

Chapter 4 - The provision of preferential loans

Part 05-01-01d

This manual should be read in conjunction with sections 122 and 122A of the Taxes Consolidation Act 1997

Document created July 2021

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1 Introduction

This manual outlines the tax position, as set out in section 122 Taxes Consolidation Act 1997 (TCA 1997), where an employee is in receipt of a preferential loan (as defined in [section 2.1](#) below).

These provisions apply both to directors and employees, irrespective of the level of emoluments from the office or employment, unless otherwise stated.

Generally, 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 [section 2.3](#) below), 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', and
- the amount of interest, if any, actually paid **or payable** on the loan.

The amount charged to tax under s122 TCA 1997 is treated as if it was interest actually paid. In certain cases, subject to the usual restrictions, this amount may be eligible for relief. See [section 5](#) below for further information on the relief available.

2 Definitions

2.1 'Preferential Loan'

A loan to an individual, or his/her spouse or civil partner, which is or has been:

- made by an employer (as defined in [section 2.2](#) below),
- originally made by a third party and taken over by an employer, or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 on the loan is paid at a rate less than the specified rate (as defined in [section 2.3](#) below).

It should be noted that these provisions are not confined to new loans, and a loan can be a preferential loan for the purposes of these provisions irrespective of the date on which it was made.

2.2 'Employer'

Any one of the following can be considered an individual's employer for the purposes of section 122 TCA 1997:

- (i) a person in respect of whom the individual (or his or her spouse or civil partner) is or was an employee or office holder,
- (ii) a person in respect of whom the individual becomes an employee either subsequent to the making of a loan or while any part of the loan (or 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.

Note, a person may refer to an individual, a body corporate or an unincorporated body of persons. In addition, an individual will be regarded as connected to another for the purpose of section 250 TCA 1997 if they are, broadly speaking, a member of the individual's family. In the case of a company, it will be regarded as connected to

another for the purpose of section 250 TCA 1997 if broadly speaking, one company controls the other or both companies are under the control of the same third party.

2.3 'Specified Rate'

There are three categories of preferential loan for the purpose of determining the specified rate:

1. Where the loan is a mortgage used by the individual solely to purchase, repair, develop or improve a residence used by either:

- the individual,
- a former or separated spouse or civil partner of the individual, or
- a dependent relative (where the residence is provided by the individual rent-free),

or to pay off another mortgage used for such purpose, a specified 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 where **all** of the following circumstances apply:

- (i) the loan is made at a preferential rate between employer and employee,
- (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 1

John works for a car dealership. He received a loan of €50,000 from his employer to assist with the purchase of a house. Interest of 5% was payable on the loan in the same year. John did not make any capital or any interest repayments on the loan in that year. Is this a preferential loan?

Yes, this is a preferential loan. John has received a loan from his employer and although the interest **payable** on the loan is above the specified rate of 4%, no interest was actually **paid** by John in the tax year and John effectively paid a rate of 0% interest for the period.

Example 2

Anna works for a bank and received a loan of €80,000 from her employer to assist with the purchase of a house. Interest of 3% was payable on the loan in the same year and Anna paid this interest in full. During this time, interest of 3% was applied to similar loans issued to external customers. Is this a preferential loan?

No, this is not a preferential loan. Although Anna has received a loan from her employer, on which interest paid is below the specified rate of 4%, Anna's employer is in the business of issuing the type of loan provided to Anna and the interest rate applied to Anna's loan is the same as the rate which was applied to similar loans issued to external customers in the same period.

3 Calculation of Amount of Interest at the Specified Rate

The specified rate is applied annually to the balance of the principal amount that is outstanding. The specified rate 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 only to the amount of the loan outstanding.

There are various methods used to determine how interest can be calculated on a loan, such as:

- on a reducing balance basis,
- by reference to the amount outstanding at the start of each year, or
- by reference to the amount outstanding at the mid-point of each year.

