H N A & Co LLP
Chartered Accountants
(Formerly known as Hiregange & Associates LLP)

Research Paper

GST Implications on Personal & Corporate Guarantees

PREPARED BY
Research Team
of H N A & Co. LLP

Index

Research Paper on
"GST Implications on Personal & Corporate Guarantees"

Introduction:

Taxation of guarantees (whether personal or corporate) has been a long-standing issue for taxpayers both under GST and erstwhile tax era too. The recent Supreme Court decision has brought clarity to a certain degree for taxation of guarantees under service tax. Further, for taxation under GST, the same has been clarified by the GST Council in its 52nd Council meeting held on 7th October 2023.

This research paper is drafted to analyse GST implications on corporate and personal guarantees, open-ended issues, impact on industry and action points to be undertaken by the industry.

Meaning of Guarantee:

In general terms, guarantee is understood to mean a kind of contract wherein a third party promises or undertakes to pay the debt of another person in case they default in making the debt re-payment. P. Ramanatha Aiyer's Advanced Law Lexicon defines guarantee as follows:

"An undertaking by the guarantor that should a debtor, who is obliged to pay a sum of money to a creditor, not pay it, the guarantor would pay the same or otherwise compensate the creditor for the losses suffered by such failure to pay. Guarantee inherently leads to a tri-partite contract between the debtor, creditor and the guarantor."

It would also be relevant to refer to Section 126 of Contract Act, 1872 which provides for "contract of guarantee". It is extracted hereunder:

"A "contract of guarantee" is a contract to perform the promise, or discharge the liability, of a third person in case of his default. The person who gives the guarantee is called the "surety"; the person in respect of whose default the guarantee is given is called the "principal debtor", and the person to whom the guarantee is given is called the "creditor". A guarantee may be either oral or written."

A contract of guarantee is not a primary transaction, but an independent transaction containing independent and reciprocal obligations [IFCI Ltd Vs. Cannore Spinning and Weaving Mills Ltd (AIT 2002 SC 1841)]. A contract of guarantee is a complete and separate contract by itself and an enforcement as per its terms cannot be restrained by considering the terms of the underlying contract. [NHAI Vs. Ganga Enterprises (AIR 2003 SC 3823).

In a tri-partite contract of guarantee, the surety/guarantor is one, who, in consideration of some act or promise on the part of the creditor, promises to perform the promise or to discharge the liability of a third party, in case of his default [Bittan Bibi Vs Kuntu Lal (AIR 1952 All 996)].

Guarantee, being a "contract" as per Section 126, there needs to be a presence of "consideration". However, the question which arises here is what is the "consideration" given the guarantor/surety in a guarantee contract? This is answered in Section 127 of the Contract Act which is extracted hereunder:

"127. Consideration for guarantee.— Anything done, or any promise made, for the benefit of the principal debtor, may be a sufficient consideration to the surety for giving the guarantee.

Illustrations

(a) B requests A to sell and deliver to him goods on credit. A agrees to do so, provided C will guarantee the payment of the price of the goods. C promises to guarantee the payment in consideration of A's promise to deliver the goods. This is a sufficient consideration for C's promise.

(b) A sells and delivers goods to B. C afterwards requests A to forbear to sue B for the debt for a year, and promises that, if he does so, C will pay for them in default of payment by B. A agrees to forbear as requested. This is a sufficient consideration for C's promise.

(c) A sells and delivers goods to B. C afterwards, without consideration, agrees to pay for them in default of B. The agreement is void."

From the above, it could be said that the benefit given to the creditor (i.e., by way of re-payment of the debt by the principal debtor) itself would amount to consideration given to the guarantor.

The consideration for surety's promise does not move from the principal debtor, but from the creditor. It was held in the case of Prasanjit Mahtha Vs United Commercial Bank Ltd (AIR 1979 part 151) that:

"...the very nature of a contract of guarantee does not stipulate for the surety to receive or, for that matter, retain the money or advantage himself as the actual beneficiary is the principal debtor..."

It was also held in the above judgement that in a tripartite agreement for guarantee, the consideration, may move either from the creditor or from the principal debtor or both. The consideration may benefit the surety/guarantor, but it is not necessary that the surety/guarantor should receive any benefit under the contract.

In a guarantee contract, the guarantor/surety may be any person – individual or corporate. The provisions regarding corporate guarantee is given in Section 186 of the Companies Act, 2013. The relevant provisions are summarised hereunder:

i. No company shall directly or indirectly give any guarantee or provide security in connection with a loan to any other body corporate or person exceeding 60% of its paid-up share capital, free reserves and securities premium account or 100% of its free reserves and securities premium account, whichever is more.

ii. Where the giving of guarantee exceeds the above limit, then a special resolution is required to be passed at a general meeting.

iii. The company shall disclose to the members in the financial statement the full particulars of the guarantee given.

iv. No guarantee or security shall be given by the company unless the resolution sanctioning it is passed at a meeting of the Board with the consent of all the directors present at the meeting along with prior approval of the public financial institution. Such prior approval of the public financial institution is not needed if loans, investments and guaranteed made so far and the loans, investment, guarantee proposed to be made does not exceed the limits mentioned in point (i).

Based on the above understanding of concept and regulation for guarantees, the taxation of such guarantee transactions under indirect taxation is discussed hereunder. Before that, it is important to analyse relevant portions for RBI circular regarding personal & corporate guarantees.

RBI Master Circular on Guarantees:

The RBI issued Master Circulars providing framework for bank guarantees, personal guarantees from directors and corporate guarantees. The circular was continuously updated and the latest Circular applicable for guarantees is Circular DBOD.No.Dir.BC.17/13.03.00/2014-15 dated 1st July, 2014.

The relevant portions of the Circular is summarised hereunder:

I. Regarding Personal Guarantee: -

a) Personal guarantee is not necessary if the financial institution is satisfied with the corporate governance, economic viability, and financial position of the public companies.

b) Further, sometimes without insisting the personal guarantee, lending institutions may give financial facility with stringent conditions such as restrictions on distribution of dividend creation of further charge on assets and stipulation of maintenance of minimum net working capital etc.

c) However, Personal guarantees may be taken in the following cases: -

- Where the shares of the company are closely held by a person or connected or group
- When the loans are given on unsecured basis for the Public limited companies other than rated as first class
- When the financial position of the company is not satisfactory.

d) In addition, the system of providing guarantee should not become as source of income for the director or other managerial from the company.

e) To comply with the same **Banks has to take an undertaking from the company and the director or other managerial personal stating that no consideration** by way of commission, brokerage fees or any other form will be paid by company or received by the director or other managerial personal. Banks has to keep this requirement in their terms and conditions for the sanctioning the loans.

f) However, Consideration for providing guarantee can be paid by the company in cases where the person providing personal guarantee ceases to be the Director.

