

GST on Personal & Corporate Guarantee

Introduction

The 52nd GST council has recommended clarity w.r.t personal guarantee given by a director and Corporate Guarantee including GST taxability on the same. This has been a long pending issue. It is relevant to note the very recent hon'ble Supreme Court's decision on Edelweiss Financial Services Ltd under Service Tax regime which went in the favour of the assessee. However, the major difference between this case of service tax compared to GST is non-levy of service tax in absence of consideration.

Difference between Personal, Bank & Corporate guarantee

Section 126 of the Indian Contract Act 1872 defines 'Guarantee' as a contract to perform is a contract to perform the promise, or discharge the liability, of a third person in case of his default.

As per Section 127 of the Indian Contract Act 1872, 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.

One must understand and ensure the facts of the case are clearly understood and the contract between the parties is not a contract of indemnity as defined in Section 124 of the Indian Contract Act 1872 which states that when one party promises to compensate another against the losses incurred by them due to anything done or omitted to be done by the promisor, a contract of indemnity is said to be made between the parties.

Note: Contract of Indemnity has only 2 parties - an Indemnifier and an Indemnified.

A tabular depiction which will help understand the various types of guarantees:

<i>Details</i>	<i>Personal Guarantee</i>	<i>Bank Guarantee</i>	<i>Corporate Guarantee</i>
Surety	Director	Bank	Parent Co.
Principal Debtor	Company	Bank's Customer	Subsidiary Co.
Creditor	3 rd party/Bank	3 rd party	3 rd party/Bank
Underlying Asset	Not necessary	Yes	Not necessary
Fee charged	Director cannot charge as per <i>Master Circular</i> – <i>RBI/2012-13/69</i> Others – Yes/No	Yes	Not necessary

Few relevant decisions

Corporate guarantee is not liable to tax when consideration is not prescribed – *Edelweiss Financial Services Ltd (ST Regime – Supreme Court - Civil Appeal Diary No. 5258/2023)* & *Sterlite Industries India Ltd (Chennai CESTAT)*.

Corporate guarantee is liable to tax when consideration is prescribed – *Olam Agro India (Delhi CESTAT)*

Personal guarantee (director) is liable to RCM under GST- Writ petition dismissed in the case of *BST Steels Pvt Ltd (Telangana High Court Writ Petition No. 21384 of 2023)*.

Changes recommended in 52nd GST council meeting:

1. 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 maybe treated as NIL and hence, no tax is payable.
2. Notified vide NN 52/2023-CT dated 26th October 2023 - To insert sub-rule (2) in Rule 28 of CGST Rules, 2017, to provide for taxable value of supply of corporate guarantee provided to banking company or financial institution on behalf of related person as 1% of the amount of such guarantee offered, or the actual consideration, whichever is higher. It is also clarified that the valuation would stand irrespective of whether full ITC is available to the recipient of services or not. The same is also clarified by way of a Circular 204/16/2023-CGST dtd 27th October 2023.
3. As the notification does not have anything specifically mentioned to being made effective retrospectively, we can safely assume that it is applicable prospectively only.

Note: *Safe Harbor Rules issued by CBDT provides that commission or fee would be considered at 1% of amount guaranteed in case of Corporate Guarantee given to wholly owned subsidiary. Similar valuation principle being considered for GST purpose as well.*

Issues due to recent recommendations:

- 1. Whether the liability would recur on annual basis or only in the first year the guarantee has been provided?**

This has not been clarified as yet. It seems to be that liability would arise only when corporate guarantee is given and is deemed at be 1% of the guarantee value. The authors opine there must not be a recurring GST levy annually.

2. When corporate guarantee is given by an entity in India would it still count as an export?

Although the basic criteria for exports are met, with the fixed valuation under Indian GST law, the ability to receive such amount from foreign counterparts may be counterproductive. This will ensure that the transaction is not an export of service on account of non-realization of foreign convertible currency. This will lead to a cost on the transaction, which goes against the general global practice and may make India not conducive to International markets.

