[2015] UKFTT 0649 (TC)

TC04777

Appeal number: LON/2008/2037

VAT – MTIC – onus of proof on HMRC – whether the Kittel principle applies to the contra trading construct – whether the appellant knew or should have known that its transactions were connected with a fraudulent evasion of VAT – yes – appeal dismissed

FIRST-TIER TRIBUNAL
TAX CHAMBER

BLUE ORANGE INFORMATION TECHNOLOGY LIMITED **Appellant**

- and -

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

TRIBUNAL: JUDGE ANNE SCOTT
MEMBER: SHAMEEM AKHTAR

Sitting in public at Bedford Square, London on 1, 2, 3 and 6 October 2014

Closing submissions dated 27 October 2014, 15 December 2014, 8 January 2015 and 14 July 2015

Having heard Mr Robert Holland of Dass, Solicitors for the Appellant and Ms Karen Robinson of QEB Hollis Whiteman instructed by HMRC

DECISION

1. This appeal is brought by the appellant against the decision of the respondents ("HMRC"), which expression is used for convenience to include HMRC's predecessor, HM Customs & Excise, dated 10 September 2008 ("the decision letter") denying the appellant the right to deduct input tax claimed on the appellant's VAT return for the period 08/06. The total sum refused is £378,350.

2. That decision was predicated on the basis that the appellant was not entitled to claim the VAT credit in that sum on the purchase of mobile phones in that period because the three transactions to which the claim related have been traced back directly to identified tax losses which were fraudulent. It was asserted that the appellant knew or should have known that the transactions were connected with fraudulent evasion of VAT. Essentially, HMRC's decision was made on the basis that the transactions to which the claims related were connected to the fraudulent evasion of VAT and part of a missing trader intra-community ("MTIC") fraud and that the appellant knew or should have known that this was the case.

3. On 23 September 2008 the appellant submitted a Notice of Appeal stating that the decision under appeal was wrong both in fact and in law. The detail of those grounds of appeal are set out at Appendix 1 since the position changed subsequently.

Preliminary issues and procedural matters

4. The Tribunal had before it an application dated 26 August 2014 for permission to adduce witness evidence of Officer Camm and a third witness statement for Officer Quinn. There was no opposition to the witness statement of Officer Camm being admitted. The application in regard to Officer Quinn was opposed.

5. There was a further application dated 22 September 2014 for permission to adduce a witness statement of Officer Reardon and exhibits and that was agreed by the appellant.

Officer Quinn's third witness statement

6. As far as Officer Quinn's witness statement was concerned the appellant objected only to three paragraphs, namely paragraphs 13, 16 and 20 and the relevant exhibits thereto.

7. We were referred to three authorities in this matter, namely *Mobile Export 365 Limited and Another v Revenue and Customs*[1] ("*Mobile*"), *Data Select Ltd v HMRC*[2] and *Leeds City Council v HMRC*[3]. Only *Mobile* was quoted from directly and that

[1] 2007 EWHC 1737

[2] 2012 UKUT 187 (TCC)

[3] 2014 UKUT 0350 (TCC)

was Mr Justice Lightman at paragraph 20 where he stated:- "The presumption must be that all relevant evidence should be admitted unless there is a compelling reason to the contrary." HMRC relied on that paragraph and the appellant argued that the converse held true.

8. Our attention was not drawn to the decision of Judge Mosedale in *Masstech Corporation Limited (in administration) v HMRC*[4] where she analysed *Mobile* and also *O'Brien v Chief Constable of South Wales*[5] where the House of Lords gave guidance on the approach and balancing exercise to take when considering admitting evidence generally.

9. We agree entirely with Judge Mosedale's analysis where she said:-

"8 The conclusions I draw from these cases and from general considerations of fair hearings are as follows:

- Only relevant evidence should be admitted;
- Such evidence should nevertheless be excluded where there is a compelling reason to do so;
- Whether there is a compelling reason to do so will be a balancing exercise the object of which is to achieve a trial that reaches the correct decision by a process fair to all parties;
- To conduct that balancing exercise the Tribunal must consider the likely probative value of the evidence, any unfair prejudice caused to either party, good case management and any other relevant factor;
- Unfair prejudice includes the factors listed by Lord Bingham which were particularly relevant in that case but in this case, not being a trial by jury, perhaps of less relevance. Unfair prejudice would include a party being ambushed so that it is strategically disadvantaged or put in a position that it has no time to bring evidence in rebuttal;
- Considerations of good case management will include the need for a sanction against a party which adduces late evidence particularly where the evidence could have been produced earlier; it will recognise the desirability of adhering to trial dates and avoiding unnecessary costs."

10. We also had in mind the provisions of Rule 2 of the Tribunal Procedure (First-tier Tribunal) (Tax Chamber) Rules 2009 and that reads as follows:

2.—Overriding objective and parties' obligations to co-operate with the Tribunal

(1) The overriding objective of these Rules is to enable the Tribunal to deal with cases fairly and justly.

(2) Dealing with a case fairly and justly includes—
(a) dealing with the case in ways which are proportionate to the importance of the case, the complexity of the issues, the anticipated costs and the resources of the parties;
(b) avoiding unnecessary formality and seeking flexibility in the proceedings;
(c) ensuring, so far as practicable, that the parties are able to participate fully in the proceedings;
(d) using any special expertise of the Tribunal effectively; and
(e) avoiding delay, so far as compatible with proper consideration of the issues.

(3) The Tribunal must seek to give effect to the overriding objective when it—
(a) exercises any power under these Rules; or
(b) interprets any rule or practice direction.

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[4] 2011 UKFTT 649 (TC)

[5] (2005) 2 WLR 1038

(4) Parties must—
(a) help the Tribunal to further the overriding objective; and
(b) co-operate with the Tribunal generally.

11. The only witness for the appellant in this hearing was Mr Anthony Andreou, the controlling mind of the appellant and also of its sister company Megtian Limited ("Megtian"). The contested evidence related to *Megtian Limited v HMRC*[6]. In his first witness statement Officer Quinn had referred to, but not produced, the witness statement prepared by Mr Andreou for the Megtian appeal tribunal held in July and August 2008. He now sought to exhibit

(a) that statement in full,

(b) all other statements used in that appeal,

(c) the transcript of the cross-examination of Mr Andreou in those tribunal proceedings in regard to A1 Inspections Limited, and

(d) details of the due diligence undertaken by Megtian.

12. HMRC argued that

(a) The supplementary evidence simply clarified and corrected Officer Quinn's original witness statement.

(b) This was not an application for extension of time, rather a simple application to serve a witness statement with exhibits and therefore timing was but one issue.

(c) It was the relevance of the material that was crucial.

(d) The two appellants were inextricably linked and linked therefore to the state of knowledge which lay at the heart of this appeal.

(e) Nothing in the material was new as far as Mr Andreou was concerned.

13. The appellant argued strenuously that there was no need for clarification or correction of the issues referred to in the disputed paragraphs:

(a) There was a clear agreed timetable for service of witness statements and exhibits as set out in Directions dated 23 October 2012; HMRC's "Supplemental Statements plus Exhibits" were to be served by 9 April 2013.

(b) The disputed paragraphs and exhibits sought to widen HMRC's case but not in response to any challenge from the appellant.

[6] 2008 UKVAT V20894

(c) In any long running appeal, such as this one, there is an obligation to ensure that all evidence is exchanged in good time to avoid an ambush.

(d) In this instance there had been a delay in serving this evidence, of at best 16 months, and the explanation given for the need for the supplementary evidence was not accurate as the disputed evidence went far beyond clarification.

(e) Further in terms of relevance, much of the material in the witness statements and due diligence related to issues and other parties who were not involved in this appeal.

(f) The documentation referred to was extensive and ran to 863 pages. Although Mr Andreou would have seen that evidence in 2008 this appellant was differently represented and it would take extensive time to thoroughly investigate all of the documentation at this late stage.

(g) Since a key issue in this appeal was the credibility of Mr Andreou, the late admission of the witness statements would have led to many hours of cross-examination in regard to his credibility.

14. We note that in his witness statement when referring to the Tribunal for Megtian, Officer Quinn stated that "Any documentation or correspondence from this Tribunal can be provided". Clearly he had considered whether or not that was relevant when drafting his statement and decided not. Equally clearly the appellant did not seek lodgement of any such evidence.

15. The Tribunal has a wide discretion when considering whether or not to admit evidence and we carefully weighed in the balance all of the various factors.

The disputed paragraphs

Paragraph 13

16. Paragraph 13 blandly refers to paragraph 111 of the first witness statement which paragraph read:

> "111. A witness statement prepared by Mr Andreou for the Megtian appeal tribunal, held in July and August 2008, confirmed that he was fully aware of MTIC fraud and its various manifestations. The witness statement read, 'It is a common fact that Megtian was aware of potential fraud in the system and did everything it could to avoid fraudsters and engaged the Commissioners in its due diligence procedures.' "

Officer Quinn then produces all of the witness statements for the appellant in the Megtian appeal.

17. The extent of Mr Andreou's knowledge of the incidence of MTIC fraud has never been a disputed issue in this appeal. Accordingly in our view it is not appropriate to use that as a basis for introducing Mr Andreou's detailed witness statement which not only refers to knowledge but also deals with replies to numerous other witness

statements which have no direct relevance to this appeal. On the same reasoning it cannot be the basis for the introduction of the witness statements of other witnesses in that appeal.

Paragraph 16

18. This refers to paragraph 173 of the first witness statement where Officer Quinn had stated "…Blue Orange had previously been untroubled by A1 managing to inspect over 20,000 phones in one day for its sister company, Megtian." and then went on to exhibit the deal sheets from that particular day (6 April 2006), the inspection reports for those deals and the cross-examination of Mr Andreou in the Megtian tribunal proceedings in relation to A1 Inspections Limited ("A1"). Lastly, a visit report dated 24 March 2006 to A1 was produced in support of an assertion as to the number of its employees.

19. Paragraph 173 is in fact the last of 22 paragraphs in the first witness statement dealing with A1 and the appellant and there are a further seven paragraphs at 270-276 covering A1 and Megtian. There was no argument advanced as to the relevance of the detail of A1's size and activities at the end of March and beginning of April 2006 and the deals in this appeal took place in July 2006. The only argument advanced was that the exhibits went to the credibility of A1 (who had been engaged by the appellant) as that was relevant in the context as to whether or not there was an overall scheme to defraud the Revenue. As can be seen below, latterly, that point has been conceded.

Paragraph 20

20. Paragraph 20 simply states that the due diligence undertaken by Megtian was exhibited. The appellant argued compellingly that that encompassed many companies which were not the subject matter of this appeal and therefore it was not relevant. At this juncture in the proceedings it was argued that all relevant due diligence had been lodged in process.

Decision on the disputed paragraphs and exhibits

21. We decided that those three paragraphs should be deleted and the relevant exhibits also deleted. However, in the course of the hearing when looking at due diligence (see paragraph 214 below) Mr Andreou spoke to a Veracis report, some of the enclosures to which had not been exhibited. With the consent of both parties, at that stage the report which formed part of the excluded evidence was duly admitted into evidence.

Burden of proof

22. It was a matter of agreement between the parties that the burden of proof lay with the Commissioners since it was they who asserted that the appellant's transactions were connected to fraudulent evasion of VAT and that the appellant either knew or ought to have known about that connection.

23. HMRC conceded that it was not sufficient to establish that the appellant knew or should have known that it was more likely than not that his transactions were connected with the fraudulent evasion of VAT. The issue is that if a trader should have known that the only reasonable explanation for the transaction in which it was involved was that it was connected with fraud and if it turns out that the transaction was connected with fraudulent evasion of VAT then the trader should have known of that fact.

Issues in the appeal

24. The parties agreed that the Tribunal must determine the following issues in this appeal, namely:-

(i) whether there was a tax loss,

(ii) whether the tax loss resulted from a fraudulent evasion,

(iii) whether the appellant's transactions were connected with that evasion, and

(iv) whether the appellant knew or should have known that its transactions were connected with a fraudulent evasion of VAT.

25. By letter dated 13 November 2013, and in their Skeleton Argument dated 22 September 2014, the appellant had indicated its acceptance of the following facts, namely:-

1. West 1 Facilities Management Limited ("West 1 FM"), D T M Provisions Ltd ("DTM"), Fonestyle Limited ("Fonestyle"), Heathrow Business Solutions Limited ("HBS"), 3D Animations Limited ("3D"), Phone City Limited ("Phone City"), Vision Soft UK Limited ("VSUK"), Prompt Information Limited ("Prompt Info"), and Restar Limited ("Restar"), are all fraudulent defaulting traders ("the nine identified traders");

2. Officer Quinn has traced the three supply chains leading to goods being offered to the appellant by Optronix;

3. Optronix is a contra-trader in the sense that it offsets its inputs against its outputs. It is not admitted that Optronix carried out this offsetting in a dishonest manner.

26. By letter dated 26 September 2014, the appellant indicated that it now accepted that Optronix was a fraudulent trader.

27. Just immediately prior to the hearing it was conceded for the appellant that it was now accepted that Optronix was a fraudulent trader and that the deal chains in which Optronix features as a despatching trader (its broker chains) had been properly traced and evidenced.

28. In summary therefore from the parties perspective it was not in dispute that

(a) the appellant's three deal chains had been properly and accurately traced back to acquisitions by Optronix,

(b) that Optronix was a fraudulent contra-trader, and

(c) that Optronix's broker deal chains in the relevant period had been traced accurately to a fraudulent tax loss created by one of the various defaulting traders.

Nevertheless, as both parties pointed out to us, these matters still fall to be decided by the Tribunal. For the reasons set out below we did so find.

