TC03303

Appeal number: TC/2013/3581

Income Tax – employment income – employment-related loans – whether loan on ordinary commercial terms – official interest rate exceeding normal lending rates.

FIRST-TIER TRIBUNAL
TAX CHAMBER

P D CURTIS **Appellant**

- and -

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

TRIBUNAL: JUDGE CHARLES HELLIER
DAVID E WILLIAMS CTA

Sitting in public at 45 Bedford Square WC1B on 27 January 2014

The Appellant in person

Christine Cowan for the Respondents

DECISION

1. Mr Curtis appeals against a HMRC closure notice dated 30 March 2012 in respect of his income tax liability for 2009/10. The issue in dispute is whether, as the notice contends, he is liable to income tax on the benefit of a mortgage loan provided by a subsidiary of his then employer under the "beneficial loans" legislation in s175 ITEPA 2003.

2. Mr Curtis worked for Royal Bank of Scotland (RBS) from September 2007 until December 2010. He was also a long-standing customer of NatWest which was acquired by RBS before 2008.

3. In May 2008 Mr Curtis decided to replace his existing mortgage, which was with Abbey National, with one from NatWest. He said that he was minded to change because the Abbey National mortgage was about to revert from a fixed rate to Abbey National's less favourable standard variable rate. On 14 May 2008 he borrowed £309,000 from NatWest secured on his house (this we call the first loan). In July 2009 he borrowed a further £15,000 from NatWest on the same terms and the same security (this we call the second loan).

4. RBS have an employee help line. When Mr Curtis was thinking about changing his lender he rang the helpline and was put in contact with the group's mortgage people. He arranged the mortgage with them.

5. His new mortgage was an interest rate tracker mortgage: the interest rate was set at a fixed percentage above the bank's base rate for the first two years or so, and then reverted to the bank's standard variable rate. The mortgage offer[1] did not require any fee to be paid, noted that Mr Curtis valued his house at £570,000, and specified the following rates of interest:

> NatWest base rate plus 0.44% until 30 June 2010
>
> NatWest's standard variable rate thereafter.

6. At the time Mr Curtis took out a loan, NatWest base rate was 5% and its standard variable rate was 7.19%.

7. From March 2009 and during 2009/10 NatWest's base rate was 0.5% and so Mr Curtis paid interest at 0.94%.

8. On 23 March 2010 HMRC sent a revised 2009/10 PAYE coding notice to RBS in which a deduction of £3,534 was made against his allowances in relation to a loan from his employer. It showed a resultant code of 421L.

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[1] The mortgage offer contained the following statement in bold type in the special conditions section: "Under current rules there are tax implications whenever your bank mortgage rates are less than the official rate quoted by HM Revenue and Customs, which is currently 6.25% (and is subject to change). You will be taxed on the difference between the official rate and the rate of interest you pay."

9. It appeared that the revised coding notice arrived at RBS too late for them to use it - given its date of 25 March 2010, 10 days before the year end and possibly a few days before the last payment of emoluments for 2009/10.

10. On 2 July 2010 RBS sent a P11D relating to Mr Curtis to HMRC for 2009/10. This showed the receipt of taxable benefits of £10,974.43 in respect of the first loan and £192.72 in respect of the second loan, a total of £11,167.16.

11. The 28 January 2011 Mr Curtis submitted his tax return for 2009/10. It included no entry in relation to the loans because he thought they had been taken care of in his tax code. HMRC opened an enquiry into the return on 7 December 2011 asking why the benefit reported in the 2009/10 P11 D form from NatWest had not been declared, and indicating that if it was taken into account the additional tax payable would be £4,466.80.

12. Following some correspondence in which Mr Curtis explained the difficulty he had as a former employee of RBS in obtaining any reliable detail or explanation from his former employer of the amounts shown in the P11D, it appeared that HMRC made an amendment to his self-assessment, by including in it the benefit in kind and increasing the tax payable by the amount shown above. Mr Curtis made an appeal. There was then further correspondence and a review which confirmed the assessment. Mr Curtis now appeals to this tribunal against the decision to amend his self-assessment.

The jurisdiction of this tribunal.

12. When an appeal is made against an assessment, the task entrusted to us by statute is to decide, on the basis of: (i) the law and (ii) the facts as we find them from the evidence before us what the assessment should be and to declare it as such (see section 50 TMA 1970).

13. In relation to the law we start with the Acts of Parliament and the Regulations made under them, and consider the effects of judgements of other Courts interpreting those statutes.

