[2016] UKFTT 0449 (TC)

TC05202

Appeal number: LON/2007/1652

VALUE ADDED TAX – input tax – denials of right to deduct on grounds that the Appellant knew or should have known that the transactions were part of fraud – alleged MTIC – whether shown that the Appellant's transactions connected with fraudulent evasion of VAT – yes – whether Appellant knew or should have known of fraud – yes – valid refusals of right to deduct – appeal dismissed – assignment of appeal where assessment made – whether valid – no – appeal relating to 03/06 period struck out

FIRST-TIER TRIBUNAL
TAX CHAMBER

LEEDS SMITH CONSULTING LIMITED **Appellants**

- and -

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

TRIBUNAL: JUDGE JENNIFER BLEWITT
MR ALBAN HOLDEN

Sitting in public at Manchester on 8, 9, 10, 15, 16, 17, 18, 19, 23, 24, 25, 26 September 2014 and 13 April 2015.

Mr Stuart Wright, Director of Leeds Smith Consulting Ltd, for the Appellant

Mr Christopher Foulkes, Counsel instructed by HM Revenue and Customs, for the Respondents

DECISION

Introduction

1. This is an appeal by Leeds Smith Consulting Limited ("LSC") against the decisions of HMRC to deny input tax in the sums of £767,025 and £1,367,100 incurred by the Appellant in its VAT periods 03/06 and 06/06 respectively.

2. The decision in relation to period 06/06 was notified to the Appellant by letter dated 5 September 2007. The decision in respect of period 03/06 was notified by letter dated 9 December 2008. In respect of period 03/06, as the claim had already been paid by HMRC an assessment was raised against the Appellant.

3. HMRC's primary case, as set out in its Statement of Case, is that the relevant transactions carried out by the Appellant in the periods 03/06 and 06/06 were connected to the fraudulent evasion of VAT and that the Appellant, through its director Mr Stuart Wright, knew of that connection. Alternatively HMRC contend that the Appellant should have known that these transactions were connected to MTIC fraud.

Missing Trader Intra-Community Fraud: Legislation and Case law

4. The legislation governing the right to deduct is contained within Sections 24 – 26 of the Value Added Tax Act 1994 and the VAT Regulations 1995 (SI 1995/2518). If a trader has incurred input tax which is properly allowable, he is entitled to set it against his output tax liability or to receive a repayment if the input tax credit due to him exceeds that liability. Evidence is required in support of a claim (Article 18 of the Sixth Directive and regulation 29 (2) of the VAT Regulations 1995).

5. Missing Trader Intra-Community Fraud (hereafter referred to as "MTIC fraud") was described by Roth J in *POWA (Jersey) Ltd v HMRC* [2012] UKUT 50 (TCC) as follows:

> *"[1] This is yet a further case of so-called missing trader or "MTIC" fraud on the system of VAT. The decision of the First-tier Tribunal ("FTT") conveniently describes the nature of a typical MTIC fraud as follows:*
>
> *"5 … goods (almost always small but valuable items such as mobile phones and computer chips) are acquired by a registered trader in the United Kingdom from a trader in another member State, and sold to a second UK-registered trader. The goods then usually change hands several times within the UK before they are sold to an overseas trader which, if it is located in a member State of the European Union, is registered for VAT in that member State. Commonly the transactions all occur within a few days of the entry of the goods into the UK, sometimes even on the same day, so that goods enter the UK in the morning, pass through the hands of several UK traders during the day, and are exported again in the afternoon.*

6. The first UK vendor, the acquirer from overseas, charges VAT on the consideration paid by his purchaser, but fails to account to the respondent Commissioners for that tax, and disappears. Such documentation as he may have had—if any—relating to his acquisition is never produced to the Commissioners. For the scheme to work he must be a VAT-registered trader who provides the purchaser with a genuine VAT invoice, on the strength of which the purchaser claims an input tax credit. The purchaser's own sale, and those of the other UK traders save the last in the sequence, usually generate a small profit and, consequently, a small net VAT liability, for which those traders account. The last trader, selling overseas, claims credit for the input tax he has incurred, but has no output tax liability since the sale is zero-rated. Usually this trader makes a significant profit, though that is not invariably the case; occasionally one of the antecedent traders can be shown to have made the greatest profit of all those in the chain. All of these sales and purchases, including the sale to the overseas buyer, are almost always properly documented.

[2] In the jargon that has developed to describe the various participants in such chains, the initial importer of the goods who fails to account for the output tax he has charged to his purchaser and disappears, is known as the "defaulter" or "missing trader." The trader at the end of the UK chain who sells the goods to a purchaser overseas is known as a "broker". The traders between the defaulter and broker are referred to as "buffers". In the present case, it is alleged that PJL was a broker.

[3] There are various variations and developments of this typical scheme of MTIC fraud. One of these, of which three of the transactions in the present case are said to be an example, comprises what is called "contra-trading". I again gratefully adopt the description given by the FTT:

"9 A contra-trader, a broker in one chain of transactions—again adopting the commonly used jargon, a "dirty" chain—in which a default has occurred, buys goods from a supplier in another member State, and sells them to a UK customer; after one or more further sales and purchases they are sold to a customer in another member State. The contra-trader and, usually, all the other traders in this chain account correctly for their VAT liabilities; taken by itself it is a "clean" chain. The acquirer in the clean chain has incurred a liability for output tax which (because the values are engineered to achieve this result) matches the input tax credit due to him (or ostensibly due to him) as the broker in the dirty chain. He does not need to make a large repayment claim, attracting the Commissioners' attention, but instead makes a modest payment, or a minimal repayment claim. The same result may be achieved by undertaking a number of transactions generating an aggregate input tax credit matching the broker's output tax liability for the relevant accounting period. It is then the broker in the clean chain who has an input tax claim which, unless they can establish a link between the clean and dirty chains, the Commissioners must meet since the goods in the clean chain have not themselves been used for fraudulent purposes.""

