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# **CONTINGENT COMMITMENTS AND TAXABLE SUPPLIES - REASSESSING THE GST TREATMENT OF CORPORATE GUARANTEES**

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Vagisha Gupta, O.P. Jindal Global University

## **ABSTRACT**

This paper scrutinizes the way corporate guarantees are treated under the GST regime in India, and it argues that the taxability of these guarantees is both legally flawed and commercially unviable. This is argued on the basis that corporate guarantees do not constitute a 'supply' under the GST Act, which is the foundational requirement for GST to be applicable. This is derived from two key arguments: first, that gratuitous corporate guarantees lack the essential element of consideration required for a taxable supply under Section 7(1) of the CGST Act; and second, that they often fall outside the "in the course or furtherance of business" criteria necessary for deemed supplies under Schedule I. The paper further contends that corporate guarantees are contingent internal arrangements, not commercial services, and that their taxation misrepresents their true nature. It advocates for aligning the law with practical commercial realities.

## A. Introduction

A corporate guarantee is a contractual commitment given by a parent company or holding company to a third party, usually a financial institution or creditor, assuring them that it will fulfil the obligations of its subsidiary or group entity in case of default. This guarantee acts as a financial backstop and provides comfort to lenders, enabling the subsidiary to secure loans or other credit facilities on better terms. Such guarantees are common in corporate structures where group entities support each other to ensure smooth financial functioning and to leverage group strength in accessing credit markets.

However, the classification of corporate guarantees under the Indian Goods and Services Tax (GST) regime has emerged as a complex and contentious issue. While businesses typically treat these guarantees as internal support arrangements with no independent commercial consideration, tax authorities have increasingly sought to classify them as "supply" under GST law, thereby making them liable to tax. This has raised significant legal and practical questions regarding the true nature of a corporate guarantee, the scope of "supply" under GST, and whether such internal financial assurances should attract tax at all.

## B. Legal Framework Governing Corporate Guarantees Under GST

To assess the GST implications of corporate guarantees, it is necessary to first examine the legal framework specifically governing their treatment under the CGST Act. To justify the taxability of corporate guarantees, the Central Board of Indirect Taxes and Customs (CBIC) has relied upon Section 7(1)(c) of the Central Goods and Services Tax (CGST) Act, 2017 read with Schedule I of the act which deems certain activities as "supply" even when made without consideration.<sup>1</sup> One such activity is provided for in Entry 2 of the Schedule which states *“Supply of goods or services or both between related persons or between distinct persons as specified in section 25, when made in the course or furtherance of business”*

The term “related persons” is defined in the Explanation to Section 15 of the CGST Act and includes, among others, entities that share common control, ownership, or managerial relationships, such as directors of each other’s businesses, legally recognized partners, members of the same family, or entities under common control. Further, persons who are

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<sup>1</sup> Circular No. 204/16/2023-GST, available at: <https://gstcouncil.gov.in/sites/default/files/2024-06/circular-no-204-16-2023.pdf>.

associated in business as sole agents, distributors, or concessionaires are also deemed to be related. Moreover, the term “person” itself is broadly defined under Section 2(84) to include individuals, companies, partnerships, LLPs, trusts, societies, governments, and entities incorporated outside India.

Accordingly, where such related persons engage in a transaction without consideration, it may still qualify as a deemed supply under Schedule I provided it is undertaken in the course or furtherance of business.

The valuation of corporate guarantees between related persons is governed by Rule 28 of the CGST Rules. Furthermore, Rule 28(2) deems the value of such services to be 1% of the guaranteed amount per annum or the actual consideration, whichever is higher, subject to specific exceptions where full ITC is available.

### **C. The Controversies surrounding Corporate Guarantee**

The objection to the taxability of corporate guarantees under GST is two-fold. First, such guarantees, when issued without charge, lack the element of consideration required under Section 7(1) of the CGST Act which specifies the elements for an activity to constitute “supply”. Secondly, that exceptions under Schedule I which permit taxation of supplies made without consideration, would not apply for most corporate guarantees since this applies only where the activity is in the course or furtherance of business and providing corporate guarantees is rarely part of the guarantor’s core business with it typically being an internal financial arrangement, not a commercial activity. As such, it often falls outside the scope of business under GST.

#### ***Lack of Consideration***

Under Section 7(1) of the CGST Act, a taxable "supply" must involve an activity such as sale, transfer, barter, exchange, lease, licence, or disposal, undertaken for consideration. This requirement of consideration is fundamental to the structure of GST, as it reflects the reciprocal nature of a commercial transaction. Without identifiable consideration, monetary or otherwise, there is no taxable event. Corporate guarantees, particularly those issued gratuitously within group structures, often lack this essential element, making their classification as “supply” under GST legally questionable.

In most cases, parent companies offer corporate guarantees in favour of their subsidiaries not as independent commercial services but as internal risk allocation mechanisms. These undertakings are contingent in nature and are rarely invoked unless the subsidiary defaults. They are typically issued without separate consideration and are not commercially monetized in the ordinary course of business. From a legal standpoint, this characterization is supported by Section 126 of the Indian Contract Act, 1872, which defines a "contract of guarantee" as a contract to perform the promise, or discharge the liability, of a third person in case of default. This definition emphasises that a corporate guarantee does not constitute a supply of a benefit or a service in itself but is merely a contingent financial assurance.

