

GST levy on corporate guarantee challenged before Delhi HC

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Summary

The imposition of Goods and Services Tax (GST) on 'corporate guarantee' has been challenged before the Delhi High Court (HC) on the premise that issuance of such guarantee to an associate company is an in-house guarantee and does not qualify as a supply of services. The petitioner relied on the decision pronounced under the erstwhile Service Tax regime in its own case as well as the Supreme Court's (SC) decision in the case of Edelweiss Financial, which held that issuance of corporate guarantee to a group company without any consideration would not fall within the ambit of taxable services. The Delhi HC has restrained from taking any coercive action for the interim period.

Facts of the case

- Sterlite Power Transmission Limited (petitioner) has challenged the imposition of GST on the activity of providing a corporate guarantee to a subsidiary company by the holding company on the premise that it does not fall within the ambit of supply of services.
- The petitioner has also assailed the Central Board of Indirect Taxes and Customs (CBIC) Circular No. 204/16/2023-GST dated 27 October 2023, vide which the taxability of personal and corporate guarantee was clarified.

Key submissions of the petitioner

- The petitioner stated that the Customs Excise and Service Tax Appellate Tribunal (CESTAT) Chennai, in the case of its own group company, M/s. Sterlite Industries India Limited, had held that providing a corporate guarantee to an associate company is like an in-house guarantee to protect the company's own investment and would not amount to providing taxable services.
- Drawing reference from the SC's judgement in M/s. Edelweiss Financial Services Limited, the petitioner,

contended that even in the erstwhile service tax regime, issuance of corporate guarantee to a group company without any consideration was construed as a non-taxable service.

- The petitioner emphasised that corporate guarantee is in the nature of contingent contract, which becomes enforceable only at the instance of a bank/financial institution in the event of a default. Accordingly, extrapolating the value of enforcement with the value of the guarantee and fixing a value of 1% of the corporate guarantee would put an onerous burden on the entity providing such a guarantee.

Delhi HC's observations and order [W.P. (C) 2966/2024, order dated 28 February 2024]

- The HC has issued a notice in the matter and directed that no coercive action should be taken against the petition where a final assessment is passed or demand is created.

Our comments

The issue surrounding the taxability and valuation of corporate guarantee has been a bone of contention ever since the decision of SC in the case of Edelweiss Financial Services Limited came out, which ruled out service tax applicability on the provision of corporate guarantee in the absence of consideration. However, the SC did not specifically delve into the applicability of 'service' per se in its decision.

Consequently, the tax authorities treated the activity of providing a corporate guarantee to associated enterprises, with or without consideration, as a supply of service under GST, whereas the taxpayers argued that the holding company has a fiduciary duty to fund its subsidiary, and therefore, such guarantee was in the nature of actionable claims and not liable to GST.

However, the GST council, in its 52nd council meeting, recommended issuance of the impugned circular to clarify the taxability of personal and corporate guarantee and amended Rule 28 of the Central Goods and Services Tax (CGST) Rules to specify the value of supply of corporate guarantee to be 1% of the value of the guarantee or consideration to that effect.

Ever since new valuation rules came into effect, there have been ambiguities with regards to time and value of supply. The challenge of GST levy and valuation rules will have multi-faceted implications and will be closely monitored by the taxpayers.

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