TC02442

Appeal number: MAN/2007/0728

VAT – input tax – MTIC – appeal dismissed.

FIRST-TIER TRIBUNAL
TAX CHAMBER

CLUB 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 Mail a 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 £404,495.60 which it had claimed in its VAT return for the three month period ending 30 April 2006. Only £401,502.50 of that sum is disputed. The balance was disallowed as a result of credit notes being incorrectly dealt with and has no relevance to this appeal.

3. The disputed amount arises from three transactions in which the appellant bought mobile phones from Waterfire Ltd (a UK company) and sold them to SARL Phone C@nnected (a French company) in one transaction which we will refer to as deal one and to Kiara Trading International (a French company) in two transactions which we will refer to as deals two and three. In each case the sales were of the same phones as were purchased. No consignments of phones were either split or amalgamated by the appellant. In each case Waterfire had bought the phones from FAF International (an Italian company).

4. Deal one concerned 4,000 Sony Ericson phones bought by Waterfire for £211.00 each on 21 April 2006 which Waterfire sold (or agreed to sell) to the appellant for £214.00 each on 25 April 2006 and which the appellant sold (or agreed to sell) to Phone C@nnected on 26 April 2006 for £239.00. Waterfire had acquired the phones from an EU country and so in effect no tax was payable by it on the purchase from FAF because the acquisition tax was offset by an input tax claim, as the purchase was for its business. Waterfire achieved a mark-up of £12,000 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 £25.00 per phone and it did not have to charge output tax when it sold the phones to Phone C@nnected 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 £49,800 because the tax inclusive price it paid to Waterfire was that much more than the tax exclusive price it received from Phone C@nnected but if the input tax had been credited the appellant would have achieved a mark-up of £100,000.00 on the deal and will make that amount if the appeal succeeds. That is an 11.68% mark up.

5. Deal two had similar characteristics. It concerned 2,000 Nokia N91 phones acquired by Waterfire on 23 April 2006, sold (or agreed to be sold) to the appellant on 26 April 2006 and sold (or agreed to be sold) to Kiara Trading on 27 April 2006. Waterfire made £5.00 per phone. The appellant would have achieved a mark-up of £43.75 per phone or a total of £87,500 (9.07%) if the input tax had been credited. It will achieve that mark up if the appeal succeeds but will be out of pocket to the tune of £81,200 if not.

6. Deal three also had similar characteristics. It concerned 1,800 Nokia 7380 phones acquired by Waterfire on 21 April 2006, sold (or agreed to be sold) to the

appellant on 27 April 2006 and sold (or agreed to be sold) to Kiara Trading on 28 April 2006. Waterfire made £3.50 per phone. The appellant would have achieved a mark-up of £26.50 per phone or a total of £47,700 (10.05%) 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 £35,302.50 of not.

7. The dates above are the dates of the transactions shown on documents between the relevant parties but the passing of title to the goods may have occurred only upon payment.

8. Between 25 April 2006 and 28 April 2006 the appellant therefore engaged in deals worth a total of £2,695,802.50 with a potential gross profit of £235,200 on an outlay of £166,302.50. 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.

9. 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.

10. 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.

11. 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 financed 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.

12. 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.

13. 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".

14. 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.

15. 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.

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

17. 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.

18. 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.

19. 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.

20. 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.

21. 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".

22. 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.

23. 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.

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

The evidence about Waterfire (alleged contra trader).

25. 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.

26. 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.

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

28. Waterfire was registered for VAT on 5 July 2004 and its tax period relevant to Club Mobile's appeal ended 30 April 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.

29. 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.

30. 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.

31. 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.

32. 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.

33. In the three months ending 30 April 2006 Waterfire engaged in 85 transactions.

34. Leaving aside five transactions which we will return to later the position was that in the three months ending 30 April 2006 but as at 28 April Waterfire had been involved in 47 transactions in which it had acquired goods from EU suppliers and sold to UK customers (including the three under appeal), six buffer transactions in which it bought from and sold to UK traders and 27 broker transactions in which it had bought from UK suppliers and sold to EU customers. As at 28 April Waterfire had bought and sold goods to an approximate value of £72,000,000 and had made large profits on those deals but its tax position would have been that had the tax period ended on that day its liability for output tax and its claim for input tax would have been matched with the result that it would have been liable to pay HMRC only £2,942.50.

35. However, in the same period the 27 broker transactions in which Waterfire had been involved led back to tax losses of £5,706,616.90 caused by various suppliers.

