

Corporate Guarantee - Liable to GST Prior to October 26, 2023?

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In the realm of indirect taxation, corporate guarantees play a pivotal role in ensuring compliance and financial responsibility within corporate structures. These guarantees, offered by one entity to secure the obligations of another within the same corporate group, serve as a safeguard for Company and mitigate the risk of non-compliance of financial commitments. Understanding the nuances of corporate guarantees under indirect tax are essential for businesses navigating regulatory landscapes and optimizing tax strategies. In this article, we have analyzed the applicability of GST on corporate guarantee prior to 26th October 2023.

What is a corporate Guarantee (CG)?

A Corporate Guarantee is a legal promise or commitment made by one person (the guarantor) to assume responsibility for the debts, obligations, or liabilities of another (the beneficiary or principal debtor) in the event that the principal debtor fails to meet its financial obligations. In essence, it's a form of financial support or assurance provided by a financially stable or creditworthy company to help secure a transaction or arrangement involving the beneficiary company.

Most corporate guarantees are granted to banks and other lenders by the parent company on behalf of its subsidiary. It is merely an entrepreneurial act which is given to get synergy gain to group as a whole, and **generally doesn't have consideration or security attached**. It is a **consensual security for collateral** on loans provided by banks or other lenders.

This guarantee will show how much of a loan will be given and who will take the responsibility if the debtor defaults in repayment of such loan.

Taxability of Corporate Guarantee (CG) has always been ambiguous to determine whether corporate guarantee was subjected to Service tax/ GST. Supreme Court's decision on [Edelweiss Financial Services Ltd](#) under Service tax had held as there was no consideration for providing the corporate guarantee, the question of levying service tax on corporate guarantee does not arise.

The decision pronounced in the case of Edelweiss Financial Services cannot be applied under -GST, as the provisions under GST differ from the provisions of service tax under Finance Act 1994. Generally, as a trade practice corporate guarantees are given by the parent company to its subsidiary companies

without any consideration. However, , as this is a related party transaction, in GST, it would be covered under schedule I of section 7 of CGST Act 2017 which covers supplies without consideration for levy of GST.

GST from 26th October 2023

CBIC vide [Notification No. 52/2023 -CT dated 26.10.2023](#) inserted clause 2 to Rule 28 of CGST Rules, which is extracted as under.

1)

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.*

Clause 2 started with notwithstanding clause1.

There are two schools of thought/ views in this regard.

1st View- Whether GST would be levied on corporate guarantee under Rule 28(1) of valuation Rules Or under any other rule prior to 26.10.2023 and post 26.10.2023 corporate guarantee is taxed at 1% of guarantee amount in terms of notification 52/2023-CT dated 26.10.2023

2nd view - GST on corporate guarantee would be taxed only from 26.10.23, in terms of notification 52/2023-CT dated 26.10.2023, subjected to 1% of guarantee amount or actual consideration whichever is higher in terms of notification 52/2023- CT dated 26.10.2023

Valuation under Rule 28 of the CGST Rules, 2017:

The amendment to Rule 28 was carried out Vide Notification No. 52/2023 dated 26.10.2023. Rule 28 of CGST Rules is applied chronologically in a sequential order.

In terms of sub-clause “a” of 28 Rule of CGST Rules. In case the taxpayer is unable to determine the valuation as per the 1st sub-clause, he may then refer to sub-clause “b” of the said Rule and if such rule does not give any direction for valuation the taxpayer may refer to sub-clause “c” and finally the provisio for the said Rule, if applicable.

Let us now examine each leg of the above cited provision in detail:

1. Sub-clause (a) of the Rule reads as follows: **(a) be the open market value of such supply**

In case of transaction between related parties is as per section 15, the assesse has to refer to the open market **VALUE** available for comparison.

The term **value** is not defined in the GST law. Value means the regard that something is held to deserve; **the importance, worth**, or usefulness of something. The said value would differ from person to person. Therefore, it may be concluded that value is not constant and in relation to anything the value is always subjective.

As corporate guarantee vary from Company to Company and based on the scenario, there is no comparable open market value. Therefore, taxpayer cannot refer to open market value in order to determine valuation for the said guarantee the valuation principal laid down in 1st clause **“(a)”** fails.

2. Sub-clause (b) of the Rule reads as follows: **(b) if the open market value is not available, be the value of supply of goods or services of like kind and quality;**

Guarantee given in each case differs on the facts and circumstances of the case. Resultantly, such guarantee is not measurable as the same differs from person to person who gives the guarantee. Value

of like kind and quality for a service which is intangible is immeasurable. Resultantly, the said sub-clause laying down the provision for determination of value also fails.

3. Sub-clause (c) of the Rule reads as follows: *Rule 30. Value of supply of goods or services or both based on cost.*

Where the value of a supply of goods or services or both is not determinable by any of the preceding rules of this Chapter, the value shall be one hundred and ten percent of the **cost of production or manufacture or the cost of acquisition of such goods or the cost of provision of such services.**"

The said provision states that the cost based valuation may be used wherein the value may be determined to be 110% of cost of provision of such services. In the current scenario, there is no cost incurred either for manufacture, production or provision of services. There is input of corporate guarantee for which the Appellant is incurring any cost. As there is no cost of production or manufacture or cost of acquisition of such goods or cost of provision of such service. Consequently this Rule cannot be applied.

