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Mandatory Input Service Distributor (ISD) under GST from April 1, 2025: A Comprehensive Analysis

The GST framework in India has undergone a significant change from April 1, 2025, with Input Service Distributor (ISD) mechanisms becoming mandatory for businesses operating across multiple GST registrations. Until March 2025, organizations with multiple state-wise GST registrations under a single PAN had flexibility in how they allocated input tax credits on common services, either by

registering as an ISD or by resorting to intra-company cross-charges. Many businesses opted for cross-charging expenses (such as corporate office rent, software licenses, or audit fees) to various branches due to its straightforwardness, despite complexities in tracking input tax credit (ITC) distribution and reconciling taxes across states. However, legislative amendments notified in 2024 have removed this optionality, making the ISD route compulsory for distributing credits of common input services across distinct GST registrations of the same entity.

Understanding the Concept of ISD under GST

Under the GST law, an **Input Service Distributor (ISD)** refers to a centralized office, typically the Head Office (HO) of a business, that receives invoices for input services intended for consumption by multiple units or branches of that business.

Why ISD is relevant: In multi-state businesses, certain services are procured centrally but used by multiple outposts. In essence, the HO (or any designated office) could accumulate ITC on common input services (which includes enterprise software subscriptions, nationwide advertising campaigns, group legal consultations, insurance or facility management covering assets in different states, corporate rentals, etc.) and then allocate (distribute) those ITCs to its other registrations (branches) that actually utilize those services. This mechanism ensures that ITCs on shared services are accurately and fairly allocated to the consuming locations, maintaining the integrity of the input tax credit chain.

Since GST is administered state-wise, the ITC on such services, and without ISD, if the HO were to claim the entire credit only at the HO's state for a service that also benefits other state registrations, could lead to ineligible or excess credit claims, i.e., the branches in other states that actually benefit would have no visibility of that credit. The ISD framework thus provides a formal route to transfer credit from the location where an invoice is billed to the locations where the service is actually used.

Notably, only input services are eligible for ISD distribution – goods and capital goods are excluded by definition. ISD is a mechanism designed for services because services (being intangible) are more commonly procured centrally and utilized across locations (e.g. a single legal service can pertain to the whole company). If physical goods or assets are transferred between state registrations, those have to be handled via actual supply and GST invoicing, not ISD.

How the ISD mechanism works

The ISD mechanism allows the HO to receive the invoice centrally and then issue ISD invoices to distribute the eligible ITC to each beneficiary branch in proportion to their share in the consumption of that service. In practice, the ISD workflow involves a few steps from invoice receipt to credit utilization:

- 1. Invoice at Head Office (ISD):** A vendor issues a GST invoice to the HO for an input service. For example, a software provider bills the HO for licenses used by multiple branches. The invoice could be for a taxable service with GST charged, including for a service where GST is payable under reverse charge (RCM) by the recipient. (Prior to 2025, ISD could not distribute RCM credits, but the law now allows it)
- 2. Recording of Credit:** The HO records the ITC from that invoice in its books under the

ISD registration. At this stage, the credit is not yet in the operational branch's books, but parked with the ISD entity. The ISD does not utilize this credit for its own liability (since ISD typically has no output tax liability of its own); instead, it holds the credit to distribute.

3. **Allocation to Branches:** The HO calculates how much of that service's credit is attributable to each branch, as long as it is in line with Rule 39 of the CGST Rules. GST law stipulates a pro-rata distribution by turnover of relevant period if the service pertains to multiple recipients. If the input service is exclusively used by one branch, then the credit is allocated entirely to that branch alone.

4. **Issuance of ISD Invoice:** The HO issues an ISD invoice to each recipient branch, documenting the distribution of credit. This ISD invoice (prescribed under Rule 54(1) of the CGST Rules) is not a normal sales tax invoice for supply of goods or services, but a document solely for transferring ITC. In effect, the ISD invoice is a memo that moves credit from one registration of a company to another without any actual sale. (If there were an actual supply by the HO to a branch, that would be a different scenario of cross-charge, not ISD.)

5. **Credit Reflection in Branch GST Records:** Upon the ISD issuing the credit invoice and filing the return (Form GSTR-6, discussed later), the distributed ITC for each branch gets reflected in the branch's GST input records. The GST system auto-populates the details of ISD credits into the GSTR-2A/2B (purchase tax credit statements) of the recipient GSTIN.

6. **Utilization by Branch:** Each branch (recipient of ISD credit) can then claim the ITC in its own GST returns, typically in its GSTR-3B for the month. The branches record the credit as part of their eligible

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ITC and use it to offset their output GST liabilities.

