TC02441

Appeal number: MAN/2007/0710

VAT – input tax – MTIC – appeal dismissed.

FIRST-TIER TRIBUNAL
TAX CHAMBER

MAIL A MOBILE LIMITED **Appellant**

- and -

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

TRIBUNAL: JUDGE RICHARD BARLOW
DEREK ROBERTSON

Sitting in public at Manchester on 27, 28, 29 February, 1, 2, 5, 6, 7 and 8 March 2012. (Further written submissions of the parties concluded 9 August 2012).

Mr B Bhalla of counsel instructed by Key2 Law LLP for the Appellant.

Ms L Wilson-Barnes of counsel instructed by the General Counsel and Solicitor to HM Revenue and Customs, for the Respondents

DECISION

1. This appeal was heard together with that of Club Mobile Limited.

2. The appellant appeals against the respondents' decision notified to it in a letter dated 11 June 2007 by which they refused to credit the appellant with input tax in the sum of £256,401.25 which it had claimed in its VAT return for the three month period ending 31 May 2006.

3. The disputed amount arises from two transactions in which the appellant bought mobile phones from Waterfire Ltd (a UK company) and sold them to Elandour Developments SARL (a French company). In both cases the sales were of the same phones as were purchased. Neither consignment of phones were either split or amalgamated by the appellant. In each case Waterfire had bought the phones from HiLo Sweden AB (a Swedish company).

4. Deal one concerned 4,100 Sony Ericson W810i phones bought (or agreed to be bought) by Waterfire for £202.00 each on 24 May 2006 which Waterfire sold (or agreed to sell) to the appellant for £205.50 each on 31 May 2006 and which the appellant sold (or agreed to sell) to Elandour on 31 May 2006 for £220.00. Waterfire had acquired the phones from an EU country and so, in effect, no tax was payable by it on the purchase from HiLo because the acquisition tax was offset by an input tax claim, because the purchase was for its business. Waterfire achieved a mark-up of £14,350 on the deal and when it sold the phones to the appellant it charged output tax which the appellant now claims as input tax. The appellant's mark-up was £14.50 per phone and it did not have to charge output tax when it sold the phones to Elandour as that was a zero rated dispatch to an EU country. At the time the sale took place the appellant was out of pocket to the tune of £87,996.25 because the tax inclusive price it paid to Waterfire was that much more than the tax exclusive price it received from Elandour but if the input tax had been credited the appellant would have achieved a mark-up of £59,450 on the deal. It will achieve that mark up if the appeal succeeds. Either way it is a 7.05% mark up.

5. Deal two had similar characteristics. It concerned 2,200 Nokia 9500 phones acquired by Waterfire on 29 May 2006, sold (or agreed to be sold) to the appellant on 31 May 2006 and sold (or agreed to be sold) to Elandour on 31 May 2006. Waterfire made £4.00 per phone. The appellant would have achieved a mark-up of £19.00 per phone or a total of £41,800 (6.7%) if the input tax had been credited and will do so if the appeal succeeds but will be out of pocket to the tune of £67,155 if not.

6. The above dates are the dates of transactions taken from documents but the passing of title to the goods may have occurred only upon payment.

7. Between 24 May 2006 and 31 May 2006 the appellant therefore engaged in deals worth a total of £1,721,551.25 with a potential gross profit of £101,250 on an outlay of £155,151.25. Had the input tax been credited in the normal course that

repayment might have been expected to be made within less than two months of the outlay of the appellant's funds.

8. By way of introduction only, we mention that the appeal is what is called, in the jargon that has become well known through other appeals, an MTIC case and the appellant's transactions are what are known as clean chain broker transactions in which recovery of input tax is denied on the basis that those transactions are connected with fraudulent transactions through a contra-trader (Waterfire) and the appellant either knew or should have known of that connection. In using the terms clean and dirty chains and broker, contra-trader or defaulter we do so only for convenience and, as has been pointed out before by the Tribunal (see the Decision in *Totel Distribution Ltd*), use of those terms, although now well understood, cannot be allowed to prejudge or influence the Tribunal's decision one way or the other as to the correct legal and factual position.

9. The allegation is that Waterfire had engaged in transactions in which it had obtained input tax credit in export or dispatch deals which were connected with fraud because a supplier further up the chain of transactions had fraudulently failed to account for output tax (i.e. dirty chain transactions). That failure to account for output tax coupled with the purchase of goods within the chain leading to the defaulting trader at tax inclusive prices by Waterfire had created a situation where the input tax credited to Waterfire had provided the proceeds of the fraud by financing the transactions leading to the defaulting trader.

