

4. Articles

1) An Insight into GST on Corporate Guarantees

CS D. Devadoss (A66933)
Practising Company Secretary and
Retd. Assistant General Manager,
Bank of India



Introduction

The Goods and Services Tax (GST) has significantly transformed the taxation landscape, affecting various business and personal transactions in India. One such operational area that stands altered by GST regime pertains to Guarantees provided by corporates to banks and financial institutions to secure credit facilities for their group / associate concerns. Such Corporate guarantees are now TAXABLE under GST. This article attempts to explore the related issues in this regard.

Corporate Guarantee: Meaning and Need

Typically, corporate guarantees are normally given by companies to support their subsidiaries or associates or Joint ventures to facilitate obtention of credit facilities for their businesses. This guarantee is a promise to meet the repayment obligations of the borrowing company in case it defaults. Such acts of guarantee fall under “related party transactions” in GST law. These guarantees are issued, mostly, without any financial consideration and only to facilitate group businesses and they are not of commercial nature.

Taxation during Service Tax Regime (Pre-GST)

During the service tax regime also, the issue of service tax on the corporate guarantees used to crop up. The Finance Act 1994 which introduced the service tax, had provided that the service tax was payable on all services including service between the related parties but only on the amount of consideration. It therefore followed that where the consideration was Nil, no service tax was payable.

Yet, there were disputes between some tax authorities and the stakeholders. The matter was finally put to rest by the Supreme Court through its judgement in the case COMMISSIONER OF CGST AND CENTRAL EXCISE Vs. M/S EDELWEISS FINANCIAL SERVICES LTD (2022). It held that where a corporate guarantee was given without any consideration, no service tax was payable on it.

Taxation in the GST regime

The provisions pertaining to related party transactions are different under GST. As per Schedule I of CGST Act 2017, the supply of goods or services between related persons made in the course of business shall be treated as taxable supply even if made without consideration. Therefore, the corporate guarantees between related parties, even if issued without any consideration, fall within the ambit of such taxable supply of service under GST and hence is taxable like other services.

Under GST, the company that gives the guarantee is the “supplier of service” and the company that borrows the money (which is guaranteed) is the “recipient of service”.

Valuation of related party transactions under GST

Corporate guarantees were taxable under GST since inception but no specific valuation method had been prescribed for the same. They were to be valued under the general valuation rules of GST laid down for all related party transactions which is basically the market value irrespective of the actual consideration involved. While for goods and regular services, market values can be determined based upon the prevailing rates for comparable goods or services, in respect of corporate guarantees, it is not possible to determine the same as each one of these guarantees is unique in its nature and they are not comparable at all. This gave rise to disputes.

Valuation of corporate guarantees and amendment of rules

In view of the above, the CBIC (Central Board of Indirect Taxes and Customs), as per the recommendations of the GST council, amended the valuation rules (Rule 27 of CGST Rules 2017) and introduced a uniform mechanism for taxation of corporate guarantees with effect from 26-10-2023. Accordingly, it introduced a “deemed value” concept and stipulated that the taxable value of the guarantee between related parties would be reckoned at 1% of the guarantee amount or actual amount of consideration whichever is higher. (Vide CBIC Notifications No 52/2023 dated 26.10.2023 and No 12/2024 dated 10-07-2024). The GST rate for this transaction is 18%.

CBIC also clarified that the above amended provisions are applicable only for guarantees issued on or after 26-10-2023 and in respect of guarantees issued prior to 26-10-2023, the valuation rules that were in force at that time would apply.

An Example for calculation of GST on Corporate Guarantees:

Suppose, Company “A” borrows a sum of Rs 100 crores from a bank for which Company “B” provides a corporate guarantee without any consideration. Then, the **taxable value for such guarantee would be Rs 1 Crore based on the deemed value of 1% of the guarantee amount. So, the tax payable on the same would be Rs 18 lacs at the rate of 18% on Rs 1 Crore.**

In this case, the Company “B” would raise an Invoice on company “A” for a sum of Rs 18 lacs towards GST alone with the consideration for the transaction shown as Nil therein.

However, if there is any actual consideration and it is more than 1% of the guaranteed amount, then the actual amount of consideration is to be reckoned.