29. Both parties agreed that the ultimate issues therefore in dispute between the parties were therefore—

1. Whether the *Kittel* principle applies to the contra-trading construct (a question of law); and

2. If so, whether the appellant knew or should have known that its transactions were connected with a fraudulent evasion of VAT.

Overview of the arguments

The appellant

30. It was argued for the appellant that if *Kittel* does apply to contra-trading then attention shifts to the true meaning of the related questions of the required "connection" with fraud and the required knowledge and to the need, noted in *Blue Sphere Global v HMRC*[7] at paragraph 46 of the judgment for a control mechanism. That reads:-

> "Plainly not all persons involved in either chain, although connected, should be liable for any tax loss. The control mechanism lies in the need for either direct participation in the fraud or sufficient knowledge of it."

It is submitted that the activities of Optronix do not provide a connection which is sufficient in law to deny the appellant the right of deduction.

31. It is necessary to be precise about what exactly constitutes the required connection with fraud and that connection can only be the deliberate inclusion of details of the transaction in question in a VAT return for the purpose of assisting a fraud in some way; the required knowledge must therefore relate to that.

32. It was submitted that a transaction which did not assist the fraud cannot be connected with a fraud.

33. There was nothing in the factual context which would be sufficient to alert the appellant to any required connection.

[7] 2009 EWHC 1150

34. The taxable person must know of the relevant connection at the time of entering into the impugned transactions as any other conclusion would infringe the fundamental EU principle of legal certainty.

35. It would be an error of law for the Tribunal to conclude that any matters could be relied upon *ex post facto* by the National Tax Authority to establish the requisite knowledge of fraud, sufficient to justify the refusal of the benefit of the right of deduction.

36. On the issue of proportionality the Tribunal should take into account the taxing authority's conduct. It is argued that HMRC had transferred their own investigative tasks to the appellant and that they had done so because they had themselves failed to carry out tasks such as verifying the integrity of supply chains etc.

37. The solicitor for the appellant was very clear in the opening submissions in regard to the excluded evidence that, from their perspective, credibility would be the most significant issue in this appeal. Credibility in that context, of course, related to Mr Andreou.

HMRC

38. HMRC state that whether the appellant's transactions assisted in the fraud deviates from the test which has to be satisfied in the appeal. The test to be met is

(a) was there a tax loss,

(b) if so, did the loss result from a fraudulent evasion,

(c) if there was a fraudulent evasion were the appellant's transactions subject to the appeal connected with that evasion,

(d) if such a connection is established did the appellant know or should it have known that its transactions were connected with fraudulent evasion, and

(e) the principles set out in *Kittel* and *Mobilx* do not require a taxpayer to take on HMRC's investigative role and HMRC have not sought to transfer its investigative obligation. It is the state of the appellant's knowledge that is the issue.

39. HMRC's case on knowledge of the fraud is based on drawing inferences from a wide range of facts in order to establish the position that the appellant knew or must have known of its involvement in fraud. HMRC aver that there is actual knowledge of fraud.

40. Alternatively, they maintain that by reason of the information available to the appellant, whether it was obtained or not, the appellant should have known that its transactions were connected with the fraudulent evasion of VAT. HMRC aver that the appellant did not take every precaution that could reasonably be required of it in

order to ensure that its transactions were not connected with the fraudulent evasion of VAT.

The *Kittel* principle and MTIC generally

41. There have now been many appeals heard by this Tribunal in respect of alleged MTIC transactions and it is unnecessary to give an explanation of how MTIC fraud is carried out. A convenient explanation is given by Christopher Clarke J in *Red 12 Trading Ltd v HMRC* [8] *("Red 12").*

42. At the European level, the legal right to a deduction for input tax is now found in Articles 167 and 168 of Council Directive 2006/112/EC of 28 November 2006. At the time of the disputed transactions the corresponding provisions in the Sixth Council Directive applied. These provisions are given effect within the UK by the Value Added Tax Act 1994 ("VATA") and in particular by sections 24, 25 and 26 thereof and by the VAT Regulations 1995 (SI 1995/2518) made under VATA.

43. However, there is no legal right to a deduction for input tax where fraud is involved. There is now extensive case-law on this subject both before the European Court of Justice and our domestic courts.

44. The decision in *Mobilx Ltd v HMRC, Blue Sphere Global Ltd v HMRC and Calltel Telecom Ltd and another v HMRC* [9] *("Mobilx")* examined the ramifications of the decision of the ECJ in *Kittel*.

45. Since the *Kittel* principle is particularly well known to both parties in this appeal we do not set out at length in the body of this decision the detail of *Mobilx* and the other relevant case law on which we rely in coming to our decision, other than as quoted in *Fonecomp Limited v HMRC*[10] ("*Fonecomp*"). The relevant extracts with our comments thereon are annexed at Appendix 2.

Does the Kittel principle apply to contra-trading?

46. A substantial part of the appellant's arguments was addressed to this issue and in opening its case HMRC disagreed with the appellant's analysis of the law in this context. In summary, the appellant argues that the *Mahagében, Bonik and LVK – 56 EOOD* cases restrict the application of the *Kittel* principle in contra-trading cases.

47. As both parties are aware, the Court of Appeal has now issued its decision in *Fonecomp* and that clarifies the law in regard to contra-trading. The decisions in the First-tier and Upper Tribunal were confirmed. It is clear that the *Kittel* principle does apply to the contra-trading construct. On 26 June 2015, we invited submissions from the parties in regard thereto but none were received from or for the appellant. HMRC

[8] [2009] EWCH 2563 (Ch) at 2

[9] [2010] EWCA Civ 517

[10] 2015 EWCA Civ 39

did respond and summarised the position arguing that Fonecomp supported their stance.

Fonecomp

48. There were three grounds of appeal in *Fonecomp* and broadly the appellant had argued its case on that basis in this appeal so it is appropriate to approach the same manner.

The first Ground of Appeal

49. It was argued that the *Kittel* principle applies where fraudulent evasion occurs in the same chain of supply as the transaction giving rise to the input tax deduction claimed. That is the "connection" required by the *Kittel* principle. It does not apply to the so called "contra-trading" scenario, where no such "connection" exists. That is precisely the same argument as the appellant advanced in this instance.

50. Lady Justice Arden, at paragraph 33, endorses the conclusion of Hildyard J in *Edgeskill Limited v Revenue & Customs Commissioners*[11]. At paragraph 124 that reads:

> "124. In short, nothing in Mahagében, or perhaps I should add for comprehensiveness, T□th, Bonik, or any other CJEU authority cited, including Hardimpex KFT [case C-444/12], LVK-56 [case C-643/11] and Forvards V SIA [case C-563-11] … involves any departure from or restriction of the Kittel principles as interpreted in Mobilx. As indicated above, that analysis is binding at this level, and I could only depart from it if I was persuaded that subsequent cases cast such doubt as to merit a reference to the CJEU: I have not been so persuaded."

51. She went on to state at paragraph 34:

> "In conclusion, I agree with paragraph 22 of the decision of Judge Bishopp in *Universal Enterprises (EU) Ltd v Revenue and Customs Comrs* [2014] STC 1515, cited by HMRC:
>
> > '22. The argument that a trader in a clean chain cannot be affected by anything which happens in a dirty chain is in my judgment wholly misconceived. Mr Young argued that there is nothing inherently wrong with contra-trading, a statement which, put in that way, is true: a trader who both imports and exports may legitimately organise his sales and purchases so that, at the end of a VAT period, he has little to pay, or a repayment claim. If he does so for reasons of cash flow, his conduct is unexceptionable. But that is not the reason for the contra-trading seen in cases of this kind. As has been said many times, not least by the then Chancellor in *Blue Sphere Global Ltd v Revenue and Customs Commissioners* [2009] STC 2239, its purpose is to conceal the fraud in the dirty chain and to make it harder to combat. The appellants' argument necessarily treats 'clean' as synonymous with 'innocent', but a clean chain in cases of this kind – that is, one in which each of the traders accounts correctly for VAT – is not innocent; it is an integral part of the fraudulent scheme. Even if I entertained any doubt (which I do not) that as a matter of EU law there is sufficient connection between a trader in the clean chain and the default in the dirty chain, there remains an insuperable connection with the fraudulent purpose of the clean chain.'"

[11] [2014] UKUT 38 (TCC)

The second Ground of Appeal

52. The issue related to what constitutes a connection between the fraud and the transaction for which the trader seeks to exercise his right to deduct? At paragraphs 43 and 44 Lady Justice Arden makes it explicit that:-

> "43. … it is for the national court to determine if there was a connection on the facts, and this question is to be determined on the objective evidence and without reference to the trader's knowledge.
>
> 44. Furthermore in my judgement, there is nothing in Kittel which would lead to the conclusion that HMRC has to show that the transaction provides tangible assistance in carrying out the fraud …. there is no warrant for reading in a requirement that, in a contra-trading case, the connection can be established only by inclusion of details of the transaction in question in a VAT return…".

Accordingly, we must, and do, adopt that approach.

The third Ground of Appeal

53. The last issue related to what is the degree of knowledge of the fraud which the trader must have in order to be liable as a participant in it? As far as knowledge is concerned, Lady Justice Arden quoted from Moses LJ in *Mobilx* where he considered the extent of knowledge required by the *Kittel* principle and that reads as follows:-

> "58 – As I have endeavoured to emphasise, the essence of the approach of the court in *Kittel* was to provide a means of depriving those who participate in a transaction connected with fraudulent evasion of VAT by extending the category of participants and, thus, of those whose transactions do not meet the objective criteria which determines the scope of the right to deduct. The court preserved the principle's legal certainties; it did not trump it.
>
> 59 - The test in *Kittel* is simple and should not be over-refined. It embraces not only those who know of the connection but those who 'should have known'. Thus it includes those who should have known from the circumstances which surround their transactions that they were connected to fraudulent evasion. If a trader should have known that the only reasonable explanation for the transaction in which he was involved was that it was connected with fraud and it turns out that the transaction was connected with fraudulent evasion of VAT then he should have known of that fact. He may properly be regarded as a participant for the reasons explained in *Kittel*.
>
> 60 – The true principle to be derived from *Kittel* does not extend to circumstances in which a taxable person should have known that by his purchase it was more likely than not that his transaction was connected with fraudulent evasion. But a trader may be regarded as a participant where he should have known that the only reasonable explanation for the circumstances in which his purchase took place was that it was a transaction connected with such fraudulent evasion."

54. Lady Justice Arden stated at paragraph 51 of *Fonecomp*:

> "51. However, in my judgment, the holding of Moses LJ does not mean that the trader has to have the means of knowing how the fraud that actually took place occurred. He has simply to know, or have the means of knowing, that fraud has occurred, or will occur, at some point in some transaction to which his transaction is connected. The participant does not need to know how the fraud was carried out in order to have this knowledge. This is apparent from 56 and 61 of *Kittel* … Paragraph 61 of *Kittel* formulates the requirement of knowledge as knowledge on the part of the trader that 'by his purchase he was participating in a transaction connected with fraudulent

evasion of VAT'. It follows that the trader does not need to know the specific details of the fraud."

55. At paragraph 49 of *Fonecomp*, she had previously endorsed the opinion set out by Briggs J in *Megtian Limited v Revenue & Customs Commissioners*[12] at paragraph 37 and that reads:-

> "In my judgment, there are likely to be many cases in which a participant in a sophisticated fraud is shown to have actual or blind-eye knowledge that the transaction in which he is participating is connected with that fraud, without knowing, for example, whether his chain is a clean or dirty chain, whether contra-trading is necessarily involved at all, or whether the fraud has at its heart merely a dishonest intention to abscond without paying tax, or that intention plus one or more multifarious means of achieving a cover-up while the absconding takes place."

56. We are in no doubt whatsoever that the *Kittel* principle does apply to contra-trading and that many of the arguments advanced for the appellant are not tenable in light of this decision, specifically those set out at paragraphs 31, 32 and 34 above.

57. In regard to paragraph 36 above, the detail of the argument, as it evolved after the hearing, is that HMRC had allegedly failed to carry out what were described as "the investigative obligations of the Taxing Authority" in respect of five of the defaulting traders (Phone City, Fonestyle, Restar, VSUK and HBS). As can be seen from the Officers' evidence in regard to those traders, as set out below, it was freely admitted that there was the possibility that those traders could have been deregistered before in fact they were. The appellant argued that European jurisprudence meant that in determining whether or not the appellant had the means of knowledge the Tribunal could not rely on, as objective factors pointing to knowledge, any alleged failures to carry out checks on suppliers etc because those checks are the responsibility of the Taxing Authority. Given Lady Justice Arden's endorsement of *Edgeskill* in particular and the other dicta in *Fonecomp*, that argument is not tenable.

58. Further, Roth J made it explicit at paragraph 60 in *Powa (Jersey)Limited v HMRC*[13] that:-

> "Furthermore, whether or not HMRC could have applied a similar approach to the traders who served as buffers in the chains (who would generally not be making a repayment claim to HMRC but simply crediting the input tax against the output tax received) does not affect that conclusion; and whether HMRC should have pursued those traders for an account of the output tax received is a question of policy regarding the effective enforcement of the VAT regime, with no doubt limited resources. Accordingly, I consider that the principle of non-discrimination is not engaged."

We are clear that the fact that HMRC did not deregister or pursue those traders at an earlier stage is not a matter with which we should be concerned. The fact is that HMRC did not do so.

59. We did consider whether or not we should grapple with the other legal issues advanced as to why we should not follow *Mobilx*. We consider that given the

[12] 2010 STC 840

[13] [2012] UKUT 50 (TC)

decision in *Fonecomp* it is unnecessary for us to do so and that we should concentrate on the essential factual issues raised by this appeal.

