TC03451

Appeal number: TC/2013/06258

INCOME TAX – employment-related loans – benefit of taxable cheap loan treated as earnings – whether exception for loan on ordinary commercial terms applied where a mortgage comprised of two different investment products with different rates of interest and terms and conditions – Yes – Appeal allowed. Income Tax (Earnings and Pensions) Act 2003 Sections 175 and 176.

FIRST-TIER TRIBUNAL
TAX CHAMBER

MRS ELIZABETH AMRI **Appellant**

- and -

THE COMMISSIONERS FOR HER MAJESTY'S REVENUE & CUSTOMS **Respondents**

TRIBUNAL: JUDGE W RUTHVEN GEMMELL,WS
MR IAN M P CONDIE, CA

Sitting in public at George House, 126 George Street, Edinburgh on 17 March 2014

Elizabeth Amri, for the Appellant

Matthew Mason, Officer of HMRC, for the Respondents

DECISION

1. This is an appeal against a decision by the Commissioners for HM Revenue & Customs ("HMRC") to issue assessments by means of a Notice of Assessment dated 22 May 2013 for the year ended 5 April 2009 for additional tax of £482.20 and a Closure Notice dated 23 May 2013 for the year ended 5 April 2010 for an amended sum of £1,087.40 in respect of benefits in kind.

Legislation

Income Tax (Earnings and Pensions) Act 2003

Section 173 Loans to which this Chapter applies -

(1) This Chapter applies to a loan if it is an employment-related loan.

(2) In this Chapter -

(a) "loan" includes any form of credit, and

(b) references to making a loan (and related expressions) include arranging, guaranteeing or in any way facilitating a loan.

(3) Sections 288 and 289 make provision for exemption and relief for certain bridging loans connected with employment moves.

Section 175 Benefit of taxable cheap loan treated as earnings

(1) The cash equivalent of the benefit of an employment-related loan is to be treated as earnings from the employee's employment for a tax year if the loan is a taxable cheap loan in relation to that year.

(2) For the purposes of this Chapter an employment-related loan is a "taxable cheap loan" in relation to a particular tax year if -

(a) there is a period consisting of the whole or part of that year during which the loan is outstanding and the employee holds the employment,

(b) no interest is paid on it for that year, or the amount of interest paid on it for that year is less than the interest that would have been payable at the official rate, and

(c) none of the exceptions in sections 176 to 179 apply.

(3) The cash equivalent of the benefit of an employment-related loan for a tax year is the difference between -

(a) the amount of interest that would have been payable on the loan for that year at the official rate, and

(b) the amount of interest (if any) actually paid on the loan for that year.

(4) If there are two or more employment-related loans, this section applies to each separately.

(5) This section is subject to -

section 180 (threshold for benefit of loan to be treated as earnings);

section 186 (replacement loans).

Section 176 Exception for loans on ordinary commercial terms

(1) A loan on ordinary commercial terms is not a taxable cheap loan.

(2) In this section a "loan on ordinary commercial terms" means a loan—

(a) made by a person ("the lender") in the ordinary course of a business carried on by the lender which includes -

(i) the lending of money, or

(ii) the supplying of goods or services on credit, and

(b) in relation to which condition A, B or C is met.

(3) Condition A is met if -

(a) at the time the loan was made comparable loans were available to all those who might be expected to avail themselves of the services provided by the lender in the course of the lender's business,

(b) a substantial proportion of the loans (consisting of the loan in question and the comparable loans) made by the lender at or about the time the loan in question was made were made to members of the public,

(c) the loan in question is held on the same terms as comparable loans generally made by the lender to members of the public at or about the time the loan in question was made, and

(d) where those terms differ from the terms applicable immediately after the loan in question was first made, they were imposed in the ordinary course of the lender's business.

(4) For the purposes of condition A a loan is comparable to another loan if it is made for the same or similar purposes and on the same terms and conditions.

(5) Condition B is met if -

(a) the loan has been varied before 6th April 2000,

(b) a substantial proportion of the relevant loans were made to members of the public,

(c) the loan in question is held on the same terms as relevant loans generally made by the lender to members of the public at or about the relevant time, and

(d) where those terms differ from the terms applicable immediately after the relevant time, they were imposed in the ordinary course of the lender's business.

(6) Condition C is met if -

(a) the loan has been varied on or after 6th April 2000,

(b) a substantial proportion of the relevant loans were made to members of the public,

(c) at the relevant time members of the public who had loans from the lender for similar purposes had a right to vary their loans on the same terms and conditions as applied in relation to the variation of the loan in question,

(d) the loan in question as varied is held on the same terms as any existing loans so varied, and

(e) where those terms differ from the terms applicable immediately after the relevant time, they were imposed in the ordinary course of the lender's business.