10. The appellant's transactions were not in chains in which a default had occurred because Waterfire declared the output tax due on its sales to the appellant (i.e. clean chain transactions). However, the respondents allege that these transactions were in fact connected with fraud because the output tax declared by Waterfire in respect of these deals enabled it to disguise the extent to which its dirty chain transactions were connected with fraud by avoiding a situation where it claimed a huge repayment of tax, which it would have done had the dirty chain transactions not occurred alongside these clean chain transactions. The respondents also allege that the funds provided by the appellant's transactions helped to finance the dirty chain transactions by providing Waterfire with money with which to engage in those transactions. Had the appellant's claim for a repayment been met the respondents would have been the source of a large part of those funds as already explained.

11. The tribunal is well aware of the fact that the connection with fraud, if proved, is not sufficient to disallow the appellant's claim for input tax recovery. The respondents must also prove that the appellant either knew or should have known that its transactions were connected with fraud.

The legal issues.

12. In *Kittel –v- Belgium* [2008] STC 1537 the ECJ held that on the one hand, at [60], where a recipient of a supply buys goods and "did not and could not know that the transaction concerned was connected with fraud" then the Member State in which the recipient is registered for VAT cannot provide, by its domestic law, that such a

transaction is void and cannot provide that input tax is not claimable on the transaction. On the other hand, at [61], the ECJ held that "where it is ascertained, having regard to objective factors, that the supply is to a taxable person who knew or should have known that, by his purchase, he was participating in a transaction connected with fraudulent evasion of VAT, it is for the national court to refuse that person entitlement to the right to deduct".

13. At [51] the ECJ had also held that a trader who has taken every precaution to ensure that his transaction is not connected with fraud must be allowed to claim input tax. At [52] the Court held that a person who "did not and could not" know that his transaction was connected with fraud would be entitled to claim input tax despite a connection between his transaction and a VAT fraud.

14. The Court did not explain specifically what it meant by "should have known" but [51] and [52] of the judgment suggest that a trader should take, at least, reasonable precautions to avoid being involved in a transaction connected with fraud. Taken literally "every precaution" and "could not know" might suggest that the test is a very strict one. But bearing in mind [56] to [58] of the judgment we do not read it in that way. The Court used the word "should" for the first time in paragraph [56] and explained the rationale of the rule it then set out at [61]. It said that the rationale was that a person who either knew or should have known of the connection with fraud is to be "regarded as a participant" and that he "aids the perpetrators"; which appears to suggest a degree of blame that would not have attached to a person simply for overlooking a precaution that he might have taken or who could have known of a connection but only in some obscure way.

15. The Court also explained the underlying rationale of the rule in terms of its being for the better prevention of fraud.

16. It is well established that the right to deduct input tax is exercisable immediately when a transaction occurs and the ECJ emphasised this in *Kittel*. One consequence of that is that the applicable circumstances known to the appellant at the time of a transaction and the actions taken by the appellant at or before the transaction occurred are the relevant facts and that information acquired by the appellant subsequently will be irrelevant. Actions taken by the appellant after a transaction will also be irrelevant as such but, of course, they may shed light on what the appellant knew at the time if, for example, they appear to amount to attempts to cover up the true circumstances applying at the time of the transaction.

17. The Court of Appeal judgment in *Mobilx and others –v- Revenue and Customs Commissioners* [2010] STC 1436 considered in detail the issues raised in cases of this sort and Moses LJ elaborated on the meaning of the "should have known" concept. He held that it is not enough for HMRC to prove that the circumstances were such that it was more likely than not that a transaction in question was connected with fraud and that what they must prove is that the transaction was connected with fraud.

18. The *Mobilx* litigation included some decisions relating to contra-trading. Moses LJ specifically held that it matters not if the input transaction in question precedes the

transaction which gives effect to the fraud. He held that if the taxable person is proved to have entered into a transaction that he knew or should have known, at the time of entering into it, was at that time connected with fraudulent evasion or would be so connected later; that is sufficient to deny recovery of input tax.

19. Moses LJ also held that, where an issue arises about what a person should have known, it is relevant to consider whether the only reasonable explanation for the circumstances surrounding the transaction is that it is connected with fraud. He also stressed the relevance of circumstantial evidence generally.

20. Lewison J held in *Livewire –v- HMRC* [2009] STC 643 at [102] and [103] that in a contra-trading case there are two frauds namely the dirty chain default and its cover up by the contra-trader and that the clean chain broker must be shown to have known or to be a person who ought to have known of one or both of those frauds. The learned judge added: "If he knows or should have known that the contra-trader is engaging in fraudulent conduct and deals with him, he takes the risk of participating in a fraud, the precise details of which he does not and cannot know". At [105] the learned judge said: "In other words, if the taxable person knew of the fraudulent purpose of the contra-trader, whether he had knowledge of the dirty chain does not matter".