Throughout this process, the ISD serves as a conduit for credit flow, moving credits from where tax invoices are billed to where the services are consumed, thereby preventing accumulation of credits at the HO and ensuring each state has the rightful portion of credit. Without ISD, a branch that benefited from a service but didn't get the invoice would technically fail the "receipt of service" condition unless a cross-charge was made. ISD provides a GST-compliant way to satisfy that condition by treating the HO's distribution as equivalent to the branch receiving the ITC.

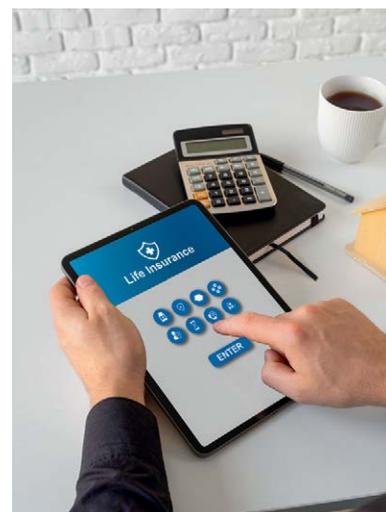
Legal Framework and Transition from Optional to Mandatory ISD

When GST was introduced in 2017, the ISD provisions were available but not compulsory. The law allowed the HO to choose the ISD route or alternatively to allocate common costs by treating them as supplies to branches (the cross-charge mechanism). This meant that, up to March 31, 2025, a company could either register as an ISD and distribute credit or simply add an internal markup/invoice and pass on costs as an outward taxable supply to branches. Each approach had its pros and cons – ISD kept it as pure credit transfer without tax, whereas cross-charging involved treating it as a service supply (often at 110% of the cost as per

valuation Rule 28 of the CGST Rules) and paying GST, which the branch would then claim. Many companies found cross-charging administratively easier to implement in their accounting (just raising invoices), albeit it meant additional GST circulation within the company (GST paid by HO and claimed by the branch).

The Finance Act, 2024 brought changes to put an end to this flexibility. Through amendments in the CGST Act (which were notified via Notification No. 16/2024 – Central Tax, dated 06.08.2024, effective April 1, 2025), the ISD provisions were strengthened and made compulsory in cases of common services. Key changes made were:

- **Expanded Definition of ISD (Section 2(61))** was broadened to explicitly cover services received for or on behalf of distinct persons and to include invoices for services liable under reverse charge (RCM). The amended definition reads (effective 1-4-2025): *“Input Service Distributor means an office of the supplier of goods or services or both which receives tax invoices towards the receipt of input services, including invoices in respect of services liable to tax under Section 9(3) or 9(4), for or on behalf of distinct persons referred to in Section 25, and is liable to distribute the input tax credit in respect of such invoices in the manner provided in Section 20.”*



“Effective April 2025, the GST framework mandates registration as an ISD as the sole permissible route for distributing ITC on common input services across business units.”

- “May” changed to “Shall” in Section 20 of the CGST Act. Until March 2025, Section 20(2) stated that the ISD “*may distribute the credit*” to the recipients. From April 1, 2025, the wording has been changed to “*shall distribute the credit*”, making it a binding duty. This one-word change legally mandates that if common service credits exist at HO, they must be passed on via ISD invoices to the respective state registrations.

Additionally,

- Section 25(4) of the CGST Act defines “distinct persons” as multiple registrations of the same legal entity across states, and
- Section 24(viii) already listed an Input Service Distributor as a category of person required to register under GST. It states that notwithstanding the normal turnover thresholds for GST registration, an Input Service Distributor must register (it was always a compulsory registration category). In the past, this was interpreted to mean that if a company wished to act as an ISD, it had to take a separate registration for it. Now, the combined reading of Section 24(viii), Section 2(61) (amended), and Section 20 (amended) means if a company has common input services to distribute, it must register and must distribute via ISD as per law, which makes the ISD mechanism effectively compulsory for any business that procures input services centrally for its branches.

- Another related amendment was in Rule 54 of the CGST Rules: a sub-rule (1A) was inserted to address scenarios of common services invoiced to a particular GSTIN of the company. It provides that for “common services, where the supplier of such services issues tax invoices to the registered person having same PAN and state code as ISD”, the ISD can issue an invoice to distribute the credit to the distinct persons. In practice, this covers cases where a vendor might have billed one of the registrations (say the head office’s regular GSTIN rather than the ISD GSTIN) – Rule 54(1A) facilitates transferring that credit through ISD invoices. It essentially ensures that even if an invoice is addressed to, for example, “ABC Ltd – Head Office (Regular GSTIN)”, but the service was used by branch offices, and the HO can still act as an ISD for that invoice and allocate the credit via ISD invoice. (Ideally, companies will instruct vendors to bill their ISD GSTIN for common services going forward, but Rule 54(1A) covers mixed cases and transitional situations.)

