Taxation of Corporate Guarantees under GST - Light At The End Of The Tunnel?

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The taxation of corporate guarantees, under Indian Indirect tax regimes, has travelled through a long and contested path. What began as a mere conceptual debate under the service tax regime has, under GST, evolved into a complex interplay between statutory provisions, valuation rules, circulars and judicial interpretation. The recent decision of the Bombay High Court in M/s D.P. Jain & Co. Infrastructure Pvt. Ltd. v. Union of India [TS-333-HC(BOM)-2026-GST] marks an important milestone in this journey. This judgement not only grants relief to taxpayers but also it reasserts foundational principles governing taxability. Let us analyze the background of the issue, history and the implications of this recent judgement.

Background to the issue.

The core of the controversy surrounding corporate guarantees stem from its commercial character. These guarantees are typically extended by a holding company to enable its subsidiary or other sister concerns to secure financing from banks or other financial institutions. These Corporate Guarantees are unlike bank guarantees, which are issued in the ordinary course of business for a consideration, by banks or other commercial institutions. This distinguishing feature has driven much of the litigation both before and after the advent of GST.

History under the erstwhile Indirect tax regime.

Under the erstwhile service tax regime, the issue was considered from the perspective of whether such guarantees constituted a “service” within the meaning of the Finance Act, 1994. If yes, whether corporate guarantees are akin to bank guarantees which are issued by banks and other financial institutions for a fee. The jurisprudence, culminating in the Supreme Court’s ruling in Commissioner of CGST & CE v. Edelweiss Financial Services Ltd. [TS-136-SC-2023-ST], firmly established that taxability depends on the presence of consideration. The absence of consideration being charged by the guarantor, was held to be absolutely fatal to the levy of service tax under the erstwhile service tax regime. The said judgement established that an activity could not qualify as a taxable service unless it involved both a service provider-recipient relationship and a measurable flow of consideration.

Introduction of GST and re-examination of the issue under GST framework

With the introduction of GST, the statutory framework for charging Indirect Taxes underwent a structural overhaul. However, the central concepts surrounding levy of tax, like “supply” as the taxable event, remained similar to erstwhile regime. Section 7 of the CGST Act defines supply to include any sale, transfer, barter etc. for consideration in the course or furtherance of business. Further, certain transactions are deemed to be a “Supply” even without consideration. The Bombay High Court, in the D.P. Jain case, carefully revisited these elements and reiterated that a transaction must satisfy multiple parameters to qualify as supply. This includes the presence of consideration unless specifically covered by deeming provisions (paras 61–63).

However, as per the Hon. Bombay High Court, Corporate guarantees did not seem to fit properly into this framework. Such Corporate guarantees are essentially contingent contracts or contingent liabilities, enforceable only upon the default of the borrower. Further. generally Corporate Guarantees are issued within a Corporate Group, and that too without any consideration. The petitioner in the case had clearly demonstrated that the guarantees were issued without any commission or fee (paras 26, 48, 63).

Despite this, the GST authorities sought to bring such transaction within the GST net, relying heavily on Schedule I, which deems certain related-party transactions as supplies even without consideration. Further, valuation provisions under Rule 28 were invoked to arrive at the value of such transactions. The valuation provisions under Rule 28 and its subsequent rules are invoked only cases where value cannot be arrived at by applying normal principles of arriving at value of a transaction.

However, resorting the valuation provisions mentioned in the rules led to inconsistent positions across jurisdictions. This ambiguous and subjective interpretation prompted the Central Board of Indirect Taxes and Customs (CBIC) to issue Circular No. 204/16/2023 dated 27 October 2023. This was further cemented through a legislative amendment in the form of introduction of Rule 28(2) which prescribed a deemed valuation of 1% per annum of the guaranteed amount.

The Circular attempted to resolve administrative ambiguities by declaring that corporate guarantees, even when provided without consideration, would constitute taxable supply of services (paras 11, 67). While this move ostensibly brought uniformity, it simultaneously triggered a fundamental controversy—whether a circular could effectively expand the scope of taxability beyond what is envisaged in the statute.

