

Is levy of GST guaranteed on Corporate Guarantee?



CA. Aditya Dhanuka

Author is member of the Institute. He may be reached at caadityadhanuka@gmail.com and eboard@icai.in

A corporate guarantee is an agreement between a borrower, lender and guarantor, whereby the guarantor takes on the responsibilities of debt repayment, if the borrower defaults. While providing corporate guarantee is a routine business activity among corporates to support and sustain their subsidiary / associate companies by guaranteeing their funding requirements. However, from the perspective of GST, the same is open to interpretation regarding its taxability. "Guarantee" has been defined in Black's Law Dictionary as "The assurance that a contract or legal act will be duly carried out"; "To assume a suretyship obligation; to agree to answer for a debt or default."

In simpler terms, a guarantee means the promise for doing of something or a promise to make payment of certain debt or performance of certain duty of another person's contractual obligation if that other person fails to make good the performance or pay his debt or fulfil his obligation, as the case may be.

The term "guarantee" or to be precise "contract of guarantee" has been defined in section 126 of the Indian Contract Act, 1872, which provides that a contract of guarantee is a contract to perform the promise, or discharge the liability, of a third party in case of his default.

Guarantee contract includes three parties namely; Creditor, Principal Debtor and Surety. The person who gives the guarantee is called the "surety"; the person in respect of whom the guarantee is given is called the "principal debtor", and the person to whom the guarantee is given is called the "creditor". A guarantee may be either oral or written.

As per section 2(11) of The Companies Act, 2013 a "body corporate" or 'corporation' includes a company incorporated outside India but does not include-

- (i) a co-operative society registered under any law relating to co-operative societies; and
- (ii) any other body corporate (not being a company as defined in this Act) which the Central Government may, by notification in the official Gazette, specify in this behalf;

On a joint reading of section 126 of the Indian Contract Act, 1872 and section 2(11) of The Companies Act, 2013, a Corporate Guarantee can be inferred as an affirmation usually made by a larger company (flagship, related or holding company), on behalf of another business entity which usually would be a smaller company. It is a guarantee to a lender that a loan will be repaid, guaranteed by a company other than the one who took the loan.

Further, Companies Act, 2013, allows for inter-corporate guarantees among related parties subject to specified conditions. As such nature of transactions do not have any financial implication on the surety / guarantor assuming that no fees / commission has been charged for providing the said guarantee (unless of course the guarantee is invoked) they do not have any consequential impact.

It is a usual presumption in case of related party transactions that the said transaction has not been carried out at arm's length price. This brings in the provisions in law which specify that transactions between related persons when undertaken at the market value are based on the common commercial terms, and thus, will be considered as a transaction made with an unrelated party.

From the perspective of GST, it becomes relevant to examine the transaction from the point of view of supply & its consequential

taxability. The term “supply” is defined under section 7 of the CGST Act to include all forms of supply such as sale, transfer, barter, exchange, license, rental, lease or disposal of goods or services or both, made or agreed to be made in the course or furtherance of business and for a consideration and includes activities mentioned in Schedule I to the Act which are made or agreed to be made without consideration.

The term “services” means anything other than goods, money and securities but includes activities relating to the use of money or its conversion by cash or by any other mode, from one form, currency or denomination to another form, currency or denomination for which a separate consideration is charged. By providing guarantee against any loan / credit facility, the guarantor basically assists the principal debtor in availing such facility, which has an element of service.

The principle of valuation in case of GST is that the value of a supply of goods or services or both shall be the transaction value, which is the price actually paid or payable for the said supply of goods or services or both where the supplier and the recipient of the supply are not related and the price is the sole consideration for the supply. When such supply is between related persons, its value will be determined by the valuation rules as prescribed.

From the perspective of GST Law, two key terms are relevant in this context being – “distinct persons” and “related persons”, where a person having multiple registrations across the same state or multiple states is

classified as a distinct person, and the following 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 percent. 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;
- ix. 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.

The term “person” also includes legal persons.

Specific provisions are in place for determining the value of supply of goods or services or both between distinct or related

“
By providing guarantee against any loan / credit facility, the guarantor basically assists the principal debtor in availing such facility, which has an element of service.”

persons, which provides that the value of supply shall –

- a) be the open market value of such supply
- b) if the open market value is not available, value of supply of goods or services shall be of like kind and quality;
- (c) if the value is not determinable as above, the value shall be one hundred and ten percent of the cost of production or manufacture or the cost of acquisition of such goods or the cost of provision of such services, and thereafter the same shall be determined using reasonable means consistent with the principles and the general provisions of GST Law. However, there is a proviso to the above provisions which lays down 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.

