
[2026] 184 taxmann.com 400 (Article)

[2026] 184 taxmann.com 400 (Article)[©]Date of Publishing: **March 20, 2026****Input Service Distributor under GST: Madras High Court Clarifies the Interplay between Entitlement and Distribution of ITC****ASHWARYA SHARMA**

Advocate, Co-Founder & Legal Head, RB LawCorp

1. Introduction

The Goods and Services Tax (GST) regime was introduced with the objective of ensuring seamless flow of input tax credit and eliminating cascading taxes across the supply chain. However, as the law has evolved, several operational provisions have generated interpretational disputes, particularly for businesses operating through multiple registrations across different states. One such issue concerns the functioning of the Input Service Distributor (ISD) mechanism, which is intended to facilitate equitable distribution of input tax credit within organisations having multiple GST registrations under the same PAN.

In this backdrop, the decision of the Madras High Court in *Reliance Jio Infocomm Ltd. v. Union of India* [2026] 184 taxmann.com 103 assumes considerable importance. The judgment is a welcome development in the direction of ease of doing business, particularly for enterprises that maintain a central head office while operating several branch units across states and procure common services centrally.

The ruling provides clarity on the interpretation of the ISD framework under Section 20 of the CGST Act read with Rule 39 of the CGST Rules, especially regarding the requirement that credit be distributed in the same month in which the underlying invoice is received by the ISD. In doing so, the Court examined whether such a stipulation, if applied rigidly, would be manifestly arbitrary and violative of **Article 14** of the Constitution of India, while also analysing the broader statutory scheme governing entitlement and distribution of input tax credit under GST.

2. Background of the concept of input service distributor (ISD)

The concept of Input Service Distributor (ISD) emerged from the need to ensure seamless flow and equitable distribution of input tax credit within organisations operating through multiple units or establishments. In large businesses, several common input services—such as audit, legal or business consultancy, advertising, information technology support, and management services—are often procured centrally at the head office, even though the benefit of such services accrues to multiple branches located across different states. In the absence of a structured distribution mechanism, the credit of such centrally procured services would remain accumulated at one location, thereby defeating the fundamental objective of GST as a value-added tax aimed at eliminating cascading and ensuring taxation on a destination basis.

Recognising this commercial reality, the concept of ISD was first introduced in India under the CENVAT Credit Rules in the pre-GST regime. Under this framework, a head office receiving invoices for input services could distribute the

eligible service tax credit to its manufacturing or service-providing units through prescribed documentation and proportionate allocation, ensuring that credit corresponded with the actual consumption of services.

When the Goods and Services Tax was introduced in 2017, the legislature retained this mechanism under Section 2(61) and Section 20 of the CGST Act. The ISD framework under GST enables an office of the supplier to receive tax invoices for input services and distribute the corresponding input tax credit to its distinct persons registered under the same PAN. In doing so, the mechanism facilitates proper allocation of credit across business units and preserves the neutrality and efficiency of the GST credit chain.

3. Factual Background

The petitioner, engaged in providing telecommunication services, had obtained separate GST registrations in each State and Union Territory from which it supplied services, with each registration being treated as a **distinct person** under Section 25(4) of the CGST Act.

Prior to 01.04.2025, Section 20 of the CGST Act merely provided the mechanism for distribution of credit by an Input Service Distributor (ISD) and did not empower the Government to prescribe any time limit for such distribution. The authority to prescribe timelines was introduced only with effect from 01.04.2025 through the insertion of the phrase "within such time and subject to such restrictions and conditions as may be prescribed" in Section 20(2) of the CGST Act, pursuant to which the rules required that ITC be distributed in the same month as the underlying input service invoice.

The petitioner therefore contended that for the period prior to 01.04.2025, the respondents lacked the statutory authority to prescribe a time limit for distribution of ITC. Consequently, Rule 39(1)(a) of the CGST Rules, insofar as it mandated distribution of credit in the same month as the issuance of the invoice, was beyond the scope of the parent legislation.

4. Issue before the High Court

The pivotal issue before the Court was whether the statutory mandate contained in **Rule 39(1)(a) of the CGST Rules** was ultra vires the enabling provisions of the CGST Act. More specifically, the Court was called upon to determine whether the requirement that the Input Service Distributor distribute credit in the same month in which the invoice is received was manifestly arbitrary and violative of **Article 14 and 19(1)(g) of the Constitution of India**.

The matter also required examination of the broader statutory framework governing input tax credit, particularly the relationship between entitlement to credit under Section 16 of the CGST Act and the mechanism for its distribution under Section 20 of the CGST Act.

5. Proceedings before the High Court

5.1 Grounds of the Petitioner

The petitioner challenged Rule 39(1)(a) primarily on the ground that although the Government may prescribe the manner of distribution of ITC under Section 20 of the CGST Act, such power cannot extend to prescribing an impracticable requirement that credit must be distributed in the same month as the issuance of the invoice. According to the petitioner, such a stipulation is impossible to comply with in practice and therefore manifestly arbitrary and violative of Article 14.

It was further contended that the amendment to Section 20 of the CGST Act with effect from 01.04.2025, which empowered the Government to prescribe timelines, could only operate prospectively. The amendment introduced a substantive change in the law and therefore could not be treated as merely clarificatory so as to validate the rule retrospectively.

