AURTUS
CONSULTING

Indirect Tax Alert

27 October 2023

Valuation for determining GST on Corporate Guarantee issued by related person

- In pursuance to the 52nd GST Council meeting, the Central Government has issued Notification No 52/2023 - Central Tax dated October 26, 2023, whereby sub-rule (2) to Rule 28 of the CGST Rules has been inserted to provide for the valuation mechanism in case of a corporate guarantee provided by a related party.

- 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 higher of the following:

  - 1% of the amount of such guarantee offered, or

  - Actual consideration.

- The valuation so provided is notwithstanding Rule 28(1) of the CGST Rules which provides the valuation mechanism for transactions between related persons. One of the methods provided in Rule 28(1) is that the value of the supply is determined at Open Market Value. 2nd proviso to Rule 28(1) provides that if the recipient is able to avail full ITC of the GST charged by the supplier then whatever value is stated in the invoice is deemed to be the open market value.

- In other words, as per the above-mentioned notification minimum 1% will be the value of the service irrespective of the Open Market Value or the deemed Open Market Value provisions.

Aurtus comments:

- At the outset, it may be mentioned that although the notification does not specify if the provision is retrospective or prospective, it can be reasonably assumed that it applies prospectively, effective from October 26, 2023. However, the possibility of authorities disputing valuation for the past period cannot be ruled out. There are judicial precedents under Income tax laws which have accepted 0.5% as an appropriate value. Typically, the corporate guarantee fee that is to be charged depends upon multiple factors such as credit standing of the borrower, standing of the group as a whole, the purpose for which the guarantee is being asked for, etc.

- In most cases, banks or financial institutions insist on a corporate guarantee with the condition that no commission or consideration is paid by the borrower company to the issuer and such a condition is also incorporated in the corporate guarantee documents. Going forward, due to the deeming fiction in the notification, the issuer would have to raise a tax invoice, discharge the GST liability, whether or not it is considered as an income from the books of accounts perspective or for income tax purposes. This could therefore be an item of reconciliation between income as per the GST return and income as per books/income tax return.

- Further, will such receipt of consideration also result in income tax adjustments alleging that since amounts have been charged for GST purposes, the same will also be construed as income for income tax purposes, though there is a strong argument available that a deeming provision created for the purposes of GST cannot be stretched to Income tax.

- The notification does not provide clarity on whether the GST on the corporate guarantee value so determined needs to be paid only on the execution of the corporate guarantee or will it apply every time it is renewed. Considering how the provisions are worded it could be viewed that the GST liability would arise at the time of issuance as well as on a recurring basis.

- The Notification creates a liability related to "*corporate guarantee to any banking company or financial institution on behalf of the said recipient".* One could potentially argue that the said Notification is ultra-vires the provisions of the GST Law as the actual 'recipient' in the transaction is the banking company and not the recipient of the corporate guarantee. As per the definition under Section 2(93) of the CGST Act, 'recipient' is inter-alia defined to mean – *"(c) where no consideration is payable for the supply of a service, the person to whom the service is rendered."* The Notification itself makes it clear that the services are being rendered to banking company or financial institution and the recipient is merely the beneficiary of such services.

Issue of taxability per se is still debatable and sub-judice:

- While the notification provides for a valuation mechanism the question is still open to debate on whether issuing a corporate guarantee *per se* qualifies as a supply. An argument exists that the loan that is granted

is based on independent credibility/financials of the group company and the parent company is not providing any assistance in this regard and is merely satisfying a condition placed by the Bank i.e., issuing corporate guarantee. The parent undertakes this obligation as a part of its shareholder functions.

Cross-Border guarantee provided to a foreign related party recipient:

- With respect to the issuance of corporate guarantee in a cross-border scenario, the following is to be kept in mind:

  - The authorities could allege that the services provided by the Indian company involve arranging or facilitating services and hence, qualify as 'intermediary' services. Such a contention if raised can be strongly contested basis of the factual transaction.

  - There could be a scenario where the HO does not charge or is restricted from recovering any fee/commission on corporate guarantee or that there is a Transfer pricing benchmarking for a lower value or an Advance Pricing Agreement stating no consideration or lower consideration. In such a scenario, is an argument still available that the arm's length price is determined at zero or lower value? Assuming the answer is negative, considering that there will be no flow of consideration between the provider and the recipient related party, the condition of receipt in foreign exchange will not be satisfied. Would this mean that the foreign recipient will have to necessarily remit the amounts to India to constitute the transaction as export of services?

Cross-border guarantee provided to an Indian related party recipient by a foreign supplier:

- Interestingly the condition of payment of taxable value and GST thereon does not apply to the case where the GST is paid under RCM. Thus, in a scenario where a corporate guarantee is issued by an overseas company to its Indian company who is a related party, and if the Indian subsidiary discharges the GST under RCM (if applicable) with respect to the past transactions, the question which arises is whether credit will be available. Recently the Karnataka High Court in **M/s. Toyota Kirloskar Motor Private Ltd. Vs. UOI [2023-VIL-734-KAR]** has granted a stay against the show cause notice issued by the GST authorities for denial of input tax credit availed on RCM basis by placing reliance on Section 16(4) of the CGST Act which deals with time limit for taking credit.

Mumbai
Wework, Raheja Platinum,
Sag Baug Road,
Off Andheri- Kurla Road,
Marol, Andheri East
Mumbai – 400059

Delhi NCR - Gurugram
Wework, 5th Floor,
DLF Two Horizon Centre,
DLF Phase 5,
Gurugram,
Haryana – 122002

Ahmedabad
South Tower – 606, 6th Floor,
One42, Bopal-Ambli Road,
Ahmedabad – 380054

GIFT IFSC*
Cabin 2, 419-421,
4thFloor, Pragya,
GIFT SEZ / IFSC,
Gandhinagar –382355
**SEZ approval received*

Singapore
3 Shenton Way #13-05,
Shenton House,
Singapore 068805

connect@aurtusconsulting.com