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The Application for Advance Ruling filed by Karnataka based Columbia Asia Hospitals Pvt Ltd highlighted the concept of Supplies between related and distinct entities among the taxpayers. A lot of controversy ran around about the concept and its consequences and by Appellant Authority affirming the ruling subsequently, it is time to discuss how the concept can be put into place and avoid any potential liability that can arise on its non-compliance.

A lot of brainstorming went into whether the taxpayers need to choose whether to follow ISD mechanism or cross-charge mechanism. This piece of article is intended to confront the myths and discuss the theories to enable the taxpayers to make a wise choice.

❖ **Relevant provision under GST:**

Section 2(61), CGST, 2017 - — *"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 7 (1)(c), CGST Act, 2017 - *For the purposes of this Act, the expression "supply" includes— the activities specified in Schedule I, made or agreed to be made without a consideration.*

Para 2, Schedule I, CGST Act, 2017 - *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 shall be treated as supply even if made without consideration.*

Section 24, CGST Act, 2017 - *Notwithstanding anything contained in sub-section (1) of section 22, the following categories of persons **shall be** required to be registered under this Act, –*

(viii) Input Service Distributor, whether or not separately registered under this Act

Section 25(4), CGST Act, 2017 - *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.***

❖ **ISD or Cross charge: A financial requirement**

Where an entity is registered in more than one state, to exercise effective control over alternate locations, it is a prevalent practice in the industry to incur some expenses from Head Office centrally. This comprises accounting, administrative work, and maintenance of IT systems in respect of all its alternate locations and also certain expenses for its functioning such as rent payment for usage of immovable property and equipment, consultancy services, traveling expenses, audit, and legal expenses, etc.

Head office is generally a cost center and does not render outward supplies. The above said practice over a period of time results in the accumulation of GST credits at the Head Office.

The outcome of such a superfluity of credits is the non-utilization of credits. Further, ITC piled up at HO is inaccessible to alternate locations for discharging GST liability.

To address such hardship that may cause ineffective deployment of working capital, a mechanism is put in place to apportion the GST credits of input services to alternate locations by way of ISD or cross charge.

❖ Is it mandatory to opt for ISD and Cross charge?

The concept of ISD earns its power from the statutory definition of "Input Service Distributor" and compulsory registration requirements which are provided under section 2(61) and section 24 (viii) of the Central Goods and Services Tax, Act 2017 ("CGST Act") respectively, which were reproduced above:

In the backdrop of the above, it is deduced that it is mandatory to get registered as ISD, only if the recipient intends to obtain invoices in the name of its one central location and has to distribute those ITC to the establishment, which has received the services. Hence, the recipient of invoices has to register as ISD for distribution of services to respective GSTIN(s).

On the other hand, the word "Cross Charge" is not defined under GST laws but it sows its seeds from the combined reading of Schedule 1 and the concept of distinct persons.

As per schedule 1 of the CGST Act, any supply between different GST registrations having the same PAN (distinct persons) shall be treated as "supply" even when made without consideration.

Thus, based on the provisions as stated above, any supplies between different GST registrations of the same entity shall be termed as cross charge and shall attract GST.

In the light of the above, "Cross charge" concept is not an option to be considered. It is imperative and mandatory in nature.

According to Advance Ruling in Columbia Asia Hospitals (P.) Ltd. in which Karnataka Authority for Advance Ruling, held that the head office and its different units registered in different states are to be treated as 'related persons' and therefore, in terms of entry 2 of Schedule 1, the activities of accounts and management done by the HO for the individual units located both within the State and outside the State amount to supply of services from the head office, even if made without consideration.

❖ Distinction between ISD and cross charge

Cross charge facilitates the allocation of expenses whereas ISD facilitates the distribution of only ITC:

Generally, the head office handles some assignments centrally, the benefit of which is received by alternate locations. This arrangement is considered as supplies made by one registered person to another under the same PAN and there is a supply of services. These assignments include:

1. Centralized accounting
2. Advertisement,
3. Sales and marketing
4. Finance and Treasury
5. Administration and Managerial Services
6. Cash management
7. Legal assignments and Audit etc.

To perform such assignments, Head Office/Corporate office has to incur expenses on the workforce, top management, time, equipment, office space. These expenses become part of valuation for executing cross charge.

Hence, it can be concluded that there is a provision of service by the Head Office/Corporate office, and the same is charged to another beneficiary of a person.

It should be noted that ISD comes into sight only when services are provided by third parties which are explained below:

Several services are provided by third parties to support above mentioned assignments such as audit fees, legal consultant fees, royalty license fees, etc. ITC on such services can be distributed through ISD. Alternatively, these can be cross charged as well by including these as part of the valuation.

It is worthy to note that, procedural aspects for distribution through ISD are designed in a way that only ITC value is required to be distributed and not the taxable value of expenses/ purchases.

It can be said that ISD is towards the distribution of ITC for the services received by the HO and consumed by the branch office and on the flip side, cross charge is a supply of service by a GSTIN to another GSTIN of the same PAN, which is taxable under GST.

Notably, the allocation of expenses incurred in operating the Head office determines the profit of each cost Centre which in turn gives a true picture of state-wise accounts.

- **Compliance**

In the case of ISD, compliance burden is increased due to the monthly filing of GSTR 6, monthly distribution working, etc. In case of the cross charge, there is issuance of tax invoices for the supply of services in a similar way as supplies by a third person.

❖ Time limit for allocation of expense or distribution of ITC

Under ISD, ITC received in a month is to be distributed in the same month. On the other hand, cross-charge invoices can be raised based on supply of services i.e. monthly, quarterly, or annually as per the arrangement between the distinct persons. Hence, time limit for availing of credit for recipient unit, in case of ISD, will start from the date invoice was issued by original supplier. However, such time limit, in case of cross charge, will start from the date of cross charge invoice.

❖ Allocation of ITC on Goods

The ISD mechanism is limited to the extent of distribution of ITC on input services only. Whereas Cross charge is applicable on inputs, input services, and capital goods as well.

❖ Allocation of Ineligible ITC

Under cross charge, an expense, ITC of which is ineligible, is also required to be allocated. GST is required to be charged on cross charge invoice even though ITC of the input service is not available. Whereas, under the ISD mechanism, ineligible credit is also required to be distributed as it is, which will remain ineligible for the recipient unit also.

❖ Non-identical GST rates

Invoices received from third parties may have different rates of GST. By opting for the ISD mechanism, ITC can be distributed as it is as the same received. On the other side, if the allocation is executed through cross charge, the GST rate on inward supply will be different from the rate applied on cross charge invoices. This situation calls for a proper valuation at the time of cross charging.

❖ Conclusion Remarks

Both the alternatives invite their respective compliances which shall be adhered to with the GST law. ISD mechanism brings in rigid frames to follow to distribute ITC, especially the condition that, 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. These structures contained in the Act, make the implementation of ISD a challenge. Contrarily, cross charge mechanism renders flexibility and is also, the only mechanism that can be deployed for supplies made between distinct persons. Both mechanisms have their pros and cons and calls for careful consideration before making a choice.

Disclaimer: The views presented are solely for educational purpose and should not be construed as any legal advice.