

## **Personal Guarantee by directors and GST**

**CA Roopa Nayak**

### **Background**

In the past few years, under GST regime, there had been notices being issued demanding GST on guarantees given in respect of loans by director of company. In context of personal guarantees by director[being the related persons of the company], dept was making demands treating it as deemed supply of services, covered in Schedule I Entry 2, leviable to tax, even when done without consideration. The GST was being demanded under reverse charge under notification no.13/2017-CT® from company as recipient.

Section 9(3) of the CGST Act and section 5(3) of the IGST Act provides that tax on certain notified supplies would be paid by the recipient of the goods or service. The list of goods and services has been notified by the Government.

Notification No. 13/2017-CT(R) dated 28-6-2017 has been issued to notify services taxable under reverse charge. This notification as amended from time to time, vide sl. no. 6 makes the company or a body corporate located in the taxable territory being recipient liable for GST for the receipt of services supplied by a director of a company or a body corporate.

Further, under the GST law, the activities stated in the Schedule I of the CGST Act, 2017 would be covered in the ambit of scope of supply even if made without consideration.

Entry no. 2 of the Schedule I includes supply of goods or services or both between 'related person' or 'distinct person', treated as supply even if made without a consideration. Consequently, guarantee given to a company by director[who is related person] could be deemed to be supply in terms of Schedule I of the CGST Act. Valuation as per Rule 28 based on open market value of same/similar services or cost plus 10% mark up. This was the departments favoured view as well which was not correct position since it could validly be contended that there was no supply of service by the director giving guarantee and in absence of supply, there would be no GST liability either.

Next we examine whether giving guarantee can be said to be "supply" at all?

We see what is meaning of "guarantee". The term is not defined in GST law. Section 126 of Contract Act provides 'Contract of guarantee' is contract to perform promise, or discharge the liability, of a third person in case of his default.

For any transaction to be taxable under GST, first it should satisfy the definition of supply of goods/services. Hence, examination of transaction to conclude whether it can be said to be a supply plays an important role under GST. We now examine whether providing guarantee is a supply.

Further, David S Miller, in a paper titled 'Fe'eral Income Tax Consequences of Guarantees; A Comprehensive Framework for Analysis' published in the 'Th' American Lawyer Vol. 48, No.

1 (Fall 1994), pp. 103-165 (<http://www.jstor.org/stable/20771688>), has stated that a **guarantee is not a service**. The following observations, at pages 114, are important:

*The position that guarantees are services has been discredited by the courts with good reason. Guarantee fees do not represent payments for services any more than payments with respect to other financial instruments constitute payment for services. A guarantor does not arrange financing for the debtor, but merely executes a financial instrument in its favour.*

In general parlance, the activity of exercising Guarantee is carried without consideration as the same is entrepreneurial in nature and is done to safeguard the financial health of the company.

Suessen Textile Bearings Ltd. vs Union of India and Ors. 1984 55 CompCas 492 Delhi on 14 November 1983, Delhi HC held that a director by entering into a contract of guarantee does not do any manual, clerical, technical, supervisory or administrative work. He gets the commission not for any services rendered. The guarantee-commission payable to a director, is not remuneration for the services rendered.

It can be recalled that there has been a circular 204/16/2023 issued 26th October 2023 wherein it has clarified that the personal guarantee given by directors to company without a consideration is not leviable to GST. This has been a welcome relief to the numerous tax payers who were in a dilemma due to confusion on taxability of guarantees to GST.

In this background the paperwriter has examined the implications of this circular for the future as well as for past under GST.

Next we examine the circular 204/16/2023 and impact under GST.

### **Clarification given in circular 204/16/2023**

... ***the director and the company are to be treated as related persons***. As per clause (c) of sub-section (1) of section 7 of the CGST Act, 2017, read with S. No. 2 of Schedule I of CGST Act, ***supply of goods or services or both between related persons***, when made in the course or furtherance of business, shall be ***treated as supply even if made without consideration***. Accordingly, the activity of **providing personal guarantee by the Director to the banks/ financial institutions for securing credit** facilities for their companies is to be treated as a ***supply of service, even when made without consideration***. ***Rule 28 of Central Goods and Services Tax Rules, 2017 (hereinafter referred to as "CGST Rules") prescribes the method for determining the value of the supply of goods or services or both between related parties***, other than where the supply is made through an agent. In terms of Rule 28 of CGST Rules, ***the taxable value of such supply of service shall be the open market value of such supply***.