4. Rule 31 reads as follows: **"Rule 31. Residual method** for determination of value of supply of goods or services or both.

Where the value of supply of goods or services or both cannot be determined under rules 27 to 30, the same shall be **determined using reasonable means consistent with the principles and the general provisions of section 15** and the provisions of this Chapter:

Provided that in the case of supply of services, the supplier may opt for this rule, ignoring rule 30."

The said Rule states that as a residuary option the taxpayer may opt to determine the value of supply with reasonable means consistent with the principles and provisions of section 15. However, the term reasonable means is not defined as the reasonable value in each scenario may vary based on each person. Further, it also states that principles and general provision of section 15 may be referred. It brought to your attention the fact that rules are referred to only when the section either specifically mentions or if the section does not provide complete instruction on how to determine the value. If the value could have been determined as per general principles of Section 15 reference to Rule 28 would not have been necessary.

Therefore, provisions of sub-clause (c) also fails in the current scenario.

5. **1st Proviso** to the Rule reads as follows: *Provided that where the **goods are intended for further supply** as such by the recipient, the value shall, at the option of the supplier, be an amount equivalent to ninety percent of the price charged for the supply of goods of like kind and quality by the recipient to his customer not being a related person:*

In the current case, issuing corporate guarantee is not supply of goods and such guarantee is also not for any further supply.

6. **2nd Proviso** to the Rule reads as follows: *Provided further that where **the recipient is eligible for full input tax credit**, the value declared in the invoice shall be **deemed** to be the open market value of the goods or services."*

The proviso states that where the recipient of such services can take full ITC of the said services, the value declared in the invoice shall be **deemed** to be value of supply.

Taking a cue from circular 199/11/2023 dated 17.07.2023, which states that **"where the recipient is eligible for full input tax credit, the value declared in the invoice shall be deemed to be the open market value of the goods or services"** *where the recipient is in a position to avail full credit any value mentioned in the invoice could be accepted. However, the issue could arise in a situation where the recipient is not in a position to avail full credit then the 2nd proviso to Rule 28 fails.*

Considering the above, it is clear that the valuation rules fail to provide the value for the purpose of

taxation of corporate guarantee prior to 26.10.2023, with respect to cases where the recipient is not in a position to avail full ITC. As the valuation fails the levy also fails in terms of decision of **CIT Vs BC Srinivasa Setty 1981 AIR 972 SCR (2) 938**.

Re: Notification 52/2023-CT dated 26.10.2023 would apply from the date it is made effective:

Notification No. 52/2023 – CT dated 26.10.2023 which notified the amendment to CGST Rules, 2017. The said Notification states in the 1st point that the Rules would come into force on the date they are published in the Official Gazette.

“Doctrine of Retrospective Legislation”.

The meaning of the word retrospective is backdated or to look back. Therefore, the retrospective law is also referred to as ex-post facto law.

The dictionary meaning of the word prospective with reference to statutes shows that it is concerned with or applying the laws in future or at least from the date of commencement of the statute. Whereas the word retrospective when used with reference to an enactment may mean:

- Effecting an existing contract or
- Reopening of the past, closed and completed transactions, or
- Affecting accrued rights and remedies, or
- Affecting procedure.

If an amendment **expressly provides that it should be deemed to have come into effect from a past date, it is retrospective in nature**. It then operates to affect existing rights and obligations, and is construed to take away, impair or curtail, a vested right which had been acquired under some existing law. If an amendment is intended to be retrospective in operation, and also in effect, **the legislature must expressly, and in clear and unequivocal language, say so, in the amendment itself**. If the amendment is expressed in a language which is capable of either interpretation, it ought to be construed prospectively.

Reference in this regard may be made to landmark Supreme Court Judgment in the case of **Commissioner of Income Tax (Central) Vs. Vatika Township Private Limited (2015) 1 SCC** *“no statute shall be construed to have a retrospective operation unless such a construction appears very clearly in the terms of the Act, or arises by necessary and distinct implication. Dogmatically framed, the rule is no more than a presumption, and thus could be displaced by out weighing factors”*.

The said position is affirmed in the following judgements:

- Assistant Excise Commissioner, Kottayam & Ors. Vs Esthappan Cherian & Anr. - Civil Appeal No. 5815 OF 2009
- Hind Metal Industries, Hyderabad Vs Commissioner of Central Excise - 2006 (200) E.L.T. 476 (Tri. - Bang.)
- C. Cus. Vs. East Punjab Traders
- Vijay v. State of Maharashtra and Ors. (2006) 6 SCC 286

Conclusion: Corporate guarantee given by holding company to its subsidiary or vice versa is **need-based arrangement and is given without charging any fee** or charges in return. These guarantees are unsecured in nature. GST is levied on supply of goods/services for a consideration, though the transaction between related party is covered under schedule 1 of section 7, in the absence of valuation mechanism, collection mechanism fails prior to 26.10.2023.

Considering the amendment to Rule 28 (2), GST on corporate guarantee would be subjected to 1% of guarantee amount or actual consideration whichever is higher in terms of notification 52/2023- CT, made effective from **26.10.2023 and not prior to 26.10.2023**, for the reasons mentioned above.