Judicial decisions have reinforced this distinction. In *Sterlite Industries India Ltd. v. Commissioner of GST and Central Excise, Tirunelveli* (2019),<sup>2</sup> the Tribunal refused to equate corporate guarantees with bank guarantees, holding that while bank guarantees are offered in the course of business and for consideration, corporate guarantees issued by group companies serve an internal function of financial support and are not akin to service provision. The Tribunal underscored that the issuance of a corporate guarantee in such contexts does not involve delivery of a commercial service in the conventional sense and cannot be taxed as such.

Similarly, in *Commissioner of CGST & Central Excise, Mumbai East v. Edelweiss Financial Services Ltd.* (2023),<sup>3</sup> CESTAT Mumbai held that corporate guarantees issued without any consideration cannot constitute a taxable supply. The Tribunal noted that "consideration" is fundamental to the taxability of services under Section 65B(44) of the Finance Act, 1994 and that notional or presumed value cannot substitute for real, demonstrable consideration. This position was later affirmed by the Supreme Court.<sup>4</sup>

More recently, this view was also reflected in *Sterlite Power Transmission Ltd. v. Union of India* (2024),<sup>5</sup> where the petitioner challenged the taxability of a corporate guarantee under GST, arguing that such guarantees are contingent contracts which do not give rise to any enforceable service unless invoked. The Delhi High Court issued notice to the Revenue and granted interim protection against coercive action, recognising the seriousness of the legal issue.

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<sup>2</sup> 25 GSTL 277 (CESTAT Chennai).

<sup>3</sup> 5 Centax 57 (Tri.-Mumbai).

<sup>4</sup> 73 GSTR 4 (SC).

<sup>5</sup> 160 taxmann.com 381 (Delhi).

Therefore, a gratuitous corporate guarantee without any agreed consideration fails to meet the threshold for a taxable supply under Section 7(1) of the CGST Act, and its automatic inclusion within the GST net lacks both statutory and commercial justification.

### ***Not in course or furtherance of business***

While Schedule I Entry 2 of the CGST Act allows certain transactions between related parties to be taxed even in the absence of consideration, this exception is limited in scope. The provision explicitly requires that the activity be carried out "in the course or furtherance of business." This qualifier imposes an important check on the application of deemed supply rules. Corporate guarantees provided by companies that are not in the business of issuing guarantees, such as manufacturing or trading concerns, are often internal financial arrangements unrelated to their core operations. As such, they fall outside the ambit of Schedule I, which continues to require a demonstrable link between the transaction and the business activities of the supplier.

This view can be supplemented by the CESTAT Delhi decision in *Sowar Pvt. Ltd. v. Commissioner of Service Tax, Delhi-II* (2023),<sup>6</sup> where the Tribunal held that corporate guarantees issued by a non-financial entity did not fall within the scope of "Banking and Other Financial Services." The Tribunal reasoned that tax liability under that category arises only when the service provider falls within a specified set of entities such as banks, non-banking financial companies, or other financial institutions. A company whose principal business lies outside the domain of financial services cannot be taxed under this head for issuing a corporate guarantee.

This distinction is further supported by *In Re: Emcure Pharmaceuticals Ltd.* (2022),<sup>7</sup> the Authority for Advance Rulings held that services provided to employees such as canteen or transportation facilities are not subject to GST when they are not directly connected to or incidental to the primary business activity. By analogy, if providing transport to employees does not constitute a supply when it is outside the ordinary course of business, the same logic should apply to the provision of corporate guarantees by a company not engaged in financial services.

Moreover, CBIC in its own published guidance has clarified that an activity will only be

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<sup>6</sup> 7 Centax 84 (CESTAT Delhi).

<sup>7</sup> (1) TMI 186 (AAR Maharashtra).

considered as being in the course or furtherance of business if it is integral, incidental, or ancillary to the core business function.<sup>8</sup> Corporate guarantees offered gratuitously to subsidiaries do not typically meet this threshold, as most companies that offer these services to their subsidiary or group company are not engaged in the business of providing guarantees or other banking services.

Hence, the use of Schedule I to justify the taxation of corporate guarantee overlooks the conditional nature of the schedule as it requires the activity to be in the course or furtherance of business, a condition demonstrably not met in most case of corporate guarantee.

#### **D. Conclusion**

The debate surrounding the taxability of corporate guarantees under GST raises vital questions about the boundaries of the tax system in encompassing intra-group financial support arrangements. While the GST framework aims to be comprehensive and robust against tax avoidance, it should not disregard commercial substance and practical business realities.

There is a pressing need for clear legislative or administrative clarification to resolve these ambiguities with the gap between the commercial and legal realities burgeoning. One clear solution would be to provide for specific exclusions or guidelines on the treatment of corporate guarantees which would offer certainty to taxpayers and reduce unnecessary disputes. Lastly, as India's GST law continues to evolve, aligning tax treatment with global best practices and respecting the commercial context will be essential for fostering a stable and predictable tax environment for businesses.

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<sup>8</sup> Central Board of Indirect Taxes and Customs, *FAQs on GST (Updated as on December 15, 2018)* Q9 (CBIC, 3rd edn, 2018) <https://gstcouncil.gov.in/sites/default/files/2024-02/final-gst-fq-31218.pdf> (Visited on July 10, 2025).