



TC04178

Appeal number: LON/2006/00801

**FIRST-TIER TRIBUNAL
TAX CHAMBER**

VAT --MTIC - preliminary issue – knew or should have known of fraud – outsourced trades to agent – agent knew of fraud -fraud of agent against Appellant – fraud exception for agents and employees - Greener Solutions applied - connection of fraud with disputed VAT transactions – fraud of agent not directly related to disputed VAT transactions – fraud exception does not apply – appeal dismissed.

MOBILE SOURCING LTD

Appellant

- and -

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

TRIBUNAL: JUDGE RACHEL SHORT

Sitting in public at 45 Bedford Square, London WC1B 3DN on 21 October 2014

Mr Geoffrey Cox QC and Mr Simon Livingstone instructed by the Khan Partnership LLP on behalf of the Appellant

Mr Michael Holland QC, Mr Chris Foulkes and Mr James Sharma instructed by the General Counsel and Solicitor to HM Revenue and Customs for the Respondents

DECISION

1. This is a preliminary hearing in an appeal against a decision by HMRC of 20 May 2008 to disallow input tax of £500,622.50 incurred by the Appellant Mobile Sourcing Limited (“MSL”) for the VAT period 04/06 because the input VAT related to transactions which MSL knew, or should have known were connected with the fraudulent evasion of VAT. The Tribunal ordered on 26 March 2014 that this aspect of the appeal should be heard as a preliminary issue on the basis of assumed facts and without any witnesses being required.
2. MSL appointed a third-party agent, WIGIG to carry out due diligence and make trading decisions on its behalf including for the transactions to which the disallowed input tax relates (“the Disputed VAT Trades”). It is not disputed that WIGIG was properly appointed as MSL’s agent and that MSL is therefore liable for WIGIG’s actions and imputed with WIGIG’s knowledge. It is not disputed that WIGIG knew or should have known that the Disputed VAT Trades for the 04/06 periods were connected with fraud.
3. The question for the Tribunal is whether, on the basis of the assumed facts, MSL can absolve itself from being imputed with the fraudulent knowledge of its agent WIGIG in respect of the Disputed VAT Trades for the 04/06 period carried out in MSL’s name through its agent WIGIG
4. MSL argues that because WIGIG acted dishonestly in its dealings with MSL the “fraud exception” considered most recently in the *Greener Solutions* decision applies to exonerate MSL from knowledge that the Disputed VAT Trades were connected with fraud. (*HMRC v Greener Solutions* [2012] UKUT 18 (TCC)).
5. HMRC contend that the knowledge of WIGIG that the Disputed VAT Trades were connected with fraud should be imputed to MSL and the fraud exception should not apply.

Assumed Facts

6. The parties agreed at the Tribunal that the assumed set of facts provided by the Appellant should form the basis of the Tribunal’s decision;
- (1) There was an agreement between MSL and independent third party entity WIGIG whereby WIGIG would carry out trades as agent for MSL using MSL’s working capital in consideration for which WIGIG would receive 50% of gross profits on each transaction as commission. (the “MSL Trades”)
 - (2) MSL was not directly involved in carrying out the relevant transactions or the due diligence checks which were carried out on its behalf by WIGIG.
 - (3) From early 2005 there was a further agreement with WIGIG whereby MSL advanced funds to WIGIG to allow it to trade on its own account and in its own name. In consideration for providing loan finance MSL was to receive 50% of the profit generated by trades carried out using its funds (the “WIGIG Trades”).