60. The key questions are whether there was a sufficient connection between the fraudulent tax losses identified and the three transactions by the appellant, and, if so, whether the appellant knew or should have known of such a connection. Those are questions of fact.

Overview of the three deals

61. The detail of the deals was described in Officer Quinn's first and third witness statements. There are three invoices and therefore three deal chains. There are no tax losses in the three deal chains. The appellant's deal chains have been properly and accurately traced back to the acquisitions by Optronix and further.

Deal chain 1 (invoice 6a)

62. On 18 July 2006 an Austrian supplier TMEA Trading GMBH ("TMEA") sold 3,000 Nokia N90 phones to Optronix at a price of £269.50. On 20 July 2006 Optronix sold those phones to a UK company Shelford Trading Company Limited ("Shelford") at a price of £269.50 per unit. As can be seen from deal 2 (invoice 6b) below, on 20 July 2006 Shelford had purchased a further 2,000 Nokia N90 phones from Optronix at a unit price of £269.50. Those purchases were combined and as far as deal 1 is concerned 3,000 of those phones were sold to the appellant at a unit price of £270. The appellant then sold the phones to La Parisienne de Commerce ("LPDC") a French company at a unit price of £286.

Deal Chain 2 (invoice 6b)

63. On 18 July 2006, an Austrian supplier KBS Handels GMBH ("KBS") sold 2,000 Nokia N90 phones to Optronix at a unit price of £268.75. On 20 July 2006, Optronix sold those phones to Shelford at a unit price of £269.50 (see deal 1 above). Shelford then sold those phones to the appellant at a unit price of £270 and in turn the appellant on the same day sold those phones to LPDC at a unit price of £286.

Deal 3 (invoice 7)

64. On 18 July 2006, a Swedish supplier AXT Telecommunication sold 4,000 Nokia N71 phones to KBS at a unit price of £201.50. On the same day KBS sold those phones to Optronix at a unit price of £202. On 20 July 2006, Optronix sold those phones to Shelford at a unit price of £202.50. On the same day Shelford then sold those phones to the appellant at a unit price of £203 which in turn sold those phones to LPDC at a unit price of £215.50.

General

65. Although in all three deal chains the first invoice traced was dated 18 July 2006, the delivery date specified thereon was 20 July 2006. Although the dates on the

invoices differ, in fact the goods passed through five wholesale traders' hands in one single day, namely 20 July 2006.

66. The appellant was a back to back trader in the sense that LPDC paid the appellant before the appellant paid Shelford.

The evidence

The appellant

67. For the appellant we had only the evidence of Mr Andreou. The witness statement of Mr Andreou, albeit headed as being "draft" was dated and signed December 2012. It is remarkably lacking in detail and extends to only 12 short paragraphs accompanied by 23 exhibits, the vast majority of which were copies of correspondence with HMRC.

68. His explanation for the brevity of his witness statement was that:

> "I have been through this with Megtian, as you know, I gave an in-depth statement about insurance, about this and about that, and it was all irrelevant, so I just kept my statement to a minimum."

69. His oral evidence was more extensive although in cross examination he repeatedly stated that he could not remember or he did not know salient matters.

HMRC

70. The oral evidence for HMRC was from the following Officers:

(a) Quinn - broker officer for the appellant

(b) Camm - contra officer for Optronix

(c) Edwards - Phonecity

(d) Raglan - Fonestyle.

(e) Yule -HB.

(f) Speight - Restar

(g) Reardon - VSUK

71. In addition there was the uncontested witness statement and exhibit evidence from the following Officers:

(a) Lam - West One SM

(b) Stone - MTIC

(c) Letherby -FCIB

(d) Johnson - 3D

(e) Kumar - Prompt Info.

72. We had 53 lever arch bundles of evidence, a core bundle and a bundle of authorities.

Circumstantial evidence

73. Both Christopher Clarke J in *Red 12* and Moses LJ in *Mobilx and Others* refer to the importance of looking at all of the circumstances and inevitably that places considerable emphasis on the significance of circumstantial evidence. Briggs J in *Megtian* made it very clear that —

> "(24) In my judgment the primary facts found by the Tribunal relevant to @tomic's knowledge were, in the aggregate, sufficient to permit the Tribunal, if it thought fit, to make a finding of dishonest knowledge on the part of @tomic. It is in this context important for an appeal court to have regard to the need to appraise the overall effect of primary facts, rather than merely their individual effect viewed separately. As Lewison J put it in Arif v Revenue and Customs Commissioners 2006 EWHC 1262 (Ch) at paragraph 22:
>
> > '22 There is one other general comment that is appropriate at this stage. It relates to the evaluation of circumstantial evidence. Pollock CB famously likened circumstantial evidence to strands of a cord, one of which might be quite insufficient to sustain the weight, but three stranded together might be quite sufficient (R v Exall (1966) 4F & F 922). Thus there can be no valid criticism of the Tribunal which considers that one piece of evidence, while raising a suspicion, is not enough on its own to find dishonesty; but several such pieces of evidence, taking cumulatively, lead to that conclusion.'"

Timing of Evidence

74. The appellant's argument is that it would be an error of law for the Tribunal to rely on evidence obtained by HMRC, as they describe it, "*ex post facto*". That is not correct. One has only to look at the FCIB evidence exhibited in almost every MTIC case. By definition that has been uncovered by HMRC long after the event.

75. HMRC quite properly rely on Clarke J in *Red 12* at paragraph 104 where he made it clear that it would unfair and wrong if the Tribunal could consider only evidence available at the time of the transactions or when the relevant and appealed decisions were made.

76. Simply put, we must decide whether or not HMRC can prove that the *Kittel* test is satisfied and we do so by looking objectively at all of the circumstances pertaining at the time, and as is made explicit in *Fonecomp*, without reference to the appellant's knowledge. HMRC are most certainly entitled to rely on evidence uncovered by them after the event and we weigh it in the balance.

Our Approach

77. Although by the time the hearing commenced there had been substantial concessions offered on behalf of the appellant and minimal evidence was in fact led, nevertheless the Tribunal must be satisfied to the requisite standard that the various individual elements of the *Kittel* test are proven. We agree that the Tribunal must and should, and we did, look at the effect of all of the evidence when viewed collectively and consider the proper inferences to be drawn from it. We have examined the written evidence produced to us and evaluated it together with the oral evidence.

The first two questions

Was there a tax loss and was it connected with fraudulent evasion?

78. We have examined all of the evidence in relation to the question of tax loss, very little of which was referred to in oral evidence. The starting point is Optronix.

Optronix

79. Optronix was incorporated on 13 July 2001 and registered for VAT on 1 September 2001. In the application for VAT registration the main business activity was declared to be "electronic equipment distributors" and the company had an estimated turnover in the following 12 months of £300,000. In March 2004, officers of HMRC visited the company and the company's business activities were described by the director as being the importation of computer components from China and the onward sale of those components to companies in the UK.

80. In March 2005 the company was taken over by a company based in the British Virgin Islands.

81. On 15 December 2006 as part of a criminal investigation, HMRC uplifted all business records for Optronix and an associated company. The primary "contact" (being neither an employee nor an officer), Mr Donnelly has been convicted upon indictment of conspiracy to cheat the public revenue and sentenced to 90 months imprisonment.

82. On 12 and 22 January 2007, Royal Mail returned mail issued to Optronix by HMRC. Officer Camm visited the principal place of business on 26 January 2007 and was unable to gain entry to the premises which appeared to be empty. There has been no further contact made by or on behalf of Optronix which is therefore deemed to be a missing trader.

The 05/06 return

83. HMRC inspected the 05/06 return which was a repayment claim in the sum of £10,744.01. It covered 29 transactions, 15 of which involved the acquisition of mobile phones from a Swedish supplier and sale to UK based companies. The output tax on those transactions amounted to £1,690,718.75.

84. The remaining 14 (broker) transactions involved the acquisition of CPUs and small high value electrical items from UK based suppliers and onward sale to EU based companies. The input tax due on the purchase of those goods was £1,732,156.13. All 14 of those transactions were traced back through UK supply chains to one defaulting trader namely 3D.

85. Officer Johnson's unequivocal evidence was that 3D, having been registered for VAT on 3 May 2006, was deregistered with effect from 7 June 2006 when HMRC had failed to contact the company. They never have been able to do so.

86. The total tax loss assessed after 3D was deregistered for VAT was £1,722,704.62.

The 08/06 return

87. The 08/06 return was another repayment claim and that amounted to £135,195.25. It covered 205 deals in July 2006, and in 103 of those deals Optronix had purchased goods from UK suppliers and despatched them to customers in the EU. All 103 deals have been traced back to defaulting traders. The total tax loss was £9,619,916.56.

88. In the remaining 102 transactions Optronix acquired goods from suppliers in the EU and sold those goods to UK customers. The appellant was the despatching trader in respect of three of those 102 acquisition chains claiming input tax of £378,350. That is the subject matter of this appeal.

89. Whilst it is now accepted that Optronix was a fraudulent trader it is worthy of note that the evidence of Officer Camm, which has not been challenged, makes it explicit that Optronix structured its trading in both periods in such a way as to ensure that the FCIB account was always in credit. The acquisition (or contra deals were conducted first) buying zero rated goods from the EC and selling to UK companies and then broker (or tax loss) deals (buying from UK companies and selling zero rated to the EC).

90. Optronix did not need to fund VAT payments because as a result of the pattern of trading in both periods the output tax and input tax almost exactly cancelled each other out. This manner of trading where a trader conducts the acquisition (or contra) deals first and therefore offsets the liability to HMRC in transactions where it acted as acquirer against its repayments where it acted as a broker is classic contra trading and is widely believed to be highly unlikely to occur in normal commercial trading.

FCIB and Optronix

91. The appellant did not hold an account at the FCIB. Officer Camm has analysed the relevant account data in respect of various FCIB accounts for the three transaction chains where the appellant was involved. She also examined eight "sample" broker deals where Optronix was the broker. Her evidence was unchallenged.

92. In regard to those deals she found that that disclosed circularity of money with funds commencing with Marxman International in Dubai, travelling through seven other FCIB accounts and back to Marxman (in exactly the same amount) in a very short period of time. In each instance the defaulting trader passed the payment (inclusive of VAT) to Maks Information Technology meaning that the VAT was sent overseas. The evidence disclosed that the directors of Marxman International and Maks Information Technology lived in close proximity to each other in Pakistan and that the FCIB secret question for both was identical.

93. Officer Camm analysed 55 deals in June 2006 where Optronix acted as a broker and circularity was established in all 55 deals and those transactions involved only five UK suppliers and 3 EU customers. Marxman International was again in a pivotal position and Maks Information Technology featured.

94. Officer Camm also analysed all the transactions in June 2006 where Optronix acted as contra-trader. Those transactions involved 11 brokers and of the 63 deals examined, Officer Camm was able to identify circularity in all but three. Those three deals involved a trader who did not have an account with FCIB. The transactions chain had similar members and each chain contains the same number of transactions and Marxman International appeared in a pivotal position.

95. We note with interest that all of the payments analysed by Officer Camm were made in sterling regardless of the domicile of the paying and recipient companies. Given that a number of the companies were EU companies it is even more surprising that the transactions were conducted in sterling. We agree with HMRC's suggestion that the inference to be drawn is that the deals were all centred around the UK with the purpose being to defraud the UK Revenue.

96. We note that Officer Camm identified the fact that Optronix and LPDC utilised the same IP (Internet Protocol) address. Officer Letherby furnished detailed evidence on the forensic integrity and cross-verification of the FCIB servers. In his second report he specifically addresses the situation where two or more individuals utilise the same IP address. His conclusion, having canvassed all reasonable possibilities is very clear. He states "It is highly unlikely that separate users in multiple locations could coincidentally achieve the same IP address consecutively in a given set of transactions. This is because to do so, each user would need to manually release the IP address lease and the next user would need coincidentally, to be using the same Internet Service Provider, and be randomly allocated that recently released IP address."

97. We agree with HMRC that we can conceive of no legitimate reason as to why two parties in any single transaction chain should share an IP address if they are

trading legitimately and at arms-length. The evidence of shared IP addresses is another indicator of contrivance in the deal chains.

98. We agree with HMRC that the chance that the circularity of money is being established in this way without there being in place an overall scheme to defraud the Revenue is remote to the point of being nil.

The Officers' evidence in regard to the defaulting traders on cross examination

99. There was very little evidence heard from any of the Officers and no material challenge to their evidence. The primary point that was addressed was whether there was a direct link with the appellant and as can be seen it was freely conceded that there was not. There does not have to be such a connection. Whilst a number of the Officers agreed that it was conceivable that some of the defaulting traders could have been deregistered before in fact they were, we find that that is said with the benefit of hindsight and in any event it is the state of the appellant's knowledge that is the issue. We do not accept that HMRC have transferred their investigative obligation to the taxpayer.

Restar

100. Officer Speight agreed that

(a) there was no evidence of any direct link or contact between Restar and the appellant,

(b) Restar had been registered for VAT in August 2004 and thereafter submitted nil returns for every quarter from 09/04 to 03/06,

(c) on 12 May 2006 a central assessment had been automatically generated because the 03/06 return was overdue,

(d) on 12 June 2006, HMRC deregistered Restar. He conceded that it would have been possible to have deregistered it at any time during 2004/2005.