II. Regarding Corporate Guarantee: -

a) An Indian Company may provide the corporate Guarantee to the lending institutions on behalf of their wholly owned subsidiaries or joint ventures subject to specified conditions.

b) An Indian party may extend corporate guarantee on behalf of the first generation step down operating subsidiary under the Automatic Route within the prevailing limit for the overseas direct investments.

c) An Indian party may issue corporate guarantee on behalf of second generation or subsequent generation step down operating subsidiaries with prior approval from the Reserve Bank, provided the Indian party indirectly holds 51% or more stake in the overseas subsidiary for which such guarantee is intended to be issued.

d) Outside Indian company may provide the corporate guarantee to the lending institutions on behalf of their Indian subsidiary companies. In this instant, in case of guarantee is invoked the outside Indian holding company as a Non-resident Guarantor will pay the guaranteed liability and further the Indian company being a principal debtor may repay to the foreign holding company.

Based on the above understanding, the taxation aspects of guarantees is discussed below.

Taxability under erstwhile indirect tax regime:

Under pre-GST taxation regime, the service tax law becomes relevant for guarantee transactions. Before analysing the applicability of service tax on provision of guarantee by a person, it would be important to understand the definition of "service" under service tax. For the period from 1.7.2012, when service tax shifted to negative list regime, where all activities forming part of the definition of "service" is liable to service tax other than those mentioned in the negative list.

Accordingly, the term "service" was defined in Section 65B(44) of Finance Act, 1994 as follows:

*"(44) "service" means any **activity** **carried out by a person for another** **for consideration**, and includes a declared service, but shall not include-*

(a) an activity which constitutes merely,--

(i) a transfer of title in goods or immovable property, by way of sale, gift or in any other manner; or

(ii) such transfer, delivery or supply of any goods which is deemed to be a sale within the meaning of clause (29A) of Article 366 of the Constitution; or

(iii) a transaction in money or actionable claim;

(b) a provision of service by an employee to the employer in the course of or in relation to his employment;

(c) fees taken in any Court or tribunal established under any law for the time being in force..."

Thus, for a transaction to be a "service", there has to be:

a) An activity
b) Carried out by a person
c) For another
d) For consideration

The term "consideration" has not been defined in Section 65B of the Finance Act, 1994, the section which defines various terms for service tax. However, in Section 67, which pertains to valuation of taxable services for charging service tax, the meaning of "consideration" is given in the explanation (a) and is extracted below:

(a) "consideration" includes-

(i) any amount that is payable for the taxable services provided or to be provided;

(ii) any reimbursable expenditure or cost incurred by the service provider and charged, in the course of providing or agreeing to provide a taxable service, except in such circumstances, and subject to such conditions, as may be prescribed;

(iii) any amount retained by the lottery distributor or selling agent from gross sale amount of lottery ticket in addition to the fee or commission, if any, or, as the case may be, the discount received, that is to say, the difference in the face value of lottery ticket and the price at which the distributor or selling agent gets such ticket."

Going by the above definition read with the definition of service in Section 65B(44), it could be said that for an activity to be service, there has to be a "consideration", which is any amount payable for taxable services provided or to be provided.

Whether provision of guarantees amounts to "service" under service tax?

The Department had raised service tax demand on personal guarantees given by directors to the companies as well as on corporate guarantees under service tax regime, both before and after negative-list based taxation. Prior to 1.7.2012, when service tax was chargeable only on specified services, dispute arose regarding service tax on corporate guarantee and divergent judgements were given at the Tribunal and High Court level.

One significant case law under positive-list regime was Olam Agro India Ltd Vs Commissioner of Service Tax, Delhi-I [2014 (33) S.T.R. 251 (Tri. - Del.)] which was affirmed by the Delhi High Court in 2014 (33) S.T.R. 234 (Del.).

Here, the Tribunal held that service tax applies on corporate guarantees as "Business Auxiliary Services" and not under "banking and other financial services". On the contrary, an assessee-favourable decision was held in Sterlite Industries India Ltd. Vs Commr. of GST & C. Ex., Tirunelveli [2019 (25) G.S.T.L. 277 (Tri. - Chennai)] wherein it was held that under no circumstances, will the activity of providing corporate guarantee falls under "banking and other financial activities".

It is also relevant to discuss cases such as DLF Project Limited Vs C.C.E. & S.T., Gurgaon-I [2020 (38) G.S.T.L. 56 (Tri. - Chan.)] wherein it was held that Corporate guarantee provided to banks/financial institution on behalf of holding company/associated enterprises for availing loan or overdraft facility, not taxable either prior to or after 1-7-2012 particularly when assessee not received any consideration from said banks/financial institutions or from their holding company/associated enterprises.

Further, it was observed that merely on the ground that such holding company/associated enterprises received loan facility from said banks at a lower rate, differential amount of interest to be considered as a consideration is not an acceptable contention. It was similarly held in DLF Cyber City Developers

Limited Vs Commissioner of ST [2019 (28) G.S.T.L. 478 (Tri. - Chan.)], which is pending with the Supreme Court in Civil Appeal No. 428 @ Diary No. 42703/2019.

Post this, a judgement was rendered by the Bombay Tribunal in the case of Commissioner Of CGST & Central Excise, Mumbai East Vs Edelweiss Financial Services Ltd [(2023) 5 Centax 57 (Tri.-Bom)] regarding taxability of corporate guarantees when no consideration was paid to the guarantor. The following was held by the Tribunal:

"8. The criticality of 'consideration' for determination of service, as defined in section 65B(44) of Finance Act, 1994, for the disputed period after introduction of 'negative list' regime of taxation has been rightly construed by the adjudicating authority. Any activity must, for the purpose of taxability under Finance Act, 1994, not only, in relation to another, reveal a 'provider', but also the flow of 'consideration' for rendering of the service. ***In the absence of any of these two elements, taxability under section 66B of Finance Act, 1994 will not arise. It is clear that there is no consideration insofar as 'corporate guarantee' issued by respondent on behalf of their subsidiary companies is concerned.***

9. The ***reliance placed by Learned Authorised Representative on the 'non-monetary benefits' which may, if at all, be of relevance for determination of assessable value under section 67 of Finance Act, 1994 does not extend to ascertainment of 'service' as defined in section 65B(44)*** *of Finance Act, 1994. 'Consideration' is the recompense for the 'contractual' undertaking that authorizes levy while 'assessable value' is a determination for computing the measure of the levy and the latter must follow the former."*

Further to this, the Department had appeal to the Supreme Court. However, the appeal was dismissed in favour of the assessee wherein it was held as follows: [(2023) 5 Centax 58 (S.C.)]

"7. The above would suggest that this was a case where the assessee had not received any consideration while providing corporate guarantee to its group companies. ***No effort was made on behalf of the Revenue to assail the above finding or to demonstrate that issuance of corporate guarantee to group companies without consideration would be a taxable service.*** *In these circumstances, in view of such conclusive finding of both forums, we see no reason to admit this case basing upon the pending Civil Appeal No. 428 @ Diary No. 42703/2019, particularly when it has not been demonstrated that the factual matrix of the pending case is identical to the present one.*

8. In consequence, the Civil Appeal stands dismissed."

Based on the above, it could be said that the law is now settled regarding taxability of service tax on corporate guarantees made without consideration. However, it would be incorrect to assume that the

said decision would find favour under GST law as well, since the levy of GST differs from that of service tax. The same is discussed below.

