Live Webcast
- by Indirect Taxes Committee of ICAI

CROSS CHARGE MECHANISM

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Cross-charge is nothing but a “supply” between -

- Two or more offices/establishments of a company; OR
- Related companies enjoying common facilities

- It may also be termed as a mechanism to allocate the value, as per the valuation rules and charge GST from distinct/related persons.
- Nevertheless, when it falls within the scope of the term “supply”, it is mandatory to cross-charge
Multi locational company renders various functions from one place.

*Example*: such as, finance, human resources, IT, legal, taxation, etc.

Head Office/Holding co. incurs common expenses for its branches/subsidiary companies, which cannot be said to have used by the head office/holding co., in relation to its own output supply.

Input tax credit can be claimed only in that State where corresponding output supply exists.
Distinct Person – Sec 25 of CGST Act

(4) Separate registrations shall be treated as registrations of distinct persons for the purposes of GST Act.

(5) Where a person has been registered or is required to obtain registration in a State/UT, then his establishment in another State/UT, then such establishments shall be treated as establishments of distinct persons.
Distinct Person – Expl to Sec 8 of IGST Act

Explanation 1.— Where a person has,—

(i) an establishment in India and any other establishment outside India;

(ii) an establishment in a State/UT and any other establishment outside that State/UT; or

(iii) an establishment in a State/UT and any other establishment being a business vertical registered within that State/UT,

then such establishments shall be treated as establishments of distinct persons.
Need for Cross Charge in GST

- **Entry 2 of Sch-I of the CGST Act:** Supply of goods or services between related persons or between distinct persons, when made in the course or furtherance of business, shall be treated as supply even if it is made without consideration.

- The term “Related Person” has been defined in explanation to Section 15 of the CGST Act.

- Any person directly or indirectly owns, controls or holds 25% or more of the outstanding voting stock or shares of both of them shall be deemed to be the “related persons”.

Therefore, the holding co. and the subsidiary co. are ‘related persons’ and the GST shall be leviable on the transactions between them, even if made without consideration.
• **Sec 16(1)** - Every registered person shall, ........, 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.

• These words (in red) refer to the registered taxable person in question and not the legal entity as a whole.

• So, ITC paid in a State must not be in relation to the business of a taxable person in another State although belonging to the same business entity.
• The phrase “taxable supply under this Act” u/s 17(2) means supply of goods/services which is chargeable to tax “under the concerned GST Act”.

• For example, ABC in Delhi takes term loan from PNB for its plant located in UP; and processing fee is charged by the bank in Delhi for such loan. Since the loan will be utilized in UP for making taxable supplies, bank charges relates to non-taxable supplies in Delhi. Therefore, ABC cannot claim input tax credit of such amount in Delhi and it may transfer to UP through ISD (input service distributor) mechanism for utilization at UP.
• Provision of goods or services BY one registered branch to another constitutes supply TO other branch.

• Provision of goods or services by registered office ON BEHALF OF another registered branch constitutes supply to the respective branch.

• ITC on inward services belonging to another branch cannot be availed by other branch, even if invoice is in the latter’s name.
Mechanisms

Two Mechanisms:

• Distribution of credit through ISD Mechanism
• Cross charge the other entity.
• *There might be overlapping between two mechanisms.*

The fundamental difference between cross-charge and ISD:

– ISD involves ITC (*necessarily*) on services which is attributable to other office. If the entity does not distribute, there is no violation of law; it will loose the benefit: *Thus, ISD is a facility only in respect of availment of ITC on services*

Cross-charge is *almost mandatory* requirement; and may or may not involve ITC; and relates to goods as well as services
Cross Charge vs. ISD

The fundamental difference between cross-charge and ISD:

- In case of cross charge, Service is of the nature of **business support/management service**. However in case of ISD, there is no service element at all; it is merely distribution of ITC.

- ITC on expenses incurred for managing own office will not be transferred on ISD basis e.g., rent, security, housekeeping; it may be availed through cross charge. However, ITC on Certification fee, Audit fee, etc; can’t be transferred as “support service”; and thus, need to be transferred as ISD.
Cross Charge vs. ISD

- **Example of ISD:** ABC India has 3 marketing units at Delhi, Chennai and Kolkata, and HO at Maharashtra. In such case, ABC India can avail all the services at Maharashtra as ISD, and distribute the ITC to its various supplying units using ISD Mechanism.

- **Example of Cross Charge:** ABC India has a plant at Maharashtra, but Marketing offices at Delhi, Chennai, Kolkata and Tamil Nadu which are only engaged in marketing activities. All supplies are directly from Plant at Maharashtra to customers across India. In this case, local offices at Delhi, Chennai and Kolkata are required to raise invoices upon Maharashtra.
Q15 – CBEC-FAQ-Part IV:

Would HO providing centralized HR, Finance and IT Functions need to raise invoice to its Branches?

