

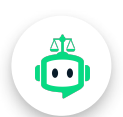
# The unexpected GST burden on Japanese corporate guarantees

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**T**he Goods and Services Tax (GST) was a game-changer in the financial and corporate sectors. Recent changes to the GST have significant implications for Japanese companies in India, particularly how corporate guarantees are taxed.

Corporate guarantees play a crucial role in project financing, primarily determining the financing, structuring and feasibility of large-scale ventures. In these arrangements, a parent company guarantees debts to or loans from banks and financial institutions for its group, subsidiary, or joint venture companies. The guarantees are commitments by the parent entity to financial institutions on behalf of its subsidiary, taking effect on default. Usually, no consideration is sought by the parent company for these services, showing their strategic importance in facilitating financial support for major projects within corporate groups.



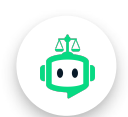


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Corporate guarantees, usually seen in corporate finance as instruments helping to arrange capital, are now chargeable under the GST. Following the GST Council's 52nd meeting and the Central Board of Indirect Taxes and Customs notifications, these guarantees are now treated as a supply of services under schedule I of the Central Goods and Services Act, 2017 (act). This includes guarantees provided without consideration, a pivotal shift in their tax treatment.

Under the previous service tax regime, corporate guarantees without consideration were not taxable, as held by the Supreme Court in *Commissioner of CGST and Central Excise v M/s Edelweiss Financial Services Ltd*. The position is different under the GST, as clause 2 of schedule I of the act provides that services supplied between related parties in the course of business are taxable, even for no consideration. Corporate guarantees are often listed in a company's memorandum of association as an incidental or ancillary object, thus categorising them as business-related activities. These amendments resolve the longstanding debate about the taxability of corporate guarantees, previously considered non-taxable actionable claims.

Amended rule 28 of the CGST Rules introduced a new mechanism for determining the taxable value of corporate guarantee services. It provides that the value shall be the higher of either one per cent of the amount guaranteed or the actual consideration. This change may significantly increase the tax obligations of Japanese parent companies providing guarantees to their Indian subsidiaries.





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Japanese corporations must deal with the complexities of the GST in the valuation and taxation of corporate guarantees. There is a notable distinction in the treatment of guarantees provided by Indian companies and those by foreign entities such as Japanese companies. For foreign companies, the GST on corporate guarantees is payable under the reverse charge mechanism as an import of services, putting the tax liability on the recipient Indian subsidiary.

The new tax regime raises several concerns for Japanese companies. As to valuations, the term “amount of such guarantee offered” may lead to ambiguity in determining the taxable value. It could include the principal, interest and additional charges secured by the guarantee. Taxpayers may contend that since the service’s recipient benefits solely from securing loans equal to the principal amount, the taxable value should include only the principal amount, excluding interest and additional charges.

For guarantees executed before the amendment, the tax computation is difficult resulting from the lack of a clear valuation method. The GST authorities may find it challenging to charge tax on such guarantees. As corporate guarantees often span many years, it is uncertain whether the tax should be levied on a one-time charge or a continuous service.

The GST Council’s decisions have made significant changes in the treatment of corporate guarantees, affecting Japanese companies. Although the amendments provide clarity, they also introduce new facets to consider regarding tax liabilities, valuations, and operational considerations. Companies must stay informed and seek expert advice to navigate these changes effectively.

There is a need for further clarification and policy adjustments to address these challenges, particularly in sectors where the GST may not be available as a credit, such as renewable



energy, conventional power, alcoholic beverages and petroleum.

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