36. We will deal briefly with the evidence that those suppliers, of whom there are six, were themselves fraudulent so that the tax losses were connected with fraud rather than being the result of innocent misfortune.

37. Three 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. Two of the three also used false VAT numbers and that in itself is strong evidence that Waterfire were fraudulent because it cannot even have attempted to verify the VAT numbers of its suppliers at all as indeed the respondents' records show was the case. A failure to verify VAT numbers is particularly significant in light of the directors of Waterfire having knowledge of VAT fraud and having claimed to regret having to deal in that business environment.

38. The next supplier was Prestige 29 UK Ltd, a company operated by one Jamie Grant who claimed to have been paid £2,000 to sign papers and provide a virtual office in the name of the company but who had no actual dealings with the goods or the transactions. That company purported to be dealing in bathroom supplies and owes HMRC £6,798,164 following assessments that have not been contested.

39. PM Wholesale Electrical Ltd supplied Waterfire and in its two months of trading that company achieved sales of approximately £350,000,000 from a small office in Manchester and many of its transactions were with two of the hi-jacked entities already referred to.

40. The last of the five suppliers to Waterfire in the 27 dirty chains on or before 28 April 2006 was LTH Ltd which made tax returns but simply failed to account for the relevant transactions.

41. We have no hesitation in finding that five suppliers were dishonest defaulters and that Waterfire's purchases were in chains leading back to defaults. That conclusion was not actively contested by the appellant who left it to the tribunal to decide on the undisputed evidence whether the transactions were dirty chain transactions.

42. The remaining five transactions of Waterfire gave rise to a claim for input tax of approximately £1,260,000 and were broker transactions. These transactions occurred on 29 April 2006. As already mentioned, Waterfire's deals up to and including 28 April would have left it in a virtually neutral position so far as VAT was concerned, its inputs and outputs would have been virtually in balance. These additional broker transactions left it claiming a total of approximately the whole of the input tax on those transactions as a repayment.

43. The five transactions were clean chain transactions in which Waterfire made a profit of £127,936 in one day and which fell outside the pattern of its other transactions. Waterfire made what was, for it, a particularly large profit on these deals. The suppler was Epinx Ltd and that company had purchased the goods from Nordic Telecommunications ApS of Denmark but the goods then circulated between Epinx, Waterfire, Kom Team SARL (a French company) and back to Nordic all in one day. Nordic apparently bought its own goods back on the same day paying a higher price than it had sold for and the goods having been delivered to it in Luxembourg having purportedly travelled to the UK as well in the meantime.

44. The respondents allege that despite these transactions being clean chain transactions and despite the fact that they upset the balance of input tax and output tax achieved by Waterfire by 28 April 2006 they were nonetheless connected with fraud because Epinx was itself a contra-trader and had used them to disguise its dirty chain broker transactions and that Waterfire's payment assisted in the financing of the Epinx dirty chain transactions. Nordic was a Danish company operated by one Andrew Salami of Bolton Lancashire but the Danish authorities had received VAT returns declaring no trading by it in the relevant period.

Conclusions concerning Waterfire.

45. 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.

46. 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.

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

48. 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.

49. 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.

50. 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.

51. Officer Thelma Davies gave mostly undisputed evidence about the appellant and an associated company called Mail a 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.

52. Club Mobile operated a retail business in which it signed customers up to contracts with mobile phone operators and it held a stock of phones which were supplied free of charge to those customers. Club Mobile received commission from the operators for that service. The company also supplied small quantities of phones to other retail shops but it never physically held stocks of anywhere near the quantities of the wholesale deals relevant to this appeal and indeed the witnesses accepted that the premises were not suitable for holding such quantities.

53. Club Mobile registered for VAT from 15 March 2004. Officer Davies provided details of the turnover of Club Mobile which rose from £134,197 in period 01/05 to £549,382 in 04/05 and £1,616,462 in 07/05 and then successively £2,784,816, £2,077,532, and £2,311,403 the last figure being the period in which the transactions under appeal occurred. Officer Davies' evidence was that the large rise in turnover was not accounted for by a big increase in the retail side of the business and was accounted for by the wholesale deals in phones which were not physically taken into stock by the appellant. We find that to be the case. The company's accountant wrote to HMRC on 25 June 2005 to notify them that the company had commenced exporting and we find that that confirms that officer Davies was right to attribute the big increase in turnover to mobile phone deals of that general type.

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

55. 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.

56. 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.

57. 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.

58. Mr Nasser'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.

59. 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.