21. In *HMRC –v- Brayfal* [2011] STC 1338 at [19] Lewison J, after noting that there is no fraud in the clean chain, said that the clean chain broker must be shown to have known or to have had the means of knowledge that his transaction is connected with fraud and "he must either know or have the means of knowledge that the contra-trader is a fraudster". We assume the judge's reference to the means of knowledge is shorthand for the "should have known" concept as understood in the authorities because having the means of knowledge by itself is not sufficient to disallow input tax. But the relevance of the passage is that the reference to the contra-trader is to him as a fraudster without any specific type of fraud being specified. The judge then added that the taxpayer's input tax claim would also be disallowed if he had knowledge or the means of knowledge of the dirty chain.

22. We interpret Lewison J's remarks as meaning that the taxpayer must know or be a person who should have known of a fraud before input tax will be disallowed and the fraud in question will in fact be either the dirty chain fraud or the cover up by the contra-trader. But he need not know or be a person who should have known what precise form the fraud takes as long as he knew or should have known there was a fraud of some type being committed by the contra-trader or alternatively that he actually knew or should have known about the dirty chain fraud, the latter being less likely to be capable of proof where the claimant is in the clean chain because he will have dealt only with the contra-trader. That interpretation of Lewison J's remarks is also more in tune with the judgment of Briggs J in *Megtian –v- HMRC* [2010] STC 840 at [35] to[39] (especially [38]) and indeed to *Mobilx* and *Kittel* itself.

23. The Tribunal was urged by Moses LJ not to over-elaborate the tests set out in *Kittel*.

The evidence (Waterfire).

24. We propose to deal first with the evidence concerning whether Waterfire acted as a contra trader and was dishonest and whether there was a connection between the appellant's transactions and any fraud before we deal with the evidence concerning the appellant itself and whether it knew or should have known of any such connection.

25. The evidence about Waterfire was mainly contained in the evidence of Nicholas Mody, customs officer, who was called to give evidence and made some minor corrections to his witness statement which stood as his evidence in chief. Mr Bhalla cross examined him only to confirm that the appellant did not know who Waterfire's suppliers were.

26. We find the relevant facts to be as follows.

27. Waterfire was registered for VAT on 5 July 2004 and its tax period relevant to Mail a Mobile's appeal ended 31 July 2006. Although Waterfire's application for registration stated that its business would be the wholesale of fancy goods, wholesale and retail of electrical equipment and white goods and consumer electronics, its actual activities were all wholesale back to back trading in mobile phones, computer equipment and other electrical items. Its turnover in the year ending 31 July 2005 was £17,130,164 (despite its having estimated its turnover at £900,000 in its application) and in the year ending 31 July 2006 it was £168,843,683. Approximately £79,000,000, nearly half of the annual turnover for y/e 2006, was in the three months ending April. The company operated from rented premises on a monthly lease without the facility to store stock of anything like the quantity traded. It was operated by two active directors and two staff.

28. All of Waterfire's transactions were in chains involving the acquisition of goods from the EU, rapid sales within the UK and the dispatch of goods to the EU; all within a few days. Deals were always matched by Waterfire in the sense that it bought goods and sold them on without splitting or amalgamating consignments and it always managed to make a profit on each deal. Waterfire acted as an acquirer, a buffer or a broker in chains in which no goods were sourced from manufacturers or authorised distributors and none were sold into the retail market. When the full chains were identified by HMRC it became apparent that many of the participants had acted in different capacities in deals that occurred close to each other in time, as Waterfire itself had. This included EU suppliers who became customers in similar chains close in time to each other and UK traders who acted as buffers acquirers and brokers in quick succession. The repeated appearance of various parties in the chains in different capacities gives rise to a conclusion that some sort of contrivance must have been at play.

29. Waterfire failed to insure the goods it dealt with and, although the directors claimed to have relied upon the freight forwarders to insure the goods, they took no steps to make sure that was the case.

30. The directors acknowledged that they were well aware of MTIC fraud. They went so far as to say they would have preferred to deal in different types of goods because they knew the types they dealt with were associated with such fraud but claimed they continued to trade in those goods because that was where their expertise lay.

31. The directors of Waterfire had also received many warnings about MTIC fraud when they had worked in no less than three other companies which were dealing in transactions in which HMRC had issued such warnings.

32. In the three months ending 30 July 2006 Waterfire engaged in 31 transactions. Seventeen of them were acquisitions of goods from EU suppliers which Waterfire then sold to UK purchasers and the remaining 14 transactions were broker transactions consisting of sales of goods purchased from UK suppliers to EU customers.

33. Waterfire's trade in the tax period ending July 2006 showed a marked pattern. All its transactions in May were acquisitions and all its transactions in July were broker transaction. Those in June included both types. All the broker transactions in June traced back to an alleged defaulting trader and every broker transaction in July traced back to a different defaulting trader.

34. Both of the defaulting traders are what are termed taxable persons purporting to be another legal entity, hi-jackers in the terminology adopted in such cases. Such traders are perforce fraudulent either because it is obviously fraudulent to use someone else's identity and then not to declare tax due or, if it should be the case that the transactions were actually by the named parties (a self hi-jack so to speak), then they were fraudulent in deliberately not declaring the tax.