Yes. If HO and Branches are distinct persons as specified in sec 25(4) of the CGST Act, invoice is required to be issued and GST should also be paid.
CBEC-FAQ-Part IT:

**Question 23:** What is the tax liability in a scenario where supplies are made from multiple locations (in different States) of the supplier to the recipient under a single contract?

**Answer:** Delivering services from various locations and integrated pricing for the contract as a whole is the norm in IT/ITES industry. Normally the contract or agreement with the recipient is entered into by one of the branches (let us say “Main Branch”). Therefore, in such cases of service delivery from multiple locations of the supplier to the recipient, the supply could be visualized as consisting of two distinct supplies.

*Contd....................*
CBEC-FAQ-Part IT:

Question 23: Contd...

First supply- The different branches of the supplier located across different States are making the supply to the main branch which entered into a contact or an agreement with the recipient for the supply of such service.

Second supply- Main branch is making a supply to the customer. GST is to be levied accordingly. In such a scenario, the main branch would get ITC of GST paid by the other branches on supplies made by them to the main branch.
Steps of Cross-Charge

I. To identify the supply of goods or services, which need to be charged to the distinct person

II. To value the supply under that cross charge
Valuation Rules (Rule 28 of GST Rules)

- Rule 28 shall be applicable for determining the value of goods or services between distinct or related persons, for charging GST.

- Where recipient is eligible for full ITC; value declared in invoice shall be deemed to be open market value of goods or services.

- Where the recipient is not eligible for full ITC (e.g. in case of exempt goods or services or blocked credits): Value shall be adopted sequentially on the following basis:
  - Open market value
  - Value of supply of goods or services of like kind and quality
  - 110% of cost of acquisition of goods or cost of provision of services
  - By any reasonable means
Explanation-

- “Open market value” of a supply of goods or services or both means the full value in money, excluding GST and the cess payable by a person in a transaction, where the supplier and the recipient of the supply are not related and the price is the sole consideration, to obtain such supply at the same time when the supply being valued is made.

- In case of branches, who are engaged in supply of exempt services, recipient branch shall not be eligible to claim full input tax credit of the common input services. Therefore, HO would need to value such cross-charges basis the open market value, as mentioned earlier.
Supply of goods

It covers the situations like:

• Supply of goods by a manufacturing unit having a separate registration to branches, separately registered, across India.

• Transfer of goods by one branch to other branch.

• Transfer of common goods procured by holding company to subsidiary company, etc.

• One unit might executing works contract and goods are procured from the distinct person
Supply of services

- It covers the situations like:
  - Head/Zonal Office may carry out work for branches.
  - Holding and the Subsidiary co. may be situated at the same premises and sharing the common rent/salary/etc.
  - Works contract is executed by one office for another office.
- Where H.O. avails services of third parties (e.g. auditor), the benefits of which is received by all places of business:

  The issue is whether the concept of ISD should be applied in this case or the cross mechanism?

  In this case, the ISD provisions should be applied as the head office is not providing the Audit Services to the branches.
Various Expenses - Cross Charge

Treatment of different types of expenses require cross charges:

a) Sales, advertisement and Marketing expense incurred by central office

b) Display and advertisement material are procured by centralized office; and then distributed to various offices

c) Managerial functions by top management of the company

d) Tax, Legal and general counsel functions at the central office

e) Royalty, Licensing and other expenses incurred by H.O.

e) Treasury administration including Cash management and finance charge
Audit related points

- **Finalization of cost allocation to branches and cross charge:**
  
  Before finalization of annual accounts, it is important to identify the cost allocation to other locations, for the purpose of cross charge under GST. Such cross charge should be included in the GSTR-3B of the tax-payer.

- **ISD is separate registration; supplier of attributable expenses must state ISD number on the invoice.**

- **An ISD is required to distribute credit on monthly basis**

- **ISD cannot make any payment under RCM and if it has to make payment under RCM, it will be required to obtain a regular registration under GST.**
Cross – Charge : To Conclude

- Since there might be overlapping between ISD and cross-charge, we should carefully make activity/expenses wise distinction

- If we fail to distribute expenses under ISD in accordance with the GST Law, it would be an additional cost to the entity by way of non-availing of ITC at the distributing office.

- In respect of central group expenses, cross charge mechanism could be followed to allocate such expenses. An MOU may also be entered between the HO and the Branch in relation thereto.

- Cross-charge, i.e., supply between distinct/related persons is mandatory requirement. However, if other office is eligible for ITC, than invoice value shall be accepted; thus no additional cost.
THANK YOU

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Email: idtc@icai.in
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