

Taxability of Personal and Corporate Guarantee: Insights from the GST Council

In its 52nd meeting held on October 7, 2023, the Goods and Services Tax Council (“**GST Council**”) clarified the position on taxability of: (a) personal guarantees offered by directors to banks for credit limits and loans sanctioned to a company; and (b) corporate guarantees extended to related persons, including those provided by a holding company to its subsidiary.

In relation to the above the GST Council has made the following recommendations:

“(a) 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/ supply may be treated as zero and hence, no tax to be payable in respect of such supply of services.

(b) insert sub-rule (2) in Rule 28 of Central Goods and Services Tax Rules, 2017 (CGST Rules, 2017), to provide for taxable value of supply of corporate guarantee provided between related parties as one per cent of the amount of such guarantee offered, or the actual consideration, whichever is higher.

(c) clarify through the circular that after the insertion of the said sub-rule, the value of such supply of services of corporate guarantee provided between related parties would be governed by the proposed sub-rule (2) of rule 28 of CGST Rules, 2017, irrespective of whether full Input Tax Credit is available to the recipient of services or not.”

Taxability of Personal Guarantees

GST authorities have continued to raise GST demands on companies to pay tax under reverse charge mechanism, with respect to personal guarantees issued by directors to secure credit limits sanctioned to the companies. It was unclear on whether personal guarantees extended by directors, constitute a service provided by such directors under their terms of employment (and hence exempt from GST as per the GST laws), or is it a service provided by the directors as a related party of the company in which it is a director (and hence subject to GST).

GST Council has recommended issuance of a circular to clarify that in cases where no consideration is paid by the company, the open market value of such transaction can be treated as zero and hence not be subject to any GST.

Taxability of Corporate Guarantees

GST authorities are of the view that extending corporate guarantees to related parties are subject to GST. Assessors have been challenging this levy of GST on various counts including the issue that there is no mechanism to value such transactions.

The GST Council has recommended that the CGST Rules, 2017, be amended to provide for the taxable value of supply of corporate guarantees provided for benefit of related parties at 1% of the amount of such corporate guarantee, or the actual consideration received by the corporate guarantor, whichever is higher. GST Laws currently do not prescribe a valuation mechanism for taxing such transactions.

Legal Standpoint of GST on Guarantees

As per the GST authorities, providing guarantee on behalf of their associated enterprises, whether with or without consideration, amounts to “supply” of services under the GST Law. Assessors argue that extending guarantees on behalf of their associated enterprises does not qualify as “supply” of goods and / or services under the GST Law. A holding company has a ‘corporate’ and a ‘fiduciary duty’ to fund its subsidiary. Such funding could be in the nature of equity investments or in the nature of loans given, and therefore, not a service. The activity of extending guarantees to associated enterprises are in the nature of actionable claims¹, and therefore not subject to GST.

The recommendations of the GST Council do not address the core issue on whether the transactions are taxable. Prescribing valuation provisions for an issue of taxability does not address the core issue of taxability of such inter-company transactions. It is important that the clarification addresses the issue of taxability for settling the controversy.

Impact on Banking and Finance Transactions

Given the ambiguities around the taxability of personal and corporate guarantees, till date financing transactions were concluded without the payment of any GST on corporate or personal guarantees. The recommendations appear as a mixed bag - relaxation for personal guarantors and additional burden for corporate guarantors.

In recent times, there is a reduced prevalence of personal guarantees in corporate financing transactions. This relaxation, though welcome, may not encourage promoters to issue personal guarantees, given the personal and unlimited nature of liabilities, and the potential risks for personal insolvencies.

Corporate guarantees are an integral part of most corporate and project financing transactions. Levy of GST thereon will certainly add to the financing cost for the borrowers / obligors. For obvious reasons, in practice, the GST will mostly have to be determined on the amount of the corporate guarantee and a recurring cost, if the same is renewed on a periodic basis. Mostly, corporate guarantees are expected to be unlimited in nature and need to cover for repayment of the principal amount and all other agreed amounts like interest, default interest, costs, fees etc. Accordingly, it may be difficult to ascertain the full aggregate value of a corporate guarantee.

It is important to note that if taxability of intercompany transactions, similar to corporate guarantees, is not clarified by the Government with adequate legal basis, treatment of other forms of contractual undertakings provided by holding companies / sponsors for the benefit of borrowers, like in the nature of shortfall undertakings or sponsor support undertakings, will also have to be examined. Keeping the tax treatment uncertain for these financing transactions may pose a serious challenge.

Adoption of recommendations of the GST Council could further open the floodgates for ambiguities around retrospective levy and taxability of corporate guarantees, including (a) corporate guarantees issued by Indian companies extended for the benefit of offshore subsidiaries, and (b) guarantees (structured obligations) undertaken by non-residents for the benefit of onshore entities.

¹ Actionable claims are included in the definition of goods under the Central Goods and Services Tax Act, 2017 (“CGST Act”). However, except specified actionable claims, such as lottery, gambling, online money gaming etc., all other actionable claims are outside the purview of GST, as per Schedule III of the CGST Act.

Conclusion

The recommendations and clarifications made during the 52nd GST Council meeting aim to address concerns of the industry.

The proposed amendments and clarifications are aimed at expanding the scope of services under the GST net, which is most certainly going to increase the financing costs for borrowers for *with-recourse / limited recourse* financings. Care needs to be exercised to ensure that this does not impede the momentum of our credit markets.

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Our practice has been consistently ranked in the top-tier for several years, and several of our partners are regarded highly, by international publications such as Chambers and Partners, IFLR, Asia Law, Legal 500, Asia Legal Business, IBLJ and Leaders League.

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