- (4) It was a term of the loan agreement that funds loaned to WIGIG were for the sole purpose of allowing it to fund its own transactions and in particular the VAT “lock up” on those transactions.
- 5 (5) It was a further term of the loan agreement that WIGIG Trades would not involve giving or receiving trade credit so as not to put the loan balance at risk.
- (6) MSL relied upon the assurances of the officers and employees of WIGIG and in particular its director Richard Jones that (a) transactions were carried out conscientiously and properly with neither the knowledge nor the means of knowledge of the alleged connection to missing traders and (b) the terms of their agreement were being observed.
- 10 (7) Funds that were removed from or repaid to MSL’s bank account to finance WIGIG Trades were recorded in a loan account, the balance of which at any time represented the amount owed by WIGIG in respect of funds loaned to finance its own trading.
- 15 (8) WIGIG was given access and was a signatory to MSL’s bank account and was responsible for dealing with money transfers.
- (9) WIGIG ceased trading in May 2006 and administrators were appointed in October 2009. WIGIG had debtors in excess of £6m and trade creditors in excess of £7m. The final balance of the MSL loan account as at 15 May 2006 was in excess of £3m and this sum remains outstanding to MSL.
- 20 (10) Following receipt of a letter dated 6 April 2006 from HMRC informing WIGIG that they would be withholding their February 2006 VAT reclaim, (relating to WIGIG Trades) WIGIG carried out no trades using MSL’s funds until 28 April 2006 when it carried out trades on which the VAT “lock up” was in excess of £500 thousand.
- 25 (11) In April and May 2006 WIGIG withdrew in excess of £1m from MSL’s bank account which it used to fund trades on 28 April 2006.
- (12) Had the trades on 28 April 2006 not been carried out and had the funds in excess of £1m not been withdrawn from MSL’s bank account, the balance of MSL’s loan would have been no higher than the £2.2m rather than the final outstanding balance in excess of £3m.
- 30 (13) WIGIG had received stock from its suppliers in respect of the May 2006 purchases before making payment and had released stock before receiving payment.
- 35 (14) Following receipt of the letter dated 6 April 2006 from HMRC, WIGIG withdrew from its own bank account almost £400 thousand and distributed the same to its shareholders as dividends.
- 40 (15) On 27 September 2012 Richard Jones gave a director’s disqualification undertaking in respect of Gold Digit Limited (an unrelated company) on the ground that he had conducted multiple transactions in respect of which he knew or possessed the means to know of their connection to fraud. Those transactions were carried out over a period that included the dates of the transactions which are the subject matter of this appeal.

Law

7. The right to re-claim input tax on transactions is derived from EU law, the Sixth VAT Directive at Article 17 and UK implementing legislation in sections 24 to 26 Value Added Tax Act 1994. The restriction of that right is derived from EU law and particularly the line of EU cases culminating in the *Kittel* decision;

5 “ a taxable person who knew or should have known that, by his purchase, he
was taking part in a transaction connected with the fraudulent evasion of VAT
must, for the purposes of the Sixth Directive, be regarded as a participant in
that fraud, irrespective of whether or not he profited by the re-sale of the
goods”. (*Axel Kittel v Belgian State & Belgian State v Recolta Recycling SPRL*
10 (joined cases C-439/04 & C-440/04) [2006] ECR I – 6161).

8. In English law the concept of constructive knowledge imputes to a principal the
knowledge of his agent; “that policy and the safety of the public forbid a person to
deny knowledge... as to keep himself ignorant and yet all the while let his agent know,
15 and himself, perhaps, profit from that knowledge”. (*Kennedy v Green* [1824 -34] All
ER Rep 727).

9. The concept of the fraud exception is based in English common law on
principles of justice and common sense explained in cases such as *Re Hampshire*
Land Co ([1896] 2 Ch 743) and is an exception to the general principle of
20 constructive knowledge; in circumstances where an agent has been involved in fraud
against the principal the assumption of constructive knowledge is rebutted. “because
common sense at once leads one to the conclusion that it would be impossible to infer
that the duty, either of giving or receiving notice, will be fulfilled where the common
agent is himself guilty of fraud”. Vaughan Williams J in *Re Hampshire Land Co*.

25 10. The question of whether in order to rebut the principle of constructive
knowledge the principal had to be the primary victim of the fraud was considered in
Arab Bank v Zurich Insurance ([1999] 1 Lloyd’s Rep 262) and it was concluded that it
was sufficient to rebut the principle if the principal had merely been a secondary
victim of the fraud because in any event, on those facts, “[the agent] has, on the
30 assumed facts, been guilty of dishonesty and one can hardly visualise a graver
dereliction of his duty to his company...the fault comes within the concept of an
agent’s fraud on his principal, but even if it does not, his fault is such a breach of duty
to [the principal] as in justice and common sense must entail that it is impossible to
infer that his knowledge of his own dishonesty was transferred to the [principal]”.

