

Preferential Loans

Part 05-04-01

This document should be read in conjunction with section 122 of the Taxes Consolidation Act 1997

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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 difference between:

- 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 [Chapter 2](#)), and
- the amount of interest, if any, actually paid on the loan.

Prior to Finance Act 2017, an employee in receipt of a preferential loan was charged to tax on the difference between:

- 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 [Chapter 2](#)), and
- the amount of interest, if any, actually paid or payable on the loan.

The amount charged to tax is treated as if it was interest actually paid. In certain cases, this amount may be eligible for relief (subject to the usual restrictions - see [Chapter 5](#) for further information).

2. Definitions

2.1 "Preferential Loan"

Any loan made to either

- an individual, or
- his or her spouse or civil partner

by an employer of the individual, is a preferential loan 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- originally made by a third party and taken over by an employer, or
- arranged, guaranteed or in any way facilitated by an employer

is a preferential loan if 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.

2.2 "Employer"

Any one of the following can be considered an individual's employer:

- (i) a person ¹of whom the individual (or his or her spouse or civil partner) is or was an employee (or an office holder);
- (ii) a person of whom the individual becomes an employee subsequent to the making of a loan by the person to the individual and while any part of the loan or of another loan replacing it is outstanding); or
- (iii) a person who would be regarded as connected with any of the above persons for the purposes of section 250 TCA 1997.

2.3 "Specified Rate"

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

1. Where the loan is a mortgage used by the individual solely to purchase, repair, develop or improve a residence used by:
 - the individual,
 - a former or separated spouse or civil partner,

¹ Person may refer to an individual, a body corporate or an unincorporated body of persons

- a dependent relative (where the residence is provided by the individual rent-free),

or to pay off another mortgage used for such purpose, a rate of 4% applies. This rate has been in force since 1 January 2013.

2. The specified rate to be used may be less than the specified rate stated in 1 above or 3 below 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) above.

3. Where preferential loans do not fall into category 1 or 2 above, the specified rate is 13.5%. This rate has been in force since 1 January 2013.

Example 2.1

John works for a car dealership. He received a preferential loan of €50,000 in 2018 to assist with the purchase of a house. Interest of 5% was payable on the loan in 2018. John did not make a capital or an interest payment on the loan in 2018. Is this a preferential loan?

This is a preferential loan. Although the amount of interest payable on the loan is above the specified rate (being 4%) no interest payment was actually made by John in 2018 - John paid a rate of 0% interest for the period.

As such, income tax, PRSI and USC is due on the amount which should have been paid at the specified rate (€50,000 @ 4% = €2,000).

3. Calculation of amount of interest at the specified rate

The specified rate is applied annually to the **balance of the principal** outstanding only. It is not:

- a flat rate applied to the principal amount borrowed disregarding repayments of principal during the life of the loan, or
- a rate applied to the sum of:
 - a) the balance of the principal amount outstanding, and
 - b) notional interest from prior periods.

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 only.

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 in the proportion which the specified rate bears to the annual rate of interest (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 3.1

Interest of €6,000 was paid in 2018 on a preferential main residence loan at a rate of 3%. The amount, which would have been paid at the specified rate, may be calculated as follows:

Interest @ 3% is €6,000

Interest @ 1% is €2,000 (i.e. €6,000 ÷ 3)

Interest @ 4% is €8,000 (i.e. €2,000 × 4)

This can also be expressed as follows:

$$€6,000 \times 4 / 3 = €8,000$$

Example 3.2

Same as in Example 3.1 save that €3,000 was paid in 2018 at 3% and €3,000 at 4%. The amount, which would have been paid at the specified rate, may be calculated as follows:

$$€3,000 \times 4 / 3 = €4,000$$

$$€3,000 \times 4 / 4 = €3,000$$

Total	€7,000
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Example 3.3

Throughout the year 2018 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 calculated as follows:

$$€10,000 \times 13.5\% = €1,350$$

Example 3.4

Same as in Example 3.3 but the loan is in existence for 6 months only. The amount, which would have been paid at the specified rate, may be calculated as follows:

$$€10,000 \times 13.5\% \times 6 / 12 = €675$$

Example 3.5

Same as in Example 3.3 but €5,000 is repaid half way through 2015. The amount, which would have been paid at the specified rate, may be calculated as follows:

$$€10,000 \times 13.5\% \times 6 / 12 = €675$$

$$€5,000 \times 13.5\% \times 6 / 12 = €337$$

Total	€1,012
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4. Calculation of the charge

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

Example 4.1

Evie received a preferential main residence loan of €20,000 in 2018 on which she pays interest at 3%. Interest paid in 2018 is €600. The amount chargeable to tax for 2018 is:

Interest	$€600 \times 4 / 3 = €800$
Less Amount Paid	<u>(€600)</u>
Amount chargeable	<u>€200</u>

Example 4.2

Peter received a preferential loan of €40,000 in 2018. The loan was issued by his employer to allow Peter to purchase a car. Interest of 5% was paid on the loan in 2018. No capital repayment was made.