VSUK

101. Officer Reardon agreed that

(a) there was no evidence of any direct link or contact between VSUK and the appellant,

(b) VSUK had been registered for VAT on 15 March 2005 and submitted six nil returns thereafter,

(c) a telephone call on 11 July 2005 had established that it was intending to commence trading the following month,

(d) he agreed that the license to occupy furnished to HMRC was for a property which was not the principal place of business. It had also provided HMRC with new customer/supplier forms and the companies involved were subsequently found to be involved in MTIC transactions. That was significantly later,

(e) no post registration visit was carried out,

(f) HMRC only became aware of its possible MTIC involvement on 3 July 2006 and it was initially deregistered on 6 July 2006, subsequently amended to 13 July 2006.

HBS

102. Officer Yule confirmed that

(a) there was no evidence of any direct link or contact between HBS and the appellant,

(b) HBS did not make any taxable supplies between December 2004 and June 2006 and between those two dates submitted only nil returns,

(c) at any time between those dates it could have had its VAT number removed.

We note that in his witness statement, he stated that there was a radical departure from HBS' stated business activity in June and July 2006, which was not communicated to HMRC. There was a change of company officers immediately before that change in business activity and the volume of the VAT default created in a little over a month was substantial. The volume of business in that short period was in excess of £182,000,000.

Phone City

103. Officer Edwards confirmed that it had been registered for VAT from 1 February 2005 and that

(a) at a post registration visit on 6 July 2005 HMRC had registered "concerns" that "none of the people seen appear to be in charge of this business which appears to be setting up as an MTIC trader. However, I have no evidence to support these thoughts and found no reason either to deny clearance at Redhill or cancellation of registration.",

(b) on 22 September 2005 HMRC wrote explicitly warning that if proper checks were not made on customers and/or suppliers or third party payments made the company might be liable to action under joint and several liability legislation. It also indicated that it appeared that the company was not undertaking proper checks,

(c) on 10 October 2005 HMRC wrote to them stating that a "significant number of the mobile telephone deals undertaken" during the period July 2005 had been traced to a defaulting trader,

(d) on 14 October 2005 an officer's visit made explicit again the risks of not making proper checks and the company acknowledged the risks of making third party payments,

(e) an officer's visit on 16 March 2006 confirmed again that all suppliers to the company up to December 2005 had been deregistered and that there had been significant VAT losses. Therefore the company's due diligence checks were clearly not working, and

(f) he agreed that there were strong suspicions that the company had been involved in fraudulent trading continuously since July 2005 and that HMRC had taken no action against the company until much later.

DTM

104.Officer Raglan confirmed that there were no direct links between the appellant and DTM.

Fonestyle

105.Officer Raglan confirmed that there was no evidence of any direct link between Fonestyle and the appellant.

106.Fonestyle had been registered for VAT from 1 March 2004 until deregistered with effect from 17 July 2006. She had not seen any evidence of VAT returns but that did not mean that they did not exist. She agreed that the first visit to the company had been triggered by the central coordination team because of possible concerns about its trading. That was on 18 May 2006. On 10 October 2006 an assessment relating to transactions in March 2006 was raised. The suggestion in cross-examination was that there was a delay between March and October. In point of fact, HMRC appear only to have received the initial information underpinning the assessment at the end of August 2006 and the October assessment was subsequently almost doubled following receipt of further information.

Optronix's trading chains

107.None of the deal chains in the periods 05/06 and 08/06 can be traced to the manufacturer or an authorised distributor nor to an end user or retailer who would sell to an end user.

108.All transactions were conducted on the same day and on a back-to-back basis and the release of goods and inspection were all arranged on the same day. The quantity and type of stock was exactly matched in each instance.

109.No members of the supply chain actually took physical possession of the goods and there is no evidence to suggest that any of the traders ever made a loss.

110.The supply chains in which Optronix acted as a broker always involved the supply of high value, low volume items purchased from UK suppliers and the mark up for Optronix was less than 2%. By contrast the brokers at the end of the supply chains achieved much greater mark ups eg the appellant achieved mark ups of approximately 6%.

111.The placing of traders in the supply chain in many of the transactions in the period 08/06 is identical.

112.The margin per unit achieved by all the traders in the defaulting transaction chains remained fairly constant according to their position in the chain and the length of the chain remained constant.

113.The majority of the EU customers and suppliers during the period 08/06 were operating from residential addresses and did not have any employees.

114.The majority of the customers and suppliers in the Optronix loss chains banked with First Curaçao International Bank ("FCIB").

115.Although Optronix implemented a risk analysis of its customers and suppliers, the checks did not confirm that the supplier had the ability to provide the goods or the customer the ability to pay. In fact the results of the credit worthiness checks undertaken by Optronix during the period May to July 2006 indicated that the majority of the customers and suppliers posed a medium to high risk.

116.There is no evidence that Optronix carried out any checks on the freight forwarders notwithstanding the high value of the goods involved. The documentation in that regard points to considerable inconsistencies in the transportation and consignment information as for example a failure to identify the goods and the possible non-existence of one freight forwarder.

117.As far as the EU suppliers in the deal chains are concerned, the Austrian tax authorities have found that

(a) TMEA had only a virtual office and was not contactable, and

(b) there is no proof that KBH moved the goods in which it dealt and it had a trading relationship with LPDC.

Summary

118.As can be seen, we have analysed the Officers evidence and in so doing we noted a few minor inaccuracies and discrepancies such as for example some of the

arithmetic is marginally inaccurate and sometimes the assessments have later been altered and the witness statement does not take account of that. None of these matters were remotely material and no issue was taken by either party. We accept HMRC's argument that looking at all of the circumstances there is clear evidence of involvement in MTIC fraud.

119. The relevant facts are that it has been established to our satisfaction that:

(a) Optronix was a fraudulent contra trader,

(b) as conceded for the appellant, the nine identified traders are all fraudulent defaulting traders,

(c) Optronix's broker deal chains, in the relevant period, have been accurately traced to fraudulent tax losses created by defaulting traders.

The remaining two questions

Were the appellant's three deal chains connected with that fraudulent evasion and if so did the appellant know or should it have known of the connection with that fraudulent evasion?

120. As we indicate at paragraph 52 above Lady Justice Arden has made it very clear that the connection with the fraud is a matter of fact, determined on objective evidence without reference to the appellant's knowledge. Of course, the factual matrix is relevant to the second question if the connection is proved by HMRC. What are the facts?

The appellant and VAT registration

121. The appellant was incorporated on 1 April 2005 and on 4 April 2005 Mr Andreou was appointed as a director. The Company Secretary, appointed on the same date, was his brother Christopher Andreou. Both remained in post at all material times.

122. Mr Andreou signed the VAT registration form on 23 May 2005. The stated current and/or intended business activities involved "computer and telecommunications products, accessories and components". The appellant declared that it intended to receive regular repayments of VAT although the value of goods it intended to sell or buy to other EC Member States was estimated at nil. The estimated value of its taxable supplies in the following 12 months was £5m. The appellant was registered for VAT on 1 June 2005.

123. The principal place of business for the appellant was at the same address as Megtian and indeed the other four companies with which Mr Andreou was associated. Those premises were a clothes shop and Officer Quinn, who visited Megtian on 6 July 2006, observed that both companies appeared to operate from a small office at the back of the shop.

124.Mr Andreou confirmed that in 2006, apart from the appellant and Megtian, he was company secretary of Stacey Lord Limited which was a retail shop which he owned selling designer clothes. It was a retail clothes shop employing approximately five people and his brother Christopher was a director. He worked there every day. He was unable to say which business was his main business, simply that he allocated his time to each business on a "need" basis.

125.He and his brother were company secretary and director of Kriston Properties which had approximately 20 flats. Occasionally they developed flats. Mr Andreou indicated that Kriston Properties had furnished unspecified funds for Megtian.

126.He was an investor in a company called Temp Bay, which was a recruitment company.

127.Lastly, he and his brother had a truck company called Yellow Dot Com but it did not trade.

128.In his oral evidence Mr Andreou was wholly unable to explain why the VAT registration form had stated that the value of goods likely to be bought from other EC Member States or to be sold to EC Member States was nil. His wholly incredible explanation was that although he had signed the form and ticked the box it did not have his name in block capital letters so it must be a mistake and he would not have filled in a form in that manner.

129.He had to concede that over the years he had completed a number of VAT registration forms and he had understood the questions. He reiterated that the answers in the form were a mistake.

130.His attention was drawn to the covering letter by the tax adviser who acted for both Megtian and the appellant. That letter, dated 23 May 2005, being the same date as the registration form, stated:

> "The company will be buying and selling computer chips and mobile phones. At the moment all transactions in this sector are carried out by Megtian Limited, which has been registered for VAT … for a number of years ... It is planned that the new company will take on some of Megtian's current activities from the same premises, and indeed it is possible that in the long term, Blue Orange may specialise solely in mobile phones. This will be dependent, however, on market conditions and opportunities."

In response to the suggestion that, effectively on his instructions, that implied that the appellant would be sharing Megtian's business, but would have no EC trade, he could not explain why his representative had phrased it in that manner. He was unable to reconcile it with what HMRC were told by him subsequently (see paragraph 152 below).

Megtian and VAT registration

131.Megtian was registered for VAT and Mr Andreou was a director of that company. He signed the VAT registration form and the stated business activity was "import and

exports of all kinds of goods, menswear". It never traded in menswear and Mr Andreou could not explain why that had been included on the form. He denied that it had been included to divert HMRC's attention.

132. The application stated that the company intended to receive regular repayments of VAT and that the estimated value of its taxable supplies in the following 12 months was £78,000. Megtian initially traded in tooth brushes and herbal products before turning its attention to the wholesale supply of mobile telephones.

133. The appellant shared with Megtian its suppliers, customers, business premises, VAT adviser and directors. The personnel directly involved in the two companies were identical. There were two extra different minority shareholders being a brother and a nephew of the Mr Andreou.

HMRC contact with the appellant and Megtian

134. HMRC wrote to Megtian on 28 July 2003 warning about the incidence of MTIC fraud in terms very similar to that of a further letter sent on 3 December 2003.

135. On 15 August 2003 HMRC wrote to Megtian's solicitors stating:

> "The Commissioners have obtained preliminary evidence from which it appears that the transactions in the periods to which the Returns relate … are part of a circle or carousel of transactions whose purpose is not the buying or selling of products in the course of a business activity".

136. On 3 December 2003, HMRC wrote to Megtian warning about the dangers of dealing in mobile phones and computer equipment, in what is commonly known as a "Redhill letter" which was in the following terms:-

> "Missing Trader Intra-Community (MTIC) VAT fraud constitutes one of the most costly current forms of VAT fraud within the EU. It is a serious problem for the UK and is Customs' top VAT fraud priority. As you may be aware I am a Tax Operations Manager with responsibility for this area of work.
>
> Amongst the commodities involved are computer equipment, mobile phones, ancillary items and any other goods. The current estimate of the VAT loss from this type of fraud in the UK alone is between £1.7 and £2.6 billion per annum.
>
> Customs and Excise are still experiencing certain problems with businesses in your trade sector offering commodities regularly involved in Missing Trader Intra Community (MTIC) VAT fraud. As part of our local controls you may previously have been verifying the VAT status of new or potential Customers/Suppliers with your local office.
>
> However, with effect from today's date, verification of the VAT status of new Customers/Suppliers should instead be faxed to **Redhill VAT Office**. However, if you do not have fax facility please contact us by telephone or E-Mail…
>
> The fax numbers at Redhill VAT Office are: 01 737 734605 or 01 737734600. The telephone number at Redhill is 01 737 734612.
>
> If known, the information provided should include the following:

- The name of the new or potential Customer/Supplier.
- Their VAT Registration Number.
- Their contact numbers (including telephone number, fax number, e-mail address and mobile numbers if known).
- The Directors and/or responsible members.
- Whether they are buying or selling goods.
- The nature of the goods.
- The quantities of the goods.
- The value of the goods.
- Their bank sort code and account number.
- We would also require you to continue forwarding, on a monthly basis, a purchase and sales listing with the identifying VAT Registration Numbers against the suppliers/customers to Redhill Vat office."

Differing versions of the Redhill letter were issued over the years but the concept remained essentially unaltered.

137. On 13 May 2004 HMRC wrote to Megtian explaining that a Danish company with whom they had dealings had been deregistered for VAT purposes. On 3 March 2005 and 9 May 2005 further such "veto letters" were sent to Megtian. Those letters stated that traders with whom Megtian may have had some connection had been deregistered for the purposes of VAT.

138. On 16 September 2004 HMRC wrote to Megtian's VAT consultants indicating that HMRC was looking into three of Megtian's deals and referring to the possibility that they involved circularity of money and goods. On 26 October 2004 that was formally confirmed.

139. On 1 December 2004 HMRC wrote to Megtian explaining that two of its purchases led back to a defaulting trader.

140. In 2005, as indicated above, Megtian had been formally told that there were defaulting traders and possible hijacked VAT numbers in some of the chains of transactions entered into by it. There was also correspondence with HMRC in regard to the standard of due diligence which was required. Megtian's VAT consultants had confirmed on 22 September 2005 that Megtian utilised the services of Veracis to carry out site visits of UK suppliers and that overseas customers were normally visited by a director.

141. A deal pack regarding a Megtian invoice dated 15 February 2006 showed that phones had been purchased from Team Mobile Global Limited ("Team Mobile") and the supplier declaration from Team Mobile had answered "no" to the question of whether it had been trading for more than 12 months and whether a supplier site visit had been conducted by Megtian or a third party. We note that the deal pack also confirms that a 100% inspection had been requested from A1 and the IMEI serial numbers had been received and checked.

142. On 18 February 2006, HMRC faxed Megtian warning them that the goods in question had been the subject of circular trading and that certain boxes were empty.