35. The July 2006 period ended with Waterfire owing, and paying, output tax of £3,926.63 which, given its turnover of £23,259,915 in that period; was itself remarkable. When the pattern of trade is taken into account it becomes clear that Waterfire was manipulating its own transactions in order to achieve that result as the pattern of trade in which output tax liabilities were built up and then reversed by transactions involving input tax claims without corresponding positive rate outputs is most unlikely to have been accidental in any normal commercial environment.

36. As the defaulting traders were hi-jacked companies it is also clear that even quite cursory enquiries by Waterfire should have alerted it to the fact that those suppliers were dishonest. One was using the name of a well known manufacturer of cooking appliances but was operating from a completely different address from the genuine company and was contactable by mobile phone or fax which would be remarkable for a company supplying goods to the large values involved. The other hi-jacked company was also operating from a different address from that of the genuine company and that should have been easily discoverable by Waterfire.

37. The respondents produced uncontested evidence that the funds paid to and by Waterfire in chains of transactions began and ended with the same entity in at least some of its transactions.

Conclusions concerning Waterfire.

38. Waterfire's trading with hi-jacked traders whose identities it could not have properly checked, its huge rise in turnover, the circulation of funds indicating that the transactions were contrived and organised by some directing mind and the pattern of trading with different types of deal being conducted at different stages in the tax periods is sufficient for us to find on a balance or probabilities that it was acting fraudulently and in view of the absence of any challenge to the respondents' evidence about Waterfire and the absence of any actual evidence to the contrary advanced by the appellant we so find.

Conclusions concerning connection with fraud.

39. The transactions in which the appellant was engaged formed part of the Waterfire fraud and were therefore connected with it in two ways as alleged by the respondents. The transactions in fact helped to disguise the large amount of input tax Waterfire was claiming in its dirty chain transactions and therefore to reduce the likelihood or at least the urgency with which HMRC might have enquired about its VAT return. The funds provided by the appellant were part of the totality of Waterfire's funds available for the dirty chain transactions it was funding.

40. Those connections between the appellant's transactions and Waterfire's dirty chain transactions are simple matters of fact.

41. A connection between the appellant's transactions and the fraudulent transactions of Waterfire is not enough to disallow the appellant's input tax claim. That depends upon whether the respondents have proved that the appellant either knew or should have known of a connection.

The commissioners' case.

42. Much of the evidence called by the commissioners consisted of the production of documents about the transactions of the appellant and the transactions and evidence relating to Waterfire which has already been discussed. The documents either spoke for themselves or were fully dealt with in the cross examination of the appellant's witnesses which we will deal with below.

43. The commissioners' evidence also dealt with the commissioners' dealings with the appellant's directors and staff and, in particular, meetings or correspondence the relevance of which was that the commissioners contend that they show that the appellant had become well aware of the existence of fraud in the type of wholesale mobile phone transactions in which it engaged; before the transactions relevant to this appeal occurred. The appellant's witnesses accepted that they had become aware of the existence of fraud in that way. It should be noted that the evidence does not support any contention that the appellant knew about the nature of such fraud in detail

and in particular it does not support a contention that the appellant was aware of the contra trading phenomenon. As the appellant's witnesses accepted that they were aware of the existence of fraud we need not go into a great deal of detail about those meetings and that correspondence.

44. Officer Thelma Davies gave mostly undisputed evidence about the appellant and an associated company called Club Mobile whose appeal was heard at the same time as this one. Mr Malik Nasser was Club Mobile's sole director at the time most relevant to this appeal but Mr Adam Kiani and Mr Walid Nasser were also shareholders and Mr Kiani had been a director previously. Mr Kiani and Mr Malik Nasser are the shareholders of Mail a Mobile. Both companies operated at the relevant time from the same premises though the appellants' witnesses said that each company had its own office.

45. After the input tax under appeal was refused the business in effect ceased to trade.

46. Officer Davies gave opinions in her witness statements about what the basic facts proved as far as the appellant's knowledge of fraud was concerned and was cross examined about that but we will make our decision on the basis of our conclusions from the facts as found by us and so we do not need to deal with that aspect of the evidence here.

47. It is convenient to deal with some evidence about due diligence enquiries made by and on behalf of the appellant at this stage though this aspect of the evidence will also be considered under the heading of the appellant's evidence.

48. The appellant placed great emphasis on the fact that it had engaged professional advisers to deal with some aspects of due diligence enquiries on its behalf.

49. Mr Kiani's witness statement refers to his belief that particular importance should be attached to due diligence concerning the appellant's supplier. The respondents' case is that their officers and their Public Notice had not suggested that due diligence only needed to cover suppliers and that the Public Notice only gave examples of what was required, leaving it to the traders to decide what they thought was necessary as a matter of normal commercial prudence but taking into account the prevalence of fraud in the particular type of transactions in question.