Implications of the recent Bombay High Court Judgement

The Bombay High Court’s judgement assumes a great significance. The judgement analyses the nature of corporate guarantees, the statutory framework, and the binding precedents in a layered manner. It first emphasized that corporate guarantees are not issued in the ordinary course of business but are “in-house” arrangements (paras 39, 44, 52). This distinction from bank guarantees was critical, as it undermined the Revenue’s attempt to equate the two. The revenue’s probable aim to equate the two was to establish a market equivalence between corporate guarantees and bank guarantees. This would enable using the valuation adopted by the banks as the open market value for Corporate Guarantees issued as “in-house arrangements”.

More importantly, the Court re-iterated the importance of consideration, under GST regime as well. It held that in the absence of any fee, commission, or economic recompense, the transaction failed to satisfy a fundamental requirement for a transaction to qualify as a “Supply” under GST (paras 68–70). The Court’s reasoning is a direct extension of the principle laid down in Edelweiss judgement, thereby ensuring continuity between the pre-GST and GST jurisprudence.

In doing so, the Court implicitly rejected the proposition advanced in the 2023 Circular that taxability could arise even in the absence of consideration. While Circular not struck down, it was made abundantly clear that tax liability must emanate from the statute and cannot be imposed through circulars (paras 15, 67–68).

At the same time, the judgement cautiously did not strike down Rule 28(2) on constitutional grounds. Relying on settled principles that fiscal legislation warrants judicial deference, it upheld the validity of the rule while leaving its application to be tested in appropriate cases (paras 72–79).

Concluding Remarks

Thus, the judgment, when read holistically and harmoniously, does not appear to create a broad proposition on the taxability of corporate guarantees. It leans towards deciding on the interplay between the absence of consideration and the lack of a workable valuation framework in the pre-amendment regime (prior to Oct. 2023).

Prior to the insertion of Rule 28(2), the law did not provide a clear or uniform mechanism to impute value to corporate guarantees. This, coupled with the fundamental requirement of consideration as an element of "supply," led the Hon. Bombay Court to conclude that such transactions could not be brought within the GST net. Here, although not explicit in the judgement, the Hon. Court appears to have followed the time-tested principle that in the absence of an appropriate mechanism/machinery to arrive at a 'taxable value', the levy itself fails. In that sense, the judgement assumes significance primarily in the context of pre-26 October 2023 guarantees, as it reinforces that in the absence of both consideration and a determinable value, the existence of a taxable supply itself is untenable.

However, since the issue before the Court pertained to a period prior to the introduction of Rule 28(2), the judgment does not conclusively deal with the post-amendment GST framework, particularly the interplay between the valuation mechanism and Schedule I of the CGST Act, 2017. Unlike the service tax regime considered in the Edelweiss judgment, the GST law specifically treats certain transactions between related parties as "supplies" even in the absence of consideration.

Accordingly, while the Hon. Bombay High Court has relied upon the principles laid down in Edelweiss judgement to hold that issuance of corporate guarantees without consideration may not constitute a taxable supply, the applicability of such reasoning under the distinct scheme of GST may still remain open to debate. In particular, the deeming fiction under Schedule I appears to indicate that, within the GST framework, the absence of consideration may not, by itself, be conclusive for determining whether a transaction constitutes a taxable supply.

Accordingly, the implications of this amended statutory framework are therefore likely to be tested further in judicial proceedings, and the controversy may ultimately require authoritative determination by the Supreme Court.

Additionally, the distinction drawn between the Bank Guarantees and Corporate Guarantees is also likely to be challenged. Even though Corporate Guarantee may be a one-off transaction undertaken in the course of furtherance of business, the GST legislation does not mandate that a transaction must be routine in nature in order to qualify as a supply. If this distinction is done away with, then probably the authorities would be able to equate the two and assign an open market value to Corporate Guarantees using Bank Guarantees as the benchmark.

Keeping the above considerations in perspective, the decision certainly offers a measure of clarity and relief to taxpayers, though the legal position on the issue is still evolving and may require further judicial determination. Therefore, while there is certainly a light at the end of the tunnel, whether it signifies the end of the controversy or only a step towards eventual clarity in GST regime is something that time alone will determine.