



Appellate Court Provides Guidance for Determining Whether a Credit Transaction is Subject to TILA

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The Truth-In-Lending Act (“TILA” or the “Act”) governs consumer credit transactions, which are defined as transactions in which (1) credit is offered or extended to a natural person, and (2) the money, property, or services that are the subject of the transaction are primarily for personal, family, or household purposes. Excluded from coverage of the Act are credit transactions that are primarily for business or commercial purposes.

Generally, it is clear whether a credit transaction is for a consumer or business purpose; however, in certain situations, the primary purpose of the transaction may not be clear. For example, sometimes a natural person may take out a loan that is secured by that person’s home, but the funds are used for the person’s business.

In a recent case in which it was unclear whether TILA applied to the transaction at issue, an Illinois appellate court held that the purpose of the loan was commercial in nature, even though the debtor had used his home to secure the loan and the lender had categorized the loan as a consumer transaction.

In *People’s Bank of Arlington Heights v. Atlas*, No. 1–13–3775, 2015 WL 3826237 (Ill. App. Ct. June 18, 2015), a corporation in the business of purchasing tax certificates financed its business with a revolving line of credit from a bank. The line of credit was secured by a security interest in the corporation’s tax certificates. When the bank became concerned that the loan was insufficiently collateralized, the owner of the corporation and his wife obtained a loan from the bank secured by the couple’s home. While this loan was used to pay down the corporation’s debt, it was unclear whether the transaction was for consumer credit and whether TILA would apply. Due to the ambiguity, the loan was treated by the bank as a consumer loan at closing, although the bank did not provide the borrowers with a notice of right to cancel as required under TILA’s rescission rules.

When the couple defaulted on the loan and the bank began a foreclosure proceeding, the couple responded by giving the bank notice that they were rescinding the mortgage since the bank had failed to give each of the two copies of the notice of right to cancel at the closing, which under the Act would have effectively extended the time period for the borrowers to rescind the transaction for three years.

In ruling on whether the loan to the couple was subject to TILA, the appellate judges noted a few “basic principles” for determining whether a credit is primarily for a consumer or business purpose:

- No single factor is dispositive—the transaction must be considered as a whole.
- The fact that a debtor uses his home to secure a loan does not automatically render the transaction a consumer loan.
- The fact that a creditor treats a transaction as a consumer transaction does not prove that it is a consumer transaction.
- One must consider the substance of the transaction and the borrower’s purpose in obtaining the loan, rather than the form.

Applying these principles, the court found that the mortgage loan was for a business purpose and therefore TILA did not apply. The court reasoned that the mortgage loan was made to the owner of the corporate entity and his wife so they could pay down the line of credit of the business and this was in fact how the proceeds of the loan were used. The couple did not receive the funds personally but transferred them directly to the line of credit. Additionally, the promissory note stated the purpose of the loan was to provide a shareholder loan to the business. Furthermore, the bank and the owner had an ongoing business relationship whereby the bank provided credit for the owner’s businesses.

The court also noted that the loan was not consumer credit merely because it was made to the husband and wife and not the corporate entity. TILA requires the loan to be made (1) to a natural person and (2) for a consumer purpose. The fact that a loan is made to a natural person does not render the loan a consumer loan; both requirements must be met.

For lenders facing the question of whether a particular transaction is covered under TILA, the basic principles set forth in the *Atlas* opinion can serve as a helpful tool in making such determination. If there is still uncertainty, it is generally advisable to treat the loan as being subject to TILA so as to avoid any potential liability if the Act is later determined to be applicable.

If you have any questions regarding transactions covered under TILA or the Act in general, please feel free to contact Joseph D. Simon at 516-357-3710 or via email at jsimon@cullenanddykman.com, Kevin Patterson at 516-296-9196 or via email at kpatterson@cullenanddykman.com, or Elizabeth A. Murphy at 516-296-9154 or via email at emurphy@cullenanddykman.com.

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