



TC02350

Appeal number: TC/2011/10187

*CORPORATION TAX – loans to participators – loan proving to be
irrecoverable – removal of company property – deductibility – s419 ICTA
1988*

**FIRST-TIER TRIBUNAL
TAX CHAMBER**

MIRROR IMAGE CONTRACTING LIMITED

Appellant

- and -

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

Respondents

**TRIBUNAL: JUDGE NICHOLAS ALEKSANDER
K HOSSAIN FCA FCIB**

Sitting in public at 45 Bedford Square, London on 2 October 2012

R. A. Mitchell of R. A. Mitchell & Co Accountants for the Appellant

D Linnaker, an officer HM Revenue and Customs, for the Respondents

DECISION

1. This is an appeal against amendments to Mirror Image Contracting Limited's
5 corporation tax self-assessments for the years ended 31 March 2008 and 31 March 2009.

2. Mirror Image Contracting Limited ("MIC") was represented by Mr Mitchell, and HMRC were represented by Mr Linnaker. We heard evidence from Naomi Jordan, a director of Mirror Image Contracting Limited ("MIC") and from her father
10 Keith Jordan. In addition a bundle of documentary evidence was before us.

3. At the beginning of the hearing, Mr Linnaker, for HMRC, agreed that the appeal against the amendment for the year ended 31 March 2008 should succeed. This is because the tax due should have been assessed through a discovery assessment, rather than through an amendment to the company's self-assessment.

15 **Background Facts**

4. The background facts to this sad story are not in dispute. Keith Jordan had been a building contractor, working as a sole trader. Naomi Jordan is Keith Jordan's daughter, and her domestic partner at the relevant time was Paul Sweeny, who was a professional snooker player. Ms Jordan and Mr Sweeny had been domestic partners
20 since around 1999. Mr Sweeny had studied with the Open University and had completed some modules towards a law degree.

5. In 2004, Mr Jordan's business failed, and he went through an Individual Voluntary Arrangement. Notwithstanding his insolvency, Mr Jordan still had contacts in the building industry and work that he could do. At the suggestion of Mr Sweeny,
25 Mirror Image Contracting Limited ("MIC") was incorporated to allow Mr Jordan to resume in business. The shareholding in the company was split 49% owned by Mr Sweeny and 51% by Ms Jordan. The directors of MIC were Ms Jordan and Mr Sweeny. Mr Jordan was engaged as an employee, to manage the building work. Ms Jordan and Mr Sweeny were responsible for the administration of the company,
30 although both Ms Jordan and Mr Sweeny were signatories on MIC's bank mandate, only Mr Sweeny possessed a company debit card, credit card and had access to internet banking. In practice, Mr Sweeny was solely responsible for management of the company's finances.

6. The business was successful, and built up cash balances. These were required
35 by the business as working capital. Mr Sweeny withdrew surplus cash from the business which he deposited in his own personal savings account. This was because the interest rates available on business savings accounts were low, and the rates available on personal savings accounts were significantly greater. Mr Sweeny claimed that the amounts withdrawn were held by him "on trust" for MIC, and he
40 repaid the sums in due course back to MIC. We deal with the true nature of the withdrawals below.

7. On 19 March 2008 Ms Jordan and Mr Sweeny re-mortgaged their home. The home had an outstanding mortgage of about £100,000. The new lender was prepared to lend £180,000 through an offset mortgage arrangement. Most of the £180,000 raised by the new mortgage was used to discharge the old loan, and the balance of £69,150.17 was deposited in the offset account. The effect of the offset account was to reduce the net amount owed to the mortgagee to about £120,000.

8. During the first quarter of 2008, MIC lost a number of its major contracts, and Mr Sweeny considered that the business would not generate sufficient income to justify his continued employment. He resigned as a director of MIC on 1 April 2008 and took a job at a bank, but he remained as the primary signatory on the bank account. Between 28 March and 24 April 2008 inclusive, Mr Sweeny withdrew just over £110,900 from MIC's accounts and deposited these sums in the joint offset mortgage account. He did this without having told Ms Jordan. Ms Jordan subsequently found out about the withdrawals, but was assured that the funds were held on trust for MIC, and would be paid back (with interest) when the company needed them, and in the meantime the funds would be earning better interest rates than if they were left in the company's business savings account. Ms Jordan was reassured by this statement, and of course was aware that Mr Sweeny had done this previously.

