

GST Alert 11/2024-25

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Clarification on Taxability of Corporate Guarantee

[Circular No. 225/18/2024 GST dated 11th July 2024]

In October 2023, Council proposed, and the board disposed with a series clarification and amendment rules for taxability of inter-company corporate guarantees, however many open issues were left which have now been clarified vide this circular. This alert deals with analyzing this circular and also put out our views on the legal implications.

Issue No. 1 : Will sub-rule (2) of Rule 28 of the CGST Rules apply to corporate guarantees issued before October 26, 2023? Additionally, for intra-group corporate guarantees issued before this date that remain active today, will GST be applicable on "1% of the amount of such guarantee offered"?

Clarification : It is clarified that the service of providing a corporate guarantee (CG) to a banking company or financial institution by a supplier to a related recipient, on behalf of the recipient, was taxable even before rule 28 (2) was added to the CGST Rules on October 26, 2023. Rule 28(2) specifically addresses how to determine the value of this taxable supply, not its taxability.

Before the amendment, the valuation of such services was based on the provisions of Rule 28 of the CGST Rules as they existed at that time. Therefore, for CGs issued or renewed before October 26, 2023, the valuation should follow the rules in place at that time. For guarantees issued or renewed on or after October 26, 2023, valuation should adhere to Rule 28(2) of the CGST Rules.

NJJ views : Rule 28 as it existed before 26.10.2023, stated that services supplied to related person must be valued as under:

a. Open Market Value



- b. Value of similar service
- c. Cost or any other prudent means

It is known fact that CGs are not traded or available in any open market hence open market value is not readily available. Same is the case with finding a similar service to value another CG, as the former is not available at all. Last way to arrive at value as per rule 28 is to find out cost of providing CG service or any other prudent way, there is no cost whatsoever at the end of the corporate for giving this CG and there is no prudence method as well, all in all even if go by the old rule 28, there was no probable way of valuing CG.

Further, it is a legally settled principle that levy fails without a valuation mechanism in place. As the valuation mechanism for CG was first prescribed in October 2023 by way of rule 28(2), this clarification has no legal legs to stand on. It is our firm belief that CG given before 26.10.2023 will not be taxable under GST for want of valuation mechanism.

Issue No. 2 : When a CG covers a specific amount, but only part of the loan is disbursed, or none at all, how is the value of the CG service determined? Can the recipient claim full Input Tax Credit (ITC) even before the entire loan is disbursed?

Clarification : The provision of a CG service is independent of whether the loan is disbursed. The guarantor's service involves assuming the risk of default, regardless of actual loan disbursement. Therefore, the value of the CG service is based on the guaranteed amount, not the amount actually disbursed to the recipient.

Additionally, the recipient of the CG service can claim ITC, provided all other conditions specified in the Act and Rules are met. This eligibility applies regardless of when or how much of the loan is disbursed to the recipient.



NJJ views : We do not agree with this clarification because the service purported to being taxed is the guarantee that one is giving to the other, when the bank to whom the CG is given can execute the guarantee only upto the amount of disbursal, how can the service be valued on loan sanctioned amount. Underlying context of providing a service has to be seen when a service is sought to be taxed through a deeming valuation method, it cannot be taxed in thin air.

Issue No. 3 : When an existing loan is taken over, does GST apply if there is only an assignment of an already issued CG?

Clarification : In the service where a corporate entity provides a CG to a banking company or financial institution on behalf of a related recipient, the corporate entity is the supplier of the service, and the related entity is the recipient of the CG.

Therefore, if another entity takes over a loan issued by a banking company or financial institution, this activity does not fall under the service of providing a CG. Hence, GST does not apply in such cases unless a new CG is issued or an existing one is renewed. However, if the loan takeover is accompanied by the issuance of a fresh CG, GST would be applicable on the new guarantee.

NJJ views : No Comments.

Issue No. 4 : When multiple entities or co-guarantors provide a CG, how is GST calculated for each co-guarantor?

Clarification : In cases where several related entities provide CG, the value of the service is determined by the total consideration paid or payable to the co-guarantors. If this total consideration exceeds one percent of the guaranteed amount, GST is calculated on the actual consideration paid by



each co-guarantor. If the total consideration is less than one percent of the guaranteed amount, GST is payable proportionately by each co-guarantor on one percent of the guaranteed amount.

For example, if two co-guarantors, A and B, jointly provide a CG of Rs. 1 crore to a banking or financial institution on behalf of a related recipient C, each of them would pay GST on 0.5% of the guaranteed amount.

However, if in the same scenario, A covers 60% of the guarantee amount and B covers the remaining 40%, GST would be payable proportionately by A and B — 0.6% by A on Rs. 60 lakhs and 0.4% by B on Rs. 40 lakhs. In other words, A would pay GST on 1% of the amount guaranteed by A (Rs. 60 lakhs), and B would pay GST on 1% of the amount guaranteed by B (Rs. 40 lakhs).

