

ANALYSIS OF TAXABILITY OF PERSONAL GUARANTEE AND CORPORATE GUARANTEE UNDER GST FROM OCTOBER 2023

By: Vivek Jalan

Partner – Tax Connect Advisory Services LLP



1. Whether GST on Corporate guarantees provided by one person to another is applicable retrospectively or prospectively from 26th October 2023?

Comments – The following points need to be considered –

a. Rule 28(2) of CGST Rules 2017 shall come into force on the date of their publication in the Official Gazette.

b. Further Circular No. 204/16/2023-GST states that –

iA. ..The activity is to be treated as a supply of service between related parties as per provisions of Schedule I of CGST Act, even when made without any consideration.

IB. ..Taxable value will be determined as per rule 28 of CGST Rules.

ii. .."Accordingly, consequent to insertion of the said sub-rule in rule 28 of CGST Rules, in all such cases ..., the taxable value of such supply of services, will henceforth be determined as per the provisions of the sub-rule (2) of Rule 28 of CGST Rules"

On the basis of the above, it is clear that as per the Circular 204, even prior to 26th October 2023, where corporate guarantee was provided by a company to the bank/financial institutions for providing credit facilities to the other related party, it would be considered as taxable and the valuation would be done as per erstwhile Rule 28 of CGST Rules wherein value would be the 'open market value'. It is important to note that as per 2nd proviso to erstwhile Rule 28, 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. In case Rule 28 fails, the value for periods prior to 26th October

2023 can also be determined u/r 31 of CGST Rules wherein value would be determined as per reasonable means.

2. What would be the time of supply of GST on Corporate guarantees provided?

Comments – The time of supply would be as per Section 13 of the CGST Act 2017.

3. Going forward what would be the value of taxable supplies of service of provision of corporate guarantee by a company to the bank/financial institutions for providing credit facilities to the other company?

Comments – In case of supply between unrelated parties, the value of supply would be as determined in the invoice, in case raised. However, in case of related persons the value of supply would be 1% of the amount of such guarantee offered, or the actual consideration, whichever is higher.

4. Would the value as per transfer pricing norms in Income Tax affect GST on provision of corporate guarantees?

Comments – Generally as Transfer pricing norms, the value of corporate guarantees is taken as 0.5%. The same may be treated as 'open market value' for periods before Rule 28(2). However, post Rule 28(2), the value determined herein i.e. 1% may be considered for transfer pricing regulations.

5. Is there any relief for recipients like 'alcohol companies' or 'petroleum companies' or such companies supplying exempt/ Non-GST goods/services where ITC is not available to recipients?

Comments – No, after 26th October 2023, there is no relief for anybody and GST needs to be charged on the value of 1% of the amount of such guarantee offered, or the actual consideration, whichever is higher. Hence, for those subsidiary companies/ recipients whose outward supplies are totally exempt, the amount of GST charged would be a cost. For those holding companies whose outward supplies are totally exempt, like alcohol companies, and their subsidiaries whose outward supplies are taxable, this taxable

outward supply would increase the ratio of the common ITC available for holding company. Further while the lower value of the service is considered as 1%, there is no ceiling for a higher value of deemed consideration.

6. Since director is also a 'related person', is the personal guarantee provided by him/her to the company liable to also be taxed as per Rule 28(2)?

Comments – No. Rule 28(2) shall not apply in respect of the activity of providing personal guarantee by the Director to the banks/ financial institutions for securing credit facilities for their companies and no GST would be chargeable on the said transaction.

7. Whether Personal guarantees provided by directors to the banks/ financial institutions for securing credit facilities for their company is taxable under GST?

Comments – The activity of providing personal guarantee by the Director to the banks/ financial institutions for securing credit facilities for their companies is to be treated as a supply of service, even when made without consideration as per Section 7 and read with Schedule I Entry 2 of The CGST Act 2017. In terms of Rule 28 of CGST Rules, the taxable value of such supply of service shall be the open market value of such supply.

However, as per RBI guidelines, the no consideration by way of commission, brokerage fees or any other form, can be paid to the director by the company, directly or indirectly, in lieu of providing personal guarantee to the bank for borrowing credit limits. As such, when no consideration can be paid for the said transaction by the company to the director in any form, directly or indirectly, as per RBI mandate, there is no question of such supply/ transaction having any open market value. Accordingly, the open market value of the said transaction/ supply may be treated as zero and therefore, taxable value of such supply may be treated as zero. In such a scenario, no tax is payable on such supply of service by the director to the company.

