[5.4.1] Charge to tax in respect of interest on preferential loans received by employees from employers

Updated February 2016

1. Introduction

Section 122 TCA 1997 sets out the provisions for the tax treatment of preferential loans. Generally it provides that an employee in receipt of a preferential loan will be charged to tax on the excess, if any, of the amount of interest which would have been payable on the preferential loan if interest had been paid at the "specified rate" (as defined in paragraph 2) over the amount of interest, if any, actually paid on the loan.

The amount of the excess charged to tax is treated as if it were interest actually paid and, in certain cases, may be eligible for relief subject to the usual restrictions.

2. Definitions

(a) "Preferential Loan"

Any loan made to an individual or his/her spouse or civil partner by a person who, in relation to the individual, is an employer, is a preferential loan if no interest is paid on the loan or if interest is paid at a rate less than the "specified rate". A loan originally made by a third party and taken over by an employer or a loan arranged, guaranteed or in any way facilitated by an employer is a preferential loan if no interest is paid or interest is paid at a rate less than the "specified rate". It should be noted that the section is not confined to new loans and a loan can be a preferential loan for the purposes of the section irrespective of the date on which it was made.

(b) "Employer"

Any one of the following is an employer in relation to an individual -

(i) a person by whom the individual or his/her spouse or civil partner is or was employed,

(ii) a company of which the individual or his/her spouse or civil partner subsequently becomes a director or a person by whom the individual or his/her spouse or civil partner subsequently becomes employed while the loan, or a loan which replaced the loan, or any part of the loan is outstanding,

(iii) a person who would be regarded as connected with the above company or person for the purposes of Section 250 TCA 1997.
"The specified rate"

The definition of “the specified rate” divides preferential loans into three categories for the purpose of determining the specified rate to be applied:

1. Where interest on the loan would qualify for relief under the provisions of Section 244 TCA 1997 [viz. the provisions providing for relief in respect of main residence interest], the rate of 5% applies in 2012, and a rate of 4% applies in 2013 et seq.

2. The specified rate to be used may be less than the specified rate (in section 122) in a limited category of loans where the following circumstances apply:

   (i) the loan is made at a preferential rate between employer and employee, and

   (ii) part of the employer’s trade is the making of loans for a stated number of years at a fixed rate of interest for the purpose of purchasing a house for occupation by the borrower, and

   (iii) at the time the preferential loan was made to the employee, the rate of interest charged by the employer to customers for main residence loans made at arm’s length was less than the specified rate.

   In such cases the “specified rate” will be the arm’s length rate charged to customers as per (iii).

3. Where preferential loans do not fall into category (1) or (2) above, the specified rate is 12.5% for 2012, and 13.5% for 2013 et seq.

3. Calculation of amount of interest at the "specified rate"

The "specified rate" is a true rate of interest on the balance of principal outstanding from time to time, and not a flat rate applied to the original amount borrowed disregarding repayments of principal during the currency of the loan.

Where in relation to a loan the rate of interest is not expressed as a true annual rate, the taxpayer should be requested to state the annual rate equivalent to the interest actually charged. In the case of an interest-free preferential loan, the specified rate is applied to the amount of the loan outstanding without any addition for interest, which would have accrued if interest had been chargeable in the past at the specified rate.
In practice, the amount of interest which would be payable at the "specified rate" may be arrived at by increasing or decreasing, as appropriate, the actual interest paid or payable in the proportion which the "specified rate" bears to the annual rate of interest paid or payable (the equivalent annual rate where interest is charged on a different basis).

Where an amount of interest was paid at more than one rate, the amount paid at each rate should be obtained and the specified rate applied to each separate amount.

**Example 1**

Interest of €6,000 was paid in 2015 on a preferential main residence loan at 3% interest. The amount, which would have been paid at the specified rate, may be taken as:

€6,000 \times \frac{4}{3} = €8,000

**Example 2**

Same as in Example 1 save that €3,000 was paid in 2015 at 3% and €3,000 at 4%. The amount, which would have been paid at the specified rate, may be taken as:-

€3,000 \times \frac{4}{3} = €4,000

€3,000 \times \frac{4}{4} = €3,000

Total = €7,000

**Example 3**

Throughout the year 2015 an individual has an interest free non-main residence loan of €10,000. The amount, which would have been paid at the specified rate, may be taken as:

€10,000 \times 13.5\% = €1,350

**Example 4**

Same as in Example 3 but the loan is in existence for 6 months only. The amount, which would have been paid at the specified rate, may be taken as:

€10,000 \times 13.5\% \times \frac{6}{12} = €675
5.4.1

Example 5

Same as in Example 3 but €5,000 is repaid half way through 2015. The amount, which would have been paid at the specified rate, may be taken as:

\[
\begin{align*}
\text{€10,000 x 13.5\% x 6 / 12} & = \text{€675} \\
\text{€5,000 x 13.5\% x 6 / 12} & = \text{€337.50} \\
\text{Total} & = \text{€1,012.50}
\end{align*}
\]

4. Calculation of the charge

Where an employee has a preferential loan the difference between the interest paid or payable, if any, and the interest which would have been payable at the specified rate is treated as an emolument of his employment.

