Tax alert: Gujarat HC holds corporate guarantee provided to related parties as taxable supply under GST Law; however reads down valuation Rule 28(2) of CGST Rules

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The Gujarat High Court has held that corporate guarantees provided by holding companies to subsidiary companies, is a taxable supply. However, it has read down the words “whichever is higher” in the valuation Rule 28(2), to mean value would be 1% or actual consideration as applicable. It also restricted the application of Rule 28(2) to corporate guarantees issued/ continuing for only periods post its introduction.

In a nutshell

Gujarat HC has held that furnishing of a corporate guarantee by a holding company to support borrowings of its subsidiary, constitutes a taxable supply of service under the GST law.

The Court has upheld the constitutional validity of Rule 28(2) of the CGST Rules, 2017 and Section 15(4) of the CGST Act, 2017. However, it has read down the expression "whichever is higher" in Rule 28(2), holding the same to be arbitrary and violative of Articles 14, 19(1)(g) and 265 of the Constitution.

The HC restricted the applicability of Rule 28(2) to corporate guarantees pertaining to period post its insertion i.e., from 26 October 2023 onwards.
While sustaining the validity of CBIC circulars, the Court held that the circulars would stand modified to the extent they are contrary to the findings and directions contained in the judgment.

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Background:

- The Gujarat High Court has addressed a batch of petitions wherein the petitioners who have furnished corporate guarantees (CGs) have challenged the validity of Rule 28(2) of the CGST Rules, 2017 and Section 15(4) of the CGST Act, 2017.
  - As per section 15(4), in case of a related party transaction, value needs to be determined as prescribed in the Rules.
  - Rule 28(2)[1]provides that the value of supply of services by way of providing a CG to a related person shall be deemed to be 1% of the amount of such guarantee offered per annum or the actual consideration, whichever is higher.
- The petitioners also challenged the validity of CBIC Circular No. 204/16/2023-GST dated 27 October 2023 and Circular No. 225/19/2024-GST dated 11 July 2024.
  - Circular No. 204 clarified taxability of personal guarantee given by Directors and CG under GST Law.
  - Circular No. 225 provided clarifications regarding taxability and valuation of provision of CG between related persons.
- All the petitioners referred to the Bombay High Court's judgment[2] which had relied on the Supreme Court decision[3] and had ruled that CGs issued without consideration on behalf of group companies do not constitute a taxable supply under GST. Additionally, the petitioners made the following key arguments –
  - CG does not constitute 'supply of service'.
  - There is violation of constitutional provisions i.e., Articles 14, 19(1)(g), and 265.
  - Absence of consideration.
  - It is an actionable claim and hence out of the ambit of supply.
  - It is a shareholder/ investment activity.
  - Valuation is arbitrary and lacks a legislative or commercial foundation.
  - Opposed the retrospective application of Rule 28(2)
  - Respective circulars are contrary to the legislative framework.
  - CGs being contingent in nature, time of supply of services cannot be determined.
  - CGs do not qualify as "continuous supply of services" as they do not involve periodic payment obligations.
  - Challenged the invocation of Section 74 of the CGST Act

Gujarat High Court Judgement[4]:

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[1] Inserted with effect from 26.10.2023

[2] D.P. Jain & Co. Infrastructure Pvt. Ltd. vs. Union of India (2026) 42 Centax 208 (Bom.)

[3] Commissioner of CGST and Central Excise vs. Edelweiss Financial Services Ltd. (2023) 5 Centax 58 (S.C.)/2023 (73) G.S.T.L. 4 (S.C.)

[4] Torrent Power Ltd Versus Union of India & Ors.[TS-592-HC(GUJ)-2026-GST]

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- At the outset, the HC distinguished the Supreme Court judgement[5] pertaining to service tax regime that had held that service tax is not leviable on CGs in the absence of consideration. Unlike GST law[6], the erstwhile regime contained no deeming fiction to tax transactions between related parties in the absence of consideration. Accordingly, it also distinguished the Bombay High Court's judgment7 relied upon by the petitioners.
- Unlike the erstwhile service tax regime, Section 7(1)(c) of the CGST Act read with Schedule I permits taxation of specified transactions between related parties even where no consideration exists. Accordingly, absence of guarantee commission does not by itself take the transaction outside GST.

Taxability of Corporate Guarantees

- The court held that CGs furnished by holding companies to their subsidiaries, even without consideration, constitute a "supply of services" under Section 7(1)(c), read with Schedule I which treats specified activities as 'supply' even if made without consideration.
  - The term "business" under GST includes ancillary and incidental activities, even where there is no profit motive or regularity of transactions. There is no compulsion of volume, continuity, or frequency, and even single or isolated transactions still count as business. The activity of the Holding Company in giving the CG to its subsidiary, which enables it to secure loan for its commercial activities, will be an activity incidental to "similar activity" to trade, commerce etc., and hence qualifies as "business".
  - A CG as sought by the subsidiary from the Holding Company and acknowledged by the Holding Company for fulfillment of its financial security, will fall within the expression "agreeing to do an obligation to do an act".
  - Even though the subsidiary company may not be a party to the contract of CG, the supply of services ultimately accrues to and is rendered for the benefit of the subsidiary company. Accordingly, the subsidiary company would be a "recipient" of the services.
  - The CG arrangement creates contractual rights and obligations not only between the lender and guarantor but also between the guarantor and subsidiary through statutory indemnity and subrogation principles under the Contract Act.

Implied consideration

- The High Court held that the act of providing a CG, even without monetary consideration, constitutes a "supply of service" under the CGST Act due to the implied consideration arising from the benefit conferred upon the subsidiary by the creditor bank. This satisfies the requirements of "consideration" under both the CGST Act and the Indian Contract Act, 1872.