35 11. The combination of these two legal sources in the context of VAT fraud and the
Kittel test was considered in the *Greener Solutions* decision suggesting that the EU
law’s purpose to defeat fraud should lead to a restrictive application of the fraud
exception in VAT cases.

40 “a major purpose of the *Kittel* principle is to combat fraud, the Tribunal’s
decision would make a serious in-road into that principle; in cases where there
are innocent shareholders or directors who had been deceived by a fraudulent
employee or director, the company might be able to escape liability
notwithstanding that it was able to profit considerably from the transactions
conducted on its behalf.”

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12. As a result it was made clear in *Greener Solutions* by reference to earlier authorities that (i) the scope of those whose knowledge could be imputed to the principal whose VAT was alleged to be connected with fraudulent deals was wide; the knowledge of all employees and agents who are involved in making of the relevant supplies is imputed to the taxpaying entity (ii) the fraud exception is limited to circumstances in which the alleged fraud would cause significant harm to the entity which seeks to rely on the exception; a neutral result (such as the entity being able to claim input tax) was not sufficient to trigger the fraud exception (iii) in determining the harm suffered by the entity seeking to rely on the exception, the test to be applied is on the basis that the fraud has succeeded, not taking account of the costs and results of the failure of that fraud (including in the VAT context the denial of input tax).

13. MSL set out in their letter of 25 September 2014 the legal issues which they considered were in dispute:

(1) Are the activities of the person, which do not relate to misconduct of deals on behalf of MSL, relevant to the attribution of knowledge in respect of those deals?

(2) Did the person whose acts and or knowledge it is sought to impute to MSL know or believe that his acts and or knowledge, in the context of the agency agreement, were detrimental to the interests of MSL in this respect?

(3) Is MSL a true victim of fraud rather than simply being used as a vehicle for the commission of fraud against HMRC i.e. was the risk to his investment not limited to simply the possibility that HMRC would fail to re-pay its own or WIGIG's VAT repayment claims.

(4) In judging whether MSL is to be regarded as a victim of the acts for that person, should consideration be given to the effects of the acts themselves, rather than what the position would have been had this act actually proved to be effective i.e. what did the fraudulent individuals intend to happen.

(5) As such, should the exception to the general rule of attribution apply?

Appellant's Arguments

Background

14. Mr Cox explained that MSL is owned by Mr Ridge who has built up substantial mobile phone businesses including a retail business known as "KJC" with 50 outlets in the UK, sold by Mr Ridge in 2000. Mr Ridge now has a business known as Premier Telecom which employs 35 people with a turn-over of £5 million and is a "premium tier" partner of Vodafone in the UK. Mr Ridge is the principal directing mind of MSL.

MSL Trades and WIGIG Trades

15. MSL agreed a trading arrangement with WIGIG, run by Richard Jones who has admitted being involved in fraudulent mobile phone deals. MSL's involvement with WIGIG took two distinct forms (i) Relying on WIGIG's infra-structure, expertise and contacts to provide deals for MSL which were concluded in MSL's name (The MSL Trades)(ii) Providing financing to WIGIG through a bank account in MSL's name to

enable WIGIG to enter into transactions in its own name (the WIGIG Trades). WIGIG Trades were recorded in a loan account, the balance of which represented all amounts owing by WIGIG to MSL for funds loaned for WIGIG Trades.

Funding for WIGIG Trades

5 16. The funding provided to WIGIG by MSL was intended to allow it to enter into
its own deals only and included funding for the “VAT lock up” i.e. to fill the cash
flow shortfall resulting from the amount of time HMRC could take to re-pay
WIGIG’s input VAT reclaims. It was a term of this funding that WIGIG was to have
no creditors other than MSL. Funds would be put into the MSL account at Lloyds by
10 MSL but Richard Jones was a signatory for that account and could withdraw funds to
finance WIGIG Trades.

The Fraud

17. WIGIG, through Richard Jones, had perpetrated a fraud on MSL by accessing
funds in the MSL bank account contrary to the terms of the agreement between MSL
15 and WIGIG, leaving MSL with a significant debt. WIGIG’s overall aim was to access
MSL’s cash by fraudulent means, including by providing deal packs for VAT
transactions to MSL so that funds would be released to WIGIG through the MSL
account.