***RBI has provided guidelines for obtaining personal guarantee of promoters, directors and other managerial personnel of the borrowing concerns vide Para 2.2.9 of its Circular No.***

RBI/2021-22/121 dated 9th November, 2021, which is reproduced below: “2.2.9 Guidelines relating to obtaining of personal guarantees of promoters, directors, other managerial personnel, and shareholders of borrowing concerns Banks should take personal guarantees of promoters, directors, other managerial personnel or major shareholders for the credit facilities granted to corporates, public or private, only when absolutely warranted after a careful examination of the circumstances of the case and not as a matter of course. In order to identify the circumstances under which the guarantee may or may not be considered necessary, banks should be guided by the following broad considerations: ..... C. Worth of the guarantors, payment of guarantee commission, etc Where personal guarantees of directors are warranted, they should bear reasonable proportion to the estimated worth of the person. The **system of obtaining guarantees should not be used by the directors and other managerial personnel as a source of income from the company. Banks should obtain an undertaking from the borrowing company as well as the guarantors that no consideration whether by way of commission, brokerage fees or any other form, would be paid by the former or received by the latter, directly or indirectly. This requirement should be incorporated in the bank's terms and conditions for sanctioning of credit limits.** During the periodic inspections, the bank's inspectors should verify that this stipulation has been complied with. There may, however, be exceptional cases where payment of remuneration may be permitted e.g. where assisted concerns are not doing well and the existing guarantors are no longer connected with the management but continuance of their guarantees is considered essential because the new management's guarantee is either not available or is found inadequate. ....”

As per mandate provided by RBI in terms of Para 2.2.9 (C) of RBI's Circular No. RBI/2021-22/121 dated 9th November, 2021, **no consideration by way of commission, brokerage fees or any other form, can be paid to the director by the company, directly or indirectly, in lieu of providing personal guarantee to the bank for borrowing credit limits.** As such, when **no consideration can be paid** for the said transaction by the company to the director in any form, directly or indirectly, as per RBI mandate, **there is no question of such supply/ transaction having any open market value. Accordingly, the open market value of the said transaction/ supply may be treated as zero** and therefore, taxable value of such supply may be treated as zero. In such a scenario, **no tax is payable** on such supply of service by the director to the company. There may, however, be cases where **the director, who had provided the guarantee, is no longer connected with the management** but continuance of his guarantee is considered essential because the new management's guarantee is either not available or is found inadequate, or there may be other exceptional cases where the **promoters, existing directors, other managerial personnel, and shareholders of borrowing concerns are paid remuneration/ consideration** in any manner, directly or

indirectly. In all these cases, **the taxable value of such supply of service shall be the remuneration/ consideration provided to such a person/** guarantor by the company, directly or indirectly.

### **Key Take Aways from circular**

- It is clear that GST is leviable on supply done for consideration.
- In case of guarantee there is no consideration payable to director, levy fails
- No open market value as per Rule 28 of GST rules either as there is no consideration.
- When the consideration is paid to persons, who were director but no longer connected with management, only then the GST would be leviable on the remuneration/consideration to such person.

### **Action points:**

- It has been clarified now by virtue of above circular that GST is not leviable on the guarantee given by director without consideration.
- Circulars are binding on dept. Similarly held in Dhiren Chemical Industries [2002 (143) ELT 19 (SC)].case.
- Beneficial circular can claim is applicable retrospectively in respect of past demands raised by dept on guarantees by directors. Similarly held in Suchitra Components Ltd. v. CCEx., Guntur, 2007 (208) E.L.T. 321 (S.C.) Supreme Court held that circulars which are beneficial to the assessee have to be applied retrospectively while oppressive circulars have to be given effect prospectively.

### **Conclusion**

In this article the GST implications of guarantee given by director are examined.

For any queries mail [roopa@hnaindia.com](mailto:roopa@hnaindia.com)