Related Party Relationship

- Holding companies and subsidiaries qualify as "related persons" under the Explanation to Section 15 of the CGST Act due to the element of control. Consequently, Entry 2 of Schedule I applies.

Whether corporate guarantee is an actionable claim

- A CG cannot be regarded as an actionable claim. An actionable claim represents a direct, primary right to

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[5] Commissioner of CGST and Central Excise vs. Edelweiss Financial Services Ltd. (2023) 5 Centax 58 (S.C.)/2023 (73) G.S.T.L. 4 (S.C.)

[6] Section 7(1)(c) of CGST Act read with Schedule I of CGST Act

[7] D.P. Jain & Co. Infrastructure Pvt. Ltd. vs. Union of India (2026) 42 Centax 208 (Bom.)

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claim a payment or debt, which cannot be compared to CG which stems out of secondary, contingent liability that triggers on default of the principal debtor emanating from a tri-partite agreement.

Whether corporate guarantee is a shareholder activity or not

- The doctrine of shareholder activity cannot be applied stricto senso to the GST regime, and it depends on the nature of execution of CG.
- The fact that CGs were excluded from the scope of international transactions under Income Tax Act cannot restrict the expression 'supply of service' under GST Law.

Pledge of shares and guarantee

- The Court distinguished pledge from a guarantee but observed that where pledge arrangements form part of the overall financing package, the substance of the transaction must be examined. The existence of a pledge does not negate the supply arising from the corporate guarantee and if the ingredients of CG are satisfied, tax liability would arise.

Time of supply and whether it is continuous supply

- CG service officially begins and fulfills its "time of supply" on the exact date the contract is executed and tax levy gets attracted on the execution date.
- In the instant cases, the time of supply is the date on which the recipient (subsidiary) reflects the guarantee in its books of accounts, and it occurs annually based on the outstanding balance of the guaranteed amount.
- CG is one time undertaking, with continuing obligation. It does not qualify as "continuous supply of services" under GST Law due to the absence of periodic payment obligations.

Vires of Rule 28(2) and Section 15(4)

- The Gujarat High Court upheld the constitutional validity of Rule 28(2) of the CGST Rules but read down the expression "whichever is higher" to discharge GST based on the actual consideration or the deemed value of 1%, as applicable. It held that the mandatory application of the higher value would violate Articles 14,19(1)(g) and 265 of the Constitution.
- Imposition of levy of GST on 1% valuation per annum to the CG prior to the introduction of Rule 28(2) w.e.f. 26.10.2023 is harsh and unfair to the taxpayers. It will be hit by the doctrine of unjust enrichment and violative of Article 14 and 19(1)(g) of the Constitution of India. However, GST would be applicable from 26 October 2023 onwards in respect of CGs that continue beyond such date.
- The Court upheld the constitutional validity of Section 15(4) of the CGST Act.

Validity of Circular No. 204 and Circular No. 225

- The Circulars merely operationalize and clarify the statutory framework and do not independently create a levy.
- The FAQs in the circulars would be altered based on the explanation of the statutory provisions provided by the Court and the reading down of the expression "whichever is higher". Accordingly, Revenue may consider issuing fresh Circulars / Administrative Instructions falling in line with this decision.

Invocation of Section 74

- The court quashed the invocation of Section 74 of the CGST Act (pertaining to fraud, willful misstatement, or suppression of facts) against the petitioners, holding that there was no deliberate intent to evade tax.

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Discrimination Claims:

- The court rejected the petitioners' claim of discrimination regarding exemptions granted to government-backed guarantees, holding that such exemptions are permissible under Section 11 of the CGST Act to serve public interest.
- The Court directed the Revenue to refund the excess GST paid by the petitioners. Alternatively, the parties may adjust the GST amount if they so desire.

Indirect Tax comments:

The ruling is a significant development in the ongoing controversy surrounding GST on CGs. The HC has affirmed the Revenue's position that CG provided to related parties without consideration are taxable supplies. However, relief has been granted as follows-

- **Reading down the words "whichever is higher"** in the valuation provision to mean value would be 1% or actual consideration as applicable. Where actual guarantee commission is ascertainable, taxpayers may contend that GST should apply on the actual commission and not on the deemed 1% valuation. This could significantly reduce GST exposure in many cases.
- **Restricting the application of Rule 28(2) to CGs active for only periods post its introduction**. This is likely to benefit taxpayers facing disputes relating to CGs where they are compulsorily valued at deemed rate of 1% for prior periods.
- It also reinforces that **extended limitation** cannot be invoked in this case due interpretational disputes.

Practical impact

- The judgment is likely to have significant implications for ongoing audits, investigations and appellate proceedings involving CGs valuation.
- There may be interpretation issues in respect of valuation of CGs for periods prior to introduction of Rule 28(2) and for later periods with regard to 'quantum' of actual consideration vis-à-vis arms-length price.
- Industry needs to watch out for any clarifications from CBIC as the Court has categorically set aside the clarification issued vide impugned Circulars dated 27.10.2023 and 11.07.2023 to the extent they run contrary to the observations and directions issued by the Court.
- Given the wider ramifications of the ruling, the matter may witness further challenge before the Supreme Court by both, the department as well as taxpayers, for their respective interests.
- Moreover, this being a Gujarat High Court judgment, it may have a persuasive value before the other High Courts but will not have binding effect on them.

Direct Tax comments:

- Taxability of CG commission be examined (especially where the recipient of commission is a non-resident should be examined based on applicable tax treaty provisions). Further, the same should generally be at arm's length from a deductibility perspective.

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