Nevertheless Megtian continued to purchase goods from Team Mobile during its VAT periods 04/06 and 05/06.

143. On 5 June 2006 HMRC wrote to Megtian with a "Swiss warning letter" stating that it was their view that there were circular transaction chains in mobile phones which was began and ended with a UK trader that failed to meet its VAT liability. Goods were being exported to a freight forwarder in Switzerland but within hours the same goods were then consigned to France and shortly thereafter consigned back to the UK. The goods were only outside the UK from between 48 and 72 hours. It was HMRC's stated view that the Swiss transaction chains, which passed through Megtian, formed an integral part of an overall scheme to defraud the Revenue.

144. On 22 June 2006, HMRC notified Megtian that 11 of its 04/06 broker deals had been traced back to a tax loss of £1,461,267.50 and that enquiries were continuing.

145. On 19 July 2006 HMRC notified Megtian that 10 of its 05/06 broker deals had been traced back to a tax loss of £1,993,022.

146. All remaining chains in those two periods were traced back to tax losses.

147. Megtian was subsequently found to have knowledge of MTIC fraud in regard to those periods and its VAT repayment claims were disallowed. The decision of the Tribunal was appealed but that decision was upheld both in the Upper Tribunal and in the Chancery Division. Indeed, the last decision, from which we quote the endorsement by Lady Justice Arden at paragraph 54 above, is a very well-known authority on MTIC fraud. We note that within the deals under appeal therein there were purchases from Shelford and sales to LPDC.

Officers' visits

Visit - 26 January 2004

148. Officer Ross met with Mr Andreou and others and discussed defaulting traders, the need for appropriate checks and due diligence and joint and several liability.

Visit – 15 November 2005

149. At paragraph 4 of his witness statement Mr Andreou relied on HMRC's record of the meeting on 15 November 2005, which contained an explanation for the incorporation of the appellant. He expanded upon it and confirmed that the appellant had been incorporated to carry out sales to purchasers in the EU because Megtian was selling to non-EU purchasers, albeit owing to lack of sufficient demand outside of the EU, Megtian also sold to purchasers based in the EU.

150. This was a pre-registration MTIC visit and Officer Gormley interviewed Mr Andreou in the presence of his representative. Mr Andreou said that no deals had been carried out by the appellant and that there was therefore no evidence of trade available. He stated that the appellant would have capital of approximately £200,000.

He and Christopher Andreou would own 25% each and Costa Andreou would have a 20% shareholding, Nick Nickolou, a family friend, would have a 25% holding and Andrew Kyriricou would hold the remaining 5%.

151.If it proved impossible to raise the funding then Megtian would provide funds via loans. Megtian in turn had been funded by loans from Kriston Properties. Nick Nickolou was also a 33% shareholder in Megtian. Although not a director of Megtian Nick Nickolou was the other trader with Mr Andreou in Megtian.

152.Mr Andreou told the officers that it had been decided to split the Megtian business into territories. It was the intention that Megtian would sell phones to traders in non-EU Member States and the appellant would sell phones to traders in EU Member States and CPUs to traders both within and outwith the EU.

153.Both parties relied upon and produced the Officer's notes of this meeting. Mr Andreou expanded upon them in his oral evidence.

154.His oral evidence was particularly inconsistent. In the first instance he indicated that from the outset Megtian's wholesale transactions in phones and CPUs were all broker transactions, ie purchases in the UK and selling to another EU Member State, albeit Megtian had done a couple of transactions which were wholly in the UK. He then went on to state quite specifically that Megtian had never traded in the EU before the appellant had been established.

155.It was put to him that in respect of the 2004 VAT repayment claim for Megtian, HMRC had written to Megtian on 26 October 2004, pointing out that in respect of three sales, one to Denmark, one to Holland and one to Belgium, input tax had not been repaid so clearly Megtian had been trading with EU companies. He then said that it had only been at the beginning that Megtian had traded with EU companies. He confirmed that in 2005 Megtian had been trading with Switzerland which, of course, is a non-EU country.

156. At that meeting, in the context of Megtian, there was a detailed discussion of due diligence and specifically, in the context of possible defaulters, it was stressed that due diligence should be extended to suppliers and the suppliers' suppliers.

Visit – 6 July 2006

157.This was a meeting with Mr Andreou and his co-director of Megtian. Officer Gormley and Officer Quinn discussed with the directors the various defaulters in Megtian's deal chains. It was specifically explained, with reference to Notice 726 (a copy of Section 8 of which is annexed at Appendix 3) that where a trader had genuinely checked the integrity of the supply chain and has no reason to suspect that VAT would go unpaid the joint and several liability measures would not be applied. There was a discussion about the necessity for inspection reports, IMEI numbers, site visits etc.

158.On 31 July 2006, following that meeting, HMRC sent the appellant another Redhill letter.

The appellant's described *modus operandi*

General

159. Overall, as described by Mr Andreou, there was no discernible difference in how Megtian and the appellant operated on a daily basis.

160. Mr Andreou said that he had done no research into the mobile phone industry other than looking at the mobile phone databases and websites. From December 2003 until it went into administration Megtian dealt only in wholesaling CPUs and mobile telephones and for the most part it operated as a broker trader (that is to say an exporter). Of course, the appellant only operated as a broker trader.

161.The appellant used the IPT website in trying to place its deals where there was no known contact. Mr Andreou did not use IPT exclusively but only when and if he needed it. He stated that he kept a note of potential trading partners on his telephone.

162.His evidence in regard to how he kept a database was less than consistent. He had initially said that the secretary employed by Megtian was not concerned in the appellant and that the appellant had Mr Andreou himself and Mr Nikolaou as traders and his brother Costa Andreou did the paperwork. However, at a later stage in the hearing, when asked about the database, he was asked how the data was maintained at the shop. He said "The secretary would maintain it daily. She would see what stock was offered, at what price, what people were looking for and what price they wanted to pay. And we would try to match it."

163. Mr Andreou accepted that in the summer of 2006 the market in mobile phones was very busy and competitive. Mr Andreou saw nothing untoward in being the middle man between two other wholesalers and readily conceded that he was the middle man who had brokered the deals.

164.Mr Andreou's evidence was that as soon as he was ready to do a deal he would provide HMRC with information as to the deal, the price, the freight forwarder, who his customer was, who his supplier was and the price. He conceded that by the time that he did that, the goods would already have been with the freight forwarder.

165.The appellant and its counter parties appear to have had no written contracts apart from the relevant purchase orders and sales invoices. There is therefore no written record of agreement on important commercial issues such as shipping terms, insurance, the date and method of payment and responsibility for the return of faulty goods.

166.We were provided with evidence in regard to the timing of faxes of purchase orders etc. However, in our experience such evidence is frequently unreliable and therefore, beyond noting that the transactions involving the appellant, and therefore

the inspections, appear to have been conducted at some stage in the afternoon on 20 July 2006, it forms no part of our deliberations.

167. Mr Andreou was very clear in his evidence that he did not pay for goods until he himself had received payment and that he was permitted to send goods to his customer on "ship on hold". He stated "they would be shipped on hold and the title would be kept in, I would presume, Shelford's name until I paid and released, and then they released the goods to me. They only shipped on hold in my name.

> Q – yes but you have removed them from the country
>
> A – they have allowed me to, yes. That's how all the deals work. I don't think there is any paper for that …. Well, yes. 100% we'd have permission. Don't forget, this is a company that I have traded with for the last two or three years, so they know us. But that's the way the whole industry works. You were allowed to ship on hold. They were never in your name, yes, they were never in your name".

168.He is quite clear that he was unconcerned about the matter of title since he was able to ship the goods on hold.

169.Mr Andreou indicated that although he would ask a customer what specification they required for the handset itself he was never asked about the language in the manuals or the languages of the software on the phone itself and he had never made any such enquiry of his suppliers. Further none of the purchase orders or invoices in respect of the phones identified what languages were involved. On reflection he conceded that perhaps he should have asked about the manuals. We find it extraordinary that neither he nor his counterparties appear to have done so.

170.We find it equally extraordinary that Mr Andreou considered that the colour of the phones was "neither here nor there" and that both he and the customer would simply accept the colour on the inspection report because if it was a desirable phone then the phone would be purchased in any colour. We put it to him that that did not accord with our understanding of the market at that time. He had no further comment.

171.Mr Andreou stated that he simply sent the inspection report of the goods and it was either accepted or, presumably, not. In his words "What mattered was that the inspection report – what the phones were, what the spec was…".

The inspection reports

172.The appellant engaged A1 to conduct inspections in respect of goods traded in period 08/06. The reports indicate that the warranty detail is "limited warranty". Mr Andreou did not know what that meant and conceded that he had never asked. We find that odd.

173.Although the inspection reports available in respect of each of the transactions suggest that A1 scanned 100% of IMEI numbers, no records of those numbers have ever been made available to HMRC. In his witness statement Mr Andreou states blandly that "A1 Inspections ('A1') had a database of the IMEI numbers of those telephones bought

and sold by the appellant and Megtian. I knew that A1 were an ISO registered company and this gave me the confidence that A1 would be carrying out competent inspections." He conceded that he had not requested that those databases be cross checked. In a market redolent with fraud that would have been a prudent precaution.

174. In all three deal chains the A1 report is dated 20 July 2006.

175. The report on the 5,000 Nokia N90 phones in deal chains 1 and 2 states that they are pearl black and light blue with two pin chargers. The inspection type was the box check quantity and IMEI scans with power test quantity 3.

176. As far as deal chain 3 is concerned, the inspection report was of 4,000 black silver Nokia N71 phones with box check and IMEI scans but the power test quantity was two. The manuals were in English and English and French. The charger was again two pin.

177. Accordingly for the appellant alone, on the afternoon of 20 July 2006, A1 must have completed a labour intensive inspection of 9,000 phones. A1 define what is involved in any inspection with a 100% box check and in particular specify as follows:

> "1. Ensure phone, charger, battery and accessories are present. (Quantities of missing items will be provided).
>
> 2. Evaluate the condition of the phone, charger, battery, accessories and Manual.
>
> 3. Collate the different language codes ….
>
> 9. State if there are any markings present (customs stamps etc ….).
>
> 10 Unique pallet IDs allocated per pallet.
>
> 11. Goods will be shrink wrapped and security sealed ready for transportation."

178. In summary that would mean opening 9,000 separate boxes, checking and noting the presence and appearance of its contents, scanning all the IMEI numbers and shrink wrapping the goods back.

179. It is argued for the appellant that there was no way of knowing whether or not, prior to receiving instruction from the appellant, A1 had already carried out an inspection for the supplier, Shelford. Although that question was posed to Officer Quinn and he indicated that he did not know the answer, we note from the Veracis report on Shelford that under the heading "Stock Inspection" it states that "For UK trades no reports are requested. For exports 100% inspection reports are requested …". Self-evidently the sale to the appellant was a UK trade. Accordingly we do not accept that argument and of course no evidence was provided in support thereof.

180. There is a particular problem with the A1 report for deals 1 and 2 as it disclosed that some of the manuals were in English, some in French and some in Norwegian. The software was in a number of languages but the phones with Norwegian manuals

did not include French software. That seems odd for a delivery to France for a French company and, as indicated above, there is no evidence elsewhere of any specification about the languages involved.

181.Mr Andreou's repeated assertion that the manuals could be changed, ignoring completely the presumed cost attached to that, was simply incredible.

182. Furthermore, those inspection reports did not match the inspection obtained by LPDC which was provided to the appellant. The report for LPDC (by A.F.I. Logistique ("AFI")) stated that the manuals for all 9000 phones were in English. Mr Andreou was asked about that and simply said that he had not noticed. Equally pertinently it would appear that LPDC either did not notice or care.

183.We find it wholly incredible that without any questions being posed either to the supplier or to the purchaser, the goods in question met the needs of all parties when they varied considerably and all were furnished with a two-pin charger which meant that they could not be utilised in the UK market without an adaptor. In summary, Mr Andreou conceded that he and his customer might be buying phones that were not the colour they wished, might require an adaptor and the manual might have to be changed. His explanation that the parties would be aware of that prior to purchase (because they would have the inspection report) did not sit well with the discrepancies in the inspection reports referred to in the preceding paragraphs nor with the fact that it seems that the inspection report was not available in advance of the deal being agreed.

184.Although Mr Andreou stated explicitly that "…the report would go before the goods are shipped. So we'd wait for clearance that they're happy with the inspection report before we actually sent the goods", in point of fact that is not borne out by the evidence. AFI Logistics (UK) Ltd confirmed that they shipped the 5000 Nokia N90 on 20 July 2006 yet the appellant sent the inspection report for agreement on 21 July 2006. There are other examples.

185.As far as inspections are concerned it is surprising that the appellant, in the knowledge that there were tax losses in the majority of Megtian's deal chains, and indeed it transpired tax losses in all of the deal chains, was nevertheless content to continue using A1 in the light of that knowledge. Specifically, we are surprised that (see paragraphs 141 and 142 above) after it had been established that there had been circularity in regard to the Team Mobile transaction and certain of the boxes had been empty no action was undertaken. There was no evidence produced of any updated due diligence on A1 after the receipt of the tax loss letters. We agree with HMRC that at the time of the deals in July 2006 the appellant should have been aware that A1 were not providing credible inspection reports.

186.In summary, we find that Mr Andreou's alleged reliance on the importance and accuracy of the inspection reports for all parties was unfounded. Neither he nor LPDC seem to have paid a great deal of attention to the inspection reports.

Due Diligence

187.Mr Andreou agreed that the primary responsibility for protecting the appellant from participating in fraud lay with the appellant itself.

