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GST ALERT | AUGUST 2026

GST on Corporate Guarantees Between Related Persons without consideration

Gujarat High Court Rules in Torrent Power Ltd.

In a landmark judgment dated 14 August 2026, the Gujarat High Court in Torrent Power Ltd. v. Union of India & Ors. has delivered a nuanced and commercially significant ruling on the GST treatment of corporate guarantees furnished between related persons. The judgment addresses the constitutional validity of Rule 28(2) of the CGST Rules, the temporal scope of the 1% deemed valuation mechanism, and the limits of penalty proceedings under Section 74 of the CGST Act.

This alert summarises the background, key findings, and practical implications of this important development in indirect tax jurisprudence.

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Background: From Service Tax to GST

A corporate guarantee is an arrangement whereby one entity agrees to act as guarantor for a sister concern or group entity, securing financial assistance or credit facilities from a bank or financial institution. The guarantor may or may not charge a fee from the group entity as consideration for such facilities. The tax treatment of such arrangements has evolved significantly over time.

Service Tax Position

Under erstwhile Service Tax law, the existence of consideration was a sine qua non to classify an activity as a taxable service. Notwithstanding this, departmental authorities assessed Service Tax on corporate guarantees by adopting a notional consideration equal to the commission rate charged by banks for bank guarantees.

This dispute was finally settled by the Supreme Court in **Commissioner of CGST & Central Excise vs. Edelweiss Financial Services Ltd.** [(2023) 5 Centax 58 (S.C.)], which held that a corporate guarantee provided without consideration cannot be considered a taxable service.

GST Position — Pre-Rule 28(2)

Under GST, the legal framework diverged from the Service Tax position. Section 7 read with Schedule I, Entry 2 of the CGST Act treats supplies between related persons as taxable even without consideration. However, significant divergence existed in determining the taxable value of such supplies.

Rule 28 prescribed that the Open Market Value (OMV) or the value declared in the invoice (where full ITC was available) would govern. In practice, different approaches were adopted by taxpayers and the department, creating uncertainty and inconsistent treatment across the industry.

The Regulatory Intervention

To bring uniformity, the Government introduced Rule 28(2) via Notification No. 52/2023 dated 26 October 2023, prescribing a deemed valuation mechanism. This was accompanied by Circular No. 204/16/2023-GST (27-10-2023) and Circular No. 225/19/2024-GST (11-07-2024), which clarified the scope and retrospective intent of the new rule.

STEP 01

Service Tax era

Consideration essential; settled by Edelweiss (SC)

STEP 02

GST pre-Rule 28(2)

Schedule I taxability; OMV valuation uncertainty

STEP 03

26 Oct 2023

Rule 28(2) introduced: 1% deemed value

STEP 04

Circulars 2023-24

Scope and retrospective intent clarified

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Key Findings of the Gujarat High Court

The petitioners challenged the constitutional validity of Rule 28(2), Section 15(4) of the CGST Act, and the relevant CBIC Circulars on three primary grounds: (i) non-taxability of corporate guarantees provided without consideration; (ii) arbitrariness of the 1% deemed valuation mechanism; and (iii) impermissible retrospective application of Rule 28(2) to guarantees furnished prior to 26 October 2023. The Revenue contended that Rule 28(2) is merely a valuation provision and does not create a new levy. The Court's findings are summarised below.

1

Taxability Upheld

The Court held that a corporate guarantee furnished by a holding company for its subsidiary constitutes a supply of services between related persons under Entry 2 of Schedule I to the CGST Act, even without consideration. The subsidiary derives an economic benefit by facilitating access to finance, establishing the requisite business nexus.

2

Rule 28(2) & Section 15(4) Valid

The constitutional validity of Section 15(4) of the CGST Act and Rule 28(2) was upheld. The Court recognised that the statutory framework permits a specialised valuation mechanism for related-party supplies where the ordinary transaction-value mechanism may not be applicable.

3

"Whichever is Higher" Read Down

While upholding Rule 28(2), the Court read down the expression "whichever is higher". Where the actual commission or consideration attributable to the corporate guarantee is ascertainable and lower than the deemed 1% value, the taxpayer cannot be compelled to adopt the higher deemed value. The 1% mechanism operates as a deemed framework but cannot impose a fictional value where actual consideration is ascertainable.

4

No Retrospective Application

Rule 28(2), effective from 26 October 2023, cannot be applied to impose a valuation-based GST liability for the period preceding that date. However, where a guarantee issued prior to that date continues in force beyond 26 October 2023, GST implications under Rule 28(2) may arise prospectively from that date onwards.

5

Section 74 Proceedings Quashed

The Court held that a bona fide dispute regarding taxability or valuation — particularly in the absence of settled law — cannot establish fraud, wilful misstatement, or suppression of facts. Mere non-payment arising from a legally unsettled issue does not justify invocation of Section 74. Proceedings challenged before the Court were quashed.

6

Circulars Cannot Override Statute

The Court examined CBIC Circulars dated 27 October 2023 and 11 July 2024, reiterating that administrative circulars may explain or operationalise the statutory framework but cannot independently create a tax levy or operate contrary to the statute as interpreted by the Court. Inconsistent portions of the circulars and related FAQs cannot prevail.

Key Takeaways & Action Points

The judgment provides significant relief for historical corporate guarantees while affirming the fundamental proposition that such guarantees constitute taxable supplies under GST. Businesses must undertake a structured review of their arrangements and compliance positions in light of the Court's findings. Given the potential revenue implications, a further challenge before the Supreme Court cannot be ruled out, and taxpayers should adopt a cautious approach pending finality of the legal position.

Pre-26 Oct 2023 Guarantees

Rule 28(2) and the 1% deemed valuation mechanism cannot apply to periods prior to 26 October 2023. Taxpayers who have discharged GST under Rule 28(2) for such periods should evaluate consequential relief, including potential refund or adjustment, based on the facts and applicable legal provisions. Note that the judgment does not comprehensively settle the appropriate valuation methodology for the pre-Rule period — questions concerning valuation and taxability for historical periods may continue to require careful examination, particularly where demands are based on provisions other than Rule 28(2).

Post-26 Oct 2023 Guarantees

For guarantees issued or continuing on or after 26 October 2023, reassess valuation methodology in light of the Court's reading down of "whichever is higher". Where actual consideration is ascertainable and lower than 1%, the lower value may be adopted. Conduct a detailed review of all corporate guarantee arrangements to ensure compliance methodology aligns with the Court's interpretation.

Section 74 Proceedings

Taxpayers facing penalty proceedings under Section 74 for bona fide non-declaration of GST on corporate guarantees should examine the sustainability of such proceedings in light of the Court's findings. Absent fraud, wilful misstatement, or suppression with intent to evade tax, such proceedings are vulnerable to challenge. This is particularly relevant where demands were raised based on legally unsettled positions at the relevant time.

Ongoing Monitoring

Given the significance of the issues and potential revenue implications, a further appeal to the Supreme Court by the Revenue cannot be ruled out. Until the legal position attains finality, taxpayers should adopt a cautious approach to consequential actions and continue to monitor further judicial, legislative, and administrative developments. We recommend designating a point of contact within your tax team to track developments and coordinate with advisors as the matter evolves.

Important: This alert is based on the judgment of the Gujarat High Court dated 14 August 2026. The legal position remains subject to further judicial review. Taxpayers are advised to consult their tax advisors before taking any consequential action.

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