Appellant's evidence.

60. Mr Malik Nasser who was a director of the appellant at the material times gave evidence. Mr Kiani, in his own witness statements, also stated that he agreed with much of what Mr Nasser had said in his witness statements.

61. Mr Nasser made four witness statements in total. As he gave detailed evidence orally we need not summarise the witness statements separately from dealing with his oral evidence.

62. Mr Nasser described how the appellant had had a successful retail business in the mobile phone sector and how it has also earned commission by signing consumers up to mobile phone networks. He said that there came a time when the company had decided to expand into wholesale trading of the type in question in this appeal.

63. Mr Nasser claimed that, Mr J Baines, a customs officer who visited the appellant had emphasised that the appellant's due diligence enquiries should concentrate on the appellant's supplier. We heard Mr Baines' evidence and we find that whatever impression Mr Nasser may have formed about who should be emphasised in the due diligence enquiries Mr Baines certainly did not say that the enquiries should be restricted to the supplier.

64. Mr Nasser also claimed that Mr Baines had advised the appellant to deal in exports because that was a more profitable type of transaction than buying and selling in the UK and that there was "nothing fraudulent" in the export market. We reject that claim entirely. Mr Baines warned Mr Nasser against back to back deals at very low margins, in other words buffer transactions in the MTIC jargon, but that is not the same thing as advising the appellant to engage in a different type of transaction. Nor do we accept the assertion that Mr Baines had said there was nothing fraudulent in the export market. Mr Baines knew very well that a lot of export transactions were connected with fraud and we can think of no good reason why he should have made that remark.

65. The appellant's due diligence enquiries included reports obtained at considerable expense from Messrs Chiltern PLC a consultancy firm staffed, for the purpose of obtaining the reports in question, by experienced ex-customs officers. The appellant had consulted Chiltern after finding a firm of solicitors, which had done some due diligence enquiry work, had produced unsatisfactory reports.

66. The appellant admits that it was well aware of the fact that there was a great deal of fraud in the type of wholesale dealing in mobile phones it was proposing to become involved with. The appellant, however, claimed to have no knowledge of the contra trading phenomenon and we accept that there is no evidence that Mr Nasser was aware of that as indeed it seems that none of the officers who dealt with the appellant at the time of the transactions was aware of the phenomenon at that time.

67. Mr Nasser began his evidence by making a number of amendments to his written statements. When cross examined about them he said there were time constraints when he signed the main statement and that there was information in them which he said: "I don't think was factual" and he attributed some of the amendments to the need to remove opinions expressed by Mr Kiani. He admitted that he had not read the statement in detail before he signed it.

68. One particular paragraph in his statement denied receipt of a letter dated 28 February 2005 which confirmed discussions between Mr Nasser and Mr Kiani and customs officers about due diligence at a meeting held on 24 February. That letter was of some significance because it referred to the prevalence of MTIC fraud and the need to "make adequate checks into your client's commercial background" and "new contacts' VAT registration and incorporation certificates". The references to clients and new contacts are clearly not apt to convey any suggestion that only suppliers' details should be checked. Mr Nasser had denied, in a witness statement, that the letter was received but then asked for the paragraph denying receipt to be deleted from his statement.

69. He agreed that although in the witness statement he had denied receipt of a letter dated 24 February it was the letter dated 28 February he was referring to. He asserted that the letter was "irrelevant anyway". When asked why he had said the letter was not received he said he could not recall if he had received the letter or not. When pressed as to how he could positively deny receiving a letter when he could not recall whether he had received it or not he reverted to saying there was confusion

about the date of the letter, though we note that any confusion was in Mr Nasser's mind as the letter is correctly dated 28 February and the meeting was on 24 February.

70. In a witness statement Mr Nasser explained the appellant's entry into the wholesale market as somehow an extension of the retail business in that the appellant had bought parcels of phones for sale in the retail business. But he admitted that the wholesale deals of the type in question in this appeal were on a different level, so far as quantity was concerned, from the level of purchases of stock in the retail business. In particular he admitted that it had never been envisaged that the appellant would take physical possession of the volumes of goods involved in the transactions in question in this appeal and indeed did not have the storage space to do so even if it had wished to do that.

71. Mr Nasser agreed that he knew the transactions would involve goods moving between freight forwarders. In other words Mr Nasser was admitting that the appellant knew before any of the type of transactions under appeal actually occurred that they would have the characteristics they did have. He explained that he had done research and discovered that this was the practice in what he called "the phone industry".