188. In his witness statement he stated:

> "Much of the due diligence relied on by the Appellant was undertaken by Megtian. In this regard Megtian commissioned Veracis to carry out reports, approximately every 6-12 months. I also visited trading partners as well. I was aware that Veracis' reports did sometimes contain negative indicators. I balanced these against the positive indicators and made a commercial decision as to whether or not the Appellant should trade with a particular trading partner.
>
> The Appellant always tried to obtain written as well as verbal references. If written references are not contained within the Appellant's paperwork, I do not know the reason for this."

We had examples of due diligence for Shelford and LPDC and Mr Andreou gave oral evidence in regard thereto.

Shelford

189.In respect of its supplier, Shelford, the following due diligence material was available:

(a) a Veracis report and enclosures dated 11 November 2005;

(b) a Redhill check result;

(c) a letter of introduction to Megtian dated 16 June 2006;

(d) a completed Megtian trade application form dated 16 June 2006;

(e) a webcheck printed on 22 June 2006;

(f) various billing documents evidencing the Shelford address;

(g) copy certificate of incorporation and VAT certificate;

(h) company accounts for y/e 31.7.04.

We comment on some issues arising in relation to some of those items.

(a) Veracis report

190.The Veracis report had been produced on 11 November 2005 following an earlier visit on 1 March 2005. There were a number of potentially negative matters identified namely:

1. "For the present, the company are selling on the UK market until they resolve outstanding issues with HMRC ….".

2. "The company have an ongoing dispute with HMRC in respect of periods June and July 2005".

3. "We did not meet the two directors and further proof of residential address had been requested."

However, there were numerous positive indicators and it was stated that "robust due diligence procedures appear to be in place".

191. Of course for deals being conducted in July 2006, this was not an up to date report particularly given the disclosed dispute with HMRC.

192. We accepted the unchallenged evidence of Officer Quinn that Shelford had an associated company called Shelford IT Limited ("Shelford IT") and they both traded out of the same business premises with the same directors and the same VAT advisers. The Veracis report did not identify that fact. Mr Andreou averred that he had frequently visited Shelford so he should have been aware of that.

193. We note that Shelford IT purchased all of its goods from Shelford and sold them on a very large scale to three EU customers, two of whom were LPDC and its associated company France Affaires.

194. Specifically, in 2006 Shelford IT had been dealing with LPDC. Each and every purchase made by Shelford IT in the relevant periods of its dealings with LPDC had come from Shelford. It seems inherently unlikely that Shelford itself or via Shelford IT would not have sold directly to LPDC rather than the appellant, given that LPDC were apparently in the market for the precise number of phones that Shelford held on 20 July 2006.

(b) Redhill check result

195. The appellant's request to Redhill dated 20 July 2006 describes "our trade" being all three of the deals with which we are here concerned.

196. The check result was in standard form confirming that the VAT registration was valid at that time. It states explicitly that "This confirmation is not to be regarded as an authorisation by this Department for you to enter into commercial transactions with this trader and any input tax claims you make may be subject to subsequent verification."

197. Mr Andreou was insistent that he relied upon HMRC to "check the line" when he sought Redhill verification. We cannot and do not accept that assertion. Although when seeking verification he did request a "line check" he must have known from his extensive experience with Megtian and defaulting traders that that was not part of HMRC's function. Further the terms of the verification as set out in the preceding paragraph make the position explicit.

(c) Letter of introduction

198.Megtian received a letter of introduction from Shelford dated 16 June 2006 but by then it had been trading with Shelford for some time. There were no further transactions between those two entities after that date. Its value therefore is not apparent and begs the question why it was produced at all.

(d) Completed trade application form

199.The appellant, of course, purchased goods from Shelford in July 2006.

200.A Megtian trading application form was completed by Shelford on 16 June 2006 (Megtian had completed a Shelford trading application form on 24 May 2005). In our view, bizarrely since the course of trading between the entities should have been enough, the answer to the question "how did you hear about Megtian Limited" reads "through the industry, IPT, trade references ECT".

201.In summary we take the view that the letter of introduction and the trade application form are a matter of form over substance since those parties had been trading previously and did not trade thereafter.

202. In addition, in the exhibits, we also had

(a) suppliers declarations,

(b) a letter from AFI Logistics,

(c) a reference from Shelford's accountants and

(d) a D & B Risk Assessment as follows:

(a) Suppliers declarations

203.We have two supplier declarations completed by Shelford and delivered to the appellant, being one for the 5,000 Nokia N90s and one for the 4,000 Nokia N71s. The same supplier is involved in both.

204. In the case of the former it is not clear what the answer might be as to whether or not the supplier has been trading for 12 months. Both Y and N are circled although N is circled in greater bold and apparently above the circle on the Y. When one then looks at the second supplier declaration that unequivocally states that the answer is "No". There is no reference from the supplier's accountants. One might reasonably have expected that that might raise alarm bells.

205. There is an undated letter from Shelford to the appellant stating "Further to our recent telephone conversation regarding the stock supplied by Shelford Trading to Blue Orange Information Technology Limited on the 20.07.06. I write to confirm that Shelford Trading have dealt with the same supplier on numerous occasions (sic). They form part of a large organisation in which we are familiar with and had many dealings with." It is described in the Bundle as a trade

reference. If it was in response to any query about the supplier declarations it is remarkably lacking in specification.

206.Mr Andreou was asked about the suppliers declarations and this letter and he was clear that he had not asked about the detail, extent, nature and content of Shelford's checks on its supplier. His response was that he was happy with Shelford who had not gone missing and if Shelford were happy with their supplier then so was he. That supplier is, of course, Optronix.

(b) Letter from AFI Logistics

207.Although the stock was apparently held for Shelford at AFI Logistics (UK) Ltd ("AFI"), AFI blandly stated on 20 July 2006 that "due to security reasons we won't be able to supply you with pictures of your stock…". Mr Andreou's explanation was that they might have had "some break-ins" there but he was not sure. It did not appear to be a matter of concern. Had there indeed been break-ins then we would have expected further enquiry to ensure that his purchase was unscathed.

(c) Reference from Shelford's accountants

208.Shelford's accountants wrote to Megtian on 28 June 2006 stating that "the Company is able to trade as a viable concern. However this information is based upon historic trading patterns…". That provided no indication in regard to their ability to enter multi million pound transactions in 2006.

(d) D & B Risk assessment

209.In addition there was a D & B Risk Assessment dated 28 February 2006 which indicated that the maximum credit should be £425,000 and the risk of business failure was lower than average. It therefore appeared to be a relatively profitable company. However, the context for the appellant was trades worth more than £2 million. If Shelford defaulted on its purchase then title could not pass to the appellant. The maximum credit in respect of these deals alone is not adequate.

LPDC

210.Due diligence was prepared for Megtian by Veracis dated 23 March 2006. The report identified three negative indicators namely that

(1) the director of the company was not available to be interviewed,

(2) there was no suppliers declaration form in use, and

(3) the company did not use trade agreement forms.

211.Further issues identified include

(a) the director allegedly "normally" operated from Dubai and it was he who made all the trading decisions and purchases,

(b) Veracis could not guarantee that third party payments were not made or accepted,

(c) the minimum requirement for an asset base of €8,000 had been introduced to the company although Veracis "suspect" that substantially more funds were available as working capital. There is no explanation for that suspicion,

(d) the turnover was not disclosed, and

(e) Veracis also made it explicit that "as with other mobile phone and computer component companies in France, the requirements by law within the trade are very much less stringent than in the UK".

212.Mr Andreou was asked about that due diligence in some detail in the course of cross-examination.

(i) He confirmed that he had not noticed that the date on the report was repeatedly stated to be 23 March 2005 as opposed to 2006 although he conceded that it might have been an updated version although he was not sure.

(ii) He conceded that he would have been concerned had he learnt that the director of the company was in fact based in Dubai and he had not really identified whether or not the director ever operated from France.

(iii) Mr Andreou conceded that he had made no enquiries about the company's turnover and if it had been, say "75,000 or similar", he would not have entered into the transactions in question. Since he chose to make no enquiries about the turnover, he could not assess the risk.

(iv) He could not recall whether or not he had obtained a credit report or credit reference or trade references for LPDC. He indicated that he would simply have relied on the Veracis report.

213.The Veracis report produced as an exhibit in this appeal was not complete but the complete report furnished for the Megtian appeal was in the excluded evidence and with the consent of both parties was produced. There were no trade references or credit references therein. There was a Europa check dated 22 June 2006.

214.Mr Andreou tried to argue that the director might have gone on holiday because he had a copy of his French ID with an address in France. That simply does not fit with the clear statement in the Veracis document that the director normally operated from Dubai.

215.The reference from LPDC's accountants was in the due diligence but gave absolutely no useful information. Indeed, on the contrary, it said:

> "La Parisienne de Commerce has enough liquidity to carry business and is a viable business. La Parisienne de Commerce has been trading successfully for three years."

That is quite impossible since the company was only incorporated on 22 January 2004 and the letter from the accountants was faxed to Megtian on 5 July 2006. In our view that should have caused some concern to Mr Andreou. In his oral evidence he simply said he could not remember whether he had got a reference from the accountants.

216. The Veracis report explicitly states that LPDC is connected with and on the same premises as a company called France Affaires. Officer Quinn pointed out that Veracis had prepared a report for Megtian on that company which had identified that France Affaires had a trading relationship with Shelford. It is therefore not clear why the appellant should have been interposed.

Summary

217. It was argued for the appellant that the due diligence checks carried out were detailed and exhaustive. We think not partly for the reasons set out above and partly because there is absolutely no evidence, beyond Mr Andreou's bland statement that he always did so, to show that the appellant or Megtian obtained bank references or trade references.

Payment in the three deals

218. As we indicate above Officer Camm's unchallenged evidence in regard to FCIB identified the sequence of payment in many deals including the three with which we are here concerned.

219. Unfortunately the oral evidence was not entirely clear and has proven to be somewhat inaccurate. In oral evidence it was suggested that the appellant received payment from LPDC on 25 July 2006 (which is correct) and in turn paid Shelford on 31 July 2006; the latter "fact" is patently inaccurate.

Payment by LPDC to the appellant

220. It is very clear that on 25 July 2006 as LPDC itself received funds, it in turn paid the appellant within less than an hour. The £862,000 due for deal 3 was paid at 13:15:05, the £858,000 for deal 1 at 13:18:07 and the £572,000 for deal 2 at 13:18:08.

Payments to and by Shelford Trading

221. In his witness statement, Mr Andreou said that not all of the written terms contained on invoices were complied with. He produced as an example Shelford's invoice which stated that it was "for immediate settlement" and said that he had agreed with Shelford orally to vary the terms on the invoice and that payment followed "some days later". In support of that he produced a copy of the NatWest BankLine Payments Module which suggested that the due date for payment was 31 July 2006, albeit it also states "awaiting sanction".

222.Further, the invoice stated that Shelford retained title until paid in full. He had to agree that the appellant released the stock to LPDC on 28 July 2006, three days before he alleged that the appellant had paid Shelford. He stated that he had telephoned Shelford on the Friday and assured them that he would pay for the stock on Monday 31 July 2006. It transpires that is incorrect.

Deals 1 and 2

223.On 1 August 2006 at 16:08:26 Shelford Trading received £1,586,250 into its FCIB account with the description "B/O Blue Orange". In turn it paid £1,583,312.50 to Optronix at 19:18:07.

Deal 3

224.Although at 13:15:05 on 25 July 2006 LPDC had paid the appellant £862,000, it was only on 11 August 2006 at 20:22:45 that Shelford received an amount of £954,100 into its FCIB account with the description "B/O Megtian for (and then the details of Shelford's account number). Again the stock had been released on 28 July 2006.

225.We note from the exhibits that Megtian was the "ordering customer" when instructing the inter-bank transfer on 7 August 2006. In relation to the NatWest BankLine, we had asked Mr Andreou if the accounts of Megtian and the appellant were interlinked and he was adamant that they were not. He was unable to account for Megtian's involvement.

226.Lastly in this context we also note that Shelford owed Optronix £951,750 but paid them only £947,050 at 14:48:06 on 15 August 2006. There is no evidence that the balance was ever paid to Optronix.

227.When Mr Andreou was cross-examined about the remittance of funds he referred only to the two NatWest BankLines relating to the transfers to Shelford. Those indicated that the funds were due on 31 July 2006 (which presumably accounts for his assertion that that was the date payment was made, he having negotiated deferment). Clearly it was overtaken by events in the sense that it was not authorised for deal 3 until 7 August 2006 and was a day late for deals 1 and 2. There was no explanation.

IMEI numbers

228.Mr Andreou's evidence on IMEI numbers was not consistent. Initially he stated that the records were held by A1 but latterly he said that Megtian and the appellant had those numbers on disc. He had given no instructions to cross-check the IMEI numbers with the numbers of phones traded by Megtian. It seems quite clear that the number of "cross checks" of the numbers was miniscule in that there was a request that only five IMEI numbers be checked against the web database. We agree with HMRC

that the cross-referencing of such a small number (0.05%) was almost valueless. It is certainly an insufficient method by which to conduct a meaningful check.

Knowledge

229.We agree entirely with HMRC that the Tribunal's function is not to conduct a review of whether HMRC's decision was reasonably made in the light of the material held by HMRC at the time the decision was made. Rather, the Tribunal's function is to determine whether the *Kittel* test is satisfied, on the basis of the evidence presented to us.

230.HMRC's primary assertion is that the appellant had actual knowledge of a connection with fraud. However, alternatively they argue that the appellant should have known about the connection with fraud. In that regard the appellant's awareness of MTIC fraud is of clear significance. We certainly considered the state of mind of the appellant company at the relevant time. In that context we had to consider the state of knowledge by reference to all of the relevant personnel whose own state of mind is attributable to it. We find as a matter of fact that at all material times Mr Andreou was the controlling mind of the appellant.