Where the actual consideration is less than the deemed 1% guarantee value, entities may decide to implement milestone basis payments within the agreement to enable smooth refund processing to the extent of export of services.

3. When a director ceases to be a director of the company where a guarantee has been provided, would the GST levy change?

Yes, this is possible as the guarantor (ex-director) may seek consideration against guarantee provided. In such case, the liability to pay GST would arise on such person providing the guarantee under GST law, subject to applicability to register under GST Act. The impending clarification only bring about clarity for director guarantees wherein GST would not be applicable where consideration is not obtained directly or indirectly. *This has also been clarified vide Circular 204/16/2023-CGST dated 27th October 2023.*

4. Whether a corporate guarantee can be considered as a supply under GST?

Under erstwhile ST law, the criticality for determination of service, requires consideration. In the absence of which the taxability u/s 66B of the Finance Act 1994 does not arise. Although, under CGST Act, Section 7 r/w Schedule I, activities performed without consideration can be deemed to be a supply when performed between related persons. The GST Council recommendation now brings in a deemed liability even if there is no consideration for the purpose of valuation under GST. Although, to be covered under schedule I, the activity must be a supply of service first. A corporate guarantee can be said to be a facilitation performed for the purpose of the overall growth of the entity and a shareholder activity in the nature of quasi-capital which should not be construed as a provision of service. *[Micro Ink vs ACIT [(2016) 176 TTJ 8 (Ahd)].*

Additionally, the option to dispute levy is by considering such guarantees as actionable claims covered under Schedule III of CGST Act, thereby excluding it from supply definition.

5. Whether the Government can implement the recommendations retrospectively, i.e. to bring in corporate guarantees into the tax net from July 2017 onwards?

Keeping aside the fact that the levy is questionable, the valuation changes in the GST law expected by way of notification cannot have been known prior to this day. Ambiguity in law will always favour the assessee. Therefore, for the past the law as is would be applicable, i.e. Rule 28 read with second proviso and Circular 199/2023-GST dated 17th July 2023 which allows for supply to be deemed as NIL where ITC is eligible (for entities within India only).

Another key element would be identification of time of supply, therefore entry in books of accounts, payment entries must be clearly understood. Where it forms part of contingent liability only, there may not be any entry in books of accounts. In such cases we cannot conclude that levy fails, as time of supply also includes certain residuary provisions. Understanding the agreement and its effective date, renewals may be key in identification of liability.

To Summarise the impact in an illustration:

Details	Personal Guarantee	Corporate Guarantee
GST liability BEFORE Notification 52/2023-CT	Directors/Others - NIL consideration – Not liable <u>Other than Director if consideration > Rs. 0:</u> Yes, liable	Associated Enterprise - NIL consideration – Not liable <u>Where consideration > Rs. 0:</u> <ul style="list-style-type: none"> • Domestic - where ITC eligible – Not liable (Circ. 199/2023) • Where RCM-ITC eligible – Not liable • Where ITC ineligible – Yes, liable
GST liability AFTER Notification 52/2023-CT	Same as above	Liable irrespective of consideration being NIL or not. Actual consideration or 1% of guarantee (WIH) deemed valuation liable @ 18%

Note-1: Consideration is charged against Bank Guarantee – would be liable before and after.

Note-2: Effective date – 26th October 2023 (NN 52/23)

WIH -Whichever is Higher

Conclusion

Other than the fact that levy under GST remains questionable, where the recipient entity is eligible to ITC, even though the levy can be disputed, conservatively RCM can be discharged, and ITC claimed (conservative and revenue neutral position).

Where GST liability pertains to an outward supply to entities outside India, the option of considering the same as an export is hinged upon actual remittance from foreign entities which would deviate India from global best practices and drive out business from our country.

On the other hand, this imposition can be justified to bridge the gap for indigenous entities and those entities capable of obtaining such guarantees.

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