

# New GST valuation rule for corporate guarantees: Boon or bane?

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## ***This update covers:***

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## 1 Background

The applicability of goods and services tax (GST) on corporate guarantees has been a contentious issue since the introduction of the GST laws.

Typically, a corporate guarantee transaction involves one group company (usually, the holding company) providing a corporate guarantee on behalf of another company in the same group (usually, its subsidiary or a newly established joint venture company) for securing loans from banks and financial institutions, often without charging any consideration, or with nominal consideration. Historically, many group companies have not been discharging GST in respect of such corporate guarantees provided by them by taking a view that the corporate guarantee was issued to the bank and not to the group company benefiting from the loan, and that this was a shareholder activity rather than a service being provided to their group company. Therefore, in the past couple of years, GST authorities have been investigating and issuing notices to various group companies involved in such corporate guarantee transactions.

Another issue regarding corporate guarantee transactions has been the conflict regarding the value of corporate guarantee transactions between the related parties. Generally, the value of the supply of services between related parties is deemed to be the open market value of such services. As there is no standard value or rate that is widely accepted for corporate guarantee transactions in the market, GST authorities have raised demand notices valuing these services, with such valuations ranging from 2% of the value of the corporate guarantee provided by a group company (based on the general rate charged for bank guarantees) to the entire amount of loan availed as a result of such corporate guarantee. This has led to various disputes concerning the valuation of these corporate guarantee transactions between group companies.

To address these concerns and to bring uniformity in the valuation of such transactions, an amendment was made to Rule 28 of the Central Goods and Services Tax Rules, 2017 (CGST Rules) introducing a separate valuation mechanism in respect of corporate guarantee transactions between related persons (Valuation Amendment).

A recent GST-related amendment introduces a specific valuation rule with respect to corporate guarantee transactions between related persons. This newly inserted rule runs contrary to a commonly adopted industry view that no GST is applicable to the provision of corporate guarantee between related parties. While this change seeks to provide a deeming valuation mechanism for corporate guarantee services between related persons, it also gives rise to additional complexities regarding the computation method for determining the value of such corporate guarantee services. Further, the objective of providing an overriding effect to the newly inserted rule even in cases where such services between related persons are fully creditable is unclear.

## 2 Position prior to the Valuation Amendment

Under the GST laws, GST at the prescribed rate is required to be discharged on the value of supply of any goods and/or services. As per Section 15 of the Central GST Act, 2017 (**CGST Act**), the value of supply of goods or services is generally the transaction value, i.e., the actual price paid or payable for the supply. In cases where the supplier and the recipient of the goods or services are '*related persons*' under the GST laws, the value of supply of goods or services is required to be at '*arm's length*' as per the valuation rules contained in the CGST Rules.

Generally, the open market value of a supply is considered to be at arm's length. However, if the recipient of services is eligible for full input tax credit (**ITC**), the value of supply declared in the invoice is deemed to be the open market value of the services between related persons, and such value is deemed to be at arm's length under GST laws. Therefore, in case of supplies that are fully creditable for the recipient, industry players often assign a nominal invoice value to the supply in the tax invoice, and such value is deemed to be at arm's length under the GST laws. In the context of corporate guarantees before the Valuation Amendment, if the corporate guarantee services provided for a related person were fully creditable in the hands of such related person, then a zero or nominal value invoice could be raised for such supply of corporate guarantee services between related persons. Therefore, prior to the Valuation Amendment, a related person did not have to bear GST on the provision of corporate guarantee services, provided the services were fully creditable for such borrower.

## 3 Position post the Valuation Amendment

The newly inserted Rule 28(2) of the CGST Rules, effective from 26 October 2023, provides that the value of supply of services, by way of providing corporate guarantees to any banking or financial institution on behalf of a related person, will be deemed to be 1% of the amount of guarantee offered, or the actual consideration paid by the recipient for such guarantee, whichever is higher.

This specific valuation principle has been made applicable even if these services are fully creditable for the recipient. Therefore, no related person transactions involving corporate guarantee can be undertaken at a nominal value anymore, even if it is fully creditable in the hands of the recipient borrower.

Further, a circular issued on 27 October 2023 (**Circular**) clarifies that the activity of providing corporate guarantee by a company to any bank or financial institution, for providing credit facilities to another company, where both the companies are '*related persons*', is to be treated as a supply of services between '*related persons*' as per the provisions of Schedule I of the CGST Act, even when made without any consideration.

Consequently, group companies that have entered into corporate guarantee transactions since the introduction of the GST laws on 1 July 2017 are now required to discharge GST in respect of such transactions, along with the applicable interest. While the valuation of corporate guarantee transactions prior to 26 October 2023 would not be subject to Rule 28(2), the valuation mechanism provided in this Rule can be used as a guide for discharging GST for the past tax periods. Further, while the Valuation Amendment effectively disallows the option of discharging GST on a nominal value for such transactions, even when the recipient is eligible for full ITC; this would not result in an increased GST burden on the recipient as long as it is able to utilise the ITC availed in respect thereof.

## 4 Conclusion

The amendment to Rule 28 and the clarificatory Circular conclusively establish that the provision of corporate guarantee services between related persons is a taxable transaction. This puts to rest the long-standing debate about whether GST is applicable to the provision of a corporate guarantee between related persons, and the value on which GST is required to be discharged is now specifically provided under Rule 28(2) of the CGST Rules. However, certain aspects remain unclear, especially where the payment of consideration is on a milestone payment basis. Additionally, it is unclear whether the valuation rule would apply to corporate guarantee transactions that were entered into prior to the Valuation Amendment, but where the payment of consideration is spread over periods post this amendment on a milestone payment basis.

Further, to arrive at the value of services between related parties, since the new Rule 28(2) provides that such valuation will be calculated by taking the higher of 1% of the guaranteed amount, or the actual consideration paid for such guarantee, it is unclear whether this determination should be made comparing the notional value of 1% of the guaranteed amount to the total consideration (cumulative of all the payments spread over the years), or to each of the part consideration paid for the continuing guarantee services. Having said that, Rule 28(2), in its current form, nowhere indicates that the comparison of 1% of the guaranteed amount should be made with each part payment of the guarantee fee. Therefore, it is possible to adopt the interpretation that the value of the corporate guarantee services between related persons ought to be computed as the higher of 1% of the guaranteed amount or the cumulative corporate guarantee fee. However, if GST authorities take a contrary view, this may expose corporate guarantors to much higher GST costs for these services.

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