Taxability under GST:

Discussion on relevant provisions:

As per Section 9 of CGST Act, central goods and services tax shall be levied on all intra-state "supplies" of goods or "services" or both. To summarise, the term "service" is defined in Section 2(102) of CGST Act as anything other than goods, money and securities.

Further, the scope of "supply" is given in Section 7(1) which can be summarised as under:

a) "supply" includes all forms of supply of goods or services or both such as sale, transfer, barter, exchange, licence, rental, lease or disposal made or agreed to be **made for a consideration** by a person in the course or furtherance of business;
b) Supply includes the activities or transactions, by a person, other than an individual, to its members or constituents or vice-versa, for cash, deferred payment or other valuable consideration.
c) Supply includes import of services **for a consideration** whether or not in the course or furtherance of business
d) Supply includes the activities specified in Schedule I, made or agreed to be made **without a consideration.**

Thus, unlike in the service tax law, where the definition of "service" mandatorily included the term "consideration", under GST, for an activity to be considered as "supply", there need not be "consideration" always. In certain cases as specified in Schedule I, the activities amount to "Supply" and GST is payable even if the supplier does not receive any consideration.

Also, another differing aspect from service tax is that the GST law provides for a definition of the term "consideration". The same is extracted hereunder [Section 2(31)]:

"(31) "consideration" in relation to the supply of goods or services or both includes––

*(a) **any payment made or to be made**, whether in money or otherwise, in respect of, in response to, or for the inducement of, the supply of goods or services or both, whether by the recipient or by any other person but shall not include any subsidy given by the Central Government or a State Government;*

*(b) **the monetary value of any act or forbearance**, in respect of, in response to, or for the inducement of, the supply of goods or services or both, whether by the recipient or by any other person but shall not include any subsidy given by the Central Government or a State Government:*

Provided that a deposit given in respect of the supply of goods or services or both shall not be considered as payment made for such supply unless the supplier applies such deposit as consideration for the said supply;"

Accordingly, under GST, consideration does not only include payment in monetary terms, but also by way of any act or forbearance in respect of a supply. Thus, consideration can be either in terms of money or otherwise.

Schedule I includes the following activity:
"2. Supply of goods or services or both between related persons or between distinct persons as specified in section 25, when made in the course or furtherance of business:"

Here, to analyse the term "related persons", reliance can be placed on the explanation (a) to Section 15 which provides as follows:
"(a) persons shall be deemed to be "related persons" if––

- ***(i) such persons are officers or directors of one another's businesses;***
- *(ii) such persons are legally recognised partners in business;*
- *(iii) such persons are employer and employee;*
- ***(iv) any person directly or indirectly owns, controls or holds twenty-five per cent. or more of the outstanding voting stock or shares of both of them;***
- ***(v) one of them directly or indirectly controls the other;***
- *(vi) both of them are directly or indirectly controlled by a third person;*
- *(vii) together they directly or indirectly control a third person; or*
- *(viii) they are members of the same family;"*

Thus, related persons for a company includes its directors as well as its holding company. Based on this, the GST Officers had began demanding GST on corporate guarantees given by a holding company to its subsidiary as well as on personal guarantee given by the directors to the Company. GST was demanded even though there was no monetary consideration paid to the guarantors.

The Supreme Court decision in Edelweiss created more confusion among the industry regarding taxability of service tax on the same.

Validity of levy of GST on corporate guarantee

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. Owing to it, the same is also unsecured in nature as there is no security provided by the company if there is a default of the loan.

For any transaction to be taxable under GST, first it should satisfy the definition of supply under GST. Hence, examination of transaction to be a supply plays as important role under GST. We now examine whether providing guarantee is a supply?

When view is taken that the issuance of corporate guarantee by assessee on behalf of its subsidiary company is in nature of quasi capital or shareholder activity then it may not be considered to be in nature of 'service'.

The Hon'ble ITAT-Ahmedabad in the matter of Micro Ink Limited v. ACIT (I.T.A. No.: 2873/Ahd/10) has held corporate guarantee not be a service and while holding so, the Hon'ble bench held that "When the legislature itself does not group 'guarantees' in the 'provision for services' and includes it in the 'capital financing', it is reasonable to proceed on the basis that issuance of guarantees is not to be treated as within the scope of normal connotations of expression 'provision for services'. In Suzlon Energy Limited, Ahmedabad vs The Dcit.,Circle-8,, Ahmedabad bearing ITA No.2074 & 2179/Ahd/2013 similar view was again taken by the Hon'ble ITAT-Ahmedabad and in due course, it was held that "the issuance of corporate guarantees in question was not in the nature of "*provision for services' and these corporate guarantees were required to be treated as shareholder participation in the subsidiaries."*

David S Miller, in a paper titled 'Federal Income Tax Consequences of Guarantees; A Comprehensive Framework for Analysis' published in the 'The 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 view can be taken that in the absence of any intention to supply service, levy itself fails. However, the intention of the revenue seems to levy guarantee to GST, as evident from the recommendations of 52nd GST Council meeting and subsequent developments, discussed further.

Recommendations in the 52nd GST Council Meeting:

In the 52nd GST Council Meeting held on 7th October 2023, the following was recommended:

"ii) Clarifications regarding taxability of personal guarantee offered by directors to the bank against the credit limits/loans being sanctioned to the company and regarding taxability of corporate guarantee provided for related persons including corporate guarantee provided by holding company to its subsidiary company: *The Council has inter alia recommended to:*

(a) issue a circular clarifying that when no consideration is paid by the company to the director in any form, directly or indirectly, for providing personal guarantee to the bank/ financial institutes on their behalf, the open market value of the said transaction/supply may be treated as zero and hence, no tax to be payable in respect of such supply of services.

(b) to insert sub-rule (2) in Rule 28 of CGST Rules, 2017, to provide for taxable value of supply of corporate guarantee provided between related parties as one per cent of the amount of such guarantee offered, or the actual consideration, whichever is higher.

(c) to clarify through the circular that after the insertion of the said sub-rule, the value of such supply of services of corporate guarantee provided between related parties would be governed by the proposed sub-rule (2) of rule 28 of CGST Rules, 2017, irrespective of whether full ITC is available to the recipient of services or not."

The recommendation is summarised as follows:

a) Rule 28(2) to be inserted which provides for valuation in case of corporate guarantees as 1% of guarantee offered or actual consideration, whichever is higher.
b) A circular to be issued for clarifying that once Rule 28(2) is inserted, valuation of corporate guarantee between related parties would be governed by sub-rule (2) only, irrespective of whether full ITC is available to the recipient or not. Thus, the option of valuation based on value mentioned in invoice would not be available.
c) A circular would be issued for clarifying that GST is not applicable when no consideration is paid by the company to a director for personal guarantee.