Example 6

An employee has a preferential main residence loan of €20,000 on which he pays interest at 3%. Interest paid in 2015 is €600. The amount chargeable to tax is:

\[
\begin{align*}
\text{Interest} & = 600 \times 4 / 3 = \text{€800} \\
\text{Less amount paid} & = \text{€600} \\
\text{Amount chargeable} & = \text{€200}
\end{align*}
\]

5. Relief for amount charged

The employee is entitled to claim relief in respect of the excess amount charged as if it were an actual amount of interest paid on the preferential loan to which it relates. Relief may be claimed under the following provisions only -

(i) Section 244 TCA 1997

(ii) Section 71(1)(e) TCA 1997

(iii) Section 73 TCA 1997.

Relief is not, therefore, available under any other provisions and no relief can be claimed under, for example, -

(i) Section 97(2)(e) TCA 1997 and

(ii) Sections 248 and 253 TCA 1997.
The amount of relief due is subject to the same restrictions, which would have applied if the interest had actually been paid.

The reference to interest paid in Section 244 TCA 1997 includes interest deemed to have been paid by virtue of Section 122(4) TCA 1997.

Examples

**Example 1:** A married man or civil partner (who is not a “first time buyer”) has a preferential main residence loan of €300,000 on which he pays interest at 3%. Interest paid in 2015 is €9,000.

**Calculation of chargeable benefit-in-kind**

Interest deemed payable at specified rate \( \frac{9,000 \times 4}{3} = 12,000 \)

Less interest paid \( -9,000 \)

Chargeable benefit in kind \( 3,000 \)

**Calculation of interest relief**

Actual interest paid \( 9,000 \)

Plus deemed interest paid [S.122 (4) TCA 1997] \( 3,000 \)

Interest relief \( 12,000 \)

**Restricted to max interest relief for 2015 of €6,000 equals a tax credit of €900 (15% rate applies)**

**Example 2:** A married man or civil partner (who is not a “first time buyer”) has a preferential main residence loan of €500,000 on which he pays interest at 3%. Interest paid in 2015 is €15,000.

**Calculation of chargeable benefit-in-kind**

Interest deemed payable at specified rate \( 15,000 \times 4/3 = 20,000 \)

Less interest paid \( = 15,000 \)

Chargeable benefit in kind \( = 5,000 \)

**Calculation of interest relief**

Interest paid \( 15,000 \)

Deemed interest paid [S.122 (4) TCA 1997] \( 20,000 \)
Restricted to max interest relief for 2015 of €6,000 equals a tax credit €900 (15% rate applies)

**Example 3:** Throughout the year 2015, a single person (who is not a "first time buyer") has an interest free main residence loan of €100,000.

**Calculation of chargeable benefit-in-kind**

Interest deemed payable at specified rate €100,000 x 4% = €4,000

Less interest paid Nil

Chargeable benefit-in-kind €4,000

**Calculation of interest relief**

Interest paid Nil

[S.122 (4) TCA 1997] €4,000

Restricted to max interest relief for 2015 of €3,000 equals a tax credit €450 (15% rate applies)

**Example 4:** A married man or civil partner has a preferential car loan of €20,000 on which he pays interest at 4%. Interest paid 2015 is €800.

**Calculation of chargeable benefit-in-kind**

Interest deemed payable at specified rate €800 x 13.5 / 4 €2,700

Less interest paid €800

Chargeable benefit-in-kind €1,900

Interest relief does not arise in view of the "non-qualifying" nature of the loan.
6. Miscellaneous

(a) Anti-avoidance – loans written off

Provision is made at Section 122(3) TCA 1997 to prevent avoidance by drawing up a loan agreement under which interest is payable (perhaps even at the specified rate) but the interest or the capital is written off, in whole or in part, so as to produce the same net payment position that would have applied in the case of a preferential loan.

In circumstances where a loan which had been made directly or indirectly to an employee, is released or written off, either in whole or in part, then a charge to tax arises in respect of the amount written off.

For the purposes of determining the tax arising the individual who had their loan written off, or reduced, is treated as having received a perquisite equivalent to the amount written off.

This amount is, under section 112, deemed to have arisen in the year the loan is written off, and assessable to tax under Schedule E. If the loan recipient is assessable under Case III of Schedule D, the additional amount is also assessable under Schedule D.

It should be noted that no relief is due as set out in paragraph 5 in respect of any amount chargeable by virtue of a write off of capital.

(b) Family arrangements

Where the employer and employee are related and the preferential loan is given for family reasons section 122 does not apply.

(c) Employee (PAYE) Credit

The amount chargeable by virtue of section 122 is to be regarded as emoluments for the purposes of determining whether a PAYE tax credit is due.

(d) Returns by employers

An employer may be obliged by notice given under Section 897 TCA 1997 to give particulars of all preferential loans made by him including particulars of any amounts of capital or interest released, written off or refunded.