Greener Solutions.

20 18. Mr Cox attempted to differentiate MSL’s position from that of the company in
Greener Solutions because MSL had not merely been put in a position to reclaim
input tax which should not have been due, but they had also been the victim of a
wider fraud namely that WIGIG, contrary to the terms of the loan agreement with
MSL, had raided MSL’s bank account and left MSL with a debt of some £3 million. It
25 was this aim to access MSL’s cash which had driven all of WIGIG’s actions.

19. While as far as the Disputed VAT Transactions were concerned the only victim
was HMRC, not MSL, MSL’s position was not the same as the entity in *Greener
Solutions* which was a “straightforward” fraud exception case; MSL’s agent WIGIG
had breached its fiduciary duty and the terms of its financing agreement. It had failed
30 to notify MSL of HMRC’s letter of February 2006 notifying WIGIG that its VAT
would not be repaid. WIGIG had instead withdrawn significant further sums from
MSL’s account to carry out transactions on 28 April 2006, in its own name. This was
a concerted and deliberate conspiracy by WIGIG against MSL.

Overarching Fraud.

35 20. In considering whether the fraud exception applied the question was whether
there was a nexus between the fraudulent acts of an agent and the fraud of which the
principal was accused, in this case there was such a nexus; MSL were the victims of a
fraud which was closely associated with the Disputed VAT Transactions. MSL was
the victim of an “overarching fraud” by its agent WIGIG and for that reason the fraud
40 exception should apply to exonerate MSL from the acts of its agent in the context of
the deals done in MSL’s name by WIGIG including the Disputed VAT Transactions.
It was not possible to separate the MSL Trades from what was going on in the MSL

bank account. The trades were the pretext for the drawdown of large sums from MSL's bank account.

HMRC's Arguments

5 *MSL Trades and WIGIG Trades*

21. Mr Holland argued that while MSL might have been the victim of fraud by WIGIG concerning amounts withdrawn from the bank account to which MSL gave WIGIG access, this was a separate fraud from the Disputed VAT Transactions. The Disputed VAT Transactions were in MSL's name and were between HMRC and
10 MSL, the funding from MSL's bank account was to finance transactions in WIGIG's name and that alleged fraud was between WIGIG and MSL. This separate fraud could not be extended to provide a cover for the fraud related to the Disputed VAT Transactions in MSL's name.

22. As for the alleged raid on MSL's bank account, that cannot have arisen from the
15 Disputed VAT Transactions since these were in MSL's name so no indebtedness could have been created in WIGIG's account as a result of these deals. Nor was it clear on the basis of the assumed facts that the creditors and debtors which Mr Cox alleged WIGIG had contracted counter to the terms of the loan agreement arose from deals connected with MSL at all. WIGIG had had disputed VAT reclaims in its own
20 name but appeals against these had all been withdrawn. WIGIG's withdrawal of funds from the MSL bank account could have been for the purpose of WIGIG Trades or to make payments on behalf of MSL, any suggestions as to what these funds were to be used for was supposition by the Appellant and not supported by the assumed facts.

23. In Mr Holland's view, even if there was a fraud in relation to the monies taken
25 from the MSL bank account, this was not sufficiently connected with the fraud arising from the Disputed VAT Transaction to trigger the fraud exception. It was not clear, ignoring some of Mr Cox's extrapolations from the facts, that even this fraud on the MSL bank account was intended.

Greener Solutions

30 24. For HMRC Mr Holland suggested that the "fraud exception" was to be applied with "common sense and justice" and that none of the authorities, most of which were cited in the *Greener Solutions* decision, provided for the fraud exception to apply if the fraud of the agent related to other circumstances and was not central to the disputed transaction carried out by the principal.

35 25. Mr Holland pointed out that if Mr Cox's approach was applied in the arena of VAT it would allow companies to escape from the consequences of fraud and the *Kittel* approach merely by delegating all decisions to an agent. In his view MSL's position was on all fours with the facts in the *Greener Solutions* decision and the fraud exception should not be available here anymore than it was in that case.