Appellant's awareness of MTIC fraud

231.Mr Andreou has accepted that he was aware that there was fraud within the wholesale mobile telephone sector at the time that he traded in those goods and in his evidence he confirmed that he understood the important implications of warnings provided to him by HMRC. He had received more than one copy of Notice 726.

232.In cross-examination Mr Andreou agreed that he had read Notice 726, he had understood it at the time and taken it seriously. He had known that his deals fell fairly and squarely within the category of MTIC goods. He had discussed that with the VAT consultant to both Megtian and the appellant, who had explained to him exactly how MTIC fraud worked. He averred that he had asked Redhill to verify the VAT details for every single deal every time that he traded. He had also performed Europa checks on some of the deals. He understood that Europa and Redhill offer different quality of service and a different type of information. He conceded that Redhill offered a better quality of information since it had the ability to confirm whether the number corresponded to the other details held in regard to the company whereas Europa could only confirm whether or not a particular number was valid.

233.As we indicate above Mr Andreou had extensive contact with HMRC in the years before these deals and considerable exposure to education about MTIC fraud.

234.It is common ground that in contra-trading cases it is for HMRC to prove that there is a connection between the appellant's "clean" transaction chains and the "dirty" chains containing the defaulting traders and the fraudulent evasion of VAT. The necessary connection between a broker's deals and the tax losses in a contra-

trader's chains is the question of fact and that is established simply by the tracing of the trader's deals to a contra-trader. That is the case in this instance.

235.HMRC are not required to prove that the appellant knew the identity of any of the other parties in any overall fraudulent scheme.

236.There is nothing before us to show that the appellant was aware of the actual tax losses when it entered into its transactions which were traced to those losses and we so find.

237.Undoubtedly there is no direct evidence as to knowledge and in fact rarely would there be any such direct evidence. It is inevitable that direct evidence of the appellant's knowledge is almost never, if ever going to be available. Nevertheless the combination of individual factors made together can give rise to a clear inference that the appellant had, or ought to have had, knowledge of a connection with fraud.

238.Since it was argued for the appellant that Mr Andreou's credibility lay at the heart of this appeal the very minimal evidence produced by Mr Andreou caused us considerable problems. In cross examination he repeatedly stated that he could not remember or he did not know salient matters.

239.Latterly in the hearing when explaining why he had produced very little evidence Mr Andreou, referring to the proceedings before the First-tier Tribunal and presumably the Upper Tribunal and Court of Appeal, stated:

> "I have actually been through a lot in the my life in the last years, so, you know, I am putting myself through something twice, not once, for being accused of something I haven't done, and knowledge of something that I don't know, so I wouldn't be putting myself through it once if I have done something wrong, let alone coming back for the second time so I wasn't going to go through everything I went for (sic) through the first time, the second time as well."

He has been professionally advised throughout and that is his choice.

240.Nevertheless, the paucity of the evidence adduced by Mr Andreou was surprising. Undoubtedly the legal burden rests on HMRC to prove that the transactions were connected with fraud and that the appellant knew or ought to have known. However, the decision in *Megtian* should be particularly well known to the appellant and we agree entirely with Judge Barlow at paragraph 48 of that decision where he states:

> "The legal burden of proof does not alter throughout the proceedings. However, the evidential burden shifts. Once a party has produced enough evidence to satisfy the legal burden the other party is obliged, not because of any rule of law but in order to succeed in the appeal, to produce evidence to refute the other party's case so far as possible."

241. It is plain, indeed we regard the evidence as overwhelming, that before and during the period concerned in the appeal the appellant in the form of Mr Andreou knew that there was fraud in the wholesale mobile phone industry, and that the fraud involved an importer defaulting on its VAT liability on selling the phones to another UK trader. He also knew that MTIC fraud was fed by the sale of phones in a chain of

transactions within the UK and by the export by brokers such as the appellant. He was further aware of the possibility that their purchases could be connected to a fraud committed by a trader who was the appellant's immediate supplier. He had been repeatedly informed that MTIC fraud was widespread and involved very large sums of money.

Conclusions

242.Given that the appellant was aware of the serious impact of MTIC fraud the appellant should have been under a duty to mitigate the risk of entering into transactions tainted by such fraud. It could reasonably be expected to conduct commercial checks on its business partners whether suppliers or customers. Indeed the VAT Notice 726, section 8 suggests a number of potential checks. That is explicitly not mandatory or comprehensive.

243.We are simply unable to accept his claim that he believed that his counter-parties in deals were doing their own due diligence. That completely ignores all the advice offered in Notice 726. In any event Notice 726 is a guide and is not prescriptive.

244.As far as the appellant's due diligence is concerned we have set out our reservations thereanent at more length above. However, a major thrust of the argument for the appellant was that Mr Andreou was expecting HMRC to "verify the line" and effectively police his deal chain. He tried to argue that on more than one occasion HMRC had said to him that they were unable to trace the whole chain thereby suggesting that they were making checks. It was explicitly put to him that that was extremely unlikely to have ever happened because HMRC could not possibly go and check the deal chain because they had no means of knowledge and accordingly his recollection of events could not be correct. He insisted that he was correct. We disagree. We also disagree because we simply cannot see that HMRC could possibly, or would, have verified these deals. The fax to Redhill was only sent to HMRC on 20 July 2006 and the deals done the same day.

245.Furthermore, given that by the time the appellant embarked upon these deals Mr Andreou would have been aware of the tax losses in the deal chains for Megtian, he must have known that HMRC was in no position to "check the line". Lastly the Redhill letter makes it explicit that confirmation of the VAT registration number is not an authorisation for the commercial transaction.

246.The whole purpose of carrying out commercial checks is to make sure that a potential supplier or customer is credible and will be able to meet their obligations in high value transactions.

247.Even if it were reasonable to ship the goods on hold, it should have been a matter of importance to Mr Andreou to know that his supplier was financially sound and in turn had title to the goods. Title would only be obtained by payment or obtaining credit for the goods to the value of the transaction. That begs the question the

appellant did not make more extensive enquiries about Shelford as to whether or not it was able to obtain credit or make payments without having first been paid itself.

248.In our judgment Mr Andreou should reasonably have asked what the phones were doing in the UK, why there was a market for them in Europe and why they had European two-pin chargers. He was aware that all of those matters raised questions requiring answers but completely ignored them. There was no likely explanation for the goods having been imported into the UK other than that they were to be exported. We find that Mr Andreou must have known that that was the case.

249.It seems obvious to us that if a trader was contacted first by a customer, as Mr Andreou suggested, there would be a delay between obtaining the order and finding someone able to supply the precise quantities and specifications of goods required by the customer. The fact that no such delay occurred in any of the three transactions with the requirements being instantly matched in every single case, in our judgment, indicates that these deals were artificially contrived.

250.When one considers that the product descriptions on the invoices and purchase orders issued by the appellant and other traders in the chains were generic, identifying only the model and handset it is extraordinary that the documentation does not distinguish further by reference to frequency, network configuration, warranty type, colour, required accessories, software, and language etc. Nothing is specified either in the purchase order from the appellant's customer or elsewhere in any document which sets out the particular requirements for each transaction.

251.We were surprised to discover that notwithstanding the magnitude of the contracts in these deals, in fact there were no written terms and conditions of purchase of sale, even in a basic standard form. In normal commerce that would be remarkable. One would reasonably have expected there to have been such terms and conditions of sale. The absence of contractual documentation indicates to us that the appellant did not trade on terms which protected them in the event of a dispute with either suppliers or customers. It further indicates, and we find by inference, that the appellant's contracts were not genuine, but rather were contrived.

252.HMRC argued that the appellant had added no value to the phones and that that therefore was an objective factor showing knowledge of fraud

253.It was argued for Mr Andreou that when he has bought and sold menswear he did not add value. The simple fact is that, in that context, he has bought the goods wholesale and is then selling the menswear in a retail shop. That is quite different. In the case of the deals with which we are concerned, in what he described as a crowded and competitive market, he knows that he is purchasing the goods from a UK wholesaler and he is selling to yet another wholesaler without in any way differentiating or adding value to the goods.

254.Mr Andreou suggested that he had added value to the goods in that he had insured them and arranged for inspection and shipping. We do not agree that that adds value. Those are simply incidental expenses in the nature of the trade and would

be incurred by any trader. On the evidence provided there is little evidence that the additional overheads incurred by the appellant in exporting the goods accounted for more than a relatively small proportion of the mark-up.

255.We therefore find it extraordinary that the gross profit for Optronix in deals 1 and 2 was £3,750, for Shelford £2,500 and yet for the same telephones for the appellant £80,000. The comparison is less marked in deal 3 where the appellant makes a gross profit of £50,000 with Optronix and Shelford making a gross profit of £2,000. In what was described as a very competitive market that is extremely unlikely, particularly where Shelford, through Shelford IT, had a trading relationship with LPDC and could have made the profits itself.

256.For the reasons set out above, we agree with HMRC that at the time of the deals in July 2006 the appellant should have been aware that A1 were not providing credible inspection reports. At the very least, in the absence of photos from AFI, and the conflicting inspection report from LPDC some action should have been taken.

257. Further whilst it is true that Officer Quinn wrote to Megtian on 19 July 2006 informing it that ten of its transaction chains involved tax losses (and one of them involved LPDC), we accept that that letter would not have been received by 20 July 2006. However, it would have been received shortly thereafter. It is surprising that no action was taken in regard thereto particularly as by the time the appellant embarked on its three deals in July 2006 it would have received the letter to Megtian dated 22 June 2006 stating that 11 out of Megtian's April deals had involved a tax loss and ten out of the 15 May deals. Again that included a deal involving LPDC. Lastly, notwithstanding the warning that Megtian's deal chains had involved massive tax losses in a situation where A1 had allegedly managed full inspections of more than 20,000 phones in one day, the appellant appeared to be unconcerned that A1 was now required to inspect 9,000 phones in part of one afternoon.

258.Officer Quinn was able to identify the fact that all 9,000 phones transacted in by the appellant passed through a minimum of five traders from three countries namely Austria, UK and France on 20 July 2006 and each trader made a profit on the sale. Each one of the five different traders operating on the same day must have had to contact each other, agree terms and conditions, arrange for transport and release of goods, conduct stock inspections and organise insurance in the space of that day. That seems inherently unlikely.

259.We accept that the appellant may not have been aware of the circularity of the money flows in the transaction chains. However, for the payment patterns revealed by the analysis of Officer Camm to have been maintained, the appellant must have been involved in the chains: the appellant must have been told when to expect to receive payment from their customers and when to make payment to their suppliers. That points to actual knowledge of a connection with fraud.

260.In summary the appellant exported goods to a very substantial value without having made payment or given any security for payment. He was able to release the goods to LPDC without having first made payment to his supplier. We agree with

HMRC that the lack of the appellant's title to goods that it released to customers coupled with Mr Andreou's apparent lack of concern as to who in fact had title at any given point in time is compelling evidence that Mr Andreou knew that the appellant was being drawn into transactions involving the evasion of VAT. Even if he did not know then at the very least it should have put any reasonable businessman on notice that he was not involved in legitimate trade.

261. There are other more minor adminicles of evidence. Since all of the goods were being sold to a French company it does not make immediate sense that some of the phones had no French software and according to the purchaser the manuals were only in English. It makes even less sense that according to the appellant some of the phones were apparently for the Norwegian market. The lack of any manufacturers, retailers, end-users or authorised distributors is in our view also indicative of a series of contrived transactions.

262. There is much in the factual context which, in our view, should have alerted any prudent businessman to the possibility that there was a likelihood of fraud. The appellant's profit margins are simply "too good to be true" in the context of the market on that day.

263. We agreed with and had regard to the comments of Judge Bishopp in *Calltel Telecom Ltd v HMRC*[14]*:*

> *"(52)…it is, we think, possible that a trader could have the means of knowing that, by his participation, he is assisting a fraud. Much will depend on the facts, but an obvious example might be the offer of an easy purchase and sale generating a conspicuously generous profit for no evident reason. A trader receiving such an offer would be well advised to ask why it had been made; if he did not he would be likely to fail the test set out at paragraph 51 of the judgment in* Kittel*".*

264. For the reasons set out above, we rejected the appellant's tacit submission that it was an innocent dupe in the scheme and in the absence of any alternative reasonable explanation for the appellant's involvement we were wholly satisfied that the appellant, through Mr Andreou, had the knowledge and, at the very least, the means to conclude that its transactions were connected to fraud.

265. For the avoidance of doubt, we confirm that we found that some reasons carried more weight than others and we did not base our decision solely on one reason but rather the cumulative effect of our findings viewed in totality. We have specifically weighed in the balance facts which were known, could have been known, and/or were available to the appellant in July 2006 had proper and timeous enquiries been made.

266. We did not focus unduly on the issue of due diligence, and we took into account all of the surrounding circumstances in reaching our decision that the appellant knew that all three of its transactions were part of an artificial scheme. In doing so, we concluded that the appellant, through Mr Andreou, had actual knowledge that the transactions were connected to fraud and that, by its purchases, it was taking part in

[14] [2007] UKVAT V20266

transactions connected with the fraudulent evasion of VAT. We were also satisfied that the factors identified above would also support a finding of means of knowledge.

Decision

267.HMRC has proved that the appellant's means of knowledge was such that the transactions fell outside the scope of the right to deduct input tax. Accordingly we found that the decision of HMRC to deny the appellant's input tax was correct and is upheld.