50. The respondents' case so far as due diligence enquiries about Waterfire, the appellant's supplier, was concerned is that the enquiries were made to provide evidence with a view to satisfying them that the appellant had carried out adequate due diligence but that on further examination the result of those enquires showed that the appellant had had reason to conclude that Waterfire was not a company with which it should deal. Indeed the respondents allege that the fact that the appellant knew what it did about its supplier and customers and others involved in the transactions shows that the appellant knew that the transactions were part of a fraudulent scheme. In particular, the respondents allege that the facts known to the appellant would have led it to refuse to engage in the deals in question unless it had

known that the deals were contrived for fraudulent purposes and were therefore safe deals to engage in despite the known facts suggesting they were not.

Evidence of the appellant.

51. The main witness for the appellant was Mr Adam Kiani who had worked with Mr Malik Nasser in the Club Mobile business. They decided to set up Mail a Mobile to deal in mail order sales and the boards of directors of both companies had held a meeting at which it was decided that Mr Kiani would be responsible for Mail a Mobile and Mr Nasser would continue to be responsible for Club Mobile but that they would regularly discuss how to operate both businesses profitably. Mr Kiani said that the mail order business had been successful and that in early 2006 he had decided to expand into wholesale dealing after Club Mobile had done that successfully.

52. Mail a Mobile was operated from premises above Club Mobile's shop which was also from where Club Mobile was operated but each had its own space in the offices.

53. Mr Kiani said that "after discussions with HMRC" it was decided that the method of trade would be that the company would identify a supplier of goods before looking for a customer.

54. The method of trading was to be that goods would be sent abroad on "ship on hold" terms and Mr Kiani described that as meaning that goods would be sent to a location of a freight forwarder decided by the customer on terms that the customer could inspect the goods but not remove them from the freight forwarder's premises until they had been paid for and that, in the event that the customer did not pay for the goods, they would be returned to the UK by the supplier but that Mail a Mobile would have to pay the cost of returning the goods. Title to the goods would not pass until Mail a Mobile paid the supplier which therefore meant that the customer would have to have paid Mail a Mobile first as Mr Kiani had admitted it could not finance the deals in full itself.

55. Mr Kiani said that deals were negotiated over a period of time but that when they materialised the paperwork and the transactions themselves all took place on the day of the deal as once a deal was agreed he wanted it to be finalised quickly to avoid the supplier being able to find a better deal in what was described as a fast moving business.

56. Mr Kiani emphasised the due diligence enquiries made about the appellant's suppliers and claimed that HMRC had emphasised the need for due diligence enquiries about suppliers though he did also claim that he had satisfied himself that the customers were experienced and knowledgeable in the industry and had a good reputation as far as payment was concerned.

57. The appellant had employed Messrs Chiltern PLC to carry out some due diligence on its behalf and in his main witness statement Mr Kiani mentioned that this included what that company had said in meetings and on the telephone (that is to say as well as in written reports). We do not believe that Chiltern certified any particular

transactions by telephone. Mr Kiani did not make this claim until he was pressed in cross examination. It is not a claim he made in his witness statements and there is no documentary evidence to support it.

58. Mr Kiani said that all goods were inspected before the deals went ahead.

59. Mr Kiani admitted he knew about fraud in the industry in general and that it had been discussed in meetings with officers of HMRC and with his accountant but he added that he had never been given any understanding of how prevalent it was or how the company could have any connection to it.

60. Mr Kiani made a supplemental witness statement in which he agreed with what Mr Nasser had said in his statement in respect of both this appeal and Club Mobile's appeal.

61. When he was cross examined Mr Kiani was asked about due diligence enquiries about Elandour, the appellant's customer in the relevant deals. Some documents, mostly in French, were produced emanating from that company and Mr Kiani admitted that he could not read or speak French but he claimed that more documents had been received and that some were in English though he did not recall what they were.

62. Asked about a D&B credit report which said that Elandour was formed only 4.5 months before the relevant deals, despite which Mr Kiani had received a letter from it claiming a successful track record in business, he said that he was not concerned about that and indeed he was not concerned about the fact that D&B had said there was insufficient information to form a view about Elandour's credit rating. His explanation was that he had carried out credit checks on Mail a Mobile and Club Mobile and that they had both come back with similar comments despite having what he considered to be successful trading figures.

63. Mr Kiani said that there was a language barrier between him and the person he dealt with at Elandour so that he preferred to deal in emails and faxes rather than by telephone.

64. At first he said he may well have sent Elandour standard terms and conditions but then when he was asked, immediately after that answer, if Mail a Mobile had standard terms and conditions he said there were none and then, almost immediately again, he said "To be honest I can't remember there was or there wasn't".