Analysis of Notification and Circulars by CBIC regarding guarantees:

Consequently, Notification No. 52/2023-Central Tax dated 26th October 2023 was issued which notified changes in Rule 28. The change has been extracted hereunder:

"2. In the Central Goods and Services Tax Rules, 2017 (hereinafter referred to as the said rules), rule 28 shall be renumbered as sub-rule (1) and after the sub-rule as so renumbered, the following sub-rule shall be inserted, namely:-

*"(2) **Notwithstanding anything contained in sub-rule (1)**, the value of supply of services by a supplier to a recipient who is a related person, by way of providing **corporate guarantee** to any banking company or financial institution on behalf of the said recipient, shall be deemed to be one per cent of the amount of such guarantee offered, or the actual consideration, whichever is higher."*

Further, Circular No. 204/16/2023-GST dated 27th October 2023 was issued for clarifying certain aspects relating to taxability and valuation of personal/corporate guarantees. The issue and clarifications provided therein are summarised below.

Issue 1: Whether the activity of providing **personal guarantee** by the Director of a company to the bank/financial institutions for sanctioning credit facilities to the company without any consideration will be treated as a supply of service or not and whether the same will attract GST or not?

Clarification:

- **Whether it amounts to supply:** 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, 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.
- **Whether consideration is payable:** 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.
- **Valuation under GST:** 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.
- **Cases where consideration paid to guarantor:** 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.

Issue 2: Whether the activity of providing corporate guarantee by a person on behalf of another related person, or by the holding company for sanction of credit facilities to its subsidiary company, to the bank/ financial institutions, even when made without any consideration will be treated as a taxable supply of service or not, and if taxable, what would be the valuation of such supply of services?

Clarifications:

- **Whether it amounts to supply:** Where corporate guarantee is provided by a related person, such as when a holding company, for its subsidiary company, those two entities also fall under the category of 'related persons'. Hence the activity of providing corporate guarantee by a holding company to the bank/financial institutions for securing credit facilities for its subsidiary company, even when made without any consideration, is also to be treated as a supply of service by holding company to the subsidiary company, being a related person, as per provisions of Schedule I of CGST Act.
- **Valuation under GST:** Considering different practices being followed by the field formations and taxpayers in determining such taxable value , sub-rule (2) has been inserted in rule 28 of CGST Rules vide Notification No. 52/2023-CT (as discussed above), for determining the taxable value of such supply of services between related persons in respect of providing corporate guarantee. Thus, in all such cases of supply guarantee services by a related person to another person, the taxable value of such supply of services, shall be determined as per Rule 28(2), irrespective of whether full ITC is available to the recipient of services or not.
- **Valuation as per new rule not applicable in certain cases:** It is clarified that the sub-rule (2) of Rule 28 shall not apply in respect of the activity of providing personal guarantee by the Director to the banks/ financial institutions for securing credit facilities for their companies and the same shall be valued in the manner provided in clarification to issue 1.

Important points to be noted:

a) Non-applicability of GST when no consideration is involved for guarantee services applies only to personal guarantee given by directors to Company. It does not apply to corporate guarantees. Thus, if a holding company provides corporate guarantees to its subsidiary for zero consideration, GST would apply. Valuation would be as per new Rule 28(2).

b) Although the Supreme Court in the Edelweiss case held that service tax is not applicable on "corporate" guarantees given without consideration, the Government has not followed the same in GST. Instead, the judgement has been applied to "personal" guarantees from director.
c) Given the jurisprudence under service tax and the wide definition of "service" and "supply" under GST, it could be said that intention of Govt is to levy GST citing guarantee services amount to supply of services, irrespective of whether consideration is paid to the guarantor or not. GST not being applicable in case of director's personal guarantee is ONLY because valuation fails (since there is not open market value).

Time of supply in case of guarantees:

It is usually seen that in a contract for corporate guarantee, the commission/consideration is payable upfront to the guarantor. In such case, the time of supply would be as per Section 13(2) of CGST Act, 2017, being the earliest of:

(a) the date of issue of invoice by the supplier, if the invoice is issued within the period prescribed under section 31 or the date of receipt of payment, whichever is earlier; or
(b) the date of provision of service, if the invoice is not issued within the period prescribed under section 31 or the date of receipt of payment, whichever is earlier; or

As per Section 31 read with rule 47 of CGST Rules, invoice for supply of service shall be issued within a period of 30 days from the "date of supply of service". The question here that arises as to what is "date of supply of service" in a corporate/personal guarantee. For this, the following 3 events may be considered:

a) Date of guarantee agreement/tri-partite loan agreement
b) Date on which loan is sanctioned to the principal debtor
c) Date on which the guarantor pays the loan amount to the creditor/bank upon default of the principal debtor

In order to determine which of the above dates could be considered as "date of supply of service" for the purpose of guarantee, it is relevant to analyse certain case laws under Contract Act.

We can first rely on one landmark decision of the House of Lords in Lakeman Vs. Mountstephen [1874 7 HL Cas 17] wherein the following was held:

"There can be no suretyship unless there be a principal debtor, who of course may be constituted in the course of the transaction by matters ex post facto, and need not be so at the time, but ***until there is a***

principal debtor there can be no suretyship. *Nor can a man guarantee anybody else's debt unless there is a debt of some other person to be guaranteed."*

Further, the Gujarat HC held as follows in the case of Lalbhai Trading Company Vs UOI [(2006) 1 GLR 497]:

*"It is well settled that the surety's liability is co-extensive with that of the principal debtor unless otherwise by special provision the liability is so varied. Thus, where the debt due by the principal debtor is scaled down the surety is liable only to the extent of such scaled down amount. A contract of guarantee must necessarily involve three parties. In other words all the three parties should be privy to the contract if contract of guarantee is to be invoked. The person who wants to rely upon the contract of guarantee must prove the express participation or implied assent to such a contract. In absence of any liability there can be no contract of guarantee****. The liability of the guarantor /surety presupposes the existence of a separate liability of the principal debtor and the liability of the surety is normally secondary which comes into existence only in case of default by the principal debtor****."*

Thus, it could be said that unless there is a debt owned by the principal debtor, there can be no surety/guarantee. Such debt owed begins when the loan amount is actually sanctioned to the debtor by the creditor bank/financial institution.

Considering the above, it could be said that the "date of supply of service" would be the date on which the surety/guarantee starts, being the date on which the principal debtor gets sanctioned the loan, and when guarantor gives the promise to discharge the liability, in case of his default.

Thus, for the purpose of Section 31 read with Rule 46, the time limit to issue invoice would be 30 days from date on which loan is sanctioned to the principal debtor.

Accordingly, the time of supply would be as follows in various scenarios:

1) **When consideration is paid to guarantor: The time of supply shall be:**
    a. <u>If invoice raised by the guarantor within 30 days from date of sanction of loan to the principal debtor:</u> Date of invoice or date of payment of consideration/commission, whichever is earlier
    b. <u>If invoice is NOT raised by the guarantor within 30 days from date of sanction of loan to the principal debtor:</u> Date of provision of service (date of sanction of loan to principal debtor may be considered for this) or the date of payment of consideration/commission to guarantor, whichever is earlier.

