NOTE ON TAXABILITY AND VALUATION OF CORPORATE GUARANTEES

The controversy surrounding the GST treatment of corporate guarantees between related entities (e.g., parent and subsidiary and alike), is not reaching anywhere in view of the conflicting decisions of the High Courts.

The taxpayers must take a call based on the statutory intent rather than litigating, to avoid accumulated tax liability and interest/penalty.

Judicial conflict between the Gujarat High Court (Torrent Power Ltd. v. UOI, 14 August 2026) and the Bombay High Court (D.P. Jain & Co. Infrastructure Pvt. Ltd. v. UOI, 7 May 2026), has created uncertainty but the Gujarat High Court decision appears to be on sound reasoning.

While the Gujarat High Court in Torrent Power upheld taxability under Section 7(1)(c) read with Schedule I (Entry 2) while reading down Rule 28(2)'s mandatory 1% floor, the Bombay High Court in D.P. Jain & Co. held that gratuitous corporate guarantees are purely non-taxable shareholder acts outside the scope of "supply."

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Gujarat High Court (Torrent Power Ltd. - 14 August 2026)

- Taxability Upheld: Confirmed that corporate guarantees issued for related entities qualify as a deemed "supply of service" under Section 7(1)(c) read with Entry 2, Schedule I of the CGST Act, even without consideration.
- Expansive View of Business (Sec 2(17)): Rejected the argument that issuing a guarantee is a mere "shareholder function." Financial backing directly furthers group economic health and is incidental/ancillary to business.
- Rule 28(2) Read Down: Upheld the constitutional validity of Rule 28(2) under Section 15(4), but struck down the phrase "whichever is higher". Where actual consideration/commission is charged, forcing an arbitrary 1% floor violates Article 14.
- Temporal Limitation Error: Ruled that taxability applies only prospectively from the insertion of Rule 28(2) (26 October 2023).

Bombay High Court (D.P. Jain & Co. - 7 May 2026)

- No Consideration = No Supply: Transposed the Supreme Court's Service Tax ratio in Edelweiss Financial Services into GST, holding that in the absence of consideration, no taxable service arises under Section 7.

Shareholder Act Exclusion: Held that a gratuitous parent guarantee is a noncommercial shareholder/parent obligation, not an activity "in the course or furtherance of business" under Schedule I Entry 2.

- CBIC Circular 204 Held Ultra Vires in Application: Struck down CBIC Circular No. 204/16/2023-GST to the extent it purported to create taxability on gratuitous guarantees, clarifying that administrative circulars cannot expand statutory charge.
- Rule 28(2) Preserved but Inoperable: Declined to strike down Rule 28(2) itself, holding it to be a valid valuation rule for cases where a supply independently exists (e.g., where actual consideration is charged), but inoperable where there is no underlying supply.

Besides the contradictory decisions by the Nagpur Bench of Bombay High Court and the Gujarat High Courts plus writ petitions pending in other High Courts i.e. Punjab & Haryana HC

- CWP No. 10249 of 2024 (Acme Cleantech Solutions), Bombay HC (Principal Seat) - WP No. 4519 of 2024 and Delhi HC - WP (C) No. 2966 of 2024 (Sterlite Power Transmission), will reach before the Supreme Court.

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Therefore, it is advised that the Taxpayers should take a considered view. We would suggest that:

i. Obtain a formal valuation report from a Certified Valuer / Transfer Pricing Expert.

ii. Benchmark the corporate guarantee commission against prevailing commercial Bank Guarantee (BG) rates (typically 0.25%–0.75%), adjusting for creditworthiness, counter-indemnities, and underlying collateral. iii. Use this certified rate to establish Open Market Value (OMV) under Section 15(1), leveraging Gujarat HC's reading down of the 1% floor.

iv. Structure inter-company guarantee agreements to provide for an annual recurring fee based on the outstanding guaranteed balance during the year, rather than a single upfront charge. This reflects standard commercial banking practice and avoids front-loading tax liability.

v. Where the recipient subsidiary is eligible for full Input Tax Credit (ITC), the second proviso to Rule 28(2) specifies that the value declared in the invoice is deemed to be the Open Market Value.

vi. **No invoice or nil value lacks statutory backing.**

vii. Audit all guarantees provided by foreign holding companies to Indian lenders. Ensure RCM liabilities are computed and paid under the correct Time of Supply (Sec 13(3)), claiming corresponding ITC where eligible.

Conclusion

Section 7 covered supplies and Schedule-I dispensed with consideration in case of related persons. Section 15(4) and Rule 28 already existed prior to Rule 28(2), therefore, the levy existed even before 26.10.2023 as Rule 28(2) merely prescribed a special valuation methodology but it did not create the taxable event or the supply and it is not the charging provision. CBIC always maintained that guarantees were taxable even prior to Rule 28(2) and only valuation differed.

In case of conflicting decisions, tax payment (and availing ITC) is good strategy rather than avoiding tax with "nil" consideration etc. The Gujarat HC's striking down of the "whichever is higher" clause has impact on GST valuation where actual consideration is identifiable. It affirms that procedural deeming tools cannot override real transaction values under Section 15(1). The tax exposure must be evaluated based on guarantees issued prior to 26 October 2023 versus post-amendment execution/continuation.

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