65. Mr Kiani was asked about Mail a Mobile's first wholesale deal which had occurred on 28 February 2006 and in particular about a meeting with a customs officer called Cook on that day. It was put to him that he had not mentioned the imminent deal to Mr Cook despite the fact that, albeit in the context of a Club Mobile deal in April 2005, he had been made aware that HMRC would like to be informed that a deal was going to occur. Mr Cook wrote a letter to Mr Kiani following that meeting and Mr Kiani said he thought the letter implied that he must have told Mr Cook about the intended deal because the letter referred to Mr Kiani having checked his supplier in detail. We cannot make a finding that Mr Kiani failed to declare the

deal to Mr Cook at the meeting and he was under no legal obligation to do so but the letter made it very clear that due diligence on the supplier was something HMRC regarded as important.

66. As already mentioned, Mr Kiani claimed that HMRC had said that due diligence on the appellant's suppliers was particularly important.

67. He was cross examined about the appellant's due diligence concerning Waterfire. Some of the enquiries were done on behalf of Club Mobile and shared with Mr Kiani. Waterfire had issued a document described as a letter of introduction in which it claimed to have had years of experience and reputable trading partners in Europe, UAE and Asia Pacific. However, Club Mobile had on record a certificate of incorporation showing that Waterfire had only been incorporated in April 2004. Mr Kiani said that whether it was right to describe itself as having had years of experience only two years after it was incorporated was something that would have to be put to Waterfire. He claimed that Mail a Mobile and Club Mobile had data bases of potential customers and suppliers and appeared to think that that was equivalent to the claim made by Waterfire that it had years of trading experience. He said that he could not remember if he had seen the documents just referred to but that if he had it had not given him any cause for concern.

68. A firm of solicitors called E & K Solicitors had provided some due diligence consisting of the letter of introduction and the certificate of incorporation referred to above and a VAT Registration certificate and a note of a Redhill verification.

69. Mr Kiani thought he had probably seen the due diligence documents referred to which were provided to Club Mobile

70. Mail a Mobile had issued a document to Waterfire claiming that it carried out site inspections but Mr Kiani admitted that only referred to the type of things he had done for Club Mobile.

71. Asked again about the financial information about Waterfire and Elandour before the appellant's first deal with them on 28 February 2006 and whether their financial standing showed them to be both high risk trading partners Mr Kiani again referred to the fact that both Club Mobile and Mail a Mobile were given poor scores on credit checks but were "very good retailers".

72. Mr Kiani agreed that the appellant had not taken up any trade references about Waterfire because he could "assume that safely Club Mobile would have done that" but that the references may only have been by telephone. He then added that he thought E & K Solicitors would take up references.

73. Mr Kiani admitted that the only checks he had done on the freight forwarders concerned in the transactions under appeal was to check that they were freight forwarders and he said that he could not recall if they had standard terms and conditions.

74. Mr Kiani was asked about the transactions directly in question in this appeal and he said they were all done at the end of the tax period for cash flow reasons.

75. The Chiltern report showed that Waterfire were importing goods from the EU but Mr Kiani said it did not occur to him as being odd that they sold goods to Mail a Mobile which were then exported when, on the face of it, they might have exported those goods themselves.

76. The Chiltern Report was relied on by the appellant as part of its case that its due diligence enquiries had been exceptionally thorough but we note that the Report only dealt with what Waterfire had told Chiltern it did by way of due diligence on its suppliers and customers and that Chiltern neither purported to have checked that Waterfire carried out what it said it did nor to have carried out any checks in respect of the actual transactions engaged in by the appellant.

77. In his witness statement Mr Kiani set out what was "typically the trading process" but when he was cross examined Ms Wilson-Barnes pointed out that Mail a Mobile only carried out three wholesale deals and that two of them are relevant to this appeal. She asked if the sequence of events set out in the witness statement was what had happened in the two deals in question to which Mr Kiani replied "not necessarily … I was attempting to explain how a deal might have taken place".

78. Asked about where he first heard the phrase "ship on hold" which he referred to in his witness statement he said he could not remember but that he thought it was "quite common in our industry". Pressed further he described the industry as telecommunications and that the term was more likely to be referring to wholesale than retail deals.

79. He described identifying that Waterfire had certain stock available perhaps a week before the deals and that he had put it on his list of stock he could offer to customers and he then described negotiating with both parties. He said that he had dealt with Benoit at Elandour but that "his English was not the best".

80. A number of documents were produced dated 31 May including purchase orders from the appellant to Waterfire and from Elandour to the appellant and inspection instructions from the appellant to the freight forwarder, supplier declarations and shipping documents. Mr Kiani said he could not remember in what order the documents were produced.