40 26. Finally, looking at the intended effects of the fraud, being in this case the VAT fraud, not the alleged bank account fraud, if those deals had been successful their intended effect would not have led to WIGIG raiding the MSL bank account, that occurred only when it was clear to WIGIG as a result of HMRC's letter to them of

February 2006, that the VAT fraud was in danger of not succeeding. The intended effect of the VAT fraud was that both MSL and WIGIG made profits at HMRC's expense. It could not therefore be said that the intended effect of the fraud was to cause harm to MSL.

5 **Decision**

27. The onus of proof is on the Appellant to demonstrate that it can bring itself within the fraud exception as a result of the actions of WIGIG. To succeed before this Tribunal MSL needs to demonstrate on the basis of the assumed facts that (i) WIGIG as the agent of MSL is an entity to which the fraud exception can apply (ii) the
10 fraudulent acts of WIGIG are related to the Disputed VAT Transactions (iii) WIGIG intended by those actions to cause significant harm to MSL and did more than leave MSL in a neutral position (iv) the harm arises as a result of the intended effects of the fraudulent actions and not as a result of their failure.

28. It was not disputed by the parties the WIGIG was an effective agent for MSL
15 and that its fraudulent knowledge could in principle be attributed to MSL.

29. Both parties stressed the need to ensure that the Tribunal came to its decision on the basis of the assumed facts only and not any further extrapolation from those assumed facts. In coming to its decision the Tribunal has relied in particular on the following facts:

20 (1) The deals which are disputed by HMRC and for which input tax has been denied are MSL Deals for the 04/06 period which were carried out in MSL's name by WIGIG on 28 April 2006. The input tax reclaim is in MSL's name. They are not deals for which funding provided through the MSL account to WIGIG was required.

25 (2) The alleged fraudulent actions of WIGIG in respect of the MSL bank account, being (a) the failure to notify MSL of HMRC's letter 6 April 2006 (b) the withdrawal of significant sums in April and May 2006 from MSL's bank account to fund trades (c) the payment of large sums by way of dividends to WIGIG's shareholders as dividends and (d) the creation of unauthorised debtors
30 and creditors, all relate to WIGIG's loan agreement with MSL concerning the funding of WIGIG Trades.

30. The Tribunal's conclusion on the basis of the assumed facts is that MSL should not be allowed to rely on the fraud exception for the Disputed VAT Transactions by
35 reference to WIGIG's alleged fraud on MSL's bank account. This is primarily because in order to take advantage of the fraud exception the acts of MSL's agent have to be directly linked to the acts of which MSL is accused as principal. On the basis of the assumed facts there is not a sufficient connection between the alleged fraudulent acts of WIGIG as agent of MSL and the Disputed VAT Transactions.

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Greener Solutions- Restrictive application of the fraud exception.

31. The *Greener Solutions* decision made clear that the fraud exception should be applied restrictively in the context of EU legislation which is itself intended to combat

5 fraud. The Tribunal agrees with HMRC's interpretation of the law which limits the fraudulent acts of an agent to which the fraud exception can apply to acts which are directly related to the acts of which the principal is accused, here the Disputed VAT Transactions. Mr Cox made a valiant attempt to demonstrate that the alleged bank account fraud and the Disputed VAT Transactions were all part of the same fraud, but it is not clear that this case can be made on the basis of the assumed facts. HMRC made the point that the Disputed VAT Transactions were in MSL's name while WIGIG's access to MSL's bank account was to finance deals in its own name. This seems to the Tribunal to sever any direct connection between the Disputed VAT Transactions and the alleged bank account fraud.

Agent's actions not causative of relevant fraud

15 32. In order to bring itself within the fraud exception for these Disputed VAT Transactions, MSL needs to demonstrate that the fraudulent actions of WIGIG were causative of the Disputed VAT Transactions. As stated by Dyson J in the *McNicholas* case: "*It is obvious good sense and justice that the act of an employee should not be attributed to the employee company if in truth the act is directed at and harmful to the interests of the company*". (*McNicholas Construction Co Ltd v HMRC* [1998] VTD 15885). It is clear from this, and from the underlying legal principal that there must be some coincidence or direct link between the fraudulent acts of the employee (or agent) and the acts which are attributed to the company. It would not be either good sense or justice if some unconnected or only indirectly connected fraudulent acts of an agent or employee could absolve a company from being liable for different acts carried out in its name by that agent.

