

GST Alert 08/2023-24

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### Clarification on Taxability of Corporate Guarantee

In the recent GST Council meeting, it was recommended that inter-company corporate guarantee would be made taxable by providing valuation norms which were missing in the law. In line with this the government has amended (notification 52/2023-CT) the rules and provided for valuation mechanism and has also issued a circular (204/16/2023-GST dated 27.10.2023) to clarify certain open issues, gist of these changes is as under:

**Please note that Corporate Guarantees between related companies will be taxable effective from 26.10.2023, it is not a retrospective change.**

**Issue No. 1 : Are Personal guarantees given by directors to his company and Corporate Guarantee given by holding companies to its subsidiaries or group companies taxable?**

**Clarification :** As clarified by the circular, personal guarantees given by directors as well as corporate guarantees given by companies are taxable under section 7 read with schedule I of the CGST Act even if they are given without charging any consideration.

**NJJ views :** This issue was plaguing the industry for long, huge demand notices were being issued without backing of law. GST council has thought it prudent to clarify it accordingly. I am mindfully not commenting on the legal aspects on the issue of taxability of personal or corporate guarantees, as I believe in case of Indirect taxes, one has the choice of passing on the cost to the customer and hence it is sometimes prudent to charge and pay up rather than fight a long legal battle. In the recent case of Edelweiss Financial Services (which was based on the erstwhile Service tax regime) where the Supreme Court dismissed the appeal of the government and therefore upheld the verdict of the Tribunal which said that as there was no



consideration involved in giving corporate guarantee, said act of giving corporate guarantee by group company cannot be taxed. However, unlike service tax, GST has a provision to consider non consideration transactions between related persons as taxable hence this judgement will not come to the rescue.

**Issue No. 2 : If Personal Guarantee given by director to his company is taxable, what would be the value on which the director is required to pay tax?**

**Clarification :** As per RBI guidelines issued vide Para 2.2.9 of its Circular No. RBI/2021-22/121 dated 9th November 2021, wherein it had been clarified that directors cannot use the system of giving guarantees as a source of income from the company. Further, the guidelines also say that banks will have to take an undertaking from the borrowing company as well as the directors that no consideration in any form is paid for obtaining guarantee.

In view of this guideline that there can be no consideration in case of personal guarantee, the circular concludes that market value of giving such personal guarantee by the director would be zero and therefore no tax would be payable by the director. So, even though the transaction is taxable, there would no requirement to pay tax due to lack of valuation mechanism or rather the value being zero.

**NJJ views :** I agree with the beneficiary aspect of the conclusion drawn whereby personal guarantees though taxable are kept out. I therefore applaud the government in taking a stand that where a statutory body like RBI issues any guidelines on valuation or otherwise, they will apply it in GST as well.



**Issue No. 3 : What happens when the director resigns from his position and the personal guarantee given by him continues?**

Clarification : If the director who provided the guarantee is no longer connected with the management, but continuance of his guarantee is considered essential by the bank, then the valuation norms would apply as they are applied to all unrelated suppliers of services. Accordingly, the said transaction would be taxed if the company is paying any consideration to the person in any manner, directly or indirectly. In other words, in all such cases, the taxable value of such supply of service shall be the consideration paid by the company to such a guarantor, directly or indirectly. If there is no consideration being paid, then one can take a stand that the transaction would not be taxed for lack of valuation.

NJJ views : No Comments.

**Issue No. 4 : If Corporate Guarantee given by a company to its related company is taxable, what would be the value on which the Company giving guarantee required to pay tax?**

Clarification : Value of Corporate Guarantee will henceforth be determined as per the provisions of Rule 28(2) of CGST Rules, irrespective of whether full ITC is available to the recipient of services or not. **As per this new sub rule, the value would be deemed as 1% of the amount of such guarantee or the actual consideration (if charged), whichever is higher.**

For example, company ABC Ltd. has given Corporate Guarantee of Rs. 100 crores to the bank on behalf of its group company XYZ Ltd, ABC charges 50 lacs for granting this guarantee.

Taxable value in the above example would be 50 lacs or 1 crore (1% of 100



cr) whichever is higher, so taxable value would be 1 crore and the tax payable would be 18 lacs.

**NJJ views** : This new valuation norm is a classic example of a deeming fiction. Courts have repeatedly ruled (in case of Manish Munjaal Bhatt (Gujarat High Court) and in case of Wipro by the Supreme Court) that if actual value of the transaction is available then valuation prescribed by the government would not hold any sway. This amendment in rule 28 will also meet the same fate and in my personal view will be struck down sooner than later. However, court may not accept the stand that the value was zero and hence no tax was payable, in that case valuation as given by the government would rule the roost, hence, it is advisable for companies to charge some consideration for giving corporate guarantees from 26.10.2023.

**Issue No. 5** : **As this new valuation mechanism is coming into effect from 26.10.2023, what happens to guarantees given before this date, is one required to pay tax on them, if so, how to determine the value.**

**Opinion** : This amendment in valuation is made effective from 26.10.2023 onwards, hence Corporate Guarantees given prior to this date would not be taxable and therefore no tax would be payable on CGs given prior to 26.10.2023.

**NJJ views** : Circular doesn't clarify this aspect, above is based on our opinion.

**Issue No. 6** : **Is corporate guarantee a continuous supply of service and therefore to be taxed every year (periodically). Or should it be taxed on every extension/renewal of such guarantee?**

**Opinion** : Service of giving corporate guarantee won't be classified as 'Continuous



supply of service' because in this transaction recipient is not under an obligation to make periodical payments.

NJJ views : Circular doesn't clarify this aspect, above is based on our opinion.

**Issue No. 7 : What happens to the demand notices issued by the department for the period prior to 26.10.2023?**

**What would be the case where non-related persons give guarantees to the banks for availing of loans?**

Opinion : As discussed above, amendment in rule 28 is made effective from 26.10.2023 and therefore all transactions involving grant of corporate guarantees prior to this date cannot be taxed. Circular also clarifies that personal guarantees given by directors and the like also cannot be taxed. Accordingly, all demand notices issued for period prior to 26.10.2023 will have to be adjudicated in favour of the taxpayers and demands will have to be dropped.

NJJ views : **It would have been ideal if this issue was clarified in this circular so that officials would take refuge of it and drop the demands raised so far. If anyone has paid any tax on this issue, they must quickly file refund application seeking refund of the tax, interest and penalties paid. Time limit of 2 years will start from 26.10.2023 for all past periods.**

### Conclusion

Most of the businesses availing corporate guarantees are eligible for ITC, hence the cost to them due to this change would be revenue neutral, we do not see department raking in big tax collection on this count. Hence this change was not merited that too by way of a deeming fiction. The Council and the department need to resist taxing transactions through deeming valuation



norms. This will create a lot of litigation for the department to eventually loose, in my view, they should focus on taxing sectors and transactions which are still outside the GST net, easing compliance pressure on the trade and simplifying the issues plaguing the industries rather than wasting its energy on issues that will not result in increasing the revenues.

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