81. Mr Kiani said that it had not occurred to him at the time of the deals that Waterfire's supplier declaration in which they claimed to have kept IMEI numbers was contradicted by Chiltern's report to the appellant which said that Waterfire only did box counts and did not obtain IMEI numbers.

82. The goods were shipped to Elandour on 5th June but Mr Kiani said he had assumed they would go on 1st June. He admitted that the documents showed no agreed delivery date required by Elandour. He also admitted there was no written agreed delivery date between the appellant and Waterfire.

83. Asked about the meaning of "ship on hold" Mr Kiani admitted it was not mentioned in the documents but he said that it did not need to be as "I understood that they've the goods once they've paid for it".

84. Mr Kiani said that he was sure the appellant had terms of trade and conditions somewhere though they were not on any of the deal documents. He said "I know we managed to find the terms and conditions at the, at the retail website". It was pointed out that he had not claimed there were terms and conditions in his witness statements and he said "isn't it a common assumption that when you're doing trade that the trade's going to be subject to some form of terms and conditions". Pressed again to say what they were he said he did not know. Then he said they were in a trading pack that was sent out. Pressed again he said he was sure the trade pack would have had the company details in it such as registration certificate and VAT certificate and other details of the company. He was reminded that earlier in his evidence at one stage he had said there were no terms and conditions. He then repeated that he could not remember if there were.

85. He was asked how Elandour would know that the goods would be shipped on hold before seeing the invoice on which that phrase was used and how they would know what that meant and he said he assumed that would have been made clear during conversations with them. Later he claimed only to have managed to get the gist of the meaning of the term across to Mr Benoit but then reverted to his assertion that he thought there were some written documents. Finally he fell back on the assertion that the term was commonly used in the industry and so potential buyers and suppliers – "everyone" – had an understanding of the term. He added that he had explained the basics of it and when asked why, if everyone understood it, he needed to have explained it he said "just in case".

86. Mr Kiani said that allocation of stock to the appellant by Waterfire would have been notified by telephone.

87. He said that he would have discussed with Online Logistics (the UK freight forwarder) what their charges would be.

88. Only a box inspection of the stock was carried out and Mr Kiani said he thought that was acceptable at the time.

89. Mr Kiani was asked how he knew that Online Logistics knew what ship on hold meant and he said he "would have explained [when he rang them] or obviously understood from them what their understanding is … the exact term, my assumption is that they understood … and I didn't get a breakdown individually of what's expected". It was then put to him that he had not had a conversation with Online Logistics about what ship on hold meant and he had not had a conversation about the meaning of ship on hold. He then said that "these conversations took place" not just that he was speculating about what he thought should have happened. He was unable to explain how he could be sure that Online Logistics would explain the situation to the French freight forwarder who took delivery of the goods on Elandour's behalf.

90. Mr Kiani accepted that although he expected Elandour would want to inspect the goods before paying for them there was no time scale laid down in the documents and there was no time scale laid down for payment at all despite the fact that he had described the fast moving market in which prices could go up or down. He admitted that there was nothing to stop Waterfire from pressing for payment before Elandour had paid the appellant.

91. Waterfire did have standard terms and conditions that were referred to in the Chiltern due diligence report. Those terms said that title would not pass until they had been paid and there were fairly specific terms about how the goods should be stored and dealt with before title passed and Mr Kiani said he just assumed the French freight forwarder would know what to do about those terms.

92. Mr Kiani admitted there was no instruction to Elandour about the identity of the bank account to which payment to the appellant was to be made.

93. Mr Kiani claimed that Elandour knew that title would not pass until they had paid the appellant and the appellant had paid Waterfire and that they knew that because they had dealt on those terms before the deals in question in the appeal. When asked how they got to know, before the first deal, that was the method of trading he reverted to asserting that there had been conversations and then that there had been documents which are now missing and which he thought it unnecessary to mention in his written statement.

94. Mr Kiani was asked if he made a note of any of the phone calls in which important details of the deals were discussed and he said it would have been physically impossible to note all the calls but then he added that it did not seem relevant at the time to note them. He then said that it was not that he was too busy but that he did not know he had to note them.

95. We find that Mr Kiani was a thoroughly unreliable indeed dishonest witness. He repeatedly made a statement that he then withdrew and replaced by a fundamentally different statement such as that he had given instructions by phone then that he thought there may have been and then then that there were missing documents. We have cited examples above as to which see paragraphs 77, 84, 85, 89, 93 and 94.

96. Some points of his evidence were impossible to believe. Examples were that he claimed it would have been physically impossible to note the results of telephone conversations about the terms of trade (see paragraph 94). Bearing in mind the value of the goods in question and the possible consequences if terms were not understood by the parties to the transactions it is obvious that a note would be needed even if no written confirmation were to be made. It is also implausible to claim that time would not have permitted some sort of contemporaneous note to be made. Another example of evidence which we find to be impossible to believe was Mr Kiani's assertions about how he explained to the French customer what ship on hold and other terms of business meant or at least how he discovered that the customer understood that in the same terms that he did.

