

Decoding Dilemma on GST implications on Personal Guarantee by Directors

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Introduction

The debate relating to GST implications on personal guarantees provided by directors of a borrower company to financial institutions and banks has been a longstanding one. A director may extend personal guarantee, if the lender institutions insist on such guarantee on behalf of the company. Pursuant to the same, if circumstances of default arise, the director will be obligated to pay off the borrower company's debt. In such arrangements, the company is left in a muddle, as the GST Department may demand GST on the provision of such personal guarantees from the borrower company on reverse charge basis.

Relevant legal provisions and the controversies.

In the GST regime, any services between related persons in the course or furtherance of business, qualifies as a 'supply' leviable to GST, even without any consideration.^[1] Further, persons are deemed to be "related persons" if inter alia they are 'employer and employee' or 'one of them directly or indirectly controls the other'.^[2] Therefore, the Department may contend that provisioning of personal guarantee by a director qualifies as a taxable supply, if the director qualifies to be an employee of the company or the director directly or indirectly controls the company or vice versa. Further, the services supplied by a director to the company are taxable under reverse charge in the hands of the company.^[3]

The debate has been further fueled by the recent [Circular No. 201/13/2023-GST dated 17.07.2023](#) issued by the Central Board of Indirect Taxes and Customs wherein it has been clarified that services supplied by a director of a company or body corporate to the company or body corporate in his private or personal capacity are not taxable under RCM. Therefore, a question may arise whether a director furnishes personal guarantee for the company in his 'private or personal capacity'. It may also be noted that services provided by an employee to the employer 'in the course of or in relation to his employment' is not treated as a 'supply'.^[4]

Whether personal guarantees are taxable under GST?

RBI Master Circular

The answer to the above question may be answered in light of the **Master Circular DBR. No. Dir.**

BC.11/13.03.00/2015-16 on **“Guarantees and Co-acceptances”** issued by the Reserve Bank of India. The said Circular provides that 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.

In view of the above Circular, it may be argued that since RBI has expressly prohibited the directors from deriving income by giving personal guarantees, such guarantees are rendered on a non-commercial basis. Accordingly, one can also argue that such transactions are not in the course or furtherance of business of director, hence, the transaction is not a “supply”. On the same ground, it can be argued that such transactions will not be covered under para 2 of Schedule I (supply even without consideration), since the said entry also requires the activity to be in the course or furtherance of business, to qualify as a supply.

However, the above argument may be disputed by the Department on the ground that legality or illegality of a transaction does not affect its taxability. The Hon’ble Delhi High Court in the case of [Commissioner of Trade and Taxes v. Schneider Electric India Pvt. Ltd.](#),^[5] rejected the requirement of license/certificate under Electricity Act and allowed exemption of supply of electrical equipment to buyers. Further, it has been observed in [Commissioner of Income-Tax v. S.C. Kothari](#),^[6] that the taint of illegality or wrong-doing associated with income, profits and gains is immaterial for the purpose of taxation. In [Karlheinz Fischer v. Finanzamt Donaueschingen](#),^[7] the Court ruled where legal gaming is exempt from VAT in terms of article 13(B)(f) of the sixth directive, unlawful gaming should also be exempt from VAT.

In view of the above, the Department may contend that the restrictions prescribed by the RBI Master Circular do not change the nature of the transaction.

Provision of personal guarantee may be a stipulation as per the employment agreement.

As discussed above, services provided by an employee to the employer in the course of or in relation to his employment shall not be treated as a supply, as per Schedule III of the CGST Act. Therefore, there may be cases where the directors such as whole-time directors, managing directors, executive directors, etc. of the company who qualify as employees of the company, may provide personal guarantee in terms of an express stipulation in their employment agreement or appointment letter. In such cases, it may be argued that such a transaction is merely a service performed by an employee for the employer in the course of or in relation to his employment and will be excluded from the ambit of GST.

International Jurisprudence

Argument against taxability of personal guarantees by directors finds support in the Australian Ruling GSTR 2006/1 which explains how guarantees and indemnities are treated under the GST legislation. The said ruling states that, whether or not the principal (borrowing company) pays a fee to the surety (guarantor), the principal has no rights under the guarantee, and does not acquire any interest in a guarantee. That is to say, surety does not make a supply of an interest in a guarantee to the principal. It does, however, make a supply of such an interest to the creditor, wherein the consideration that the creditor provides is their agreement to enter into the arrangement with the principal.

Basis the above, a view is possible that provision of personal guarantee by a director is a transaction between such director and the bank / financial institution and not the director and the borrower company, since such guarantee will protect the interest of the bank in case of default by the borrower company. In such a scenario, since the director and the bank / financial institution will not qualify as related persons (more often than not), the transaction will not be leviable to GST without any consideration.

Conclusion

The quandary involving GST implications on personal guarantees by directors underscores the complexities of current GST legislation. The intersection of GST law with the prevailing and well-

established business practices has raised yet another legal question which curtails ease of doing business. Generally, the law ought to evolve to adapt to the changing business landscape. However, issues such as taxability of personal guarantees under GST compels one to think whether the prevailing business landscape ought to evolve in view of the provisions of GST law? Even though the arguments discussed above may come to the rescue of taxpayers, it is such taxpayers, being the borrowing companies, who continue to suffer due to lack of clarity.

[1] Section 7, Central Goods and Services Tax Act, 2017 (“CGST Act”) read with Schedule I, CGST Act.

[2] Explanation (a) to Section 15, CGST Act.

[3] S. No. 6, Notification No. 13/2017- Central Tax (Rate) dated 28.06.2017.

[4] Schedule III, CGST Act.

[5] [\[TS-331-HC-2019\(DEL\)-VAT\]](#)

[6] [\[TS-5210-HC-1967\(GUJARAT\)-O\]](#)

[7] 105 (case C-283/95)