14. HMRC are given a power and duty by section 1 Taxes Management Act 1970 to manage income tax. Under this power they may, in appropriate circumstances, decide not to collect tax which is, on a proper understanding of the statute and the facts, properly due. This may be done on an individual basis or through more generally published statements and concessions.

15. This tribunal however is not given any general power to have regard to these statements or concessions when considering an appeal against an assessment. Our task is limited to the determination of the proper amount of tax determined in accordance with the statutory provisions. If the taxpayer wishes to argue that HMRC behaved oppressively or unfairly in the exercise of their powers, he may pursue that argument only by way of judicial review in the High Court or by way of extra judicial proceedings with bodies such as the Adjudicator or the Ombudsman.

16. As a result, and mindful of Judge Bishopp's decision in *Prince and Others* (2012) TC 01852, we do not, and cannot, address in this decision the question of whether Mr Curtis is entitled, as suggested in his grounds of appeal, to the benefit of HMRC's extra statutory concession A19.

The relevant statutory provisions and their application to Mr Curtis

17. By virtue of sections 6 and 7 Income Tax (Earnings and Pensions) Act 2003 ("ITEPA") amounts treated as earnings under Chapter 7 of Part 3 of that Act form part of the employment income of a taxpayer which is charged to tax under section 6 of that Act, and, as a result of Part 1 of the Income Tax Act 2007, forms part of his total income on which he is liable to income tax.

18. Chapter 7 of Part 3 contains sections of 173 to 182 ITEPA which deal with employment-related loans. Rather confusingly the best place to start understanding how they produce an amount which is liable to tax at income is in the middle of that range of sections. Section 175 provides:

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

19. One then needs to go back to section 174 to find out what an employment-related loan is:

> "(1) for the purposes of this chapter an employment-related loan is a loan-
>
> (a) made to an employee or a relative of an employee,
>
> (b) of a class described in subsection (2)
>
> (2) For the purposes of this chapter the classes of employment-related loans are:
>
> A.
>
> A loan made by the employee's employer.
>
> B.
>
> A loan made by a company or partnership ever which the employee's employer had control.
>
> …"

20. Pausing here, the first loan and the second loan were made to an employee, so subsection (1) is satisfied. They were made by NatWest, a company controlled by RBS. Thus they fall within B. Hence, unless any exception applies, they were employment-related loans.

21. The only exception is that in section 174(5). This relates to loans made in the course of family relationships (such as might be made by the proprietor of the business to a child of his working in the business). That is not applicable here. Thus the loans were employment-related loans.

22. The next question is whether loans were "taxable cheap loans" in relation to 2009/10. The answer to that question lies in subsection 175(2):

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

23. Pausing again:

> (1) paragraph (a) is satisfied in relation to Mr Curtis and the loans in relation to 2009/10. He was an employee in the year during which the loans were outstanding.
>
> (2) paragraph (b) is satisfied if the interest Mr Curtis paid on a loan was less than that which would have been paid at the "official rate".

24. We now have to go to section 181 to find out what is the “official rate”:

> "(1)" the official rate of interest" for the purposes of this Chapter means the rate applicable under section 178 Finance Act 1989 (general power of Treasury to specify rates of interest).”

25. That takes us to section 178 Finance Act 1989 which says:

> "(1) The rate of interest applicable for the purpose of any enactment to which this section applies shall be the rate which for the purposes of that enactment is provided for by regulations made by the Treasury under this section.
>
> (2) This section applies to ... Chapter 7 Part 3 [ITEPA]…..
>
> (4) The power to make regulations under this section shall be exercisable by statutory instrument which shall be subject to annulment pursuance of a resolution of the House of Commons.”

26. Paragraph 5 of the statutory instrument 1989/1297, Taxes (Interest Rates) Regulations 1989 as amended currently provides that:

> (1) subject to paragraph (2) the rate applicable under section 178 for the purposes of Chapter 7 of Part 3 of ITEPA 2003 ("Chapter 7") shall on and after 6 April 2010 be 4.00 % per annum.
>
> (2) [applies to non-sterling loans].

27. For the period 6 April 2009 to 5 April 2010 the rate which was specified in paragraph (1) was 4.75% to (it having been changed by statutory instrument from 6 April 2010 to 4.00 percent). That was therefore the "official rate”. In this period Mr

Curtis paid interest on his borrowings at 0.94%. As a result amount the interest he paid on the loan for that year was less than that which would have been payable at the official rate.

28. Therefore the condition in paragraph (b) is satisfied.

29. That brings us to paragraph (c). This condition requires us to consider the exceptions in sections 176 to 179. Section 177 deals with loans at a fixed rate, section 178 concerns loans which qualify for tax relief and section 179 with advances for necessary expenses. None of these are relevant on the facts. That leaves section 176. This provides:

> "(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 supply of goods or services on credit, and
>
> (b) in relation to which condition A, B, or C is met.

