



INDIRECT TAX ALERT

03rd NOVEMBER 2023

CBIC introduces amendments and clarifications to prescribe the method for valuing the supply of providing corporate guarantees under GST law

BACKGROUND

- A corporate guarantee is an arrangement wherein one of the entities agrees to act as a guarantor for its sister concern or a group entity. The guarantee is towards securing financial assistance or credit facilities from a bank or a financial institution. In such cases, the guarantor entity may or may not charge a fee from the other group entity as a consideration for providing such facilities.
- Under erstwhile Service Tax law, the existence of 'consideration' was a *sine qua non* to classify an activity as a 'Service' to levy Service Tax on the same. However, the departmental authorities had been assessing Service Tax on the provision of Corporate Guarantees by adopting a notional consideration equal to the commission rate charged by Banks for providing Bank Guarantees.
- The dispute in Service tax was finally settled by a recent decision of the Hon'ble Supreme Court in **Commissioner of CGST and Central Excise vs. Edelweiss Financial Services Ltd. [(2023) 5 Centax 58 (S.C.)]**, wherein the court held that facility of providing corporate guarantee on behalf of group companies, where there was no consideration received by the assessee, cannot be considered as taxable service.
- It is relevant to note that the above judgment applies only in cases where no consideration was charged at all. The Supreme Court is silent regarding the taxability where consideration was actually charged for providing corporate guarantee. Further, unlike the Service tax regime, Sec. 7 of the CGST Act, 2017 read with Schedule I prescribes a deeming fiction that assumes that an activity between 'related persons' would qualify a supply even if made without consideration. Accordingly, it appears that



GST would be applicable on the activity of providing corporate guarantee.

- Different practices were being followed by the department and taxpayers in determining the taxable value of such services as Rule 28 (applicable rule for valuation of supplies between related persons) prescribed that the Open Market Value (OMV) or value declared in the Invoice (where full ITC was available to the recipient) shall be the value of supply.

RECENT AMENDMENTS IN GST

- To ensure uniformity and ease of implementation, sub-rule (2) has been inserted to Rule 28 of the CGST Rules, 2017 via Notification No. 52/2023 dated 26-10-2023 which provides that the taxable value of such services will be **the higher** of:
 - (i) 1% of the amount of such guarantee offered, or
 - (ii) the actual consideration
- Subsequently, Circular No. 204/16/2023-GST dated 27-10-2023 has been issued by the CBIC to clarify that:
 - (i) Corporate guarantee provided by a company to a bank or financial institution for providing credit facilities to a related company is considered a supply of service between 'related persons' even if it is made without any consideration;
 - (ii) Value of supply of providing corporate guarantees shall be henceforth valued as per Rule 28(2);
 - (iii) The value shall be as per Rule 28(2) irrespective of whether full ITC is available to the recipient of services or not;
 - (iv) Rule 28(2) does not apply to personal guarantees provided by Directors to banks or financial institutions for their companies.

KEY TAKEAWAYS

- It appears that the amendment so introduced is only for determining the notional value on which GST is payable and it is likely that this may not affect the valuation adopted under the Income Tax and Transfer Pricing provisions. The invoice would indicate the value of supply for GST purposes in addition to the consideration actually charged (in cases where actual consideration is lower than 1% of the guarantee) as disclosure of the value of supply is one of the necessary requirements for a Tax Invoice. As an alternative, a commercial invoice indicating the actual consideration and a separate GST invoice indicating the value of supply and tax payable, may be issued together. GST@18% would be chargeable on the value of supply and the recipient would be eligible to avail ITC of the same.
- It is pertinent to note that as per Transfer Pricing provisions under the Income Tax Act, 1961, furnishing of corporate guarantee on behalf of the Associated Enterprise is considered as an International Transaction. The said transaction is generally benchmarked by applying a rate of 0.25% to 0.50% based on the fees charges by the banks/financial institutions. The said benchmarking has also been upheld by various courts/tribunal. However, the said benchmarking may always be disputed by the department by charging a higher rate of fees.
- Also, Rule 10TD of the Income Tax Rules, 1962 prescribes a minimum rate of 1% p.a. of the guaranteed amount as the safe harbour rate. Thus, a view may be taken that the value of supply so prescribed under GST appears to be adopted from the safe harbour provisions under Income Tax.
- However, the amendment and the clarifications fail to specify that 1% is as per annum rate as in Rule 28(2) it is not specified as such. This gives rise to a confusion as to whether Rule 28(2) prescribes a one-time payment or the same is to be discharged per annum as long as the guarantee is being renewed yearly. In the absence of such clarification, the prudent approach would be to charge GST at the time of raising of invoice only and disclose the tax liability in the return



for the month in which such invoice was issued.