Whatever basis the employer uses to calculate the interest payable at the preferential rate, he or she should use the same basis for calculating the interest payable at the specified rate i.e. if the actual interest is calculated on a reducing balance basis, the interest payable at the specified rate should also be calculated on a reducing balance 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

A preferential loan was taken out to acquire a main residence, and the balance outstanding on the loan was €200,000. Interest was payable at a rate of 3% and interest paid during the year was €6,000. No capital repayments were made.

The amount of interest, which would have been paid at the specified rate is €8,000.

This is calculated as follows: €200,000 @ 4%

This can also be expressed as follows:

$$\begin{array}{rcl} \text{Interest paid} & \times & \text{specified rate} \\ & & \text{loan rate} \end{array} \quad \begin{array}{r} \text{€6,000} \\ \\ \end{array} \times \begin{array}{r} \underline{4\%} \\ 3\% \end{array} = \text{€8,000}$$

Example 4

Same as in example 3, but in this case interest was payable at a rate of 3% for the first six months of the year and during this time interest paid was €3,000. For the remaining six months of the year interest was payable at a rate of 4%, and interest paid during this time was €4,000. No capital repayments were made.

The amount of interest, which would have been paid at the specified rate is €8,000.

This is calculated as follows: €200,000 @ 4%

This can also be expressed as follows:

$$\begin{array}{rcl} \text{Interest paid} & \times & \text{specified rate} \\ & & \text{loan rate} \end{array} \quad \begin{array}{r} \text{€3,000} \\ \\ \end{array} \times \begin{array}{r} \text{4\%} \\ 3\% \end{array} + \begin{array}{r} \text{€4,000} \\ \\ \end{array} \times \begin{array}{r} \text{4\%} \\ 4\% \end{array} = \text{€8,000}$$

Example 5

A preferential loan was taken out on 1 July to acquire furniture, and the balance outstanding on the loan was €10,000. The loan was interest free and no capital repayments were made.

The amount of interest, which would have been paid at the specified rate is €675.

This is calculated as follows: $€10,000 \times 13.5\% \times (6 / 12)$

Example 6

Throughout the tax year an individual has an interest free non-main residence preferential loan of €10,000. On 1 October the individual made a capital repayment of €2,000.

The amount of interest, which would have been paid at the specified rate is €1,282.

This is calculated as follows: $€10,000 \times 13.5\% \times (9/12)$, plus $€8,000 \times 13.5\% \times (3/12)$

Example 7

Throughout the tax year an individual has a non-main residence preferential loan of €10,000 on which interest is payable at 6%. On 1 July the individual repaid half the capital outstanding and throughout the year the individual paid the full interest payable of €450.

The amount of interest, which would have been paid at the specified rate is €1,013.

This is calculated as follows: $€10,000 \times 13.5\% \times (6 / 12) = €675$, plus $€5,000 \times 13.5\% \times (6 / 12) = €337$.

4 Calculation of Charge to Tax

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 8

Ellen received a preferential loan of €40,000 from her employer to purchase a new home. Interest on the loan was payable at 3% and was paid in full by Ellen. Interest paid on that loan in that year was therefore €1,200 ($€40,000 \times 3\%$). No capital repayments were made.

As the purpose of the loan was to allow Ellen to buy a new home, the specified rate is 4%. The amount of interest, which would have been payable at the specified rate is €1,600 ($€40,000 \times 4\%$).

The amount chargeable to tax for the year is the difference between the interest that would have been payable if the specified rate had been applied, and the interest actually paid. In this case, the amount chargeable to tax is €400 ($€1,600 - €1,200$).

Example 9

If Ellen had made capital repayments of €2,500 at the end of each quarter (31 March, 30 June, 30 September and 31 December) the interest actually paid on the loan would have been €1,088 [$(€40,000 \times 3\% \times (3/12)) + (€37,500 \times 3\% \times (3/12)) + (€35,000 \times 3\% \times (3/13)) + (32,500 \times 3\% \times (3/12))$].

This interest which would have been payable at the specified rate would have been €1,450 [$(€40,000 \times 4\% \times (3/12)) + (€37,500 \times 4\% \times (3/12)) + (€35,000 \times 4\% \times (3/13)) + (32,500 \times 4\% \times (3/12))$].

