

Input Service Distributor (ISD) Rules Clarified (2026): Circular No. 260/06/2026-GST

Description

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Quick summary

- Circular No. 260/06/2026-GST, dated 26/10/2026, clarifies seven recurring doubts on how an Input Service Distributor (ISD) must distribute input tax credit under section 20 of the CGST Act.
- A business can take more than one ISD registration within the same State - one for each business vertical or place of business - but each ISD can only distribute credit to the distinct persons it is actually attributable to.
- It is the recipient of the distributed credit, not the ISD itself, who must satisfy the eligibility conditions under sections 16 and 17 of the CGST Act; the ISD's own job is only to distribute what it has received, separating eligible from ineligible credit.
- An invoice, credit note or debit note issued under rule 54(1A) by a unit sharing the same PAN and State as the ISD - typically to pass on reverse-charge credit for onward distribution - does not count as that unit's own turnover, and does not qualify as its own input tax credit for refund computation either.
- Correspondingly, that same unit is not required to reverse credit under section 17(1), (2) or (4) on the amount it transfers to the ISD - that reversal obligation falls on whichever distinct person finally receives the distributed credit.

Many groups procure services centrally - a head office negotiating one contract that benefits branches across States - and then need to pass on the resulting input tax credit to the branches that actually used the service. This is what the Input Service Distributor (ISD) mechanism exists for, and Circular No. 260/06/2026-GST, dated 26 October 2026, answers seven questions that kept coming up in practice.

New to terms such as "distinct person" or "Net ITC"? See the technical terms explained in simple words further down.

At a glance

- **Circular:** No. 260/06/2026-GST, GST Policy Wing, CBIC, dated 26 October 2026.

- **Issued under:** section 168(1) of the CGST Act.
- **Covers:** section 2(61) (definition of ISD) and section 20 (manner of distribution) of the CGST Act, and rule 39 and rule 54(1A) of the CGST Rules.
- **Addresses:** multiple ISD registrations, who bears the eligibility conditions for credit, the monthly distribution timeline, reversal obligations, and the rule 54(1A) credit-transfer mechanism used heavily by banks and NBFCs.

More than one ISD registration within a State is allowed

An ISD is an office of a supplier that receives input service invoices on behalf of its distinct persons and distributes the credit under section 20. Since separate registrations for separate business verticals or places of business within a State are each treated as a “distinct person” under section 25, the circular clarifies there is **no bar on taking more than one ISD registration** within the same State - one for each business vertical or place of business, as needed. Each such ISD, however, can distribute credit only to the distinct person the underlying service is actually attributable to.

The ISD distributes; the recipient is responsible for eligibility

This is the central clarification. The ISD’s job is to distribute the credit it receives in the manner section 20 requires - including keeping eligible and ineligible credit (blocked under section 17(5) or otherwise) separate, as rule 39(1)(g) requires. But it is the **recipient of credit** who must independently satisfy the conditions for availing input tax credit under section 16 or section 17 of the CGST Act.

Consequences of getting this wrong:

- If an ISD distributes credit in contravention of section 20, resulting in excess credit reaching one or more recipients, the excess is recovered **from those recipients**, with interest, under section 21 - using the ordinary demand machinery (sections 73, 74 or 74A).
- The **ISD itself** is separately liable to a penalty under section 122(1)(ix): ten thousand rupees, or the amount of credit wrongly distributed, whichever is higher.

When credit becomes “available for distribution”

Rule 39(1)(a) requires credit available for distribution in a month to be distributed in the **same month**, reported in FORM GSTR-6. The circular clarifies that credit is not “available” the moment an invoice shows up in FORM GSTR-6A - it becomes available for distribution only once the **ISD has ascertained it is prima facie eligible** for availment. The ISD must then distribute it in the month of that ascertainment, separately as eligible and ineligible credit under rule 39(1)(g).

Reversals under section 17 stay with the recipient, not the ISD

Since the ISD only distributes and does not itself avail credit, it is the recipients of credit who must carry out any reversal required under section 17(1), (2) or (4) of the CGST Act (common-credit apportionment, exempt-supply reversal, or the banking-sector 50% option) - not the ISD.

Rule 54(1A): the credit-transfer mechanism for banks and NBFCs

Rule 54(1A) lets a regular registrant - sharing the same PAN and State as the ISD - issue an invoice, credit note or debit note to transfer credit on input services (typically reverse-charge credit) to the ISD, for onward

distribution to other distinct persons. This matters most to banking companies, financial institutions and NBFCs, who commonly pay tax under reverse charge at one registration and need to pass the resulting credit through the ISD to branches elsewhere.