72. Mr Nasser was asked about IMEI numbers. In some of the appellant's earlier trades the IMEI numbers received from the inspection company were passed on to HMRC but from January 2006 and therefore by the time of the transactions relevant to this appeal Mr Nasser accepted he had stopped sending them or even obtaining them because, he claimed, an officer had said they were irrelevant. In fact all that had happened was that the officer had asked for them in an electronic data base form which was not a form in which Mr Nasser had received them. We do not believe that an officer had said that they were irrelevant. At another point in his evidence Mr Nasser claimed to have thought that Chiltern would send the IMEI numbers but, at least by the time the transactions under appeal took place, that would not have been possible as Mr Nasser had admitted he was not receiving them at all by that time.

73. Mr Nasser claimed in his witness statement that he had followed customs' advice but, when it was put to him that he had been asked to inform Mr Baines before doing any wholesale deals, at first he said Mr Kiani had told Mr Baines before the appellant did any such deals and then conceded that he did not know if that was the case.

74. Mr Nasser agreed that it was important to have information about his customer as well as about his supplier. In his witness statement he said that he had satisfied himself that the customers were experienced and knowledgeable in the industry and that he had little concern they would not pay for the goods. He maintained that it was not as important as knowing about his supplier. He explained this on the basis that he understood MTIC fraud operated by someone in the chain of dealers in the UK failing to account for VAT and that he had to ensure that his supplier had accounted for VAT. He pointed out that in his view Notice 726 laid more emphasis on the supplier than on the customer and to a certain extent we agree that is the case. He also said that before the first export deal he had flown to Dubai to meet the customer though he

made no claim to have met the customers in the later deals directly relevant to the appeal.

75. Mr Nasser agreed that in the retail business he would not just let anyone walk out with a phone without being satisfied they could pay for the service contract on which the appellant's commission depended. As far as the wholesale deals were concerned he said that the way the industry worked was that the goods were sent on ship on hold terms which he said meant that his supplier had full control of the stock and title to the goods until they were paid for.

76. Mr Nasser's evidence about the two specific customers in the deals under appeal was that he had never dealt with them before these transactions.

77. He received a letter of introduction from Kiara which was written in terms suggesting they were offering to supply stock rather than looking to buy stock but, as he said, they would have to find a source for stock if they were to sell it. He knew that both Kiara and Phone C@nnected were run by the same person whom he knew as Gilles and he also dealt with someone he knew as Ferry. He said that he had had numerous phone conversations with them. He had an information pack from Phone C@nnected and various other documents.

78. The appellant had obtained a Dun and Bradstreet report on Kiara and Mr Nasser claimed he had had other documents that were not amongst those exhibited to his statement. He explained his failure to exhibit more documents on the basis that he thought there was not much of an issue as regards the customer. He said that the checks he made to establish that the customers were reputable would have been by making telephone calls.

79. Mr Nasser was asked about the report he had produced and it was pointed out to him that Dun and Bradstreet had said there was insufficient information to give an opinion about the level of risk involved in dealing with Kiara to which he replied that the report said that that comment applied to 4,484 other businesses which we find to be a comment which has no logic behind it. More to the point, he said that he was not giving credit to Kiara, which is true because of the ship on hold arrangement. However he was risking sending goods of a very high value to that company and risking having the expense of paying his supplier the cost of recovering them if Kiara proved to be unable to pay for them. In the supposedly volatile market for phones, which required urgent action and which he relied on as an explanation for some of the defects in paperwork, there was also a risk that if Kiara turned out to be unable to pay the appellant would also be in a position where it would have to pay its supplier more than the goods would be worth by the time the goods were recovered from France.

80. In addition, the fact that a company like Kiara could deal in goods to this value should have raised a question as to how it had got to a position, soon after it commenced trading, to make such deals without acquiring a credit record.

81. Mr Nasser added that Kiara would have given him references and that he would have taken up references with previous customers of Kiara or maybe freight

forwarders or whoever. He claimed these were written references which he still had but that he had not thought it necessary to produce them.

82. Mr Nasser gave the same evidence about Phone C@nnected concerning both a Dun and Bradstreet report and references.

83. As far as the French freight forwarder was concerned there was obviously a risk that if that company was in possession of the goods but released them without authorisation then the customers would be at least potentially in a position to deal with them before they had paid for them or even to abscond with them. Mr Nasser admitted he had made no enquiries about the standing or efficiency of the appellant's UK freight forwarder other than maybe to have made a phone call and done a Google search and at first he said he probably did the same sort of thing in respect of the French freight forwarder. Then when pressed in cross examination he said he had definitely made a phone call but he claimed he had not discovered that the French freight forwarder had only been in business for less than four months before the deals took place or that it was run by the same person as both Kiara and Phone C@nnected.