NJJ views : Agree with the clarification, however, there is one more issue that should have been clarified alongwith this issue. There are multiple cases where CG is given by 3 corporates and 2 individuals. Lets assume for a loan of 100 cr, it is guaranteed by 3 sister companies and 2 individuals who are directors. Earlier circular of October 2023 clarified that individuals cannot be taxed, so now how does one value this kind of an arrangement.

Going by the logic of this circular, in our view the 3 companies will have to pay GST on 1% of 20 crores each as 100 would be equally divided by 5 entities.

Issue No. 5 : When an intra-group CG is issued, should GST be paid by the recipient under reverse charge, considering that the recipient entity may not have an actual invoice or payment to claim input tax credit from the domestic guarantor?

Opinion : It is clarified that GST is to be paid under the forward charge mechanism for domestic corporate entities issuing intra-group guarantees. The service supplier who provides the CG to the related recipient must issue an invoice



under Section 31 of the CGST Act, 2017, in accordance with the relevant rules.

NJJ views : No Comments.

Issue No. 6 : Should the discharge of tax liability on a CG, calculated at 1% of the guaranteed amount, be carried out on a one-time, yearly, or monthly basis? How should this be handled when the guarantee is issued for a fixed term, such as five or ten years corresponding to the loan tenure?

Opinion : Rule 28(2) of the CGST Rules has been retrospectively amended from 26.10.2023 vide notification No. 12/2024 -CT dated 10.07.2024.

Thus, it is clarified that the value of providing a CG service to a banking company or financial institution on behalf of a related recipient shall be one percent of the guaranteed amount per annum or the actual consideration, whichever is greater.

Consequently, the value of providing a CG service to a banking company or financial institution on behalf of a related recipient for a specified number of years shall be calculated as one percent of the guaranteed amount multiplied by the number of years the guarantee is in effect, or the actual consideration, whichever is greater.

Additionally, in cases where the CG is issued for less than a year, such as 6 months (half a year), the valuation for that period may be prorated. In this scenario, the value of the service provided may be taken as half of one percent of the guaranteed amount ($6/12 * \text{one percent}$), or the actual consideration, whichever is greater.

For example, if a CG is issued for a duration of five years, the valuation of such guarantee would be calculated at one percent per year of the guaranteed amount or the actual consideration, whichever is greater.



Therefore, GST would be payable on this amount at the time of issuance of the CG, totaling 5% of the guaranteed amount or the actual consideration, whichever is greater.

However, if a CG is initially issued for one year and subsequently renewed five times for one-year periods, GST would be payable at one percent of the guaranteed amount or the actual consideration, whichever is greater, upon issuance of the CG in the first year and upon each renewal in the following years.

NJJ views : This clarification does not align with the GST law and rules, when the contractual arrangement between the supplier and recipient for a CG is done one time for a fixed term of say 10 years which the bank has accepted, the service if any, has been provided the day the CG was given, it cannot be deemed to be provided on annual basis by issuance of a circular. This clarification is absolutely without authority of law and courts will read it down in time to come.

Issue No. 7 : Does the benefit of the second proviso to Rule 28 (1), which deems the invoice value as the open market value when full ITC is available to the recipient of services, apply to cases falling under sub-rule (2)?

Opinion : A proviso has been added to Rule 28(2) of the CGST Rules, retroactively from 26.10.2023, through notification No. 12/2024 -CT dated 10.07.2024. This proviso is akin to the second proviso under Rule 28(1) of the CGST Rules, and it extends the benefit to cases involving the supply of CG services between related parties. Therefore, in instances where full ITC is available to the recipient of these services, the value stated on the invoice will be considered as the value of the supplied service of corporate guarantees between related parties.



NJJ views : Amendment of rule 28 is a very good step and will practically reduce tax implications on a large number of corporate taxpayers. This amendment practically means that the corporate can choose to charge any amount whatsoever from its related recipient for providing CG if it is eligible for ITC, burden of discharging GST on 1% of the CG would have otherwise proved to be too high.

Issue No. 8 : Will the valuation under Rule 28(2) of the CGST Rules apply to the export of CG services between related parties?

Opinion : The recent amendment to Rule 28(2) of the CGST Rules, effective retrospectively from 26.10.2023, specifies that this sub-rule does not apply when the recipient of CG services between related parties is located outside India. Therefore, the provisions of sub-rule (2) do not apply to the export of CG services between related parties.

NJJ views : This clarification means that in an Indian entity provides CG to its foreign subsidiary, valuation rule of 1% shall not apply to this transaction and therefore the Indian corporate will not be required to meet with any legal requirements of export of services.

Conclusion

This circular has clarified many open issues but while doing that has planted quite a few legal time bombs which in our humble view will be dealt with by courts negatively and against the department. GST has given rise enormous levels of litigation on multiple counts, Council has started to feel the pinch of it, this circular will result in giving rise to more unless the anomalies are corrected in time.

Crucial term – Corporate Guarantee – on which the entire debate hinges is not defined either in law or rule, hope this is done sooner rather than later.



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