The amount chargeable to tax would have been €362 ($€1,450 - €1,088$).

Example 10

Peter received a preferential loan of €10,000 from his employer to purchase a new car. Interest on the loan was payable at 5% and was paid in full by Peter. Interest paid on that loan in that year was therefore €500 ($€10,000 \times 5\%$). No capital repayments were made.

As the purpose of the loan was to allow Peter to buy a new car, the specified rate is 13.5%. The amount of interest which would have been payable at the specified rate is €1,350 ($€10,000 \times 13.5\%$).

The amount chargeable to tax for the year is €850 ($€1,350 - €500$).

Example 11

If Peter had made a capital repayment of €4,000 at the end of August, the interest actually paid on the loan would have been €433 [$(€10,000 \times 5\% \times (8/12)) + (€6,000 \times 5\% \times (4/12))$].

This interest which would have been payable at the specified rate would have been €1,170 [$(€10,000 \times 13.5\% \times (8/12)) + (€6,000 \times 13.5\% \times (4/12))$].

The amount chargeable to tax would have been €737 ($€1,170 - €433$).

5 Relief for Amount Charged to Tax

The employee may be entitled to claim relief in respect of the excess amount of interest which is charged to tax 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 71(1)(c) TCA 1997 - Foreign Securities and Possessions,
- (ii) section 73 TCA 1997 - Income from certain possessions in Great Britain and Northern Ireland, and
- (iii) section 244 TCA 1997 - Mortgage Interest Relief.

Note: The reference to interest paid in s244 TCA 1997 includes interest deemed to have been paid by virtue of s122(4) TCA 1997. In addition, 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 [Tax and Duty Manual Part 08-03-08](#).

Ultimately the amount of relief due is subject to the same restrictions which would have applied if the interest had actually been paid.

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

- (i) Section 97(2)(e) TCA 1997 - Relief on interest paid for commercial premises, or
- (ii) Sections 248 and 253 TCA 1997 - Relief on loans applied in acquiring interest in companies or partnerships.

Example 11

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 2018, he paid the full interest payable, being €9,000. No capital repayments were made.

Calculation of Taxable Benefit

Interest deemed payable at specified rate	$€9,000 \times (4\%/3\%)$	€12,000
Less interest paid		<u>(€9,000)</u>
Taxable Benefit		<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>
Amount eligible for Interest relief		<u>€12,000</u>

Relief is restricted to €4,500, which equals a tax credit of €675 if 15% rate applies.

Example 12

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 2018, she paid the full interest payable, being €15,000. No capital repayments were made.

Calculation of Taxable Benefit

Interest deemed payable at specified rate	$€15,000 \times (4\%/3\%)$	€20,000
Less interest paid		<u>(€15,000)</u>
Taxable Benefit		€5,000

Calculation of Interest Relief

Actual interest paid		€15,000
Plus deemed interest paid [S.122 (4) TCA 1997]		<u>€5,000</u>
Amount eligible for interest relief		€20,000

Relief is restricted to €4,500, which equals a tax credit of €675 if 15% rate applies.

Example 13

If Joan had made two capital repayments of €25,000 against the loan on 31 May and 31 August, the interest paid during the year would have been €14,313. The interest deemed payable at the specified rate would have been €19,083. The taxable benefit would therefore have been €4,770.

The amount eligible for interest relief would have been €19,083, but this would have been restricted to €4,500.

Example 14

Throughout the year 2018, Niamh has an interest free main residence loan of €100,000. She is single and is not a 'first time buyer'. No capital repayments were made.

Calculation of Taxable Benefit

Interest deemed payable at specified rate	€100,000 × 4%	€4,000
Less interest paid		<u>Nil</u>
Taxable Benefit		€4,000

Calculation of Interest Relief

Interest paid	Nil
Plus deemed interest paid [S.122 (4) TCA 1997]	<u>€4,000</u>
Amount eligible for interest relief	€4,000

Relief is restricted to €2,250, which equals a tax credit of €337 if 15% rate applies.