Costs

268.Both parties sought costs if they had won and both accepted that this was a case where costs could and should be awarded. Essentially, this was because it was an old case started before the cost position was changed. This appeal was allocated as Complex and neither party opted out of the costs regime.

269.We see no reason here why costs should not follow the event, as is usually the case, and we therefore direct that the appellant is to pay HMRC the costs of, incidental to and consequent upon the appeal, to be the subject of detailed assessment if not agreed.

270.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.

ANNE SCOTT
TRIBUNAL JUDGE
RELEASE DATE: 9 December 2015

APPENDIX 1

The Appellant's initial grounds of appeal

(a) The Commissioners failed to properly state the relevant law in making the decision under appeal.

(b) Construing the *Bond House Systems Ltd and Others* decision properly, it is clear that a taxable person's right to deduct input VAT cannot be affected unless—

(i) another transaction in the chain of supply is vitiated by VAT fraud, and

(ii) the taxable person knew or had means of knowing that the other transaction was so vitiated.

(c) The interpretation of the law provided by the Commissioners is unsustainable.

(d) In expressing themselves to be satisfied that those "transactions formed part of an overall scheme to defraud the Revenue" the Commissioners had applied the wrong test and come to a decision that was wrong in fact and law .

(e) If the Commissioners had applied the correct test they ought to have—

(i) identified one or more transactions in each relevant chain of supply that is said to have been vitiated by VAT fraud, and

(ii) pleaded their case with proper particularity, as to how it is said that the appellant knew, or had the means to know, at the time it entered into its own purchase and sale transactions in the chain in question that any transactions were vitiated by fraud, and

(iii) had the Commissioners applied the proper tests it is denied that they are able to plead any case against the appellant.

(f) The Commissioners have stated that a tax loss has occurred via a "contra trader" without explanation of that term or giving detail about how it is connected to the transaction undertaken by the appellant.

(g) The sums disallowed are input tax within the meanings of sections 24 to 26 VAT Act 1994 (VATA) and the appellant enjoys a right to deduct the claimed input tax credits provided for in Article 17 *et seq* of the EC Sixth VAT Directive 77/388/EEC and VATA must be construed purposively.

(h) The decision to disallow the claimed input tax credited is in breach of the fundamental principles of EC law, namely proportionality, legal certainty, fiscal neutrality and/or fundamental principles of Human Rights laws.

APPENDIX 2

Commentary and Extracts from Case Law

1. We have quoted paragraphs 58, 59 and 60 in paragraph in the body of the decision as they were specifically endorsed by Lady Arden in *Fonecomp*. She referred to, but did not quote in full, paragraphs 56 and 61 which are included in the following paragraphs upon which we rely from the Decision of the Court of Appeal in *Mobilx* which read:

"(41) In Kittel … after para 55 the court developed its established principles in relation to fraudulent evasion. It extended the principle, that the objective criteria are not met where tax is evaded, beyond evasion by the taxable person himself to the position of those who knew or should have known that by their purchase they were taking part in a transaction connected with fraudulent evasion of VAT … It extended the category of participants who fall outwith the objective criteria to those who knew or should have known of the connection between their purchase and fraudulent evasion. Kittel did represent a development of the law because it enlarged the category of participants to those who themselves had no intention of committing fraud but who, by virtue of the fact that they knew or should have known that the transaction was connected with fraud, were to be treated as participants. Once such traders were treated as participants their transactions did not meet the objective criteria determining the scope of the right to deduct.

(43) …A taxable person who knows or should have known that the transaction which he is undertaking is connected with fraudulent evasion of VAT is to be regarded as a participant and fails to meet the objective criteria which determine the scope of the right to deduct.

(51)…The court must have intended Kittel to be a development of the principle in Optigen… The court must have intended the phrase 'knew or should have known'… to have the same meaning as the phrase 'knowing or having any means of knowing' which it used in Optigen.

(52) If a taxpayer has the means at his disposal of knowing that by his purchase he is participating in a transaction connected with fraudulent evasion of VAT he loses his right to deduct, not as a penalty for negligence, but because the objective criteria for the scope of that right are not met. It profits nothing to contend that, in domestic law, complicity in fraud denotes a more culpable state of mind than careless, in the light of the principle in Kittel. A trader who fails to deploy means of knowledge available to him does not satisfy the objective criteria which must be met before his right to deduct arises.

(54) It must be remembered that the approach of the court in Kittel was to enlarge the category of participants. A trader who should have known that he was running the risks that by his purchase he might be taking part in a transaction connected with fraudulent evasion of VAT, cannot be regarded as a participant in that fraud. The highest it could be put is that he was running the risk that he might be a participant. That is not the approach of the court in Kittel, nor is the language it used. In those circumstances, I am of the view that it must be established that the trader knew or should have known that by his purchase he was taking part in such a transaction, as the Chancellor concluded in his judgment in BSG:-

> 'The relevant knowledge is that BSG ought to have known by its purchases it was participating in transactions which were connected with the fraudulent evasion of VAT; that such transactions might be so connected is not enough.'

(61) Such an approach does not infringe the principle of legal certainty … A trader who decides to participate in a transaction connected to fraudulent evasion, despite knowledge of that connection, is making an informed choice; he knows where he stands and knows before he enters into the transaction that if found out, he will not be entitled to deduct input tax. The extension of that principle to a taxable

person who has the means of knowledge but chooses not to deploy it, similarly, does not infringe that principle. If he has the means of knowledge available and chooses not to deploy it he knows that, if found out, he will not be entitled to deduct. If he chooses to ignore obvious inferences from the facts and circumstances in which he has been trading, he will not be entitled to deduct.

(62) The principle of legal certainty provides no warrant for restricting the connection, which must be established, to a fraudulent evasion which immediately precedes a trader's purchase. If the circumstances of that purchase are such that a person knows or should know that his purchase is or will be connected with fraudulent evasion, it cannot matter a jot that that evasion precedes or follows that purchase. That trader's knowledge brings him within the category of participant. He is a participant whatever the stage at which the evasion occurs.

(81) …It is plain that if HMRC wishes to assert that a trader's state of knowledge was such that his purchase is outwith the scope of the right to deduct it must prove that assertion.

(82) But that is far from saying that the surrounding circumstances cannot establish sufficient knowledge to treat the trader as a participant. As I indicated in relation to the BSG appeal, tribunals should not unduly focus on the question whether a trader has acted with due diligence. Even if a trader has asked appropriate questions, he is not entitled to ignore the circumstances in which his transactions take place if the only reasonable explanation for them is that his transactions have been or will be connected to fraud. The danger in focusing on the question of due diligence is that it may deflect a Tribunal from asking the essential question posed in Kittel, namely, whether the trader should have known that by his purchase he was taking part in a transaction connected with fraudulent evasion of VAT. The circumstances may well establish that he was."

These principles should be applied and in the light of the circumstances prevailing at the date of the transaction.

2. We also adopt the dicta of Lewison J in *HMRC v Livewire Telecom Ltd & HMRC v Olympia Technology Ltd* [15]*:*

> "(76 (viii)) It is not contrary to Community law to require a supplier to take every step that could reasonably be required of him to satisfy himself that the transaction which he is effecting does not result in his participation in tax evasion
>
> (ix) Likewise a taxable person can be expected to act with all due diligence and care."

3. We should also add that, in relation to the issue whether a trader's transactions were connected to the fraudulent evasion of VAT, Roth J held in *Powa (Jersey) Ltd v HMRC*[16] that it was not necessary that the trader was in privity of contract with a fraudulent trader. Instead, if a trader knows or should have known that the transactions which it entered into were part of a chain in which one or more of the earlier transactions were fraudulent, even if its immediate supplier was not fraudulent, the *Kittel* test is satisfied.

4. In *Megtian Limited v HMRC*[17] Briggs LJ made it explicit that:

(38) Similarly, I consider that there are likely to be many cases in which facts about the transaction

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[15] [2009] EWCH 15

[16] [2012 UKUT 50 (TCC)

[17] [2010] EWCH 18

known to the broker are sufficient to enable it to be said that the broker ought to have known that his transaction was connected with a tax fraud, without it having to be, or even being possible for it to be, demonstrated precisely which aspects of a sophisticated multifaceted fraud he would have discovered, had he made reasonable enquiries. In my judgment, sophisticated frauds in the real world are not invariably susceptible, as a matter of law, been carved up into self-contained boxes even though on the facts of particular cases, including Livewire, that may be an appropriate basis for analysis."

5. We also note the comments of Moses LJ in *Mobilx* in relation to questions of evidence, where he said:

"(83) The questions posed in BSG …by the tribunal were important questions which may often need to be asked in relation to the issue of the trader's state of knowledge. I can do no better than repeat the words of Christopher Clarke J in Red 12 Trading Ltd v Revenue and Customs…at [109]–[111]:

'[109] Examining individual transactions on their merits does not, however, require them to be regarded in isolation without regard to their attendant circumstances and context. Nor does it require the tribunal to ignore compelling similarities between one transaction and another or preclude the drawing of inferences, where appropriate, from a pattern of transactions of which the individual transaction in question forms part, as to its true nature e.g. that it is part of a fraudulent scheme. The character of an individual transaction may be discerned from material other than the bare facts of the transaction itself, including circumstantial and 'similar fact' evidence. That is not to alter its character by reference to earlier or later transactions but to discern it.

[110] To look only at the purchase in respect of which input tax was sought to be deducted would be wholly artificial. A sale of 1,000 mobile phones may be entirely regular, or entirely regular so far as the taxpayer is (or ought to be) aware. If so, the fact that there is fraud somewhere else in the chain cannot disentitle the taxpayer to a return of input tax. The same transaction may be viewed differently if it is the fourth in line of a chain of transactions all of which have identical percentage mark ups, made by a trader who has practically no capital as part of a huge and unexplained turnover with no left over stock, and mirrored by over 40 other similar chains in all of which the taxpayer has participated and in each of which there has been a defaulting trader. A tribunal could legitimately think it unlikely that the fact that all 46 of the transactions in issue can be traced to tax losses to HMRC is a result of innocent coincidence. Similarly, three suspicious involvements may pale into insignificance if the trader has been obviously honest in thousands.

[111] Further in determining what it was that the taxpayer knew or ought to have known the tribunal is entitled to look at the totality of the deals effected by the taxpayer (and their characteristics), and at what the taxpayer did or omitted to do, and what it could have done, together with the surrounding circumstances in respect of all of them."

6. Those questions posed in BSG as quoted by Moses LJ are:

"(1) Why was BSG, a relatively small company with comparatively little history of dealing in mobile phones, approached with offers to buy and sell very substantial quantities of such phones?

(2) How likely in ordinary commercial circumstances would it be for a company in BSG's position to be requested to supply large quantities of particular types of mobile phone and to be able to find without difficulty a supplier able to provide exactly that type and quantity of phone?

(3) Was infinity already making supplies direct to other EC countries? If so, he could have asked why Infinity was not making supplies direct, rather than selling to UK traders who in turn would sell to such other countries.

(4) Why are various people encouraging BSG to become involved in these transactions? What benefit might they be deriving by persuading BSG to do so? Why should they be inviting BSG to join in when they could do so instead and take the profit for themselves?"

We consider those questions to be pertinent in this appeal when assessing the question of knowledge.

8. Dealing with other businesses – How to ensure the integrity of your supply chain

8.1 Checks you can undertake to help ensure the integrity of your supply chain

The following are examples of checks you may wish to undertake to help establish the integrity of your supply chain.

(1) Undertaking reasonable commercial checks to consider the legitimacy of customers or suppliers. For example:

- What is the supplier's history in the trade?
- Are the normal commercial arrangements in place for the financing of the goods?
- Are the goods adequately insured?
- What recourse is there if the goods are not as described?

(2) Undertaking reasonable checks to ensure the commercial viability of the transaction. For example:

- Is there a market for this type of goods – such as superseded or outdated mobile phone models?
- Is it commercially viable for the price of the goods to increase within the short duration of the supply chain?
- Have normal commercial practices been adopted in negotiating prices?
- Is there a commercial reason for any third party payments?

(3) Undertaking reasonable checks to ensure the goods will be as described by your supplier. For example:

- Do the goods exist?
- Have they been previously supplied to you?
- Are they in good condition and not damaged?

We recommend that sufficient checks be carried out in each of the above categories to ensure that you are not caught in a fraudulent supply chain.

8.2 Checks carried out by existing businesses

The following are examples of specific checks carried out by existing businesses. These may also help you to decide what checks you should carry out, but this list is not exhaustive and you should decide what checks you need to carry out before dealing with a supplier or customer.

- obtain copies of Certificates of Incorporation and VAT registration certificates;
- verify VAT registration details with Customs and Excise;
- obtain letters of introduction on headed paper;
- obtain some form of trade reference, either written or verbal;
- obtain credit checks or other background checks from an independent third party;
- insist on personal contact with a senior officer of the prospective supplier, making an initial visit to their premises whenever possible;
- obtain the prospective supplier's bank details, to check whether:

  (a) payments would be made to a third party; and

  (b) that in the case of import, the supplier and their bank shared the same country of residence.

- check details provided against other sources, eg website, letterheads, BT landline records.

Paperwork in addition to invoices may be received in relation to the supplies you purchase and sell. We believe that this documentation should be kept as evidence of a transaction's legitimacy. The following are examples of additional paperwork that some businesses retain:

- purchase orders;
- pro-forma invoices;
- delivery notes;
- CMRs (Convention Merchandises Routiers) or airway bills;
- Allocation notification;
- Inspection reports.

Again this is not an exhaustive list, but does show some of the more common subsidiary documentation.