8. Generally banks take the corporate or personal guarantees of a value much higher than the value of the loan. What would be the value of supply for GST purposes in such cases?

Comments – For personal guarantees, the value of supply would be NIL in case they are issued in compliance with RBI guidelines. However, for corporate guarantee cases, the value of supply would be 1% of the amount of such guarantee offered.

9. What about Personal guarantees provided by ex-directors/ KMP to the banks/ financial institutions for securing credit facilities for their companies. Is it taxable under GST?

Comments – In case where the director, who had provided the guarantee, is no longer connected with the management but continuance of his guarantee is considered essential because the new management's guarantee is either not available or is found inadequate, or there may be other exceptional cases where the promoters, existing directors, other managerial personnel, and shareholders of borrowing concerns are paid remuneration/ consideration in any manner, directly or indirectly.

In all these cases, the taxable value of such supply of service shall be the remuneration/ consideration provided to such a person/ guarantor by the company, directly or indirectly.

However, again to be noted that in case 'no consideration' is paid then, even in these circumstances no GST is leviable as they are then not related.

10. What about Personal guarantees provided by director's relatives to the banks/ financial institutions for securing credit facilities for the companies. Is it taxable under GST?

Comments – In case such person is to be considered as a 'related party' as explanation to Section 15 of The CGST Act 2017 and as per mandate provided by RBI in terms of Circular No. RBI/2021-22/121 dated 9th November, 2021, or other regulations, no consideration can be paid to the said persons, directly or indirectly, in lieu of providing personal guarantee to the bank for borrowing credit limits; As such, when no consideration can be paid for the said transaction by the company to the person in any form, directly or indirectly, as per RBI mandate, there is no question of such supply/ transaction having any open market value. Accordingly, the open market value of the said transaction/ supply may be treated as zero and therefore, taxable value of such supply may be treated as zero. In such a scenario, no tax is payable on such supply of service

by the director to the company. **However, incase there is no such mandate by the RBI, then Rule 28(2) may be applicable depending upon the facts of the case.**

LEGAL PROVISIONS -

A. Vide Notification 52/2023 – Central tax, Rule 28(2) on Valuation incase of supplies between distinct or related persons, other than through an agent, has been notified from 26th October 2023 as follows -

The value of the supply of goods or services or both between distinct persons as specified in sub-section (4) and (5) of [section 25](#) or where the supplier and recipient are related, other than where the supply is made through an agent, shall-

- (a) be the open market value of such supply;
- (b) if the open market value is not available, be the value of supply of goods or services of like kind and quality;
- (c) if the value is not determinable under clause (a) or (b), be the value as determined by the application of [rule 30](#) or [rule 31](#), in that order:

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:

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.

(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.

B. Circular No. 204/16/2023-GST dated 27th October 2023 clarifies on issues pertaining to taxability of personal guarantee and corporate guarantee in GST

Issue - Sl.No.1. *Whether the activity of providing personal guarantee by the Director of a company to the bank/ financial institutions for sanctioning of credit facilities to the said company without any consideration will be treated as a supply of service or not and whether the same will attract GST or not.*

Clarification - *As per Explanation (a) to section 15 of CGST Act, the director and the company are to be treated as related persons. As per clause (c) of sub-section (1) of section 7 of the CGST Act, 2017, read with S. No. 2 of Schedule I of CGST Act, supply of goods or services or both between related persons, when made in the course or furtherance of business, shall be treated as supply even if made without consideration. Accordingly, the activity of providing personal guarantee by the Director to the banks/ financial institutions for securing credit facilities for their companies is to be treated as a supply of service, even when made without consideration.*

Rule 28 of Central Goods and Services Tax Rules, 2017 (hereinafter referred to as "CGST Rules") prescribes the method for determining the value of the supply of goods or services or both between related parties, other than where the supply is made through an agent. In terms of Rule 28 of CGST Rules, the taxable value of such supply of service shall be the open market value of such supply.

RBI has provided guidelines for obtaining personal guarantee of promoters, directors and other managerial personnel of the borrowing concerns vide Para 2.2.9 of its Circular No. RBI/2021-22/121 dated 9th November 2021, which is reproduced below:

"2.2.9 Guidelines relating to obtaining of personal guarantees of promoters, directors, other managerial personnel, and shareholders of borrowing concerns

Banks should take personal guarantees of promoters, directors, other managerial personnel or major shareholders for the credit facilities granted to corporates, public or private, only when absolutely warranted after a careful examination of the circumstances of the case and not as a matter of course. In order to identify the circumstances under which the guarantee may or may not be considered necessary, banks should be guided by the following broad considerations:

.....

