charge any GST in respect of the employee cost pertaining to HO, though the same may invite litigation.

Other common services provided by HO

48

- **Other common services received by HO from various service providers.**
- The HO would be receiving various services from various service providers. For example, when the HO **pays rent** for its premises, can it be said that in turn that similar service is provided by HO to its units in different States? When HO **pays to its statutory auditor**, can it be said that HO is providing such services to its units in different States? There is host of common services received by HO, the benefit of which is attributable to all units.
- S. No. 2. of Schedule I - *Supply of goods or services or both between related persons or between distinct persons as specified in section 25, when made in the course or furtherance of business :*
- The question now is as to whether the HO is said to be procuring such common services for the benefit of all its Units, which activity by itself can be considered as a supply, by virtue of S.No.2 of Schedule I. If so, HO should avail ITC of GST charged by all such service providers and in turn raise GST invoices on its units in different States.

Charging mechanism fails – no GST



Value of services – to be determined per Section 15(4) read with Rule 28

Valuation mechanism	Comments
Open Market Value (OMV)	OMV for the services not available
The value of supply of service of like kind and quality	Not possible to identify like kind or quality as it is Company specific
110% of cost of provision of services	Difficult to determine what would constitute cost. Exact allocation of cost for time spent by employee towards a specific branch may not possible e.g. it is not possible to identify how much time a Director would be spending on work related to HO, even not possible for department to establish
Reasonable means consistent with the principles and general provisions	Would still require allocation of employee cost which is difficult to determine. Also, methodology too vague

As the charging mechanism fails, tax cannot be levied even if ‘supply’ is assumed

Judgments – No mechanism for determination levy fails

50

- The statute should clearly and unambiguously convey the three components of the tax law i.e. the subject of the tax, the person who is liable to pay the tax and the rate at which the tax is to be paid. If there is any ambiguity regarding any of these ingredients in a taxation statute then there is no tax in law. Then it is for the legislature to do the needful in the matter.
- CIT v. B.C. Srinivasa Setty — (1981) 2 SCC 460
- Commissioner of C. Ex. & Cus., Kerala Versus Larsen & Toubro Ltd. 2015 (39) S.T.R. 913 (S.C.)
- Mathuram Agrawal v. State of M.P., (1999) 8 SCC 667
- Govind Saran Ganga Saran v. CST, 1985 Supp SCC 205

Implications for taxpayers

51

Possible scenarios

Companies who have neither followed ISD nor cross-charge mechanism

Companies who have followed ISD mechanism, but not done cross-charge

Companies who have only done cross-charge but not levied GST on employee cost

Companies who have done cross -charge, and levied GST on gross amount including employee cost

Options for the tax payer and other related issues

52

- ISD registration for third party supplies.
- Is credit available to the recipient of supply.
- Whether time limit as prescribed under section 16(4) has expired.
- How much is the tax liability and does it affect true and fair view particularly when the time limit to avail credit is over.
- If credit is available start complying immediately to avoid litigation.
- Try to make use of Second proviso to Rule 28 for the past period even if there is loss of credit as litigation exposure will may be more.
- Moreover it does not require any change in final accounts because at entity level it will be set off.
- Where credit is not available may make payment of tax under protest to keep the issue alive.
- Whether 9C need to be qualified?

Options for the tax payer other related issues

53

- Application of Advance Ruling – if negative, would lead to legal compulsion to charge GST hence not advisable
- File Representation with the GST Council/CBIC – Legal arguments as discussed in earlier slides
- Amendment in law to restrict cross charge for goods only
- Writ petition to be filed if negative Circular issued / Notices received



Issues & Case Studies relating to ISD

55

- In order to understand the concept of ISD, following examples may be considered:
- **Example: 1** - A service provider in Delhi (i.e. a place where ABC has a separate registered unit) provides certain intra-state services to ABC (which are used at Delhi office), charges CGST+SGST (Delhi) and issues invoice in the name of ABC-ISD Maharashtra, the question may arise as to whether ABC-ISD can avail the ITC as CGST+SGST (Delhi) as ISD and distribute the credit to Delhi Unit as per the provisions of the Act, or whether credit would be denied to ABC Maharashtra as the credit pertains to Delhi. In other words, can credit in respect of local services be availed by ISD registered in other States?
- **Possible Answer:** A simple advice in such case would be to ask a Delhi vendor to issue the invoice directly in the name of Delhi Unit and not to go through ISD mechanism as the same is not necessary. However, it would certainly not mean that credit will be disentitled, if such invoice is routed through ISD mechanism. In short, ITC which is otherwise available to an entity should also be allowed to it through ISD mechanism.
- **Example: 2** - The question may become little complex, when service provided by the Delhi vendor has direct nexus with Kolkata unit and not Delhi unit. In such case, will it be permissible for ABC-ISD at Maharashtra to distribute the CGST+SGST (Delhi) credit to ABC-Kolkata as IGST credit?
- **Possible Answer:** In this case, tax officials have expressed a view that, assuming there was no ISD and invoice was raised directly in the name of ABC-Kolkata, it would not have been possible for ABC-Kolkata to avail Input Tax Credit of CGST+SGST(Delhi). Therefore, possible answer in this case is that, mere availment of ISD facility would not entitle ABC-Kolkata to avail the ITC of CGST+SGST (Delhi), to which it's not otherwise entitle.

Issues & Case Studies relating to ISD

56

- **Example: 3** A supplier of Tamil Nadu (i.e. a place where ABC has no place of business) issues a CGST+SGST (TN) invoice to ABC ISD Maharashtra and such service is not specifically related to any registered unit of ABC, but a common service. In such case, can ABC-ISD avail the ITC in respect of such services or would it require another ISD registration in the State of Tamil Nadu, or whether ITC would not be available at all?
- **Possible Answer:** As ABC does not have a registered place of business in Tamil Nadu, it would not be entitled to ITC in respect of CGST+SGST (TN). Therefore, as explained in Example 2 above, mere routing the transaction through ISD Facility may not entitle ABC to avail ITC.
- **Example 4:** Whether, there is any way by which ABC shall be entitled to take ITC of CGST+SGST (TN) in respect of services availed from vendor in Tamil Nadu?
- **Possible Answer:** Yes, ABC will be required to take registration in the State of Tamil Nadu in order to avail the ITC of CGST+SGST(TN), and then use a cross charging method, in order to transfer the benefit of such credit to other units of Maharashtra. Therefore, ABC-Tamil Nadu would be required to issue an invoice for business support services to ABC-ISD, which will enable ABC-ISD to avail the ITC and distribute the same to respective units.