2) **When NO consideration is paid to guarantor: The time of supply shall be:**
    a. If invoice raised by the guarantor within 30 days from date of sanction of loan to the principal debtor: The Date of invoice
    b. If invoice is NOT raised by the guarantor within 30 days from date of sanction of loan to the principal debtor: Date of provision of service (date of sanction of loan to principal debtor may be considered for this)

Given the above understanding of GST law, the implications on corporate guarantee in various scenarios is analysed hereunder.

Taxation in specific cases of guarantees:

Valuation for personal guarantees when guarantor ceases to be the Director:

As per the RBI circular, payment of consideration for personal guarantees provided by Director shall not be given. However, when the guarantor ceases to be the Director and it is necessary to continue the guarantee given the circumstances, any form of consideration may be paid to such ex-director guarantor. In such a scenario, when the Director ceases office, it may be assumed that he/she ceases to be in office, both as a Director and as an employee. Thus, the guarantor will no longer be a "related party" to the Company.

In such case, valuation rules for related party transactions need not be considered and the valuation would be as per Section 15, being the "transaction value". And the "transaction value" in this case would be the actual consideration (in the form of commission or brokerage etc.) paid to the ex-director guarantor. It has been similarly clarified in Circular No. 204 as well.

Taxability of corporate guarantee when there are more than one Guarantors

In certain scenarios, there may be joint guarantee provided by more than one company to the principal debtor. In order to determine tax liability in such cases, reference to Section 146 & 147 of Contract Act is necessary. These sections provide for liability in case of co-sureties/co-guarantors. The extract of the sections and their summary is provided hereunder:

*"Where two or more persons are co-sureties for the same debt or duty, either **jointly or severally**, and whether under the same or different contracts, and whether with or without the knowledge of each other, the co-sureties, **in the absence of any contract to the contrary, are liable, as between themselves, to pay each an equal share of the whole debt**, or of that part of it which remains unpaid by the principal debtor.*

Illustrations

(a) A, B and C are sureties to D for the sum of 3,000 rupees lent to E. E makes default in payment. A, B and C are liable, as between themselves, to pay 1,000 rupees each.

(b) A, B and C are sureties to D for the sum of 1,000 rupees lent to E, and there is a contract between A, B and C that A is to be responsible to the extent of one-quarter, B to the extent of one- quarter, and C to the extent of one-half. E makes default in payment. As between the sureties, A is liable to pay 250 rupees, B 250 rupees, and C 500 rupees."

The Section can be summarised as below:

d) The section deals with 2 or more co-sureties (or guarantors) for a single debt.
e) Agreement with such guarantors may be either a single agreement or multiple agreements.
f) The guarantor's need not have knowledge of existence of other guarantors.
g) A contract may be entered into among the guarantors to divide the percentage/proportion of the debt which may be payable by them in case of default by principal debtor.
h) When such a contract is not entered into, then the guarantors shall be liable to pay in equal proportions.

Section 147 is extracted below:

"Liability of co-sureties bound in different sums.

Co-sureties who are bound in different sums are liable to pay equally as far as the limits of their respective obligations permit.

Illustrations

(a) A, B and C, as sureties for D, enter into three several bonds, each in a different penalty, namely, A in the penalty of each 10,000 rupees, B in that of 20,000 rupees, C in that of 40,000 rupees, conditioned for D‟s duly accounting to E. D makes default to the extent of 30,000 rupees. A, B and C are each liable to pay 10,000 rupees.

(b) A, B and C, as sureties for D, enter into three several bonds, each in a different penalty, namely, A in the penalty of 10,000 rupees, B in that of 20,000 rupees, C in that of 40,000 rupees, conditioned for D‟s duly accounting to E. D makes default to the extent of 40,000 rupees. A is liable to pay 10,000 rupees, and B and C 15,000 rupees each.

(c) A, B and C, as sureties for D, enter into three several bonds, each in a different penalty, namely, A in the penalty of 10,000 rupees, B in that of 20,000 rupees, C in that of 40,000 rupees, conditioned for D‟s duly accounting to E. D makes default to the extent of 70,000 rupees. A, B and C have to pay each the full penalty of his bond."

Section 147 provides that if the co-sureties are bound in different sums, they are liable to pay equally upto the maximum of their liability. The illustrations make it clear that subject to the limit fixed by guarantee of co-sureties, they are to contribute equally and not proportionately to the liability undertaken.

GST Implications:

Entering into guarantee contracts by multiple guarantors for a single loan would still be considered as "supply". For instance, if A Ltd and B Ltd are co-guarantors for loan procured by C Ltd from a bank, then there are two supplies provided by two different suppliers (A Ltd & B Ltd) to one single recipient (C Ltd).

Now the question arises as to valuation for the services supplied by the co-guarantors. Since Rule 28(2) provides for deemed valuation of 1% of "guarantee offered". The issue arises here as to what is "guarantee offered" for A Ltd & B Ltd. Here, it would be relevant to consider Section 146 of the Contract Act discussed above. Let us consider the following 2 scenarios:

a) **When the proportion of guarantee offered is defined in the contract:**

   In this case, each guarantors is aware of the proportion of the debt which it is required to pay in case of default of the principal debtor. Thus, the guarantee offered would be to that pre-defined extent only. Thus, the valuation of 1% of "guarantee offered" would be 1% of the proportionate value of the loan as defined in the contract. For example, A Ltd & B Ltd are joint guarantors for a loan of Rs. 10 Crores obtained by C Ltd from a bank. A Ltd & B Ltd agree for providing guarantee for 60% and 40% of the loan amount respectively.

   In this case, assuming there is no actual consideration paid to A Ltd as guarantee commission, the valuation shall be 1% of Rs. 6 Crores i.e., Rs. 6 Lakhs, on which GST to be charged by A Ltd. The valuation for B Ltd would be 1% of Rs. 4 Crores, i.e., 4 Lakhs, on which GST to be charged by B Ltd.

b) **When the proportion of guarantee offered is NOT defined in the contract:**

   In this case, with reference to Section 146 of Contract Act, when the proportion of guarantee is not defined in the contract, then it is deemed to be divided equally. The GST valuation under Rule 28(2) may also be done accordingly. For example, A Ltd & B Ltd are joint guarantors for a loan of Rs. 10 Crores obtained by C Ltd from a bank. The agreement does not specify any

proportion for guarantee offered by A Ltd and B Ltd. Thus, it is deemed that A Ltd & B Ltd would be liable for payment of Rs. 5 Crores each in case of default of payment by C Ltd.

In this case, assuming there is no actual consideration paid to A Ltd & B Ltd as guarantee commission, the valuation shall be 1% of Rs. 5 Crores each for A Ltd & B Ltd. This also ensures there is no double taxation of guarantee services on the same loan transaction.

