

## GST Taxability on Personal Guarantees of Directors - Dilemma Continues or Settled?

Aug 14, 2023



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The changing business dynamics and regulatory landscape leads to directors providing various representations and warranties in personal and professional capacity to third parties. Directors are appointed by the shareholders for managing the affairs of the company and hold the position of 'trustee' qua shareholders. However, this distinction becomes a grey area qua the promoter directors having special interest in the growth of the company.

As per **RBI Master Circular - Guarantees and Co-acceptances** [1], banks should take personal guarantees of directors for the credit facilities granted to corporates. RBI Circular further restricts payment of fees to directors for such guarantees. In this background, we are examining GST implications on the personal guarantees given by the directors during the normal course of business.

### GST RCM on all the services by director or only professional services?

The services supplied by a director of the company to the company attracts GST under reverse charge mechanism (**RCM**) [2]. It is worthy to note that RCM Notification merely mentions 'services supplied by the director', the nature of services and capacity under which such services should be provided by the director are not mentioned for payment of GST under RCM.

Recent recommendation with respect to the services supplied by the director, in the [50th meeting of the GST Council held on 11th July, 2023](#), has created further ambiguity on the nature of services of the directors which should be covered under RCM ambit.

The clarification tries to differentiate between the personal/ private capacity and professional capacity of the director. It clarifies that services supplied by director of company or body corporate, as or in the capacity of director shall be taxable under RCM. The services supplied by the director in his private or personal capacity are not taxable under RCM [3].

It is worthy to examine the nature of guarantee provided by the director to the company. Whether guarantee services are supplied in the personal or professional capacity of the director? What can be treated as the personal capacity of the director? This requires deeper evaluation based on the role played by the director.

In case, the answer is that RCM is applicable on the services supplied by the director in the professional capacity of holding a position of director, then it needs to be further examined as to why the said guarantee cannot be said to have been provided in the capacity of being an employee or a shareholder of the company. It is worthwhile determining the GST applicability on the personal guarantee provided by the director to the company.

### **Applicability of GST based on role of director:**

Directors and company are inter alia deemed to be related persons under the following cases:

- Where directors are employees of the company,
- Where directors exercise control over the affairs of the company, or
- Where directors are shareholders with more than 25% of the shares

Where the company and directors are related persons, the arrangement of providing personal guarantee by the director will qualify as a supply in terms of Section 7(1)(c) of the CGST Act, 2017 (**"CGST Act"**) read with Entry 2 of Schedule I (activity to be treated as supply without consideration) to the CGST Act.

The criteria which need consideration for applicability of GST is whether the personal guarantee for loan has been provided by the director to the company in the capacity of an employee or a shareholder or a director or an individual.

#### **Director = Employee**

The first moot point arises where a director qualifies to be an employee of the company. Whether the personal guarantee by such director can be said to be provided in the course of his employment and hence, not liable to GST.

One may argue that not all the activities undertaken by an employee for the employer would be exempt but only those which are undertaken in the course of employment and in the capacity of an employee of the company would not be subject to GST. Normally, a mere employee may not be willing to provide a personal guarantee for the loan taken by the company. The intention and understanding between the employee director and the company need to be seen and well documented in the employment agreement as well as other documents executed as a director of the company.

**Circular No. 140/10/2020- GST dated June 10, 2020** has provided clarification with respect to GST leviability on remuneration paid by the company to the director who is also an employee of the company.

The Circular does not clarify as to when a particular service of the director, with consideration or without consideration, can be said to have been provided in the capacity of an employee or in the capacity of the director.

#### **Director = Shareholder**

Another doubt arises where the director holds less than 25% shares and does not qualify to be a related person of the company. Whether the personal guarantee of such director without consideration can be said to have been provided in the capacity of a shareholder of the company and hence, not liable to GST.

One may argue that a person not having substantial investment or financial interests in the company may not be willing to provide a personal guarantee for the loan taken by the company. The shareholder's agreement or any other document executed for a director or a shareholder should properly capture the transactions between the director and the company.

The question also arises whether nominee director of the shareholder having 25% or more than 25% shares of the company will qualify to be a related person and consequently, whether GST will be leviable. Nominee director of a shareholder having 25% or more shares is an interesting situation which requires deeper examination.

#### **Director = Personal capacity as an individual**

Another uncertainty which may arise is when can the director of the company, who is neither an employee of the company nor a shareholder (holding less than 25% or more shares) of the company, can be said to have provided a personal guarantee for the loan taken by the company in his personal capacity or private capacity.

Whether personal guarantee provided by the director of the company can at all be said to have been provided in his personal capacity or private capacity and consequently, not taxable under RCM.

It is worthy to take note of **RBI Master Circular (supra)** which provides that guarantees should not be used by the directors as a source of income from the company.

One may argue that RBI prohibits directors deriving income from giving personal guarantees and essentially, the transaction should be rendered by the director on non-commercial basis. The question arises as to whether personal guarantee can be provided by a director in the course or furtherance of business? Whether it can be treated as a deemed "supply" without consideration under Entry 2 of Schedule I, in the course or furtherance of business.

#### Valuation:

Another question relates to the value to be adopted for service supplied by the related director of the company. Whether the value should be fixed as per Rule 28 of the CGST Rules, 2017 **or** as per the 'transfer pricing' matters under Income tax law which determine arms-length price in case of corporate guarantee's commission between the related parties<sup>[4]</sup>. This also needs to be seen in light of the recent circular issued for cross-charge<sup>[5]</sup>.

#### Inter-play with Companies Act:

It is also worthy to note that the director is a related party of the company under the Companies Act, 2013 ("**Companies Act**"). The company is required to make certain disclosures and fulfill compliances in the event of a related party transaction.

In other words, irrespective of the fact that the personal guarantee or any other service has been supplied by the director in his personal capacity and not in the capacity of a director, the company is required to fulfill related party transaction compliances under the Companies Act. The said treatment of related party under the Companies Act may add fuel to the aforesaid discussions and doubts raised with respect to the GST applicability on guarantees provided by the director to the company.

**On the concluding note**, it is necessary for the Government to realize and consider the above uncertainties which might be faced by the industry due to the recent circular and issue further appropriate clarification to settle the aforesaid ambiguity and avoid litigation(s) in the future.

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<sup>[1]</sup> [RBI/2021-22/121 dated November 09, 2021](#)

<sup>[2]</sup> [Sl. No. 6 of Notification No. 13/2017 - Central Tax \(Rate\) dated June 28, 2017](#)

<sup>[3]</sup> [Circular No. 201/13/2023-GST dated August 01, 2023](#)

[\[5\] Circular No. 199/11/2023-GST dated July 17, 2023](#)