- Presently, ISD cannot make payment of any GST Liability. A situation may arise that a common expense covered under Reverse Charge Mechanism (RCM) [say Legal Charges] is booked at ISD. This would lead to a scenario where the ISD would not be able to pay the GST under RCM and thus apportion ITC on such common expenses. To address this situation, two amendments have been made :

- Section 20(2) of the CGST Act provides for distribution of ITC on RCM Transactions which is first paid by the regular registration of the ISD office & then distributed. The provision verbatim is - *The Input Service Distributor shall distribute the credit of central tax or integrated tax charged on invoices received by him, including the credit of central or integrated tax in respect*

of services subject to levy of tax under sub-section (3) or sub-section (4) of section 9 of this Act or under sub-section (3) or sub-section (4) of section 5 of the Integrated Goods and Services Tax Act, 2017 paid by a distinct person registered in the same State as the said Input Service Distributor, in such manner, within such time and subject to such restrictions and conditions as may be prescribed.

- Rule 39(1A) provides that the regular registration of ISD office shall pay the RCM and then transfer the ITC to the ISD registration by raising an Invoice as per Rule 54(1A). The provision verbatim is - *For the distribution of credit in respect of input services, attributable to one or more distinct persons, subject to levy of tax under sub-section (3) or (4) of section 9, a registered person, having the same PAN and State code as an Input Service Distributor, may issue an invoice or, as the case may be, a credit or debit note as per the provisions of sub-rule (1A) of rule 54 to transfer the credit of such common input services to the Input Service Distributor, and such credit shall be distributed by the said Input Service Distributor in the manner as provided in sub-rule (1).*



Legal Consequences and Compliance Challenges

Effective April 2025, the GST framework mandates registration as an ISD as the sole permissible route for distributing ITC on common input services across business units. This replaces the earlier flexibility where ISD registration, though listed under Section 24(viii) of the CGST Act as mandatory, was often bypassed due to the discretionary language in Section 20, which used the term “may.” Many companies instead opted for cross-charge mechanisms or retained credit at the HO, particularly when the underlying transactions were not classified as ‘supplies.’

The recent amendment removes this ambiguity. ISD registration is now a statutory requirement for credit distribution, aimed at enhancing traceability and preventing misuse. As per Section 21 of the CGST Act, any credit distributed in excess or in violation of rules is recoverable from the recipient along with interest, thereby placing significant responsibility on proper distribution practices.

Failure to register as an ISD, despite being eligible, now constitutes a contravention of Section 24 and may attract general penalties under Section 125 of up to ₹25,000 each under CGST and SGST/UTGST, or ₹50,000 under IGST. Moreover, continued reliance on cross-charging for services that should be routed through ISD can be questioned as non-compliant. Such practices may lead to disallowance of credit, especially during audits.

GST officers are expected to closely examine the end-to-end credit trail, from the original invoice to its reflection in the branch’s return. Discrepancies such as excess allocation, incorrect GSTIN usage, or mismatches in distribution may trigger recovery proceedings under Section 21. Common expense entries in HO’s books may be scrutinized, and businesses may be required to justify their credit distribution method. Inadequate responses

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could result in show cause notices or demand orders.

In cases involving wrongful or ineligible credit distribution, action under Sections 74A may be initiated, depending on whether the misstatement was inadvertent or fraudulent, both of which can lead to recovery with interest and applicable penalties.

In essence, the new regime mandates not just procedural alignment but a structural shift in how businesses handle common service ITC. Adopting the ISD mechanism is no longer optional—it is a legal necessity to ensure compliance, avoid penalties, and reduce audit risks.

Compliance and Returns for ISD Credit Distribution

Operating as an ISD brings with it certain ongoing compliance obligations under GST. Let’s break down the key compliance tasks:

1. Separate GSTIN Requirement for ISD: An ISD must obtain a separate GST registration specifically for the ISD function, distinct from its regular GST

registrations. For instance, if a company’s HO in Maharashtra is already registered under GST for its business operations, it must apply for a different GSTIN within the same state to act as an ISD. While the PAN and state code remain the same, the ISD registration will carry a unique 15-digit GSTIN, differentiated by the 13th digit, which denotes the registration serial number. This ensures proper segregation of ISD-related transactions from regular business activities.