The above valuation and payment of GST would apply even in case the principal debtor ends up defaulting in only a portion of repayment of loan to the bank. The amount actually paid by the guarantors on default of the principal debtor does not determine the "guarantee offered" under valuation mechanism under GST. For example, A Ltd and B Ltd are co-guarantors (say, 50% each) for loan obtained by C Ltd from a bank for Rs. 10 Crores. C Ltd was able to pay only Rs. 6 Crores of the loan and defaulted in payment of balance amount. In this case, A Ltd and B Ltd would be required to pay the of Rs. 4 Crores, divided equally among themselves i.e., Rs. 2 Crores each. Irrespective of this, A Ltd and B Ltd would have paid GST on 1% of Rs. 5 Crores each, being the guarantee offered by them.

Taxability of corporate guarantee given to Indian subsidiary by foreign holding company

It may be seen that a holding company abroad may provide corporate guarantee to its Indian subsidiary for procurement of loans in India. From the discussions above, it is clear that a service is being supplied by the holding company to the Indian company. In order for this transaction to amount to import of services (as per Section 2(11) of IGST Act, 2017), following conditions to be fulfilled:

a) Supplier of service located outside India
b) Recipient of service located in India
c) Place of supply of service is in India.

Conditions (a) and (b) are fulfilled. For condition (c), Section 13 of IGST Act may be referred to. Since sub-sections (3) to (13) do not specifically provide for guarantee services, the place of supply would be determined as per sub-section (2), i.e., location of service recipient. Thus, place of supply of corporate guarantee services provided by foreign holding company to Indian subsidiary would be location of the recipient, i.e., India.

Accordingly, the said transaction amount to import of services. The valuation of the service would be as per new rule 28(2), i.e., 1% of guarantee amount or actual consideration paid to foreign holding company, whichever is higher.

Being an import of service, the recipient Indian subsidiary is liable to pay GST under reverse charge mechanism based on the above valuation rule.

When to pay tax under RCM?

Time of supply for RCM is given in the 2nd proviso to Section 13(3) of CGST Act as per which the time of supply shall be earlier of the following dates:

a) Date of entry of in the books of account of Indian subsidiary or
b) Date of payment of guarantee consideration to the foreign holding company.

Now the question arises, what does "date of entry in the books of account" of Indian Subsidiary mean? For the subsidiary which is in receipt of guarantee service provided by the holding company, generally, it can be seen that no journal entry is passed as such and the guarantee received is only disclosed as notes to accounts. In such as case, it could be said that (a) above would not apply and the time of supply shall be the date of payment of guarantee consideration to the holding company. In case no consideration is paid to the holding company, then time of supply as per 2nd proviso to Section 13(3) fails.

Also the Department may dispute that mere mention in notes to accounts would also be treated as "entry in the books of account" and time of supply to be determined accordingly. When considering this, then the time of supply would be the date on which such notes are included in the financials. Such contention is not correct and not in line with provisions of law.

In such case, dept could also take a view that date of signed guarantee contract, as per Section 13(5) needs to be considered explained below. Section 13(5) is extracted hereunder:

"(5) Where it is not possible to determine the time of supply under the provisions of sub-section (2) or sub-section (3) or sub-section (4), the time of supply shall––
(a) in a case where a periodical return has to be filed, be the date on which such ***return is to be filed****; or*
(b) in any other case, be the ***date on which the tax is paid."***

Where no entry is made in the books of account and no consideration is paid to the holding company, time of supply for payment of RCM based of valuation under Rule 28(2) could be covered under clause (a) of Section 13(5). The time of supply could be said to be the month in which the guarantee service was to be included in the returns, being the month in which it was received. For instance, where B Ltd

(Subsidiary) received signed guarantee contract with foreign holding Company A Inc in October 2023, the time of supply would be due date of filing returns for October 2023 i.e., 20th of November 2023.

However, it may be noted that for entities following IndAS/IFRS based accounting, IFRS 9 and/or IndAS 109 on "Financial Instruments", requires the guarantor holding company to initially recognise the guarantee commission as investment in the subsidiary on "fair value" basis. If consideration is received and is equivalent to the "fair value" computed as per the standards, then value of the same is recognised in the books. However, if the there is no consideration paid or where actual consideration does not correspond to the "fair value", then recognition as per "fair value" becomes necessary.

For example, when A Ltd (a holding company) gives guarantee to its subsidiary B Ltd, for loan of Rs. 10,00,00,000 obtained by B Ltd from the Bank with a term of 5 years. Let us assume that the comparable guarantee consideration is 3%. The fair value in the to be recorded in the books will be Rs. 1,50,00,000/- (total debt*tenure of loan*commission%=10,00,00,000*5*3%) in books of the holding company and subsidiary and journal entries are passed accordingly

Thus, in case of subsidiaries in India following IndAS and passing the accounting debit entries upon receipt of guarantee services from foreign holding company, the same could be considered as the "date on which entry is passed in the books of recipient of supply" for the purpose of determining time of supply as per Section 13(3). Thus, the month in which the above entries are passed would be the time of supply and RCM payment for such import of guarantee service to be done through GSTR-3B for that month.

To summarise the RCM provisions for guarantee services received from foreign holding company:

a) When consideration paid to holding company:
    a. Valuation: As per Rule 28(2) – 1% of guarantee offered or actual consideration, whichever is higher
    b. Manner of payment of tax: under reverse charge
    c. Time of supply:
        i. If any journal entry passed in books as per IFRS 9/IndAS 109: Then date of entry in books or date of payment of guarantee commission whichever is earlier
        ii. If NO journal entry passed in books: Date of payment of guarantee commission.
b) When no consideration/commission paid to holding company:
    a. Valuation: As per Section 28(2) - 1% of guarantee offered

b. Manner of payment of tax: reverse charge basis
c. Time of supply:
    i. If any journal entry passed in books as per IFRS 9/IndAS 109: Then date of entry in books
    ii. If NO journal entry passed in books: As per Section 13(5)(a) – due date of return to be filed for the month in which guarantee services received.
    (in this regard, an aggressive view may be taken that clause (b) of Section 13(5) would apply, i.e., pay tax under RCM and deem that to be the time of supply. However, this could be prone to disputes from the department).

Taxability of corporate guarantee given to foreign subsidiary by Indian holding company

In case where a Indian holding company provides guarantee to its subsidiary outside India, then in order to be considered as "export of service", the following conditions have to be satisfied as per Section 2(6) of IGST Act 2017:

a) Supplier of service is located in India.
b) Recipient of service is located outside India.
c) Place of supply of service is outside India.
d) The payment for such service has been received by the supplier of service in convertible foreign exchange or in Indian rupees wherever permitted by the RBI.
e) the supplier of service and the recipient of service are not merely establishments of a distinct person in accordance with Explanation 1 in section 8 of IGST Act.

Place of supply for guarantee services falls under default rule in Section 13(2)I i.e., location of recipient (i.e., country where the foreign subsidiary is incorporated), as there is no specific place of supply provided for this service in sub-sections (3) to (13).