Submissions for the appellant.

97. The appellants stressed again the significance of the fact that they had engaged Messrs Chiltern, as they claimed, to provide information and to advise them. However, we are not satisfied that that was Chiltern's role. Its main role was to carry out due diligence enquiries and they mostly only produced evidence that the appellants' counterparties, so far as covered by the reports, had claimed to have satisfactory procedures. Chiltern did not purport to have examined any of the actual transactions or even to have examined the appellants' counterparties' procedures with a view to confirming that those parties actually did what they said they would do. The only evidence that Chiltern advised the appellants about actual transactions was that the appellants assert that they asked Chiltern about them in telephone calls before they took place but as Chiltern could not advise about the actual deals and in particular knew little, if anything, about the customers we do not regard that as a significant point even if true.

98. The appellants contend that the transactions have to be judged in light of commercial realities. In particular they contend that there was a genuine market in phones and that the depth of checks they could make would depend on the speed and profitability of the opportunity. Given that the appellants knew that there was a great deal of fraud in the market in which they were trading, we cannot agree that the need for speed can be used as an excuse for any failures to make enquiries and indeed the appellants themselves rather asserted that they thought they had made satisfactory enquiries.

99. We accept that the appellants were right to assert that their negotiations stretched beyond the very short periods during which documents were created but we find that the negotiations and the deals occurred within a few days at most. On the other hand that is not particularly significant as a deal that is either legitimate or not can be negotiated within a short or long period. We find that the appellants did have insurance for the goods while they were in transit as they claim though they have not claimed to have insurance for the goods while at the buyers' freight forwarders premises. There is no proof that any third party took part in financing the deals of the appellants though there was some financing between them, which we regard as being entirely innocent given the closeness of the two businesses. We also agree that the appellants had not undertaken to inform Mr Baines before doing any deals though he had asked them to do so and that, as he had no right to demand they did so, it is not significant that they did not inform him.

Conclusions.

100. The transactions in this case had characteristics that fall outside what would be expected in any normal transaction. Goods of very large value were traded with no written or otherwise recorded terms of business between parties which had had no course of dealings such as might have established those terms. The transactions were potentially enormously profitable to the appellant considering the actual sums outlaid by it. That profit was obtained after a short period of negotiation and with very little effort on the part of the appellant. As far as the transactions with all other parties

namely the supplier, the customer and two sets of freight forwarders were concerned the appellant acted as if it had had some sort of assurance that all would be well and that it need not fear to enter into the transactions despite a complete lack of assurance that those parties even agreed what those terms were. As Mr Kiani said, everyone knew what the terms were, though he had great difficulty in explaining the exact sequence of events or how the parties came to know what the terms were or how he assured himself they all agreed what they were.

101. The transactions were clearly contrived in the sense that they were not the result of normal negotiations beginning from scratch but were rather transactions between parties that somehow knew that all would be well and that they could deal with each other despite being practically strangers to each other. The absence of any written or otherwise recorded terms of business is a very significant feature of the transactions in question.

102. It is highly relevant that Mr Kiani knew that there was a great deal of fraud in the type of transactions in question. The appellant claims to have sought to avoid that by carrying out due diligence enquiries about its supplier in particular and to some extent on its customer as well. The appellant points out that it engaged what it believed to be a competent organisation to carry out due diligence on its suppliers and we have no reason to doubt that Messrs Chiltern did produce honest reports. However, Chiltern reported what had been told to it by the businesses it was reporting on and it is clear from the reports that it did not certify that those businesses had actually carried out the due diligence enquiries they claimed to have and Chiltern certainly did not certify any particular transaction. Mr Kiani claimed that he had spoken to Chiltern on the telephone about particular transactions but we have rejected that evidence as untrue.

103. We have found that there is in fact a connection between the appellant's transactions and a fraud concerning VAT in which HMRC are the victims. We hold that the legal precedents establish that it is not necessary for the appellant to know the precise nature of that fraud before input tax recovery can be denied.

104. Adding together the facts and findings referred to in this appeal as summarised in paragraphs 100 to 102 above with the finding that Mr Kiani was a deliberately dishonest witness we have concluded that the appellant knew that the transactions were connected with fraud as well as being a body which should have known that fact. Mr Kiani holds a Higher Education Diploma and has had considerable commercial experience which are relevant facts concerning his state of knowledge.

105. In those circumstances the appeal is dismissed. The disputed input tax is not recoverable.

106. Any application for costs pursuant to this decision should be made to the tribunal within three months of the release of the decision. At the time of making any application the costs need not be quantified but the application should make it clear how and against whom the applicant wishes the costs to be assessed.

107. 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.

RICHARD BARLOW
TRIBUNAL JUDGE

RELEASE DATE: 19 December 2012