(7) For the purposes of condition B and C -

(a) the “relevant time” is the time of the variation of the loan in question, and

(b) the “relevant loans” are -

(i) the loan in question,

(ii) any existing loans which were varied at or about the relevant time so as to be held on the same terms as the loan in question after it was varied, and

(iii) any new loans which were made by the lender at or about that time and are held on those terms.

(8) No account is to be taken of amounts which are incurred on fees, commission or other incidental expenses by the person to whom a loan is made for the purpose of obtaining the loan -

(a) in determining for the purposes of condition A whether loans made by a lender before 1st June 1994 are made or held on the same terms or conditions, or

(b) in determining for the purposes of condition B or C whether rights to vary loans are exercisable on the same terms and conditions or loans are held on the same terms.

(9) No account is to be taken of amounts which are incurred on penalties, interest or similar amounts by the person to whom a loan is made as a result of varying the loan in determining for the purposes of condition B or C whether rights to vary loans are exercisable on the same terms and conditions or loans are held on the same terms.

(10) For the purposes of this section a "member of the public" means a member of the public at large with whom the lender deals at arm's length.

Evidence and Findings of Fact

2. Elizabeth Amri ("EA") was an employee of HBOS plc ("HBOS") and on 10 January 2008, under her then married name of Mrs Elizabeth Poole Cowan, together with her husband Mr Melville Cowan, received notification from Halifax that their "new mortgage account" was open.

3. The letter of 10 January 2008 stated that "this is an interest only mortgage" and continued "the following products apply to your mortgage account". It then referred to product number "STF004" being a loan amount of £35,000 with a current interest rate of 5.5% which the Tribunal were advised was the Bank of England's base rate as at 10 January 2008.

4. The other product number was "CMC156" for an amount of £105,000 where the interest rate was 6.24% or 0.74% above the Bank of England base rate.

5. The letter stated that both amounts were "tracker rates".

6. A feature of the CMC156, £105,000 amount was that the rate of interest decreased by 0.25% each year so that, for instance, in the year commencing 1 December 2009, when the Bank of England base rate had fallen to 0.5%, the total borrowing cost was 1.24% and, in the following year, the total borrowing cost had fallen to 0.99% and the year following to 0.74%.

7. EA gave evidence and was a credible witness. She stated that as she was employed by HBOS she was aware of offerings made to borrowers and called the Halifax Call Centre and enquired about the mortgage CMC156. She was switching her mortgage from Birmingham Midshires.

8. At that time she confirmed her employment was with HBOS and she was told that she could obtain part of the loan as a staff loan. EA had thought that she would not get the whole of the £140,000 mortgage as a staff loan so had not followed that route but, on being told that she would qualify for a staff loan of £35,000, was aware that this would save her, in the first year, 0.74%, on that part of the loan.

9. EA was not aware of the tax consequences of a staff loan as a benefit in kind and the first she knew about this was when she received a letter on 29 September 2011

from HMRC opening up an enquiry in to her tax return and requesting a copy of her P11D form for the year ended 5 April 2010.

10. EA then asked HBOS plc for a copy of her P11D and queried with them the assessment of benefit at £5,438.

11. HBOS explained to EA that HMRC treated the whole sum of £140,000 as a staff loan. EA asked HBOS to change the P11D to reflect what she considered to be the staff loan benefit relating to only £35,000. They refused to do this.

12. EA contacted HMRC by telephone and was advised that the full loan amount had to be treated as a benefit in kind.

13. HMRC confirmed that the £105,000 CMC156 loan was a loan on commercial terms and available to the public.

14. On checking EA's self assessment returns, HMRC noted that there was no inclusion of any benefit in kind for not only the tax year ended 5 April 2010 but also for the tax year ended 5 April 2009 and, accordingly, investigated it as well. This was confirmed to EA by HMRC's letter of 11 February 2013.

15. Closure notices of 22 May 2013 and 23 May 2013 were then issued.

16. HMRC submitted to the Tribunal a screen print of EA's 2008/2009 P11D form which showed a cash equivalent of £2,411 and the same form for the tax year ended 5 April 2010 which showed an amount of £5,437.

17. In terms of the legislation, as HMRC treated the whole mortgage as one loan, HMRC then employed the averaging method and provided calculations to the Tribunal which corresponded with the P11D forms.

18. On 12 June 2012 HBOS plc wrote to EA as follows "I can confirm that it has been agreed with HM Revenue and Customs to submit P11D information using the averaging method and, therefore, we must submit the whole value of your mortgage not just the staff element".

19. A subsequent letter was sent by Halifax to EA on 31 October 2011 advising of a further change to "one or more of your special rates".

20. On 18 April 2013, HMRC telephoned EA and asked if she agreed with the computations which she did and HMRC advised that they would not be pursuing a penalty.