For the purpose of fulfilment of condition (e) of Export of services, it is important to understand the scope of "establishments of a distinct person". For this, it is also relevant to refer to Explanation 2 of Section 8 which provides as under:

"Explanation 2. - A person carrying on a business through a branch or an agency or a representational office in any territory shall be treated as having an establishment in that territory."

-Further, Circular No. 161/17/2021-GST dated 20th September 2021 clarifies that:

"From the perusal of the definition of "person" under sub-section (84) of section 2 of the CGST Act, 2017 and the definitions of "company" and "foreign company" under Section 2 of the Companies Act, 2013, it is observed that a company incorporated in India and a foreign company incorporated outside India, are separate "person" under the provisions of CGST Act and accordingly, are separate legal entities. Thus, a subsidiary/ sister concern/ group concern of any foreign company which is incorporated in India, then the said company incorporated in India will be considered as a separate "person" under the provisions of CGST Act and accordingly, would be considered as a separate legal entity than the foreign company."

It was further clarified in the Circular that supply of services made by a branch or an agency or representational office of a foreign company, not incorporated in India, to any establishment of the said foreign company outside India, shall be treated as supply between establishments of distinct persons and shall not be considered as "export of services" in view of condition (v) of sub-section (6) of section 2 of IGST Act.

It was also clarified that a company incorporated in India and a body corporate incorporated by or under the laws of a country outside India, which is also referred to as foreign company under Companies Act, are separate persons under CGST Act, and thus are separate legal entities. Accordingly, these two separate persons would not be considered as "merely establishments of a distinct person in accordance with Explanation 1 in section 8.

Thus, going by the above Circular, it could be said that a holding company incorporated in India and its subsidiary incorporated as per Company law of the other foreign country would be two separate persons and not merely establishments of a distinct person. Thus, condition (e) for export of service could be said to be fulfilled.

In order to determine whether or not guarantee services provided by Indian holding company to foreign subsidiary amounts to export of service, two scenarios are analysed - 1) When no consideration paid to the Indian holding company; 2) Where consideration is paid to Indian holding company

1) **<u>When no consideration is paid by the subsidiary the Indian holding company:</u>**

   <u>Taxability:</u>

   In this case, it is clear that condition (d) for export of service, i.e., receipt of consideration in foreign exchange is not fulfilled. Thus, it would not be an export of service. Thus, GST would become

payable. For determining the type of GST payable, Section 7(5) of IGST Act may be referred to. The same is extracted below:

"(5) Supply of goods or services or both,––

(c) when the supplier is located in India and the place of supply is outside India;

(d) to or by a Special Economic Zone developer or a Special Economic Zone unit; or

(e) in the taxable territory, not being an intra-State supply and not covered elsewhere in this section,

shall be treated to be a supply of goods or services or both in the course of ***inter-State trade or commerce.****"*

In this scenario, the supplier (i.e., Indian holding company) is located in India and the place of supply, (as per Section 13(2) of IGST Act) is outside India, being the location of foreign subsidiary. Thus, clause (a) of Section 7(5) of IGST Act applies and would be treated as inter-state supply liable to IGST.

Valuation:

In this case, the valuation shall be as per Section 28(2). Since there is no actual consideration involved, the taxable value would be 1% of guarantee amount. IGST would be payable on this amount.

As it does not amount to export, the amount of IGST payable on the deemed 1% valuation would be a burden on the Indian holding company as it would not be able to collect the said amount of GST from the foreign subsidiary company.

2) When consideration is paid by the subsidiary the Indian holding company:

Whether it amounts to export:

When a consideration is paid to the guarantor (being the Indian holding company), then it could be said that all conditions of "export of service" are fulfilled. Accordingly, being a zero-rated supply, it is eligible for refunds under GST. Such companies may either opt for making such exports with payment of tax or without payment of tax under Bond/LUT.

Refund implications:

Considering the complexity of refund computations, it would be more convenient for the Indian holding company to select the type of export (LUT or with payment of tax) as aligning with other exports made by it. For example, if ABC India Ltd is engaged in making export of goods without

payment of tax and has provided guarantee services to its subsidiary in Thailand during September 2023, then it would be convenient for ABC India Ltd to make export of guarantee services also without payment of tax since one single refund application can be filed for September 2023.

Valuation:

However, a question of valuation arises in this scenario. That is, what is the taxable value to be shown in the export invoice. As per new rule 28(2), the valuation shall be 1% of the guarantee offered or actual consideration whichever is higher. Let us consider the following 2 situations:

a) When actual consideration is higher than 1% of guarantee offered: In this case, the taxable value would be the actual consideration and the same amount may be shown in the export invoice. The foreign exchange received for this service would also be equal to the actual consideration and thus would not cause any issues while applying for refund or while obtaining FIRC/FIRA from the AD banks.
b) When actual consideration is lower than 1% of guarantee offered: Let us consider an example where guarantee is offered for a loan of Rs. 50,00,000/- and the actual consideration charged by the Indian holding company is Rs. 30,000. In this case, for the purpose of GST, the taxable value shall be Rs. 50,000 (i.e., 1% of Rs. 50,00,000) being higher than actual consideration of Rs. 30,000.

Here, the question arises as to the value to be shown in the export invoice. If Rs. 50,000/- is shown in the export invoice, then issues may arise under the RBI regulations since the actual proceeds received from abroad (Rs. 30,000) is less than the invoice value of Rs. 50,000. Further, there might be issues under GST also wherein the department may contend that the balance Rs. 20,000 for which consideration is not received is not export of service and thus liable to be taxed.

Conversely, if Rs. 30,000/- is shown in the export invoice, then it would end up being a contravention of Rule 28(2). In order to mitigate this issue, the taxpayer may opt to enter into contract for consideration equal to 1% commission on guarantee amount where-ever feasible. In other situations, the guarantee agreement may be drafted accordingly to make adjustments

This issue is a grey-area for which there seems to be no clear-cut practical solution and may hinder refund applications in this regard. Thus, a clarification regarding this issue may be sought from the Government.

Whether the new valuation rule can be applied retrospectively?

Given that the industry has faced demands from department regarding corporate and personal guarantee, the question arises as to whether such demands can survive given the insertion of new rule for valuation and the circular issued. The valuation for corporate guarantees is made with effect from 27th October 2023. The notification which amended Rule 28 did not specifically provide for any effective date, thus, the date of issue of notification in the official gazette i.e., 27th Oct 2023 may be considered as the effective date. Since the new valuation Rule 28(2) applies w.e.f. 27th October 2023, the question arises as to whether this valuation has created levy w.e.f. 27th October or whether there is not impact on the levy.

In this regard, it is pertinent to note the Supreme Court judgement in the case of CIT Vs B. C. Srinivasa Setty [(1981) 128 ITR 294 (SC)] wherein it was held that charging section and the computation provisions together constitute an integrated code; when there is a case to which the computation provision cannot apply at all, it is evident that such a case was not intended to fall within the charging section. Thus, when valuation fails, the levy fails.

