

Corporate guarantee service provided by related party

The taxability and valuation of corporate guarantee service provided by related parties always remained a contentious issue procreating numerous legal disputes and litigation. To address these concerns of the trade and industry, effective from 26th October, 2023, the government has earlier inserted sub-rule (2) in rule 28¹ of the CGST Rules whereby it was provided that for the purpose of discharging GST liability in respect of supply of services by way of providing corporate guarantee to any banking company or financial institution on behalf of a related person the taxable value shall be deemed to be 1% of the amount of such guarantee offered , or the actual consideration, whichever is higher.

After the insertion of the above valuation provision in the CGST Rules, various other issues cropped up and were raised before the government. Now in order to address these issues, the Government has made certain amendments² in the said rule 28(2), effective retrospective from 26th October, 2023 and has also issued certain clarifications³.

Key Highlights

Key highlights of these amendments and clarifications are under:

Corporate guarantee service provided prior to 26th October, 2023	<ul style="list-style-type: none">• Service of providing corporate guarantee was taxable even before 26th October 2023 (i.e. before insertion of sub-rule (2) in rule 28 of CGST Rules).• Valuation of corporate guarantee issued or renewed before 26th October 2023 is to be done in accordance with Rule 28(1).• In case the corporate guarantee was issued prior to 26th October 2023 but renewed after such date then the valuation of the said supply will be required to be done as per Rule 28(2).
Application of deeming provision of 1%	<ul style="list-style-type: none">• The application of the deemed valuation provision of 1% in rule 28(2) is restricted to the cases where the <u>recipient is a related person located in India.</u>

¹ Vide notification No. 52/2023-Central Tax dated 26.10.2023

² Refer notification No. 12/2024-Central Tax dated 10.07.2024

³ Refer circular No. 225/19/2024-GST dated 11.07.2024

	<ul style="list-style-type: none"> The deeming provision of 1% will not apply in cases where the recipient of the services is located outside India. Thus, the provision shall not apply to the export of the services of providing corporate guarantee.
Valuation	<ul style="list-style-type: none"> The value of supply of the service of providing corporate guarantee shall be 1% of the amount guaranteed <u>per annum</u> or the actual consideration, whichever is higher. When the corporate guarantee is issued for a fixed term, the value of supply of the service shall be 1% of the amount of such guarantee offered multiplied by the number of years for which the said guarantee is offered or the actual consideration, whichever is higher. In case the corporate guarantee is provided for a period less than a year, say for 6 months, then in those cases the valuation may be done on proportionate basis. Illustration: If a corporate guarantee is issued for a period of five years, then the value of such guarantee being calculated at one per cent per year would be 5% of the amount guaranteed or the actual consideration, whichever is higher. Therefore, GST would be payable on such amount <u>at the time of issuance</u> of such corporate guarantee, i.e., 5% of the amount guaranteed or the actual consideration, whichever is higher. In case a corporate guarantee is <u>issued for a period of one year and is renewed five times</u>, for a period of one year each, then tax would be payable on 1% of the amount of such guarantee offered, or the actual consideration, whichever is higher, on the issue of such corporate guarantee in the first year as well as on every renewal in subsequent years. In cases where full input tax credit is available to the recipient of services, the value declared in the invoice

	shall be deemed to be the value of supply of the said service.
Lower disbursal of loan amount	<ul style="list-style-type: none"> Value to be calculated on the amount guaranteed and not on the amount of loan actually disbursed. The recipient shall be eligible to avail the ITC irrespective of when the loan is actually disbursed to the recipient and irrespective of the <u>amount</u> of loan <u>actually disbursed</u>.
Loan taken over by another bank	<ul style="list-style-type: none"> No GST implication in the cases where loan issued by a bank is taken over by another bank.
Corporate guarantee provided by Co-guarantors	<ul style="list-style-type: none"> If sum of the actual consideration is more than 1% of the amount of guarantee offered, then the value shall be the sum of the actual consideration paid/ payable to co guarantors. If sum of the actual consideration is less than 1 % of the amount of such guarantee offered, then GST shall be payable by each co-guarantor proportionately on 1% of the amount guaranteed by them.
Forward charge or reverse charge?	<ul style="list-style-type: none"> Where domestic corporates issue intra-group guarantees, GST is to be paid under forward charge mechanism. Where guarantee is provided by the foreign/ overseas entity for a related entity located in India, then GST would be payable under reverse charge mechanism by the recipient of service.

Tattvam Comments

- In case guarantee was issued or renewed before 26th October, 2023, the benefit of second proviso to rule 28(1), deeming the value declared on the invoice to be the taxable value where the recipient is eligible to claim full credit, can be available. Therefore, in such cases

if the supplier has not raised invoice or have discharged GST liability on a lower value (and the recipient is eligible to claim full ITC of such GST charged), it can be contended that the value of supply can be considered to be NIL or the lower value on which GST liability was discharged⁴.

- Relying upon the proviso to rule 28(2), similar view can also be taken in respect of corporate guarantees issued or renewed after 26th October, 2023.
- In case of export of service proviso to rule 28(2) shall not be applicable, as the recipient would not be entitled to take the ITC.
- Since the amendment regarding “per annum” has been made retrospectively, clarification required whether interest is payable in the cases where liability arises prior to 10th July, 2024 (i.e. the date on which the said amendment is made).
- Since the time of supply is the time of issuance of supply, one time cost of availing loan in the cases where corporate guarantee is issued for fixed term (say five years) may increase substantially, particularly in the cases where ITC is not available to the recipient. In such cases the taxpayers may consider to re-structure the corporate guarantee terms from fixed term model to renewal model.

⁴ Circular No. 199/11/2023-GST dated 17.07.2023 and Circular No. 210/4/2024 GST, dated 26.06.2024 can be referred.

Input Service Distributor

Amendments

- In the 50th GST council meeting recommendations were made for making ISD mandatory for distribution of common Input Tax Credit which are procured from a third party. Subsequently, in the 52nd GST council meeting, recommendation was made to make necessary amendments to definition of ISD under section 2 (61) and section 20 of the CGST Act as well as well amendment in rule 39 of CGST Rules to make the ISD compliance mandatory.
- In pursuance of the same, earlier amendment was made in section 20 of the CGST Act vide Finance Act, 2024 (which is yet to be made effective).
- Now, vide notification No.12/2024-Central Tax dated 10.07.2024 amendment is made in rule 39 for prescribing the manner for distribution of ITC. Earlier the manner for distribution of ITC was provided in section 20 of the CGST Act. This amendment will come into effect from a date to be notified.

Tattvam Comments

- Now it is apparent that the government has made the necessary changes to make the ISD compliance mandatory and soon these provisions can be made effective.
- For timely compliance of the ISD provisions, it is advisable that the taxpayers shall obtain ISD registration at the earliest.
- The taxpayers shall also undertake the exercise of identifying the expenses in respect of which ITC shall be distributed through ISD and the expenses which shall be considered for cross charge. Some of such expenses which may be considered for ISD are audit fees, legal expense pertaining to entire entity or more than one registrations, software/IT expenses, marketing and business promotion expenses, etc.
- After identifying the expenses relevant for ISD distribution, the taxpayers shall communicate with the existing vendors to issue invoice on the ISD registration number.
- Taxpayers shall also make necessary changes in their IT system to support ISD compliances.