Example 15

Alana is married. She has received a preferential car loan of €20,000 on 1 April 2018. Interest was payable at 8% and Alana paid the full interest due, being €1,200. No capital repayments were made.

Calculation of Taxable Benefit

Interest deemed payable at specified rate	$€1,200 \times (13.5\%/8\%)$	€2,025
Less interest paid		<u>€1,200</u>
Taxable Benefit		<u>€825</u>

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

Example 16

If Alana had made capital repayments of €200 a month starting on 1 May 2018, the interest paid during the year would have been €1,152.

The interest deemed payable at the specified rate would have been €1,944.

The amount chargeable to tax would therefore have been €792.

6 Miscellaneous

6.1 Anti-Avoidance – Loans or Interest Written Off

Provision is made in s 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 s112 TCA 1997 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).

It should be noted that where a loan has been made to an employee who ceases his or her employment, and subsequent to this, his or her loan is written off, the amount written off is also within the charge to tax under section 112 TCA 1997.

No relief is due in respect of any amount chargeable by virtue of a write off of capital.

6.2 Joint Preferential Loan Issued - Only One Employee

Where the preferential loan is issued by an employer to a couple who are married or in a civil partnership, but only one spouse or partner works for the employer, the notional pay must be calculated by reference to the entire loan, not just half.

The full amount of the loan is treated as notional pay of the spouse in employment. PAYE, PRSI and USC in respect of the full amount of the notional pay must be deducted from the actual salary of the spouse in employment.

Where the loan is in the joint names of two individuals who are not married or in a civil partnership, and only one of them is an employee, the notional pay must be calculated by reference to the portion of the loan applicable to the employee only.

Example 17

A preferential loan of €100,000 is granted by an employer in the joint names of an employee and his partner (who is not an employee of the company) on 1 January 2020, for the purposes of purchasing their principal private residence. Interest is chargeable at 2%. The couple are not married or in a civil partnership.

Interest chargeable by the employer in 2020 (€100,000 x 2%)	€2,000
Interest chargeable at the specified rate (€100,000 x 4%)	<u>€4,000</u>
Employee's taxable benefit [(€4,000 - €2,000) x 50%]	€1,000

6.3 Family Arrangements

Where the employer and employee are related, and the preferential loan is made in a personal capacity from personal resources (i.e. not from the business), section 122 TCA 1997 does not apply.

6.4 Employee (PAYE) Credit

The amount chargeable by virtue of section 122 TCA 1997 is to be regarded as emoluments for the purposes of determining whether the employee tax credit is due.

6.5 Notional Loans Relating to Shares

Legislation was introduced in section 15(1) of the Finance Act 1998, to combat a tax avoidance scheme, whereby companies allowed directors and employees to acquire shares without having to pay the entire amount due on the allotment of the shares.

The employee or director would pay a small portion of the purchase price, with the balance of the purchase price remaining outstanding. The unpaid balance, known as a 'call' might never be called for.

Under the provisions of section 122A TCA 1997, the unpaid balance is treated as an interest-free 'notional loan' in the hands of the employee or director. The interest free loan is deemed to be a preferential loan for tax purposes and the provisions of section 122 TCA 1997 apply to it.

Where the interest-free loan is written off by the company in favour of the employee or director, the amount outstanding on the loan is deemed to be a taxable emolument. See [chapter 7](#) of the Share Schemes TDMs for further information.

6.6 Preferential Loans After End of Employment

Preferential loans that continue after an employee has ended their employment (by way of termination, resignation or retirement) remain chargeable. PAYE, PRSI and USC should continue to be applied on the notional pay arising.

6.7 Employee Schemes

Occasionally, employees may pay into a scheme which enables other employees to obtain loans at a preferential rate. In these schemes, there is usually no contribution from the employer, but a company director acts as a trustee.

The tax treatment of such schemes should be examined on a case by case basis. In such circumstances, full particulars of the scheme should be submitted to the employer's Revenue Branch via [myEnquiries](#) for a ruling on the appropriate tax treatment.