Further, it is a settled law and a general principle that provisions in a statute would operate prospectively unless retrospective operation is expressly provided for. This principle is laid down by the Supreme Court in Govind Das vs ITO [AIR 1977 SC 552]. It is also further held in the case of Panchi Devi v. State of Rajasthan, (2009) 2 SCC 589 that *"Delegated legislation is ordinarily prospective in nature and a right or a liability created for the first time cannot be given retrospective effect."*

It was further held in the case of CIT v. Vatika Township Private Limited [TS-573-SC-2014] that legislations which modified accrued rights or imposed disabilities were to be treated as prospective in nature unless they were accounting for an obvious omission, or explaining a former legislation.

Thus, it could be said that prior to 27th October 2023, since there was no specific valuation provided for corporate guarantees and thus, since valuation fails, the levy fails. Further, as the new valuation mechanism modified imposed liabilities (on corporate guarantees), it could be said that it is prospective in nature.

However, the Department may contend that even prior to 27th October 2023, levy was present and valuation needed to be done based on Rules 30/31 of CGST Rules, in the absence of specific valuation provisions. Such demands would not be sustainable, as the new valuation rule was introduced only in October 2023 indicating no valuation mechanism was there prior to such date, levy fails.

Action points by the taxpayers:

a) Enter into required agreements for personal or corporate guarantee taking into account valuation aspects under GST.
b) Maintain trackers for commission made to guarantor or commission received as guarantor.
c) Maintain trackers for guarantees given/received even without payment of consideration to guarantor.
d) Passing accounting entries for guarantee as relevant and as per Indian GAAP/IndAS.
e) Ensuring payment of GST under RCM if corporate guarantees are received from holding company outside India.
f) Obtain expert advice when any corporate guarantee contracts are entered into in order to reduce any unforeseen litigation.

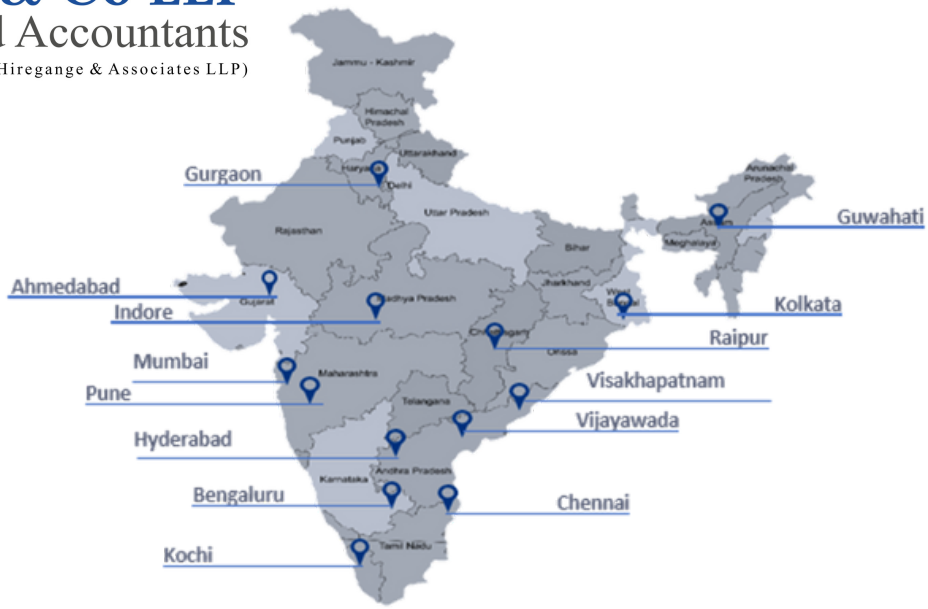
Conclusion:

The clarifications by the Government regarding taxability of personal and corporate guarantee by way of amendment in rules as well as CBIC Circular has provided clarity mainly regarding taxation and valuation aspects. However, as discussed in this research paper, there seems to be various practical issues which may crop-up while dealing with such guarantee transactions. It would be important for the industry to obtain expert advice in such circumstances.

Acknowledgements:

Thank you to CA. Ramya C for drafting this Research Paper. Gratitude to CA. Roopa Nayak for her guidance and valuable inputs.

H N A & Co LLP
Chartered Accountants
(Formerly known as Hiregange & Associates LLP)



Bengaluru (HO)
1010, 2nd floor, 26th Main,
(Above Corporation Bank)
4th T Block, Jayanagar,
Bengaluru - 560 041.
Tel:+918041210703
roopa@hnaindia.com

Pune
K Square, Office No 206, 207,
& 208, 2nd Floor, Foundry
Preschool Rd, Baner, Pune,
Maharashtra - 411045.
Tel:+912029910717
ravikumar@hnaindia.com

Hyderabad
4th Floor, Anushka Pride,
Road Number 12, Banjara Hills,
Hyderabad, Telangana – 500 034.
Tel:+919908113787
sudhir@hnaindia.com

Gurugram (NCR)
509, Vipul Trade Centre,
Sohna Road, Sector 48,
Gurugram – 122 009.
Tel:+918510950400
ashish@hnaindia.com

Mumbai
No.409, Filix, Opp. Asian Paints,
LBS Marg, Bhandup West,
Mumbai – 400 078.
Tel:+919867307715
vasant.bhat@hnaindia.com

Guwahati
2A, 2nd Floor, Royal Silver Tower,
Ulubari, Guwahati- 781 007.
Tel:+917670087000
mannu@hnaindia.com

Chennai
Fagun Chambers,
Third Floor,
No.26, EthirajSalai, Egmore,
Chennai – 600 008.
Tel:+919962508380
vikram@hnaindia.com

Vishakhapatnam
D.No 8-1-112, Premier House,
2nd Floor, Vidyanagar, Opp.III
Town Police Station,
PeddaWaltair, Visakhapatnam-
530017 Tel:+918916009235
anil@hnaindia.com

Kolkata
Unit#1009, 10th Floor, Merlin
Infinite DN - 51, Street Number 11,
DN Block, Salt Lake Sector V,
Kolkata - 700 091
Tel:+919830682188
gagan@hnaindia.com

Raipur
503, Babylon Capital,
VIP Chowk, Raipur
Tel: +917415790391
bhaveshmittal@hnaindia.com

Indore
107, B Block, The One, 5 RNT
Marg, Indore – 452001
Tel: +916366775136
vini@hnaindia.com

Vijayawada
D. No. 40-26/1-8, Sri Ram Nagar,
Mohiddin Estates,
Labbipet, Vijayawada – 520010
Tel: +9199000 68920
rajeshmaddi@hnaindia.com

Kochi
62/6742C, 2nd Floor,
Jos Brothers Building, Jos Jn,
MG Road, Kochi - 682 015.
Tel: +918547853584
arjun@hnaindia.com

Ahmedabad
908, Mauryansh Elanza,
Shyamal Cross Roads, Satellite,
Ahemedabad - 380015
Tel: +919409172331
yash@hnaindia.com