84. Mr Nasser was asked about Waterfire, the appellant's supplier, he said he had visited their premises and met their staff and that he had taken up references as well as receiving a Chiltern report about the company.

85. Mr Nasser was asked about a document in which Waterfire had acknowledged that it had read and accepted Club Mobile's terms and conditions of trade. Despite that, Mr Nasser accepted there were no terms or conditions but then when pressed further he said he could not remember if there were any and then that if there was such a document the appellant was bound by the suppliers terms rather than its own. Then he said that the reference to the document read by Waterfire might have been to a customer declaration though he admitted that was not the same thing as terms and conditions. Eventually he said he could not remember if there were any terms and conditions.

86. A Dun and Bradstreet report on Waterfire said that the company had a higher than average risk of business failure. Mr Nasser pointed out that he was not giving Waterfire credit but he admitted he thought someone else was giving that company credit. When pressed as to why he got such a report if he ignored the warnings in it he said that as far as he was concerned it was confirmation that they were who they said they were. Then he said that the due diligence he was seeking was not in relation to credit but rather was in regard to MTIC fraud. Despite that he admitted that he was not concerned about how Waterfire were able to finance the deals even though the report said their net worth was only £10,000. Clearly, the prevalence of fraud in the sector of the trade in which the appellant was engaging should have raised a question in Mr Nasser's mind as to how a company with net worth of £10,000 could obtain credit for the sale of goods to the values concerned.

87. Mr Nasser admitted he could not remember whether a Chiltern report about Waterfire had been received before the relevant transactions but he said he would

have spoken to Chiltern about Waterfire before the deals even if the report was not actually received.

88. Asked about the sequence of events leading to a transaction Mr Nasser said that he offered stock for sale once he knew the potential supplier was able to supply it and then set about finding a buyer. The negotiations might be spread over a few days but it appears from the evidence that all the documents were prepared within a short time and not always in what might be thought of as the logical sequence but such anomalies were explained by Mr Nasser on the basis that telephone contacts would have ironed out the details.

89. Mr Nasser was very unclear as to exactly when a concluded agreement amounting to a contract actually materialised.

90. Mr Nasser's cross examination was not concluded on the day it began. At the start of the second day he said that he had been very tired and nervous on the day before and that he wanted to clarify his evidence.

91. He said that the purchase order from a customer would amount to a contract with the customer and then he would make a contract with the supplier but that if it proved to be impossible to conclude the contract with the supplier then the contract with the customer would be terminated. He explained that "nothing is written in stone".

92. Passing of title to the goods was discussed and it was clear that Mr Nasser had little if any understanding of what that meant. We do not find that particularly surprising. But the practical problems inherent in the method of trade adopted in the relevant transactions and the informal nature of the contractual arrangements was not explicable by any long history of dealing between the parties. The explanation given was always ultimately the same: it is standard practice and everybody knew that is how the industry works.

93. That was given as the explanation even where what happened actually contradicted the documents issued by the parties. That explanation was even given as the reason why it was unnecessary for the parties to agree specifically that sales would be dependent on the goods being subject to inspection before the sale would be finalised (though no terms were set as to what would constitute satisfaction so far as inspection was concerned).

94. There were no agreed terms so far as delivery dates were concerned. That might be thought of as a particularly significant issue as the volatile nature of the business was stressed in other respects. However, again the parties were said by Mr Nasser to have a general understanding that goods would be shipped and payments would be made within an unspecified short period.

95. At least one of the transactions involved goods being shipped on a date when no insurance was in place. Insurance obtained by the appellant only covered the goods in transit. Mr Nasser said that he relied on the freight forwarder to insure the goods while in storage though he had not enquired specifically that they did, he claimed that

all freight forwarders did insure the goods and he may have been right about that but is seems that ultimately this, to our mind rather important, question was only dealt with on the basis that everyone concerned knew it to be so but no confirmation was sought by the appellant despite the value of the goods being so high.

96. The term 'ship on hold' was vital to the operation of the contracts between both the appellant and its supplier and the appellant and its customer. Despite that it was nowhere defined. Mr Nasser said that it was standard practice but that he had discussed it with both Kiara and Phone C@nnected on the telephone. He said that he had told them that the goods would be shipped on hold and when he was asked how he discussed what ship on hold meant with them he replied "It was standard practice" and then "I said I'm gonna ship the stock on hold and they knew what it meant".