C. Worth of the guarantors, payment of guarantee commission, etc

*Where personal guarantees of directors are warranted, they should bear reasonable proportion to the estimated worth of the person. **The system of obtaining guarantees should not be used by the directors and other managerial personnel as a source of income from the company. Banks should obtain an undertaking from the borrowing company as well as the guarantors that no consideration whether by way of commission, brokerage fees or any other form, would be paid by the former or received by the latter, directly or indirectly. This requirement should be incorporated in the bank's terms and conditions for sanctioning of credit limits.** During the periodic inspections, the bank's inspectors should verify that this stipulation has been complied with. **There may, however, be exceptional cases where payment of remuneration may be permitted e.g. where assisted concerns are not doing well and the existing guarantors are no longer connected with the management but continuance of their guarantees is considered essential because the new management's guarantee is either not available or is found inadequate.***

....."

Accordingly, as per mandate provided by RBI in terms of Para 2.2.9 (C) of RBI's Circular No. RBI/2021-22/121 dated 9th November, 2021, no consideration by way of commission, brokerage fees or any other form, can be paid to the director by the company, directly or indirectly, in lieu of providing personal guarantee to the bank for borrowing credit limits. As such, when no consideration can be paid for the said transaction by the company to

the director in any form, directly or indirectly, as per RBI mandate, there is no question of such supply/ transaction having any open market value. **Accordingly, the open market value of the said transaction/ supply may be treated as zero and therefore, taxable value of such supply may be treated as zero. In such a scenario, no tax is payable on such supply of service by the director to the company.**

There may, however, be cases where the director, who had provided the guarantee, is no longer connected with the management but continuance of his guarantee is considered essential because the new management's guarantee is either not available or is found inadequate, or there may be other exceptional cases where the promoters, existing directors, other managerial personnel, and shareholders of borrowing concerns are paid remuneration/ consideration in any manner, directly or indirectly. In all these cases, the taxable value of such supply of service shall be the remuneration/ consideration provided to such a person/ guarantor by the company, directly or indirectly.

Issue SI. No 2 - Whether the activity of providing corporate guarantee by a person on behalf of another related person, or by the holding company for sanction of credit facilities to its subsidiary company, to the bank/ financial institutions, even when made without any consideration will be treated as a taxable supply of service or not, and if taxable, what would be the valuation of such supply of services.

Clarification - Where the corporate guarantee is provided by a company to the bank/financial institutions for providing credit facilities to the other company, where both the companies are related, the activity is to be treated as a supply of service between related parties as per provisions of Schedule I of CGST Act, even when made without any consideration.

Similarly, where the corporate guarantee is provided by a holding company, for its subsidiary company, those two entities also fall under the category of 'related persons'. Hence the activity of providing corporate guarantee by a holding company to the

bank/financial institutions for securing credit facilities for its subsidiary company, even when made without any consideration, is also to be treated as a supply of service by holding company to the subsidiary company, being a related person, as per provisions of Schedule I of CGST Act.

In respect of such supply of services by a person to another related person or by a holding company to a subsidiary company, in form of providing corporate guarantee on their behalf to a bank/ financial institution, the taxable value will be determined as per rule 28 of CGST Rules.

Considering different practices being followed by the field formations and taxpayers in determining such taxable value, in order to provide uniformity in practices and ease of implementation, sub-rule (2) has been inserted in rule 28 of CGST Rules vide [Notification No. 52/2023](#) dated 26.10.2023, for determining the taxable value of such supply of services between related persons in respect of providing corporate guarantee. Accordingly, consequent to insertion of the said sub-rule in rule 28 of CGST Rules, in all such cases of supply of services by a related person to another person, or by a holding company to a subsidiary company, in the form of providing corporate guarantee on their behalf to a bank/ financial institution, the taxable value of such supply of services, will henceforth be determined as per the provisions of the sub-rule (2) of Rule 28 of CGST Rules, irrespective of whether full ITC is available to the recipient of services or not.

It is clarified that the sub-rule (2) of Rule 28 shall not apply in respect of the activity of providing personal guarantee by the Director to the banks/ financial institutions for securing credit facilities for their companies and the same shall be valued in the manner provided in S. No. (1) above.