21. On 22 May 2013, HMRC wrote sending amendments to EA's tax returns for the year ended 5 April 2010 and introducing a charge to the self assessment statement for the year to 5 April 2009.

22. On 7 June 2013, EA wrote to HMRC stating that a portion of her "mortgage" was on the "staff rate". The letter continued "the Staff portion of my £140K mortgage was

£35K but you are telling me the benefit was over £5K each year. Please use some common sense when assessing this. £105K was on a product available to the general public tracking the Bank of England base rate at 0.74% above".

23. HMRC replied on 30 July 2013 and confirmed the terms of HMRC's letter of 12 June 2012 to the effect that the whole loan was used to calculate the beneficial loan charge and said, "the legislation which covers this is Section 173(2)(a) Income Tax (Earnings & Pensions) Act [ITEPA] 2003 which states –

> Loan means more than just lending money. It includes any form of credit. It follows that any kind of advance by reason of employment is covered. For example any amount shown in the employer's books or records as owed by an employee will count as a loan".

Submissions by HMRC

24. HMRC say that EA was an employee of HBOS who made a single loan to her through its Halifax division of £140,000.

25. HMRC refer to Section 174 of ITEPA 2003 which provides an explanation of what an employment-related loan is. In simplest terms, an employment-related loan is a loan made by an employer to an employee or a relative of an employee.

26. HMRC say that the loan advance was a single loan which may be represented by two or more accounts with the interest on different segments at different rates, the staff discounted rate and the general public rate, and secured on two or more assets.

27. HMRC say, but produced no evidence to show that the agreement under which the loan was made and accepted was for a single loan and was, accordingly, treated as such for the purposes of Section 175 ITEPA 2003 and, therefore, the full amount of the loan must be taken in to account when calculating any benefit received.

28. HMRC say that they correctly calculated a cash equivalent for a cheap or interest free loan under Sections 182 and 183 of ITEPA 2003 which, in simple terms, states that when "calculating the benefit arising on a beneficial loan" the averaging method automatically applies unless the employee elects for the alternative precise method or the inspector gives notice that he or she intends to use the precise method.

29. No such elections were made and HMRC used the averaging method.

30. HMRC say that in determining whether the loan was beneficial to the applicant they look at the amount of interest that would have been payable on the loan for each year, had interest been charged at the "official rate", which HMRC confirmed was higher than the Bank of England rate.

31. HMRC say that in terms of Section 175 ITEPA the whole amount of £140,000 constitutes "a taxable cheap loan". As EA paid less interest than she would have done had the interest been charged at the official rate, EA received the benefit of a taxable

cheap loan being the cash equivalent of the difference between the interest paid and the amount of interest due at the official rate.

32. HMRC say that the beneficial loan calculations have been made on the correct statutory basis and that, subject to the exceptions afforded by Section 176 to 179 ITEPA 2003, a chargeable benefit arises when an employment-related loan, which is a taxable cheap loan, is provided to an employee.

33. Section 176 ITEPA 2003 states that where a loan is made on ordinary commercial terms it is not considered to be a "taxable cheap loan" and is exempt.

34. HMRC say that EA's loan, which they say is the amount £35,000 and £105,000 taken together, was not, therefore, on the same terms and conditions as other commercially available loans available to other borrowers and non employees, and, accordingly, the exemption under Section 176 does not apply.

35. HMRC say that the other exemptions in Sections 177 to 179 are not relevant.

Submissions by EA

36. EA says that the calculation of tax on the benefit on the whole amount of £140,000 is unfair.

37. EA says that the amount of loan used in the calculation of the benefit is incorrect as part of the loan was at a commercial rate.

38. EA says there is a contradiction between Section 173, as referred to in HMRC's letter of 30 July 2013, and Section 176 which provides for an exception for a loan "on ordinary commercial terms that is not a taxable cheap loan".

39. EA says that only part of the loan was a "taxable cheap loan" and the bulk of the loan was a loan made in the course of ordinary business and was available to the general public.

Decision

40. The Tribunal noted that the explanation, given in HMRC's letter of 30 May, purporting to be Section 173(2) (a) ITPEA 2013 did not correspond to the legislation which was produced at the Tribunal.

41. The legislation produced to the Tribunal states the following –

> Section 173 loans to which this chapter applies -
>
> (2)This Chapter applies to a loan if it is an employee-related loan.
>
> In this chapter – ("loan includes any form of credit")

42. The legislation does not say "loan means more than just lending money. It includes any form of credit. It follows that any kind of advance by reason of

employment is covered. For example, any amounts shown in the employer's books or records as owed by an employee will count as a loan".

43. The Tribunal noted that this legislation applies to "an employee-related loan" which clearly includes any form of credit.

44. The Tribunal considered that the loan of £105,000 was not an employment-related loan because it was a separate and distinct loan and was available to the general public.