97. Mr Nasser denied a suggestion that he had found the customers in the deals pretty easily. In fact it is clear that even if some preliminary negotiations did take place the deals were completed within a very few days and always at times giving the maximum advantage as far as cash flow was concerned (i.e. at the end of the tax period).

98. Mr Nasser admitted that he had transferred £240,000 into the appellant's FCIB account from its other account on 24 April which was a few days before the deals took place. It was put to him that that showed he knew that deals were going to happen even though at that time he did not know the details. He agreed that he knew he "had to deal towards the end of the quarter because my money would be stuck and I would not get my money back from the VAT people". It is untrue that he "had to deal" then though it clearly was most advantageous to do so. It was then put to him that the transfer of money showed that he knew some deal would take place even before there was any certainty as to what it would be. He said he did not know 100% that a deal or deals would happen but that he was working his hardest to make them happen. The balance of £78,000 from the £240,000 left over after the deals took place was transferred back to the other account shortly after the deals took place which appears to us to indicate that it is a reasonable inference to draw that the appellant knew that no more deals would then take place until the end of the next tax period.

99. The tribunal member asked Mr Nasser about the appellant's profit margin on the relevant deals and he said he aimed for approximately 10% and it was pointed out that, because of the fact that the appellant did not have to pay its supplier until it received payment from its customer, in terms of the money actually risked the profit margin was actually about 110%. Mr Nasser hesitated to accept that and at first said that in terms of the "the overall and the risk and the value of the phones it was a lot higher [than 10%]". Mr Nasser said that was standard practice in his experience.

100. Mr Nasser was also asked about how he came by the understanding of the term ship on hold and what it actually meant and he claimed he had discovered it by research and contact with potential suppliers and freight forwarders.

Submissions for the appellant.

101. The appellant stressed again the significance of the fact that it had engaged Messrs Chiltern, as it claimed, to provide information and to advise it. 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.

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

103. We accept that the appellant was right to assert that its 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 appellant did have insurance for the goods while they were in transit as it claimed though it has 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 appellant though there was some financing between it and Mail a Mobile, 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.

104. Mr Nasser changed his evidence repeatedly during his oral evidence as well as by amending his written statements. We have given examples above of circumstances in which he altered his evidence as earlier replies were shown to be untrue or unlikely. He was unable to give a coherent account of the negotiation process that led to the agreements for the purchase and sale of the goods in question. The operation of the business appeared to us to depend entirely upon understandings between the various parties that transactions would take a particular form. This was particularly the case where significant issues such as delivery dates, times of payment and the passing of

title was concerned. Given that Mr Nasser knew that there was a great deal of fraud in the type of transaction in question, we find the lack of proper terms of trade to be very significant. Mr Nasser claimed to be anxious to avoid becoming involved in transactions connected with fraud but the manner of dealing was inherently likely to facilitate fraudulent transactions. Mr Nasser is a graduate and had a number of years of commercial experience before he became involved in the relevant transactions. We find that he must have realised that the transactions relevant to this appeal were being conducted in a manner that was outside the normal commercial dealings for goods of the value concerned.

105. We also find that Mr Nasser was a dishonest witness having, as we have already mentioned, changed his evidence repeatedly while giving it when cross examination exposed the inadequacies of earlier answers, though that is not to say that the later versions of his answers were any more convincing that the earlier ones.

106. The lack of any adequate terms of business and the manner in which the parties, who were unknown to each other until shortly before the transactions, dealt with each other make it clear that the transactions were themselves contrived. That contrivance was such as to indicate that the transactions were connected with fraud because, given the form they took, they could only have operated successfully if the parties all knew what was required of them in a way that would not occur in the case of a normal transaction between parties operating at arms-length. We also find that the nature of the transactions also reveals that Mr Nasser, and therefore the appellant, must have known that the transactions were connected with fraud.

107. That last conclusion is also supported by the dishonest way Mr Nasser gave evidence.

108. We therefore hold that the appeal is dismissed because the transactions were connected with fraud, as we have already found, and that the appellant both should have known of that fact and indeed did know it.

109. Any application for costs pursuant to this decision should be made within three months of its release. At the time of making that application no schedule of costs need be produced but the application should state by what procedure the party making it contends the assessment should be made and against whom the award is sought.

110. 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