9. On 27 April 2008, Mr Sweeny wrote to Barclays asking to be removed from the mandate and for Ms Jordan to be substituted in his place.

10. In October 2008, MIC paid off its HP agreement on a VW transporter van. The business decided that it would be better if it had a small car for the use of Ms Jordan to undertake visits to sites and potential customers. Mr Sweeny offered to arrange to exchange the van for a car through a VW dealer where his uncle worked. Mr Sweeny did this, but arranged for the new vehicle to be purchased and registered in his own name, rather than in the name of MIC.

11. On 26 October 2008 Mr Sweeny moved out of the home he shared with Ms Jordan. Earlier that day he withdrew £100,000 from the joint offset mortgage account and transferred the money into an account in his own name.

12. Despite many requests to do so, Mr Sweeny has refused to return the £100,000 that he withdrew from the bank account, on the basis that he was holding the money pending settlement of financial arrangements with Ms Jordan. He has also refused to return the car.

35 **Findings**

13. We find that the funds originally withdrawn by Mr Sweeny, and the funds withdrawn and deposited into the joint offset mortgage account were not held on trust for MIC. If the funds had been held on trust, they would have been kept in a separate account, and not intermingled with Mr Sweeny's and Ms Jordan's personal accounts. The legal effect of depositing funds into Mr Sweeny's and Ms Jordan's offset mortgage account is to discharge a loan owed by them. This would have been an

egregious breach of any trust (had the funds truly been held on trust by them for MIC). We find that the amounts withdrawn by Mr Sweeny and deposited either into his personal account or into the joint offset mortgage account were lent by MIC as shareholder loans, and were never held on trust for MIC.

5 14. It therefore follows that when Mr Sweeny withdrew £100,000 from the joint offset mortgage account, that transaction was between himself and Ms Jordan, and did not involve the company.

15. MIC has written off the amounts loaned to Ms Jordan and Mr Sweeny as bad, and has sought a deduction for the bad debt as a trading expense.

10 16. We find that the amounts were lent to Ms Jordan and Mr Sweeny outside the course of MIC's trade, and that the deduction taken in the company's profit and loss account for the loan going bad is not a trading deduction. In this context we were referred to *Curtis v J&G Oldfield* (1925) 9 TC 319 and *Bamford v ATA Advertising* (1972) 48 TC 359. These cases related to amounts borrowed by or misappropriated
15 by a director, and we note that Mr Sweeny ceased to be a director on 1 April 2008. However the principles elaborated in these cases are of more general application, and it is clear to us that the withdrawal of cash from the company by Mr Sweeny was not undertaken in the course of the company's trading activities, and therefore a trading deduction cannot be allowed for the debt going bad.

20 17. We find that Mr Sweeny misappropriated the company's van by selling it and using the sale proceeds to buy a car which was purchased and registered in his own name. We find this to be a capital transaction, and therefore no trading deduction can be allowed for the misappropriated funds. We note that in its capital allowance
25 computations the company obtained a balancing allowance for the disposal of the van at zero consideration, and this gives the correct tax deduction for the company.

18. Finally, as loans were made by the company to participators (namely Mr Sweeny and Ms Jordan as shareholders) a charge under s419 Income and Corporation Taxes Act 1998 arises. This tax charge is refunded on the loan being repaid.

Conclusions

30 19. We therefore dismiss the appeal in respect of the adjustments made to the corporation tax self-assessment for the year ended 31 March 2009, but allow the appeal in respect of the adjustments for the year ended 31 March 2008.

20. 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
35 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.

**NICHOLAS ALEKSANDER
TRIBUNAL JUDGE**

5

RELEASE DATE: 31 October 2012