It is further provided 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. Chennai CESTAT had on 19th February, 2019, in the matter of *Sterlite Industries India Ltd. Vs Commissioner of*

GST and Central Excise, Tirunelveli held that providing corporate guarantee is not a taxable service in relation to bank and other financial services and since the issue of corporate guarantee by the appellants was only to facilitate issue

“ 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. ”

of bank guarantee by the bank, the activity by the appellant is nothing but a service in relation to issue of banking and other financial services. The activity of issue of corporate guarantees by the appellant from their associate / subsidiary companies in India and also the procurement / receipt of corporate guarantee from their parent / associate company abroad will not come within the fold of section 65(12)(a) *ibid* and in particular sub-clause (ix) of that provision of Service Tax law. It is noteworthy to observe that this judgment was given from the viewpoint of Banking and Other Financial Services. However, the decision could have been different had the point of view of taxation been from the perspective of Business Auxiliary Services or Business Support Services.

The same can be seen in the case of *Olam Agro India Ltd. Vs Commissioner of Central Excise* wherein CESTAT Delhi has recorded that a corporate guarantee is used when a corporation agrees to be held responsible for completing the duties and obligations of debtor to a lender, in case the debtor fails to comply with the terms of the debtor- lender contract and a bank guarantee is a promise from a bank that the liability of the debtor will

be met in the event the debtor fails to favour his contractual obligations. Therefore, the nature of corporate guarantee as well as of bank guarantee is one and the same i.e., for facilitation of the lending facilities. Merely

because the name of the guarantee has been changed from ‘Bank’ to ‘Corporate’, it cannot be said that it will not fall under ‘Business Auxiliary Service’ as defined under section 65 (105) of the Finance Act, 1994 and upheld the demand of Service Tax on the Corporate Guarantee Commission.

It is pertinent to note that the Ministry of Finance (CBIC) vide *Circular No. 34/8/2018-GST, dated 1st March 2018* had already clarified that the services provided by Central/State Government to any business entity including PSUs by way of guaranteeing the loan taken from financial institutions against consideration in any form including guarantee commission, is taxable.

However, later on, services supplied by Central/State Government/Union territory to their undertakings/ PSUs by way of guaranteeing the loans taken by such undertakings/PSUs from the banking company and financial institution were exempted from GST. The Ministry of Finance (CBIC) has issued another *Circular*

No.154/10/2021-GST, dated the 17th June, 2021 to re-iterate that guaranteeing of loans by Central or State Government for their undertaking or PSU is specifically exempt.

Hence, it supports the view that transaction of guaranteeing loan with consideration qualifies as supply and therefore, is leviable to GST.

Further, meaning of the term “consideration” under section 2(31) of the CGST Act, 2017, in relation to supply of goods or services or both includes--

(a) any payment made or to be made, whether in money or otherwise, in respect of, in response to, or for the inducement of, the supply of goods or services or both, whether by the recipient or by any other person but shall not include any subsidy given by the Central Government or a State Government;

(b) the monetary value of any act or forbearance, in respect of, in response to, or for the inducement of, the supply of goods or services or both, whether by the recipient or by any other person but shall not include any subsidy given by the Central Government or a State Government;

Thus, in respect of providing guarantee, consideration in the form of commission may or may not be charged.

In cases, where any consideration in the form of commission is charged by the guarantor against the guarantee provided to the creditor for loan

“ Bank guarantee is a promise from a bank that the liability of the debtor will be met in the event the debtor fails to favour his contractual obligations. ”

GST

provided to the borrower, the said activity being an agreement to the obligation to do an act, qualifies as a service.



A holding and a subsidiary company are regarded as related parties under GST.



or furtherance of business, are to be treated as supply even if made without consideration.

A holding and a subsidiary company are

regarded as related parties under GST. Therefore, any supply of goods or services by the holding to the subsidiary or *vice-versa* will be taxable according to Schedule I para 2, even in cases where there is no consideration between the two of them for the said supply.

Therefore, to conclude, the service of provision of

guarantee is understandably a service falling under HSN 9971 – Financial and related services, and is exigible to GST. Such service is covered under para 2 of Schedule I, if made without any consideration between related or distinct persons.

References used:

- *The Central Goods and Services Tax (CGST) Act, 2017*
- *The Central Goods and Services Tax (CGST) Rules, 2017*
- *Circulars & Notifications issued under the GST Law*
- *Indian Kanon*
- *The Economic Times* ■■■

It is also pertinent to note and understand that merely by not charging any “consideration”, shelter cannot be taken to escape the chargeability, as parallelly para 2 of Schedule I also comes into play for this given supply, which specifically covers that supply of goods or services or both between related persons or between distinct persons as specified in section 25, when made in the course