45. HMRC in treating the mortgage of £140,000 as one loan relied on two assumptions.

46. The first of these was the letter dated 10 January 2008 to EA. This states that "this is an interest only mortgage" but continues "the following products apply to your mortgage account". The letter then clearly states that there are two loan amounts, one for £35,000 with the product number STF004, and the other for £105,000 with the product number CMC156, which have different interest rates and it was confirmed during the hearing that each had different terms and conditions.

47. The Tribunal did not accept HMRC's interpretation of the references to "a mortgage account" and "a mortgage" as meaning that there was only one loan.

48. The Tribunal's view was that the word "mortgage" is a loose generic term, the Oxford Dictionary definition of which is "a conveyance of a property from a debtor to a creditor as security for debt".

49. The generic or common usage meaning is that there is a debt but it does not mean that it is necessarily one loan.

50. For a borrower to take out an interest only mortgage of £50,000, a repayment mortgage of £50,000 and an ISA Mortgage for £50,000, all with the same lender, would not result in either the borrower or the lender referring to these quite different types of loans as mortgages (plural) but instead they would be referred to as a "mortgage" with that particular lender.

51. It was agreed by both HMRC and EA that if EA had taken out a £35,000 mortgage at the "staff rate" with Halifax but had borrowed the other £105,000 from another lender, on exactly the same conditions as were provided by Halifax (which it was agreed were available to the public as a whole), there would be no assessment by HMRC of the £105,000 loan and the taxable benefit issue before the Tribunal.

52. HMRC also rely on the P11D form which treats the whole loan amount as a benefit in kind.

53. It is difficult to understand, in circumstances such as these, why Halifax/HBOS consider this to be a benefit to their employees when although the employee, as in this case, receives a preferential "staff rate" on part of the mortgage, the effect of HMRC's and their tax treatment is that the employee instead receives a considerably larger tax

bill which they would not receive if they borrowed any non-staff rate loans from another lender.

54. Neither Halifax/HBOS were present at the Tribunal hearing to ascertain whether Halifax/HBOS's treatment of the benefit and completion of P11D forms was in fact correct or incorrect. HMRC maintains that it was correct.

55. Similarly, neither EA nor HMRC provided the actual loan documentation for each product, namely STF004 for £35,000 and CMC156 for £105,000. EA in evidence stated that they did have different terms and conditions and in relation to the CMC156 loan, for instance, it had early repayment penalties which STF004 did not.

56. As the Tribunal considered that there were two loans, the correct consideration would be for the £35,000 employee-related loan to be taxed as a benefit in kind and to consider whether the loan of £105,000, being a loan made by Halifax, in the ordinary course of business was taxable. It would not be taxable if one of the conditions were met, as set out at Section 176(3) -

(a) "at the time the loan was made comparable loans were available for all those who might be expected to avail themselves of the services provided by the lender in the course of the lender's business;

(b) a substantial proportion of the loans (consisting of the loan in question and comparable loans) made by the lender at or about the time the loan in question was made were made to members of the public;

(c) the loan in question is held on the same terms as comparable loans generally made by the lender to members of the public at or about the time the loan in question was made; and

(d) where those terms differ from the terms applicable immediately after the loan in question was first made they were imposed in the ordinary course of the lenders business.

57. EA, in the belief that a staff loan would not be available for the amount she required of £140,000, had, as a matter of fact, approached Halifax seeking a loan on ordinary commercial terms and it was only during the application process when she revealed that she worked for HBOS that she was advised that there were staff loans available and that she could obtain £35,000 at a lower rate. It was explained, following the decision of the Upper Tribunal, whose decisions are binding on the First-tier Tribunal, in *HMRC v Hok* (2012) UK UT363 that it is explicit in paragraph 58 that "the First-tier Tribunal does not have the jurisdiction to discharge penalties on the ground that the imposition was unfair".

58. The Tribunal consider that there was a loan for £35,000 which was correctly chargeable under Section 175 ITEPA at the then tracker rate of 5.5% and a separate loan of £105,000 originally at a tracker rate of 6.24% which was an ordinary commercial loan which met the exemption criteria of Section 176 ITEPA.

59. The appeal is allowed.

60. This document contains full findings of fact and reasons for the decision. Any party dissatisfied with this decision has a right to apply for permission to appeal against it pursuant to Rule 39 of the Tribunal Procedure (First-tier Tribunal) (Tax Chamber) Rules 2009. The application must be received by this Tribunal not later than 56 days after this decision is sent to that party. The parties are referred to "Guidance to accompany a Decision from the First-tier Tribunal (Tax Chamber)" which accompanies and forms part of this decision notice.

W RUTHVEN GEMMELL, WS
TRIBUNAL JUDGE

RELEASE DATE: 31 March 2014