The circular clarifies that this transfer is **purely a credit-transfer mechanism**, with two practical consequences:

1. **Not turnover.** The amount on such an invoice, credit or debit note does not qualify as “turnover in State” or “turnover in Union territory” for that issuing unit, even though it still has to be reported in that unit’s FORM GSTR-1 to transmit the credit to the ISD.
2. **Not the issuing unit’s own Net ITC.** The transferred amount is not treated as input tax credit of the issuing unit, so it cannot be included in “Net ITC” when that unit computes its own refund amount under rule 89(4) or rule 89(5).

Because the transferred amount was never the issuing unit’s own credit, that unit is also **not required to reverse it** under section 17(1), (2) or (4) - that obligation sits with whichever distinct person ultimately receives the credit once the ISD distributes it, which may include the very unit that transferred it in the first place.

How CSM & Co LLP can help

Deciding how many ISD registrations a group genuinely needs, and getting the rule 54(1A) credit-transfer paperwork right between a bank’s or NBFC’s own registrations, avoids both excess-credit recovery notices and refund-computation errors - please reach out to our team and we will be happy to assist.

Technical terms explained in simple words

Term	What it means
Input Service Distributor (ISD)	An office that receives input service invoices on behalf of a group’s other registrations and distributes the resulting credit among them.
Distinct person	Two registrations of the same legal entity (for example, branches in different States, or separate registrations within one State) that GST law treats as separate persons for tax purposes.
Recipient of credit	The distinct person to whom the ISD actually distributes a share of input tax credit.
Net ITC	The amount of a registered person’s own eligible input tax credit used as the base for computing the maximum refund permissible under rule 89.
Rule 54(1A)	A CGST Rules provision letting a registration sharing the same PAN and State as the ISD transfer input service credit to the ISD by invoice, for onward distribution.

Frequently asked questions

Can a business obtain more than one ISD registration within the same State?

Yes. Circular No. 260/06/2026-GST clarifies there is no bar on obtaining a separate ISD registration for each business vertical or each place of business within a State or Union Territory, since each such registrant is a distinct person under section 25. However, each ISD can only distribute credit to the distinct person the underlying input service is actually attributable to.

Who is responsible for checking that input tax credit distributed by an ISD meets the eligibility conditions under section 16?

The recipient of the distributed credit, not the ISD. The ISD's role is limited to distributing the credit it receives in the manner laid out in section 20, including separating eligible credit from credit that is blocked under section 17(5); the recipient must independently satisfy the conditions under sections 16 and 17.

What happens if an ISD distributes credit in excess of what it was entitled to distribute?

Under section 21 of the CGST Act, the excess credit is recovered from the recipients of credit along with interest, using the ordinary demand provisions (section 73, 74 or 74A). The ISD itself is also liable to a penalty under section 122(1)(ix) - ten thousand rupees or the amount of credit wrongly distributed, whichever is higher.

When must an ISD distribute the input tax credit available to it?

In the same month the credit becomes available for distribution, as required by rule 39(1)(a). The circular clarifies that credit becomes "available" only once the ISD has ascertained it is prima facie eligible, so the distribution timeline runs from that ascertainment, not merely from when the invoice first appears in FORM GSTR-6A.

Does an invoice issued under rule 54(1A), transferring reverse-charge credit to the ISD, count as the issuing unit's own turnover?

No. Circular No. 260/06/2026-GST clarifies that such an invoice, credit note or debit note is not in respect of an outward supply by the issuing unit, so its value is excluded both from that unit's "turnover in State" and from its own "Net ITC" for refund computation under rule 89 - even though the amount must still be reported in its FORM GSTR-1 to transmit it to the ISD.

Does the unit transferring credit under rule 54(1A) need to reverse credit under section 17 on the amount transferred?

No. Since the transferred amount is not that unit's own input tax credit, it is not required to make reversals under section 17(1), (2) or (4) on it. That obligation falls on whichever distinct person eventually receives

the credit after the ISD distributes it, which may include the very unit that originally transferred it.

Official sources

- CBIC - GST Circulars (CGST)
- GST Portal

Related reading

- CBIC Guidelines for GST Registration Applications (2026): Circular No. 257/03/2026-GST
- 57th GST Council Meeting (October 2026): Arrest Powers Removed, Faster Refunds and Wider ITC
- Valuation of Supply under GST (2026): Section 15, Transaction Value and Discounts

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