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Corporate Guarantee GST: Tax Stays, Valuation Relief Granted

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Mains: Tax certainty, equality and evidence-based valuation



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Why in News

Published reports of a Delhi High Court ruling say that **GST remains applicable to corporate guarantees between related companies**, while the interpretation of the **1% annual valuation** under CGST Rule **28(2)** as an irrebuttable minimum has been limited.

According to the reports, a supplier can establish a lower open market value through cogent, verifiable evidence. **The 1% figure is a valuation benchmark, not the GST rate.** This distinction is central to understanding the ruling.

What Is a Corporate Guarantee?

A corporate guarantee arises when one company guarantees a subsidiary or group company's borrowing from a bank or financial institution. The borrower benefits from the guarantor's creditworthiness.

Simple example: A parent company guarantees its subsidiary's loan. Subject to the guarantee's terms, the lender gains an additional party responsible if the borrower fails to pay. A guarantee is different from directly lending money.

Taxability Is Different from Valuation

Taxability: Does the activity amount to a taxable supply of services? The reports say the Court held that such guarantees between related persons in the course of business can be taxable even without commission.

Valuation: If the service is taxable, what value should be assigned to it? The text of Rule 28(2) refers to 1% of the guaranteed amount per annum or actual consideration, whichever is higher. It also contains a separate proviso for a recipient eligible for full input tax credit.

Input tax credit: The facility allowing a business to offset eligible tax paid on purchases against its output-tax liability. Eligibility depends on the facts of each case.

> **Related reading:** GST Process Reforms: Easier Compliance and Taxpayer Rights

What Distinction Did the Court Make?

According to the published legal reports, the Court accepted the rule-making power but found an irrebuttable 1% minimum arbitrary under **Article 14**, where a lower market value could be established.

Reading down: Limiting the interpretation of a provision so that it operates within legal limits, instead of striking it down altogether. Removing a tax liability and limiting a rigid valuation rule are different outcomes.

Rebuttable presumption: A starting assumption that can be displaced by sufficient evidence. Merely agreeing on low or zero commission within a group does not itself establish a lower market value.

Why This Matters for Policy

The value of certainty: Deemed valuation can simplify administration and reduce the risk of artificial related-party pricing.

The risk of rigidity: A fixed minimum can impose similar burdens on guarantees with different durations, borrower credit profiles and real risks.

The role of evidence: A lower-value claim needs independent, verifiable support. This preserves room for relief while allowing tax officers to test the claim.

Way Forward

Clear valuation guidance, consistent administration and adequate records can reduce disputes. Taxpayers need to document guarantee terms, duration and independent valuation evidence.

Fact limit: This account relies on available news and legal reporting. A certified copy of the original judgment was not independently obtained. It does not determine any company's final liability or promise the same outcome in every case. The original order and applicable law must be checked for tax planning.

Prelims Practice Questions

Question 1. With reference to the taxation of corporate guarantees, consider the following statements:

Statement 1: The taxable value of a service and the tax rate applicable to it are separate concepts.

Statement 2: The 1% figure in CGST Rule 28(2) is the GST rate on corporate guarantees.

Which of the statements given above is/are correct?

(a) 1 only

(b) 2 only

(c) Both 1 and 2

(d) Neither 1 nor 2

▼ **Answer and Explanation**

Correct answer: (a)

Statement 1 is correct: valuation establishes the taxable value, while the applicable rate is a separate question.

Statement 2 is incorrect: 1% is a benchmark for valuing the service by reference to the guarantee amount, not the GST rate.

Question 2. In judicial review, what does 'reading down' a provision most appropriately mean?

(a) Removing the provision entirely in every situation

(b) Narrowing its interpretation so it operates within legal limits

(c) Sending a Bill to the other House of Parliament

(d) Automatically suspending tax payment indefinitely

▼ **Answer and Explanation**

Correct answer: (b)

Reading down involves a limited interpretation of a provision. It is not the same as striking the provision down altogether.

Mains Practice Question

'Tax administration needs certainty, but irrebuttable presumptions may produce arbitrary outcomes.' Discuss with reference to the valuation of corporate guarantees. (150 words, 10 marks)

Answer Outline

Introduction:

Deemed valuation assigns a statutory benchmark value. It can give administrative certainty to related-party transactions.

Main Body:

Purpose: prevent artificial pricing and simplify compliance.

Concern: an inflexible floor can treat different credit risks alike.

Constitutional test: non-arbitrariness under Article 14.

Balance: accept a lower market value supported by verifiable evidence, without treating related-party commission as sufficient proof.

Administration: valuation guidance, records and officer training.

Conclusion:

Taxability and valuation rigidity must be examined separately, balancing predictable administration with fairness.

Frequently Asked Questions (FAQ)

Has GST on corporate guarantees been removed?

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According to the reports, taxability remains. The relief concerns the interpretation of a mandatory minimum valuation.

Is 1% the GST rate?

No. It is a benchmark for valuing the service by reference to the guarantee amount.

Does zero commission establish zero market value?

No. The reports say agreed related-party commission is not, by itself, independent evidence of market value.

Was Rule 28(2) struck down entirely?

The reports describe a limited interpretation of the rule, not the removal of the entire tax treatment.

Sources

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