The amount chargeable to tax for 2018 is:

$$€40,000 \times (13.5\% - 5\%) \quad \underline{€3,400}$$

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

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 - Mortgage Interest Relief. Note Finance Act 2017 restricted mortgage interest relief for the tax years 2018, 2019 and 2020. Comprehensive guidance on mortgage interest relief can be found in the Tax and Duty Manual [Part 08-03-08](#).
- (ii) Section 71(1)(c) TCA 1997 - Foreign Securities and Possessions
- (iii) Section 73 TCA 1997 - Income from certain possessions in Great Britain and Northern Ireland

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 - Relief on interest paid for commercial premises and

- (ii) Sections 248 and 253 TCA 1997 - Relief on loans applied in acquiring interest in companies or partnerships.

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.

Example 5.1

Tim is married and is not a “first time buyer.” He has a preferential main residence loan of €300,000 on which interest of 3% is payable. In 2017, he paid the full 3% of interest payable, being €9,000.

Calculation of chargeable benefit-in-kind

Interest deemed payable at specified rate	$€9,000 \times 4 / 3$	€12,000
Less interest paid		<u>(€9,000)</u>
Chargeable benefit-in-kind		<u>€3,000</u>

Calculation of interest relief

Actual interest paid	€9,000
Plus deemed interest paid [S.122 (4) TCA 1997]	<u>€3,000</u>
Interest relief	<u>€12,000</u>

Restricted to max interest relief for 2017 of €6,000 equals a tax credit of €900 (assuming 15% rate applies).

Example 5.2

Joan is in a civil partnership and is not a “first time buyer.” She has a preferential main residence loan of €500,000 on which interest of 3% is payable. In 2017, she paid the full 3% of interest payable, being €15,000.

Calculation of chargeable benefit-in-kind

Interest deemed payable at specified rate	$€15,000 \times 4 / 3$	€20,000
Less interest paid		<u>(€15,000)</u>
Chargeable benefit-in-kind		<u>€5,000</u>

Calculation of interest relief

Actual interest paid	€15,000
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Total including deemed interest paid [S.122 (4) TCA 1997]	€20,000
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Restricted to max interest relief for 2017 of €6,000, equals a tax credit €900 (assuming 15% rate applies).

Example 5.3

Throughout the year 2017, Niamh has an interest free main residence loan of €100,000. She is single and is not a “first time buyer.”

Calculation of chargeable benefit-in-kind

Interest deemed payable at specified rate	$€100,000 \times 4\%$	€4,000
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Less interest paid	<u>Nil</u>
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Chargeable benefit-in-kind	<u>€4,000</u>
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Calculation of interest relief

Interest paid	Nil
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Total including deemed interest paid [S.122 (4) TCA 1997]	€4,000
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Restricted to max interest relief for 2017 of €3,000, equals a tax credit €450 (assuming 15% rate applies).

Example 5.4:

Alana is married. She has received a preferential car loan of €20,000, on which interest of 4% is payable. She paid the full 4% of interest payable, being €800 in 2018.

Calculation of chargeable benefit-in-kind

Interest deemed payable at specified rate	$€8,000 \times 13.5 / 4$	€2,700
Less interest paid		<u>€800</u>
Chargeable benefit-in-kind		<u>€1,900</u>

Interest relief does not arise in view of the “non-qualifying” nature of the loan.

6. Miscellaneous

6.1 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.

The amount that is written off in any year is taxed under section 112 as if it were a perquisite of the relevant office or employment received in that year, i.e. it is assessable to tax under Schedule E as additional emoluments for that year.

Where the employee in receipt of the preferential loan arising from a foreign employment, then any amount written off in a year is taxable under Schedule D Case III for that year as if it were additional income chargeable under that Case received in the year of the release or write off.

It should be noted that no relief is due as set out in [Chapter 5](#) in respect of any amount chargeable by virtue of a write off of capital.

6.2 Family arrangements

Where the employer and employee are related and the preferential loan is made in a personal capacity from personal resources, section 122 does not apply.

6.3 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.

6.4 Returns by employers

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