- Further, despite the above clarification a question arises on the legality of the amendment itself. The same may be challenged before the Courts on the following grounds:

(i) The transaction is not a supply

There is no underlying supply of goods or services by the guarantor to the group entity on behalf of which guarantee is given to the bank or financial institution. The guarantor itself does not provide financing to the group entity. Providing guarantee is in the nature of a shareholder activity and a contribution in ownership which cannot be regarded as a supply. This would make the amendment ultra vires to the CGST Act, 2017.

(ii) The prescribed valuation method is arbitrary

The CBIC has the power to prescribe specific valuation methods. Rule 32 of the CGST Rules, 2017 prescribes a notional value for services of air travel agents or forex transactions. However, adopting such valuation is at the option of the supplier. In the instant case, an arbitrary value of 1% of the guarantee value has been prescribed as the value of supply without giving an option to the supplier to adopt the actual fee charged which may very well be lower. The courts have consistently held that such arbitrary valuation cannot be sustained under law.

(iii) Corporate Guarantees can be considered as actionable claims

As per Schedule III of the CGST Act, 2017 transactions in actionable claims (Other than lottery, betting, gambling, horse racing, online games & casino) are neither considered as supply of goods nor supply of services. Providing corporate Guarantees is in the nature of actionable claims and therefore cannot be considered as supply.

- Hence, it appears that the disputes regarding the taxation of corporate guarantees are unlikely to be resolved in the near future.





CONTACT US

Corporate Offices

Mumbai

701, Leela Business Park, Andheri
Kurla Road, Andheri (E), Mumbai
- 400 059
Tel: +91 22 6672 9999

Kolkata

Constantia, "B" Wing, 7th Floor, 11
Dr. U.N. Brahmachari Street,
Kolkata - 700 017
Tel: +91 33 4002 1485

Branch Offices

Ahmedabad

407, A Wing Pinnacle Business Park,
Corporate Road,
Prahlad Nagar,
Ahmedabad - 380 015
Tel: +91 79 4899 2768

Bengaluru

No. 45, 1st Floor, 2nd Main,
Sankey Road, (Above Indian Bank)
Lower Palace Orchards, Bengaluru -
560 003
Tel: +91 80 4372 7175/76

Bharuch

307, Orion Arcade,
Near Inox, Zadeshwar
Road, Bharuch - 392
011
Tel: +91 90 9903 5457

Chennai

5B, A Block, 5th Floor,
Mena Kampala Arcade,
New No 18 & 20, Thiagaraya
Road, T. Nagar, Chennai - 600 017
Tel: +91 44 2815 4192

Hyderabad

H. No-8-3-230/4/1, Flat no 306,
Sai Spurthy Enclave,
Venkatagiri, Yousufguda,
Hyderabad - 500 045
Tel: +91 73 3707 3746

Jaipur

706, 7th Floor, Diamond
Tower, Neelkanth Colony,
Ajmer Road, Jaipur
- 302021
Tel: +91 14 1676 2726

Kolkata

Bagrodia Niket, 1st floor,
19C, Sarat Bose Road,
Kolkata - 700 020
Tel: +91 33 4009 0334

Kolkata

Devarati, 1st Floor,
8. Dr. Rajendra
Road, Kolkata - 700 020
Tel: +91 33 4037 2700

Mumbai

42, Free Press House,
Nariman Point, Mumbai
- 400 021
Tel: +91 22 2287 1806/1808

Mumbai

409, 4th Floor, Goyal Trade Centre,
Shantivan, Borivali (East), Phase - III,
Mumbai - 400 066
Tel: +91 22 4016 9305

New Delhi

3rd Floor, 52-B,
Okhla Industrial Estate Phase -
III, New Delhi - 110020 Tel: +91
11 4711 9999

Rajkot

504 Star Plaza, Near Circuit House,
Phulchhab Chowk,
Rajkot - 360 001
Tel: +91 28 1664 7070

Vadodara

204-207 Parshwa Complex, Near
Cash n Carry Ellora Park,
Vadodara, 390-023 Tel: +91 26
5239 2631

Pune

Off. No. 7 & 12, 2nd Floor,
Shivdarshan Chambers, Opposite
Hotel Jayashree, 457, Market
Yard Road, Pune - 411 037
Tel: +91 98224 93924



[in dhc-desai-haribhakti](#) [@lifeatdhc](#) [@lifeatdhc](#) [@lifeatdhc](#) [@lifeatdhc](#)

Desai Haribhakti Consulting Pvt. Ltd. (DHC) state that, this publication has been carefully prepared, but it has been written in general terms and should be seen as broad guidance only. The publication cannot be relied upon to cover specific situations and you should not act, or refrain from acting, upon the information contained therein without obtaining specific professional advice. DHC, its partners, employees and agents do not accept or assume any liability or duty of care for any loss arising from any action taken or not taken by anyone in a reliance upon the information in this publication or for any decision based on it.

Scan to View Website
www.dhc.co.in