2. Multiple ISD Registrations; Permissible but Rare: A company may obtain multiple ISD registrations if required, as the law does not prohibit it. However, in practice, a single ISD registration usually suffices and is preferred to avoid administrative complexity. An ISD is only needed in the state where common service invoices are received on behalf of other branches. Therefore, if all common input services are billed to the head office in one state, a single ISD registration in that state is adequate to distribute ITC across all other states.

3. Monthly ISD Return: Every ISD is required to file Form GSTR-6 on a monthly basis by the 13th of the succeeding month. This return captures details of all ITC received on invoices during the month, either auto-populated from the suppliers’ GSTR-1 or entered manually, and records the apportionment of such credit across various GSTINs of recipient branches. It also includes ISD credit notes for reversals and a summary of total ITC available and distributed. Essentially, GSTR-6 is a statement of ITC apportionment that links incoming credit with its outbound distribution. Once filed, the GST portal automatically transmits the credit data to the relevant recipient branches. Failure to file GSTR-6 on time attracts a late fee of ₹50 per day (₹25 CGST + ₹25 SGST), and due to the risk

of mismatches in credit flow, timely compliance is critical for ISDs.

4. Claiming ISD Credit in GSTR-3B (Branch's Return): Recipient branches claim the ITC distributed by the ISD through Table 4 of GSTR-3B, specifically under the field "ITC received from ISD." The credit must match the amount reflected in the branch's GSTR-2B for the relevant month, ensuring alignment with the ISD's filed GSTR-6. Timely filing is crucial i.e., if the ISD submits GSTR-6 by the 13th, the distributed credit appears in the branch's GSTR-2B and can be claimed in the same month's GSTR-3B (due by the 20th). A delayed GSTR-6 filing may defer the credit visibility to the following month, leading to timing mismatches between financial books and return filings.

5. Return Filing Exemptions for ISD: An ISD is not required to file GSTR-1, GSTR-3B, or GSTR-9, as it does not undertake outward taxable supplies or claim ITC for its own use. Since the ISD's sole function is to distribute ITC to recipient units, it has no output tax liability or eligible ITC under its own registration. Accordingly, Form GSTR-6 is the only mandatory return for an ISD. Furthermore, as per Section 44 of the CGST Act, ISDs are exempt from filing the annual return (GSTR-9), streamlining their compliance obligations.



Conclusion

The mandatory rollout of the ISD mechanism from April 1, 2025, marks a significant shift in GST compliance for multi-location businesses in India. What was earlier a procedural option has now become a legal requirement, reaffirming the foundational GST principle that input tax credit (ITC) must flow to the location where the services are actually consumed. This reform aims to instill greater uniformity and discipline in the distribution of common ITC, while reducing the risk of credit misallocation or undue accumulation under a single GST registration.

Adopting the ISD framework is not merely a safeguard against penalties but reflects sound tax governance. The ICAI and tax professionals have long recommended structured credit allocation to preempt audit risks. Failure to adopt ISD may offer temporary convenience, but can result in significant liabilities later due to misclaimed credits. The revised law now encourages businesses to proactively comply, making ISD an integral part of the GST compliance architecture.

In essence, the new regime aligns with the spirit of "One Nation, One Tax", but operationalized through multiple GST registrations reconciled via the ISD mechanism. The responsibility now lies with each multi-state entity to ensure that no eligible credit remains stranded and that the GST credit ecosystem functions seamlessly across locations, supported by timely ISD registration and transparent distribution.

References

- CGST Act, 2017 – Section 2(61) [Definition of ISD]; Section 20 [Manner of distribution of credit by ISD]; Section 21 [Recovery of excess credit distributed]; Section 24(viii) [Mandatory registration for ISD].
- CGST Rules, 2017 – Rule 39 [Procedure and conditions for distribution of ITC by ISD] & Rule 39(1A) [; Rule 54(1) & 54(1A) [Document (invoice) for

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distribution of credit and special provision for common services].

- Notification No. 16/2024 – Central Tax, dated 06-08-2024 – Notified amendments (Finance Act 2024) to Section 2(61) and Section 20, effective 01-04-2025.
- TaxGuru article by Chandrasekhar Kutty (2023) – “Input Service Distributor – Mandatory from 1st April 2025” – provides analysis of the amendment and its implications.
- India Briefing (Dezan Shira & Associates) – Mandatory ISD Registration from April 1, 2025 – outlines the practical steps and implications for businesses.
- ClearTax resources on ISD – Various articles and FAQs explaining ISD provisions, return filing (GSTR-6), and highlighting the change from optional to mandatory.
- ICAI publications / FAQs – e.g., IDTC-ICAI FAQs on ISD detailing conditions for distribution.

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