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Analysing developments impacting business

TAXABILITY OF PERSONAL AND CORPORATE GUARANTEE UNDER GST

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This ERGO intends to incapsulate recent clarification issued by Central Board of Indirect Tax & Customs (CBIC) with respect to taxability of personal and corporate guarantee provided to a Company under Goods and Services Tax (GST) law. In a recent circular, following clarifications have been provided:

A. Taxability of personal guarantee by directors:

Directors / promoters / employees and the Company are 'related persons' as per the explanation to Section 15 of the Central Goods and Services Tax Act, 2017 (CGST Act). The circular clarifies that personal guarantees offered by promoters, directors, managerial staff, etc. of borrowing company would be treated as taxable supplies, even if made without consideration, and is in the course or furtherance of business.

In case personal guarantee is provided without any consideration, the value of taxable supply would be determined under Rule 28 of CGST Rules which provides for determination of the 'Open Market Value'. Circular No. *RBI/2021-22/121 dated 9 November 2021* issued by The Reserve Bank of India, prohibits earning of income from such guarantees. Therefore, the circular clarifies that the taxable value for such provision of personal guarantee provided by under Rule 28 of the CGST Rules would also be zero. Hence, no GST would be payable on such supplies.

In cases where specific consideration / remuneration is provided for such guarantee, GST would apply on such consideration.

B. Taxability of corporate guarantee by group companies:

Any transaction between related / group / holding and subsidiary companies is treated as provision of taxable supply in accordance with Section 7 read with Schedule I of CGST Act, even if it is made without any consideration and is made in the course or furtherance of business.

It is clarified that where the corporate guarantee is provided by a related / group / holding company for a borrowing company to the bank / financial institutions for securing credit facilities for its group / subsidiary company, it is regarded as taxable supply under GST even when made without any consideration.

As per Notification No. 52/2023-CT dated 26 October 2023, the value of services provided by a supplier to a related person, involving the provision of a corporate guarantee to a banking company or financial institution on his behalf, is deemed to

be 1% (one percent) of the guaranteed amount offered, or the actual consideration, whichever is higher.

Comment

The deemed value of a corporate guarantee offered to any banking company or financial institution on behalf of a 'related person' is established at a rate of 1%. However, no specific valuation criteria have been outlined for cases where such a corporate guarantee is extended to government entities or individuals.

Valuation of corporate guarantees for transfer pricing purposes under Income Tax laws has been a contentious issue. The Bombay High Court, in the cases of *Everest Kento Cylinders Ltd* and *Manugraph India Ltd* has ruled that a Corporate Guarantee fee of 0.50% can be considered to be at arm's length. Conversely, the Madras High Court in the case of *Redington (India) Ltd*, has determined that a Corporate Guarantee fee of 0.85% to be at arm's length. However, Rule 10TD of the Indian Income-tax Rules, 1962, sets the safe harbour rate for this fee at 1% of the guaranteed amount.

The circular does not make any reference to Rule 10TD of the Income-tax Rules, 1962. As a result, the valuation of Corporate Guarantees extended to government entities or private individuals may be subject to the discretion of the involved parties. Furthermore, the taxability of such Corporate Guarantees prior to 26 October 2023, remains uncertain in the absence of a defined valuation mechanism. Notably, there have been recent instances where various field formations have issued notices demanding GST on corporate and personal guarantees.

In addition, the circular also does not throw any light on the manner of valuation from GST perspective in case of continuing guarantee or where the guarantee amount is not fixed.

- *Dinesh Agrawal, Executive Director; Mayank Jain, Partner; Pranay Sahay, Principal Associate*

For any queries please contact: editors@khaitanco.com