30. Pausing there it seems likely to us that paragraph (a) is satisfied: NatWest was a well-known bank and this lending is likely to have been lending in the ordinary course of its business. Continuing:

> (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 ordinary 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.

31. Then come subsections (5) to (7) which have no application in this appeal. Then:

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

(a) in determining 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 exercise above on the same terms and conditions or loans are held on the same terms.

(9) [is irrelevant]

(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 arms length.”

32. Mr Curtis provided a schedule he had obtained from NatWest showing the terms on which it was lending from 30 April 2008. This showed fixed and variable rate loans of various descriptions, and some of the provisions relating to fees, conditions of the loan and early repayment. Of the loans on the schedule which were potentially similar to Mr Curtis's loan were the following:

Product Name	Initial Rate	Followed by Standard Variable- at that time:	Product Fee	Maximum Loan to value (LTV)
Purchase				
Advantage Private/Advantage Business 2 year tracker	6.19% =1.19% above NatWest base until 30/6/10	7.19%	£999	90%
Business 3 year stepped tracker	Yr1: 5.44% Yr 2: 6.44% Yr3: 7.54% being base rate +0.44,1.44,2.54%	7.19%	£799	75%
Advantage gold 2 year tracker.; 2 year tracker; and Private/business 2 year tracker	6.29% =1.19% above NatWest base until 30/6/10	7.19%	£999	19.
Buy to Let				
Advantage Private/Advantage Business 2 year	6.54% being 1.54% above base rate. until	7.69%	£999	85%

tracker	30/6/10			
Advantage gold 2 year tracker	6.64% being 1.64% above base rate. until 30/6/10	7.69%	£1,299	85%
Private/business 2 year tracker	6.64% being 1.64% above base rate. until 30/6/10	7.69%	£1,299	85%
Remortgage				
Advantage Private/Advantage Business 2 year tracker	6.29% being 1.29% above base rate until 30/6/10	7.19%	£999	90%
Advantage gold 2 year tracker	6.29% being 1.29% above base rate until 30/6/10	7.19%	£999	90%
Private/business 2 year tracker	6.34% being 1.34% above base rate until 30/6/10	7.19%	£999	90%
2 year tracker	6.34% being 1.34% above base rate until 30/6/10	7.19%	£499	90%

34. There was a note on the schedule about product fees: "product fees, where applicable may be added to your mortgage - this means interest is charged on the fees at the mortgage interest rate for the term of the mortgage".

The application of section 176.

35. Mr Curtis' loans would fall within the exception given by section 176 if Condition A was met. Condition A has four requirements all of which must be satisfied. The first condition in paragraph (a), set out above, has to be read together with subsection (4). So read, it requires that:

> at the time the loan was made loans made for the same or similar purposes and on the same terms and conditions 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.

36. It seems clear to us that the "terms and conditions" on which a loan is made include those terms and conditions relating to interest rates. Limb (a) of the Condition requires that loans on the same terms as the employees loan to be available as described. Therefore for Mr Curtis's loan to satisfy the Condition it is necessary that loans on the same interest rate were available to others in May 2008.

37. None of the loans on the NatWest schedule bore the same interest rate as Mr Curtis' first loan. Thus that schedule did not show directly that the Condition was satisfied as regards the first loan.

38. We asked ourselves whether, in the light of that schedule, it was likely that NatWest would have made loans to any other borrower on the same interest rate as Mr Curtis' first loan. We concluded that it was not. That is because, as will be seen from the table above, all the loans described had higher interest rates than Mr Curtis' loan for the first two years, and did not make up the difference by a lower rate in later years. It therefore seemed unlikely to us that NatWest would, at the time it made the loan to Mr Curtis, make available to all those who might be expected to seek them, (or make to the public generally) loans at the same rates as those which applied to his loan.

39. We accept that the loan to value ("LTV") ratio for Mr Curtis's loan was about 54%. The schedule indicates a maximum ratio for each type of loan which is greater than that which applied to Mr Curtis. Mr Curtis therefore offered better security for his loan than the minimum required for the loans on the schedule. We considered whether the extra value of the security Mr Curtis offered might have persuaded the bank to lend to someone in similar circumstances with a similar LTV ratio at a lower rate than that shown in the table. However, we did not have any evidence to determine how much lower a rate that might have been, and so could not conclude that a loan would have been available to other people at the same interest rate as Mr Curtis' loan even if the loan to value ratio was the same as his.

