

GST ARTICLE

Cross Charge Vs ISD - Analysis of Circular No. 199/11/2023-GST

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The Government has come up with the most awaited clarifications¹ with regard to the cross charge and input service distributor ('ISD') compliances which were among the most contentious issues under GST since its inception. The taxpayers having multiple GST registrations as well as the department were uncertain with regard to the application of the cross charge and ISD provisions. Various confusions persist in the industry such as whether complying any one of these two provisions would be sufficed or both of them to be complied mandatorily, what should be the valuation mechanism, what would be repercussions in case of non-compliance or wrong compliance, etc. Furthermore, the department has also initiated saddling the taxpayers with the tax liability (along with applicable interest and penalty) citing the non-compliance or wrong compliance of the cross charge and ISD provisions and by also questioning the valuation method adopted. Now these clarifications would bring greater clarity on the issue and would certainly help in alleviating the hardship of the taxpayers.

Clarifications Issued

A. Option to distribute common ITC: A taxpayer has an option to distribute ITC in respect of common input services procured by the HO from a third party but attributable to both HO and BOs or exclusively to one or more BOs either by following the ISD mechanism or by issuing tax invoices. Thus, it is clarified that

¹ Through [Circular No. 199/11/2023-GST](#) dated 17th July, 2023

compliance of both the cross charge and ISD provisions concurrently is not mandatory. Compliance of either of the two provisions would be suffice.

B. Valuation of services provided by HO to BOs where full input tax credit is available to the concerned BOs:

- a. **If invoice issued by HO:** The value declared on the invoice issued by HO to the BOs for the services rendered by HO to BOs shall be deemed to be the taxable value. The fact whether the cost of any particular component of such services has been included or not in the value of the services in the invoice would not be relevant. Thereby, it is clarified that in such case the ***actual cost incurred for providing the internally generated services would not be relevant. GST liability need to be discharged only on the value declared on the invoice.***

- b. **If invoice not issued by HO:** 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*** and may be deemed as open market value. Thereby, no tax would be payable in such cases.

C. Non-inclusion of employee cost in the value of services provided by HO to BOs: The cost of employees of the HO, involved in providing services to the BOs, is not mandatorily required to be included while computing the taxable value of supply of such service. This is irrespective of whether full ITC of GST charged by HO is available or not to BOs.

Benevolent Implications

- o In the past, different practice followed by the taxpayers for compliance of cross charge and ISD provisions. While certain taxpayers have followed only cross charge mechanism, certain taxpayers have followed only ISD mechanism. Further, there are certain taxpayers who have complied both the

cross charge and ISD provisions. With the clarification that the compliance of both the cross charge and ISD provisions concurrently is not mandatory, the manner of distribution adopted by the industry (i.e. whether through cross charge or ISD) cannot be questioned.

- In case where full ITC is available to the recipient BO, the valuation mechanism adopted by HO cannot be questioned. Further, in such case demand cannot be raised on services provided by HO to BOs even if HO has not raised invoice on the BOs for such services.
- Cost of employees not includible in the value of supply of services supplied by HO to BOs. This clarification would help in waning the chaos created earlier by certain advance rulings wherein it was held that the employee cost should become integral part of the value of services provided by HO to BOs².
- Though it seems that the clarifications are primarily issued for support services, the benefit of these clarifications may also be available for other services internally generated such as provision of repair / warranty service by company branches to plants / depots (were sale made by such plants depots directly to clients), provision of trucks among distinct person in logistic sector or GTA sector who have opted for 12 percent rate.

Continuing Uncertainty/hardship

On the perusal of the said clarifications, it can be observed that the circular aims to divide the issue into two broader categories. First distribution of ITC on common input services and second, valuation of internal generated services. In the first case it is clarified that ITC in respect of common input services can also be distributed by issuing invoice under [Section 31](#) of the CGST Act. Whereas as per the said section 31 invoice can be issued by a taxpayer only in respect of taxable services supplied by him. The question here may arise when distribution of ITC does not involve any supply of service, how a tax invoice under said section 31 can be issued for such distribution of ITC. In such case whether an interpretation could be adopted that the HO has first availed the common input services and then supplied such services

² M/s Cummins India Ltd. [2022-VIL-03-AAAR](#)
M/s Columbia Asia Hospital Pvt. Ltd. [2018-VIL-30-AAAR](#)

to the BOs. If yes, whether the benefit of valuation provision provided in the second proviso to [Rule 28](#) of CGST Rules would be available in such case.

The department has started raising huge demand on **related party transactions such case use of brand name/trade name, provision of corporate guarantee, secondment of employees, etc.** The issue which crops up here is that whether the said clarification, though specifically issued for distinct persons, are also applicable for related party transactions. The clarifications with regard to valuation of transactions effected between the distinct persons were provided considering the provisions contained in rule 28 of the CGST Rules which are equally applicable to the related party transactions. ***Therefore, the said clarification should ideally also be applicable in respect of the related party transactions.*** However, considering the quantum of stake involved, the department is likely to dispute this position.

The circular also fails to provide clarification with regard to the inclusion of certain element of cost, other than salary of the employees, such as depreciation, finance cost, etc. in the value of services supplied by HO when BOs are not eligible to avail full ITC.

Further, as per [Section 21](#) of the CGST Act where the ISD distributes excess ITC to one or more recipients of credit, the excess credit so distributed shall be recovered from such recipients along with interest. Thus, it is evident that in such case the proceedings would be initiated against the recipients and not against the ISD. Whereas, in case of distribution of ITC through tax invoice wrongly, the possible repercussions are not provided. Whether department would initiate the recovery proceedings only against the BOs for wrongly availing the ITC or would also take action against the HO for distributing the ITC wrongly.

Concluding Remarks

Considering the fact that the change in the tax regime is very recent and the prevalent uncertainties, the clarifications issued by the Government was the vital necessity of the industry. It is for sure that the clarifications would serve a great

relief to the taxpayers and would also help in settling the disputes with the department. However, certain uncertainties still persist. Therefore, to provide further relief to the industry, the Government should also come with further clarifications in respect of the issues raised by the industry post issuance of the above clarifications. In the light of the said clarifications issued by the Government, the industry should also re-examine the process implemented by them for compliance of cross charge and ISD provisions.

Vide the [press release](#) dated 11th July, 2023, issued in respect of 50th Meeting of the GST Council meeting, it was mentioned that the 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. However, the Council has recommended for amendment in GST law to make ISD mechanism mandatory prospectively for distribution of input tax credit of such common input services procured from third parties. Therefore, the clarifications issued by the Government may have temporary application and would be meant for providing relief for the past period. Going forward, as proposed in the GST council meeting, the government may make ISD provisions mandatory. In such case the industry may have to re-visit the process implemented so as to make it in compliance with the amended provisions.

[Date: 18/07/2023]

(The views expressed in this article are strictly personal.)