C. Explanation to Section 15 provides the definition of “related persons” under GST-

Explanation. -For the purposes of this Act, --

(a) persons shall be deemed to be "related persons" if--

(i) such persons are officers or directors of one another's businesses;

(ii) such persons are legally recognised partners in business;

(iii) such persons are employer and employee;

(iv) any person directly or indirectly owns, controls or holds twenty-five per cent. or more of the outstanding voting stock or shares of both of them;

(v) one of them directly or indirectly controls the other;

(vi) both of them are directly or indirectly controlled by a third person;

(vii) together they directly or indirectly control a third person; or

(viii) they are members of the same family;

(b) the term "person" also includes legal persons;

(c) persons who are associated in the business of one another in that one is the sole agent or sole distributor or sole concessionaire, howsoever described, of the other, shall be deemed to be related.

BRIEF ABOUT THE AUTHOR:

Vivek Jalan is a Chartered Accountant & a qualified L. LM & LL.B. He is the Founder & Partner of Tax Connect Advisory Services LLP. He is the Chairman of The Indirect Tax Core Group of The Confederation of Indian Industries – Economic Affairs and Taxation Committee (ER). He is the Chairman of The Fiscal Affairs and Taxation Committee of The Bengal Chamber of Commerce and Industry. He is the Member of The Managing Committee of The Bengal Chamber of Commerce and Industry.

He is a regular Columnist and guest expert in Economic Times, Business Standard, Times of India, Dalal Street Journal, Money Control, Live mint, CNBC, Hindustan Times, Zee Business, Financial Express, other dailies and business magazines like Business Today, etc. He is also a guest expert on Taxation matters in All India Radio and other media platforms. He is the Editor of Weekly Bulletin TAX CONNECT, a publication on Direct and Indirect Taxes which reaches more than 70000 professionals.

He is also a visiting faculty in The Confederation of Indian Industries (CII), The Institute of Chartered Accountants of India, Institute of Cost Accountants of India, Indian Institute of Foreign Trade, The Bengal Chamber of Commerce and Industry, The Indian Chamber of Commerce, The Merchant Chamber of Commerce and other Business Forums. He has also delivered Lectures at various Government Taxation Forums including the CGST & SGST Departments across the country.

He has worked as a Finance Manager in ITC Ltd. and Chief Compliance Officer with IntraSoft Technologies Ltd. He has more than 18 years of experience in the field of Information Technology, Finance, Taxation and Logistics. He was also an All-India Rank holder in CA Final Examination conducted by the Institute of Chartered Accountants of India.

His Books include the following –

- COMMENTARY ON UNION BUDGET 2023 – February 2023
- HOW TO HANDLE GST LITIGATION– September 2022
- HANDBOOK ON GST– June 2022
- GST PLEADING & PRACTISE – August 2021 – **India's Bestseller**
- UNION BUDGET 2021 – February 2021
- SECTIONWISE COMPENDIUM ON GST – October 2020
- INTEGRATED APPROACH TO E-INVOICING E-WAYBILL & RETURN FILING – October 2020
- COMMENTARY ON UNION BUDGET 2020– Feb 2020
- COMMENTARY ON UNION BUDGET 2019 – July 2019
- WITHDRAWAL OF LEGAL TENDER 2016
- COMMENTARY ON UNION BUDGET 2017
- SECTION-WISE COMPENDIUM ON GST – Oct 2020
- INTEGRATED APPROACH TO GST E-INVOICE, E-WAYBILL & RETURN E-FILING – Oct 2020
- **SECTION-WISE COMMENTARY ON GST – SEPTEMBER 2018**
- HOW TO HANDLE GST-TDS, GST-TCS, GST AUDIT & GST ANNUAL RETURN – NOVEMBER 2018
- A COMPENDIUM ON GST W.E.F. 1ST JULY 2017
- GST MODEL LAW (NOVEMBER 2016) & BUSINESS PROCESSES – A TECHNICAL COMMENTARY
- GST MODEL LAW (JUNE 2016) & BUSINESS PROCESSES – A TECHNICAL COMMENTARY
- "SERVICE TAX AND VAT IN WORKS CONTRACT: A COMPREHENSIVE TECHNICAL GUIDE".

He is a regular speaker at various professional forums on the various key areas in Finance and has delivered more than 300 lectures on various topics under Information Technology, Finance, GST, Customs, Foreign Trade Policy of India, Income Tax, etc.