40. For these reasons we find that paragraph (a) of Condition A was not satisfied and accordingly that Condition A was not satisfied.

41. Mrs Cowan also argued that NatWest's loans to other people involved the payment of fees - as shown by the table. Mr Curtis did not pay a fee for his loan. It was, she said, therefore not on the same terms as other loans.

42. Mr Curtis provided a copy of a NatWest leaflet of November 2009 entitled Mortgage Fees. There was section on the making of a Higher Lending Charge (a "HLC") which was made when the LTV ratio was high. The leaflet indicated that this charge would not be made if the LTV ratio was less than 90%.

43. We accept therefore that no HLC would have been made to a member of the public on a loan similar to Mr Curtis' loans. But in the same leaflet was a section on mortgage Product Fees. This said that an arrangement fee would be levied. Those fees

seem to us to be the Product Fees set out in the table above and different from the HLC fee.

44. If the obligation to pay such a fee was part of the "terms and conditions" on which the loan was made, then, since Mr Curtis' loans did not bear such a fee, and all those in the table did, it did not seem likely to us that NatWest would have lent to a member of the public on the same terms and conditions as regards fees as they did to Mr Curtis.

45. The fees leaflet says that the product fee is payable when "you apply", and is for the administrative and legal costs in arranging the loan. It seems to us that even if the fee was payable before the loan made (which seemed unlikely given that it would be added to the loan) it was one of the "terms and conditions" on which the loan was made for the purposes of section 176(4)

46. We were reinforced in this belief by subsection (8). That said that if the loan was made before 1 June 1994 then fees should not be taken into account. That suggests that the draftsman of the section understood that fees would be taken into account otherwise. That intention and understanding is in our view to be imported into what is to be understood by "terms and conditions" in subsection (4).

47. We therefore concluded that the terms of Mr Curtis' loan as regards fees were not "comparable" with the terms which were available to all others who might be expected to borrow from NatWest.

48. Therefore we find for this reason as well that Condition A not satisfied as regards both loans.

49. As a result section 176(1) did not apply to prevent Mr Curtis's loan being a taxable cheap loan. That meant that all the conditions in section 175(1) were satisfied, and therefore that Mr Curtis's first loan was a taxable cheap loan.

50. We find it likely that the same conclusions apply in relation to the second loan.

51. The consequence of this is that section 175(1) treats the "cash equivalent of the benefit" of the loans as emoluments. The cash equivalent of the benefit of an employment related loan is defined in section 175(3) as the difference between the interest paid in the year and that which would have been paid had the loan been at the official rate.

52. The correspondence between Mr Curtis and HMRC included calculations of this sum. Mr Curtis's grounds of appeal, and his submissions to us, did not disclose any argument that the arithmetic of the computation was wrong although, as we relate below, he did challenge the fairness or legitimacy of the official rate applied. We find the taxable benefit was as assessed.

The official rate.

53. Mr Curtis complained that the official rate did not fairly the track lenders' rates in 2009/10. He produced an illuminating graph showing that between 1 July 2008 and 1 July 2010 the gap between the Bank of England base rate and the official rate had widened from about 1% at the start of that period to 3 1/2% at the end. Mr Curtis said that this would have meant that almost all variable rate commercially available loans would have been treated as "cheap".

54. Whether or not the Treasury used its power to set the official rate in relation to employment-related loans reasonably, fairly or otherwise is however not a matter which is within our power to review. We fear that Mr Curtis must look elsewhere for any remedy: we are bound by the terms of the statutory instrument.

55. Mr Curtis suggested that it was within HMRC's power to accept a settlement based on the spirit of the legislation. He was quite willing to pay tax on any real benefit he had received as an employee, but did not believe that tax based on a rate which overstated that real benefit was within the spirit of the legislation. Unfortunately this is a matter beyond our jurisdiction on this appeal and we can only echo what was said by Judge Geraint Jones QC in the similar case of *Flanagan* (2012) TC 02161: any unfairness resulting from the application of an official interest rate that has lost touch with real interest rates cannot be a matter for this Tribunal.

Conclusion

56. The taxable benefit assessed was an emolument and taxable in the year 2009/10. The amendments to Mr Curtis' self-assessment were correct.

57. We dismiss the appeal.

58. In his submissions to us Mr Curtis asked that we made clear what the relevant statutory provisions were and how they applied to him. We hope that we have managed this task. It is a requirement that the tribunal should give reasons for its decision sufficient for a party to know why he has won or lost.

Rights of Appeal

59. 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.

CHARLES HELLIER
TRIBUNAL JUDGE

RELEASE DATE: 5 February 2014