Time and amount of GST payment on corporate guarantees

The deemed value of a guarantee is calculated at 1% of guarantee amount **per annum**. So, in the example given above, if the borrowing of Rs 100 Cr is a term loan with repayment tenure of 5 years, then the total value of the said guarantee is reckoned at 5% (at 1% per year) which comes to Rs. 5 Crores. Therefore, the tax payable is calculated at 18% on the said value of Rs 5 Cr which works out to Rs 90 lacs. This entire amount is to be paid upfront at the time of signing the guarantee itself.

If the credit facility is sanctioned for one year initially, like a cash credit or overdraft facility, which is then renewed every year, the tax is payable at 1% of the guarantee amount for one year on execution of guarantee and at 1% every year on renewal as long as the guarantee continues.

(It is to be noted that even though a guarantor’s liability (and the period of limitation as well) gets triggered, as per the Indian Contract Act 1872, only when the guarantee is invoked, in terms of the GST rules, the tax is payable at the time of execution of the guarantee itself and for the entire tenure of the credit facility and the GST rules do not deal with the invocation or otherwise of the guarantee.)

GST for Guarantees between cross border entities

When the borrowings by an Indian entity is guaranteed by a foreign entity, the GST is still payable at a deemed value of 1% of the guarantee amount at 18% rate. But the same is payable by the recipient of the service in India under the Reverse Charge Mechanism and not by the guarantor who is a foreign entity.

However, if an Indian entity provides guarantee for a foreign entity, GST is not applicable on the same as it is considered as an export of service and GST payable on exports is Nil.

Multiple guarantors for same borrowing and amount of GST payable

CBIC has clarified that if multiple corporates provide guarantee for the same loan of the related party, the total GST is still only on 1% of the guarantee amount and the same is payable by them on proportionate basis.

To illustrate, supposing Company “A” borrows a sum of Rs 100 Cr from a bank for a period of 5 years and the same is guaranteed jointly by Companies “B” and “C”, or by more companies, then the GST payable in aggregate is only Rs 90 lacs in all and not Rs 90 lacs by each. (Calculated at 1% of guarantee amount per year for a period of 5 years at the tax rate of 18%).

No GST on Guarantees by Directors and Promoters

CBIC has clarified that (Vide Circular No 52/2023 dated 27.10.2023) where the Directors or Promoters provide guarantees for the loans availed by their companies, the Value of the same is treated as NIL and no GST is payable on the same. This is based on the RBI circular (No. RBI/2021-22/121 dated 9th November, 2021) that no consideration is payable to the Directors and Promoters for the guarantees they offer for the borrowings of their companies. However, RBI provides for payment of fee to some guarantors in exceptional cases and in those cases, GST is payable on the actual consideration received by them.

Input Tax Credit (ITC) availability for recipient of supply

CBIC has clarified that the recipient of the service of the corporate guarantee is eligible to claim Input Tax Credit (ITC) on the GST paid subject to admissibility of ITC to the recipient as per the provisions of GST Act and the Rules thereunder.

Approach of corporate guarantors for waivers and the Dilemma of Banks

In view of the GST payable on corporate guarantees and the consequent costs involved, companies are now reluctant to provide the guarantees. This has created a dilemma for the banks as corporate guarantees are considered as backbone for certain advances to subsidiaries or associated companies.

GST Rules under challenge before courts

The issue of GST on corporate guarantees as well as its valuation method are under challenge before courts. In the case between Sterlite Power Transmission Ltd and Union of India, the Delhi High Court has given interim relief to the company and has barred the tax authorities from taking any coercive steps against the applicant company. The final verdict is awaited.

Conclusion:

While one has to wait and see the final judicial decision in this regard, currently, the companies are finding it difficult to extend the guarantees in view of the cost factor (of the tax) which is quite substantial while they also need to support their group entities in availing credit facilities. Banks are finding it difficult to waive such guarantees as, often, the same is a critical element of protection in their risk assessment.

References:

1. CBIC Notifications No. 52/2023 -Central Tax dated 26-10-2023 and No 12/2024 dated 10-07-2024.
- 2) CBIC Circulars No. 204 /16/2023-GST dated 27-10-2023 and No 225/19/2024-GST dated 11-07-2024.
- 3) Relevant Sections and Rules of CGST Act 2017 and CGST Rules 2017.

- - X - -