ISD Applicability from April 01, 2025: Comprehensive Guide

The Goods and Services Tax ('GST') regime in India, implemented on July 1, 2017, has ushered in a transformative era in India's tax landscape. One of the most impactful features of this tax structure is the seamless flow of Input Tax Credit ('ITC') allowing businesses to claim ITC avoiding cascading taxes. As the GST system has evolved, provisions have been introduced to make the tax structure more streamlined and to ensure that businesses are able to optimize their credit utilization.

Among the various mechanisms introduced under GST, the Input Service Distributor ('ISD') plays a pivotal role. An ISD is an important tool for businesses that centralize their procurement of services but operate under multiple GSTINs across different locations. The upcoming changes to the ISD system from April 1, 2025, mark a significant shift in how businesses with multiple GST registrations under the same Permanent Account Number ('PAN') need to handle their ITC, particularly for common input services that are used across different business units or locations.

ISD basics

An ISD is a concept within the GST framework that allows a business with multiple locations (each with its own GSTIN) to centralize the procurement of certain input services and distribute the corresponding ITC to its various business units.

For instance, consider a company with multiple branches spread across different states. If the company centrally procures legal services, IT services, or any other common input services for all its branches, it may not be possible for each branch to claim ITC for the taxes paid on these services. In such cases, the head office can register as an ISD and distribute the ITC to the branches in proportion to their turnover or other criteria as specified in the law. Of course, specific compliances and procedures have also to be followed under this process.

Unlike the regular GST registration, the only goal of taking ISD registration is to distribute the ITC on various common input services procured.

ISD vs Cross charge

The concept of the ISD has been in effect since the introduction of the GST in India in 2017. However, over time, the industry found alternative ways within the legal framework to to avoid taking a separate ISD registration and the related compliances that follow it, by opting for the cross charge of invoices between distinct entities. Let's delve into how this practice works.

Consider a scenario where a company operates multiple branches, each with its own GSTIN, and receives an invoice for IT services under the Delhi GSTIN, which serves as the GSTIN for receipt of centralized services for the entire organization. Ideally, the company would register as an ISD and distribute the ITC across the various branches according to the services consumed. However, rather than following the ISD mechanism, the company opts to claim the ITC under the Delhi GSTIN and then raises tax invoices to its other branches to distribute this ITC towards common services. In this way, the company essentially bypasses the formal ISD process by leveraging the cross-charge mechanism. It is similar to inter-branch transfer of goods and cross charge for it and completely within the ambit of law.

This practice became quite prevalent, with businesses increasingly treating the ISD and cross charge mechanisms as interchangeable. The reason behind this shift is primarily the desire to reduce the compliance burden associated with the ISD system. The ISD mechanism requires businesses to obtain a separate ISD registration, which entails additional administrative work, including the filing of GSTR-6 on a monthly basis and adhering to stringent allocation formulas for ITC distribution. This adds a layer of complexity and regular compliance obligations that many companies seek to avoid.

In Circular No. 199/11/2023-GST, dated July 17, 2023, the Central Board of Indirect Taxes and Customs ('CBIC') clarified that the industry can continue to use the cross-charge mechanism for the distribution of ITC until March 31, 2025. However, from April 1, 2025, the ISD mechanism will become mandatory for the distribution of common credit. Does this mean the end of the cross-charge mechanism? Not exactly. For internally generated services, where employees of a specific GSTIN provide services to another GSTIN, the cross-charge mechanism will still be applicable.

Following table represents key difference between cross charge and ISD mechanism:

ISD	Cross charge
Covers only services and not transfer of ITC on goods	Can be done for either goods or services
Applicable to common input services received from the external vendors	Applicable on goods or services supplied from one business unit to another
Mandatory registration required as ISD	Separate registration for the business unit required
Must file GSTR-6 for compliances and follow procedures for distribution of ITC	No separate compliance requirement

Salient features of ISD provisions to be implemented from April 01, 2025

But now, the landscape changes. ISD registration becomes mandatory with the following key aspects:

(i) ITC available for distribution to be distributed in the same month.

(ii) ITC distributed should not exceed the ITC available for distribution.

(iii) Both eligible and ineligible ITC needs to be distributed separately.

(iv) ITC under each head i.e. CGST, SGST or IGST needs to be distributed separately.

(v) Method of distribution:

ITC available for distribution	Recipient in same state	Recipient in different state
IGST	IGST	IGST
CGST	CGST	IGST
SGST	SGST	IGST

(vi) ITC attributable to a particular GSTIN is to be distributed to that GSTIN only.

(vii) ITC attributable to multiple GSTIN to be distributed basis turnover.

(viii) ITC needs to be distributed even to unregistered offices or branch.

(ix) Credit note allowed in case of excess distribution of ITC.

(x) Debit note to be raised in case of additional ITC.

(xi) The common ITC related to reverse charge must also be allocated to the corresponding GSTIN. Initially, the normal GSTIN will receive the invoice, settle the GST liability under Reverse Charge Mechanism ('RCM') on it and then issue an invoice on an ISD. Following this, the ISD will distribute the ITC to the relevant GSTIN.

Implementation plan from April 1, 2025

(i) Identify the locations or branches where it is expected to receive the invoices for common services post April 01, 2025. Ideally, all common services should be planned to be received only at one centralized location to avoid multiple ISD registrations.

(ii) Take ISD registration for said locations if the common services are to be received on the said locations in the future.

(iii) Ensure communications with the vendors that from April 01, 2025, invoice for common services are issued to ISD registration instead of normal GSTIN. Update vendor agreement accordingly.

(iv) For RCM invoices, ensure that the normal GSTIN pays the tax under RCM and subsequently, transfer the ITC to the ISD for distribution.

(v) Ensure that the ITC is distributed in the month it becomes available for distribution.

(vi) Ensure that the GSTR-6 is filed within the prescribed timelines under law (13th of each month)

Challenges while implementation

(i) Increased compliance burden due to separate registration and return filing requirements.

(ii) Implement a robust system for tracking invoices and ensuring that the distribution of ITC occurs in the month in which the invoices are available for distribution. Failing to distribute the ITC within the designated period will result in the inability to claim or transfer the ITC.

(iii) ITC needs to be distributed to even unregistered offices or branches. Therefore, it shall be a cost to company.

(iv) ITC must be distributed based on the turnover of the previous financial year. In cases where the turnover of the previous financial year is not available for a particular entity, the turnover of the previous quarter should be used instead. However, if neither the turnover of the previous financial year nor the previous quarter is available, the law does not prescribe a specific method for the distribution of such ITC.

(v) Since the transfer of ITC by ISD cannot be done for goods, it is imperative that the business process be realigned to avoid disallowance of such ITC in the hands of recipient GSTIN.

Conclusion

As the new financial year 2025-26 begins, the ISD mechanism is set to undergo significant changes, presenting a significant challenge for businesses, particularly those with operations across multiple states, to carefully examine and adapt to the evolving GST provisions in relation to ISD requirements. These changes may have a direct impact on the way businesses manage and distribute their ITC, making it imperative for organizations to stay ahead of the curve.

To ensure a smooth transition and continued compliance with GST regulations, businesses, including those holding existing ISD registrations, must develop a comprehensive transition plan. This plan should not only focus on the operational adjustments required under the updated ISD provisions but should also incorporate a structured procurement planning process. Such a process will be instrumental in streamlining the distribution of ITC and minimizing disruptions to business operations, ensuring that the business remains fully compliant with the updated GST framework.

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