

DESAI SAKSENA & ASSOCIATES

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Friday Tax Alert

From:

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IMPACT OF GST ON CORPORATE GUARANTEES

The 52nd GST Council Meeting held on October 07, 2023, has recommended various changes. One of such measures is the taxability of Corporate Guarantee and Personal Guarantee.

Notification No. 52/2023 - Central Tax, dated 26.10.2023:

For implementing the changes recommended in **52nd meeting**, a new sub-rule 2 is inserted in Rule 28 of the CGST Rules by way of Notification No. 52/2023 – Central Tax, dated 26.10.2023. Rule 28 deals with the determination of the value of supply. As per this new sub-rule 28(2), in the case of corporate guarantees, the value of supply should be deemed as 1% of the amount guaranteed or actual consideration, whichever is higher.

Let's understand this provision point by point:

1. What is Rule 28 of CGST Rules?

Ans: Rule 28 deals with the determination of the value of supply on which GST is to be levied. Rule 28(1) says that in any of the below mentioned cases, the value of supply should be the open market value of such supply:

- There are multiple GST registrations of the same person either in the same state or in multiple states, or
- The supplier and recipient are related.

2. Who is a related person as mentioned in Rule 28?

Ans: As per the explanation to section 15 of the CGST Act, 2017, the persons are deemed to be “related persons” if:

- Such persons are officers or directors of one another’s businesses.
- Such persons are legally recognized partners in business.
- Such persons are employer and employee.
- Any person directly or indirectly owns, controls, or holds twenty-five percent or more of the outstanding voting stock or shares of both of them.
- One of them directly or indirectly controls the other.
- Both of them are directly or indirectly controlled by a third person.
- Together they directly or indirectly control a third person.
- They are members of the same family.

3. What is an amendment to Rule 28?

Ans: A new sub-rule 2 has been inserted into Rule 28 by way of Notification No. 52/2023 – Central Tax, dated 26.10.2023. Its wordings are as follows: **“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 a corporate guarantee to any banking company or financial institution on behalf of the said recipient, shall be deemed to be 1% of the amount of such guarantee offered, or the actual consideration, whichever is higher.”**

4. What is meant by corporate guarantee?

Ans: A corporate guarantee is a contract between a corporate entity and a debtor. In this contract, the guarantor agrees to take responsibility for the debtor's obligations, such as repaying a debt.

5. What is the difference between corporate guarantee and personal guarantee?

Ans: The difference between corporate and personal guarantee is quite simple. A personal guarantee is when an individual agrees to take on the obligations of a debt for a debtor, whereas a corporate guarantee is where a guarantor is a corporation that takes on payment responsibilities.

6. What is the effect of such amendment to rule 28?

Ans: By way of inserting this new sub rule 2 to the Rule 28 of CGST rules, GSTN has specified the value of supply of providing corporate guarantee as 1% of the amount guaranteed or actual consideration, whichever is higher. However, for personal guarantees, there is no change specified. It means, value for personal guarantees will still be calculated by applying sub-rule 1.

CIRCULAR NO. 204/16/2023-GST

This circular contains clarifications w.r.t. taxability and valuation of the activity of providing corporate guarantee by a director or related person as well as by a holding company in order to secure credit facilities for its subsidiary company.

Following are the issues which are clarified:

1. Whether the activity of providing a 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?

Ans: As per Explanation (a) to section 15 of the CGST Act, the director and the company are to be treated as related persons.

- As per section 7(1)(c) 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 CGST Rules, 2017 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.
- 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

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any other form, can be paid to the director by the company, directly or indirectly, in lieu of providing a 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, the **taxable value of such supply may be treated as zero.**
- Also, there may 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.

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?

Ans: 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(2) of CGST Rules i.e. higher of 1% of amount guaranteed or actual consideration.

3. Is the value for personal guarantee also to be calculated as per rule 28(2)?

Ans: It is clarified that sub-rule (2) of Rule 28 shall not apply in respect of the activity of providing personal guarantees by the Director to the banks/ financial institutions for securing credit facilities for their companies. It means that the rule of 1% of the amount guaranteed does not apply to personal guarantees.

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CONCLUSION

- In the light of above discussion, it is made clear that a personal guarantee provided by the director of the company to bank/ financial institutions for sanctioning of credit facilities to the said company without any consideration is not taxable under GST.
- However, if the corporate guarantee is provided by a related person, or by the holding company for sanction of credit facilities to its subsidiary company, even when made without any consideration will be treated as a taxable supply. In such cases, the value of supply will be higher than 1% of the amount guaranteed or actual consideration.

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