

# Changes to GST valuation rules for related-party corporate guarantees

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## 1 Background

Effective 26 October 2023, a specific valuation rule (Rule 28(2) of the Central Goods and Services Tax Rules, 2017 (CGST Rules)) applied to corporate guarantees between related parties, which deemed the value of the service of extending corporate guarantees to be the higher of:

- a. 1% of the guarantee offered, or
- b. the actual consideration charged.

This valuation rule applied regardless of whether full input tax credit (ITC) was available to the recipient. The Central Board of Indirect Taxes and Customs (CBIC), which is the central governing body for Goods and Services Tax (GST), had also reiterated that the provision of related-party corporate guarantee, even when made without any consideration, is taxable under the Central Goods and Services Tax Act, 2017

Subsequently, the CBIC notified amendments to the CGST Rules on 10 July 2024 making significant changes to Rule 28(2) with retrospective effect from 26 October 2023. It also issued a circular on 11 July 2024 (Circular) clarifying the taxability and valuation of the supply of the service of providing corporate guarantees between related persons.

The key changes and clarifications are discussed below.

The Central Board of Indirect Taxes and Customs has made significant changes to the Goods and Services Tax valuation rule for corporate guarantees provided by related parties. This update analyses the changes, the consequent clarifications, and their implications.

## 2 Changes to the CGST Rules

- a. **Introduction of periodicity in the computation of taxable value:** The words 'per annum' have been inserted in the valuation rule to specify that the taxable value will be 1% of the guarantee offered *per annum* or actual consideration, whichever is higher.

This insertion resolves the controversy as to whether or not the phrase '*per annum*' is to be read into the original text of Rule 28(2). Generally, the interpretation of tax statutes favours the doctrine of strict interpretation. This insertion has a major impact since it increases the total GST implication by a factor of the years for which the corporate guarantee is being provided, and more so because of the retrospective effect.

- b. **Waiver of valuation rule where full ITC is available:** A proviso has been inserted to explain that where the recipient of the service is eligible to avail full ITC, then the value declared in the invoice must be deemed to be the value of the supply of the said services. This change effectively waives the requirement to follow the valuation rule in cases where full ITC is available. This waiver was not permitted before the amendment.
- c. **Clarification on the applicability of the valuation rule:** The words '*located in India*' have been inserted to restrict the application of Rule 28(2) to only the recipients located in India. This is a clarificatory amendment.

### 3 Key clarifications under the Circular

S. No.	Issue	Clarifications
1.	Computation of applicable GST (on ' <i>per annum</i> ' basis)	<p>The value of supply for a particular number of years will be 1% of the guaranteed amount multiplied by the number of years for which the guarantee is offered, or the actual consideration, whichever is higher.</p> <p>If a guarantee is offered for less than six months, then valuation is to be done on a proportionate basis, i.e., the taxable value will be half of 1% of the amount guaranteed or actual consideration, whichever is higher.</p> <p>Each renewal is to be treated as a separate guarantee, to which this computation will individually apply.</p>
2.	Computation of GST in a co-guarantor situation	<p>The applicability of the deemed valuation rule would be verified at the overall corporate guarantee level, i.e., whether the sum of the actual consideration paid or payable cumulatively to the co-guarantors exceeds 1% of the total guaranteed amount or not.</p> <p>The GST liability of each co-guarantor will be:</p> <ul style="list-style-type: none"> <li>▪ the higher of actual consideration, if the cumulative consideration of all guarantors together is higher than 1% (per annum) of the total guaranteed amount; or</li> <li>▪ proportionate to their coverage of the total guaranteed amount, out of a 1% cumulative guarantee fee, if the cumulative consideration is less than 1% of the total guaranteed amount.</li> </ul>
3.	Applicability of the valuation rule to corporate guarantees issued before 26 October 2023	<p>The corporate guarantees issued before 26 October 2023 would not be subject to the deemed valuation rule (while still being taxable under the GST laws). This rule will only apply to corporate guarantees issued or renewed after 26 October 2023.</p>

## **4 Impact**

The '*per annum*' computation of GST on corporate guarantees is likely to be onerous and may have a chilling effect on the industry. This amendment may be challenged before the courts given that it seeks to impose a substantive liability on the taxpayer with retrospective effect, requiring an evaluation of all corporate guarantees issued or renewed from 26 October 2023 onward.

The relaxation from the applicability of the deemed valuation rule in situations where full ITC is available, while generally a welcome change (especially, considering the retrospective effect), does not soften the circumstances for sectors such as infrastructure, energy, and alcohol manufacturing, where ITC is blocked.

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