25 33. The Tribunal does not accept that the alleged fraud relating to funds in the MSL bank account was sufficiently closely related to the Disputed VAT Transactions to trigger the fraud exception. In *Belmont Finance Corp Ltd v Williams Furniture Ltd* ([1979] Ch 250) Buckley J said "*it is a well recognised exception from the general rule that a principal is affected by notice received by his agent that, if his agent is acting in fraud of his principal and the matter of which he has notice is relevant to the fraud, that knowledge is not to be imputed to the principal*". In this instance the "matter of which WIGIG had notice" was not directly relevant to MSL's Disputed VAT Transactions.

35 34. The assumed facts do not evidence any direct nexus between the monies taken from MSL's bank account and the Disputed VAT Transactions. Any concept of an overarching fraud of which the Disputed VAT Transactions were part is not supported by the assumed facts and arises only on the basis of a number of suppositions made by Mr Cox.

40 35. MSL has attempted to argue that the MSL Trades were tainted by the alleged fraud carried out by WIGIG in respect of its own transactions and the MSL bank account but, even if this can be established, the Tribunal does not consider that this is sufficient to trigger the fraud exception. Even on the basis of the *Arab Bank* decision which extends the fraud exception to instances where the principal is not the primary victim of the fraud, and accepting that WIGIG's dishonesty has severed the agency relationship and MSL's constructive knowledge of the frauds in which WIGIG was involved, those are separate from the Disputed VAT Transactions in MSL's own name.

36. At least in the context of VAT fraud on the authority of *Kittel* and *Greener Solutions*, the Tribunal has concluded that the dishonesty of an agent which is not directly causative of the disputed VAT transactions should not be taken to trigger the fraud exception. The fundamental question is whether MSL's actions in respect of the Disputed VAT Trades were influenced by the fraud of their agent, WIGIG. While there might be an economic link between the two frauds in the shape of the cash in the MSL bank account, there is no evidence on the basis of the assumed facts that WIGIG's alleged fraudulent actions influenced MSL's own VAT re-claims and this is the core of the fraud exception. The Tribunal can therefore see no basis on which, as far as the Disputed VAT Transactions are concerned, there are any relevant fraudulent acts of its agent which should not be imputed to MSL.

Harm done to Appellant

37. Finally, even if each of the above conclusions are incorrect, by reference to *Greener Solutions* criteria and as accepted by Mr Cox, it is the effects of the attempted fraud which have to be taken account of in determining whether there has been significant harm done or intended to be done to the Appellant.

38. The Tribunal accepts that it is possible that WIGIG's intention in accessing large sums from the MSL bank account when it knew that HMRC were disputing its VAT re-claims was to harm MSL. If the fraud in question were only the alleged bank account fraud, this would be sufficient to trigger the fraud exception. However, it is not this fraud which is in point, it is the fraud to which the Disputed VAT Transactions relate which is relevant. The only impact of the successful conclusion of that fraud would have been an input tax repayment to MSL.

Intended effects of successful fraud

39. Even if it was possible to accept Mr Cox's suggestion that the fraud in point is an "overarching fraud" in which WIGIG was relying on the VAT deals as a means of accessing MSL's funds, the case still does not fall within the requirement set out in *Greener Solutions* that the harm done to the principal has to arise from the successful result of the agent's fraudulent activity; WIGIG's raid on MSL's bank account was driven by WIGIG's part of the VAT fraud being put in jeopardy by HMRC's withholding of WIGIG's February 2006 input tax reclaim. On Mr Cox's analysis it was the failure of this VAT element of the "overarching fraud" which gave rise to WIGIG's actions, not its success. If there is a link between the alleged bank account fraud and MSL's Trades, the link is the failure of WIGIG's own VAT reclaims.

40. In neither of these instances is it possible to establish that the intended effect of the success of the relevant fraud was to cause harm to MSL and therefore there is no basis on which the fraud exception can be applied as between MSL and WIGIG.

41. For all of these reasons the Tribunal dismisses MSL's appeal on this preliminary matter.

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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.

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**RACHEL SHORT
TRIBUNAL JUDGE**

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RELEASE DATE: 8 December 2014