The petitioner also argued that distribution of ITC cannot take place without first verifying compliance with the conditions prescribed under Section 16 of the CGST Act. Before distributing credit, the ISD must determine the unit to

which the service relates and ascertain whether the credit is eligible, a process which makes same-month distribution practically unworkable.

It was further submitted that delayed distribution causes no revenue loss to the Government; rather, it operates to the detriment of the taxpayer since undistributed credit cannot be utilised until it is allocated to the recipient units.

5.2 Submissions of the Respondents

The respondents defended the validity of Rule 39(1)(a) of the CGST Rules, contending that it had been validly framed in exercise of rule-making powers under Section 164 of the CGST Act read with Section 20. According to the respondents, the rule merely operationalised the statutory framework governing distribution of ITC and did not travel beyond the scope of the enabling provision.

It was further argued that the requirement of distribution within the same month served legitimate objectives within the GST framework, including preventing accumulation of credit at the ISD level, ensuring contemporaneous availability of credit to recipient units, maintaining audit trail integrity, and preventing manipulation through delayed distribution.

The respondents also contended that the amendment to Section 20(2) of the CGST Act with effect from 01.04.2025 was merely clarificatory. According to this argument, the power to prescribe time limits was always implicit in the authority to prescribe the manner of distribution of credit.

Another important submission was that ISD distribution is conceptually distinct from availment of ITC under Section 16 of the CGST Act. Distribution is merely an internal accounting mechanism transferring credit between GST registrations under the same PAN. The conditions under Section 16(2), according to the respondents, become relevant only when the recipient unit actually avails the credit in its books.

Reliance was placed on various Supreme Court decisions to contend that procedural conditions governing tax benefits fall within legislative competence and do not violate fundamental rights if they are reasonable and serve legitimate policy objectives.

6. Analysis and Decision of the High Court

6.1 Statutory Scheme governing Distribution of Credit

It was noted that the ISD mechanism addresses the unique situation of entities having multiple GST registrations across different states under the same PAN. In such circumstances, the law requires distribution of common input tax credit on a proportionate basis.

Importantly, the Court observed that Section 20 of the CGST Act as it existed prior to 01.04.2025 did not contain the expression "*in such manner as may be prescribed*". This expression was introduced only through amendment by the Finance Act, 2024 (8 of 2024) with effect from 01.04.2025.

The Court further observed that Rule 39(1)(a) is a piece of delegated legislation and it must necessarily remain within the boundaries of the rule-making power conferred by the parent statute.

6.2 Interplay of Section 16 and Section 20 of the CGST Act

The Court held that while Section 16 governs eligibility and entitlement to input tax credit, Section 20 deals with distribution of credit in situations where multiple GST registrations exist under the same PAN. Therefore, both provisions must be read harmoniously.

The Court rejected the interpretation that credit must be distributed immediately upon receipt of invoices irrespective of whether the statutory conditions under Section 16 have been fulfilled. Such an interpretation, the Court observed, would create anomalies and defeat the scheme of the Act.

It was emphasised that Section 20 speaks of distribution of "credit" and not of distribution of "invoice". Therefore, the credit contemplated under Section 20 must necessarily be credit that has become available in accordance with the law.

6.3 Distinction between "Input Tax" and "Credit"

The Court further clarified the conceptual distinction between input tax and input tax credit. According to the Court, input tax converts into credit only when the statutory conditions prescribed under Section 16(2) are fulfilled. Accordingly, the Court held that what is available for distribution under the ISD mechanism is input tax credit, not merely the tax reflected in the invoice.

6.4 Final Interpretation of Rule 39

The Court ultimately held that the expression "the input tax credit available for distribution in a month" contained in Rule 39(1)(a) must be interpreted in a manner consistent with the statutory scheme of Section 16 read with Section 20 of the CGST Act.

If the rule were interpreted to mandate distribution of credit immediately upon receipt of the invoice—even before fulfilment of conditions under Section 16(2)—it would be liable to be struck down as ultra vires the parent statute.

However, by adopting a harmonious interpretation that distribution occurs only when credit has become legally available under Section 16, the Court held that the rule could be saved from invalidation.

Consequently, the Court concluded that Rule 39(1)(a) does not require to be declared ultra vires, provided it is interpreted consistently with the statutory scheme governing entitlement to input tax credit.

7. Conclusion

The decision in **Reliance Jio** is an important judicial pronouncement in the evolving jurisprudence of GST input tax credit. The judgment underscores a fundamental principle that provisions relating to distribution of credit being in the nature of or procedural law cannot be interpreted in isolation from the broader statutory framework governing entitlement to such credit. By emphasising the harmonious construction of Sections 16 and 20 of the CGST Act, the Court has clarified that the ISD mechanism operates only after input tax has matured into legally available credit.

From a practical perspective, the judgment provides welcome clarity for multi-state businesses that rely heavily on the ISD mechanism for managing common input services. It also reinforces an important interpretational principle within GST law—that procedural provisions must be applied in a manner that advances the scheme of seamless credit flow rather than frustrating it.

As GST jurisprudence continues to develop, decisions such as this serve an important role in aligning statutory interpretation with commercial realities. The ruling therefore represents a balanced judicial approach that preserves the validity of delegated legislation while ensuring that its application remains consistent with the foundational structure of the GST framework.

■ ■