6. *Kittel v Belgium, Belgium v Recolta Recycling* SPRL (C-439/04 and C-440/04) [2006] ECR 1-6161 *("Kittel")* provided the legal basis for the denial of the right to deduct in certain circumstances:

> *"55. Where the tax authorities find that the right to deduct has been exercised fraudulently, they are permitted to claim repayment of the deducted sums retroactively … It is a matter for the national court to refuse to allow the right to deduct where it is established, on the basis of objective evidence, that that right is being relied on for fraudulent ends...*
>
> *56. In the same way, a taxable person who knew or should have known that, by his purchase, he was taking part in a transaction connected with fraudulent evasion of VAT must, for the purposes of the Sixth Directive, be regarded as a participant in that fraud, irrespective of whether or not he profited by the resale of the goods.*
>
> *57. That is because in such a situation the taxable person aids the perpetrators of the fraud and becomes their accomplice.*
>
> *58. In addition, such an interpretation, by making it more difficult to carry out fraudulent transactions, is apt to prevent them.*
>
> *59. Therefore, it is for the referring court to refuse entitlement to the right to deduct where it is ascertained, having regard to objective factors, that the taxable person knew or should have known that, by his purchase, he was participating in a transaction connected with fraudulent evasion of VAT, and to do so even where the transaction in question meets the objective criteria which form the basis of the concepts of 'supply of goods effected by a taxable person acting as such' and 'economic activity'.*
>
> *60. It follows from the foregoing that the answer to the questions must be that where a recipient of a supply of goods is a taxable person who did not and could not know that the transaction concerned was connected with a fraud committed by the seller, Article 17 of the Sixth Directive must be interpreted as meaning that it precludes a rule of national law under which the fact that the contract of sale is void – by reason of a civil law provision which renders that contract incurably void as contrary to public policy for unlawful basis of the contract attributable to the seller – causes that taxable person to lose the right to deduct the VAT he has paid. It is irrelevant in this respect whether the fact that the contract is void is due to fraudulent evasion of VAT or to other fraud.*
>
> *61. By contrast, where it is ascertained, having regard to objective factors, that the supply is to a taxable person who knew or should have known that, by his purchase, he was participating in a transaction connected with fraudulent evasion of VAT, it is for the national court to refuse that taxable person entitlement to the right to deduct."*

7. *Mobilx Ltd and The Commissioners for Her Majesty's Revenue and Customs, The Commissioners for Her Majesty's Revenue and Customs and Blue Sphere Global*

Ltd, Calltel Telecom Ltd & another and The Commissioners for Her Majesty's Revenue and Customs [2010] EWCA Civ 517 ("*Mobilx*") Moses LJ clarified at [24] and [30]:

> *"The scope of VAT is identified in Art. 2 of the Sixth Directive. It applies, in addition to importation, to the supply of goods or services effected for consideration within the territory of the country by a taxable person acting as such. A taxable person is defined in Art. 4.1 as a person who carries out any of the economic activities specified in Art. 4.2. Art. 5 defines the supply of goods and Art. 6 the supply of services. The scope of VAT, the transactions to which it applies and the persons liable to the tax are all defined according to objective criteria of uniform application. The application of those objective criteria are essential to achieve:-*
> *"the objectives of the common system of VAT of ensuring legal certainty and facilitating the measures necessary for the application of VAT by having regard, save in exceptional circumstances, to the objective character of the transaction concerned." (Kittel para 42, citing BLP Group* [1995] ECR1/983 para 24.)
>
> *…the Court made clear that the reason why fraud vitiates a transaction is not because it makes the transaction unlawful but rather because where a person commits fraud he will not be able to establish that the objective criteria which determine the scope of VAT and the right to deduct have been met."*

8. As to the issue of connection, in *Blue Sphere Global Ltd and The Commissioners for HM Revenue and Customs* [2009] EWHC 1150 (Ch) the Chancellor stated (at paragraphs 42 – 45):

> *"…The nature of any particular necessary connection depends on its context, for example electrical, familial, physical or logical. The relevant context in this case is the scheme for charging and recovering VAT in the member states of the EU. The process of off-setting inputs against outputs in a particular period and accounting for the difference to the relevant revenue authority can connect two or more transactions or chains of transaction in which there is one common party whether or not the commodity sold is the same. If there is a connection in that sense it matters not which transaction or chain came first. Such a connection is entirely consistent with the dicta in Optigen and Kittel because such connection does not alter the nature of the individual transactions. Nor does it offend against any principle of legal certainty, fiscal neutrality, proportionality or freedom of movement because, by itself, it has no effect."*

9. As to the issue of knowledge, Moses LJ in *Mobilx* said:

> *"4. Two essential questions arise: firstly, what the ECJ meant by "should have known" and secondly, as to the extent of the knowledge which it must be established that the taxpayer had or ought to have had: is it sufficient that the taxpayer knew or should have known that it was more likely than not that his*

purchase was connected to fraud or must it be established that he knew or should have known that the transactions in which he was involved were connected to fraud?

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 carelessness, 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…

53. Perhaps of greater weight is the challenge based, in Mobilx and BSG, on HMRC's denial of the right to deduct on the grounds that the trader knew or should have known that it was more likely than not that transactions were connected to fraud. The question arises in those appeals as to whether that is sufficient or whether, as the Chancellor concluded in BSG, the right to deduct input tax may only be denied where the trader knows or should have known that the transaction was connected to fraud (see judgment, § 52). In short, does a trader lose his entitlement to deduct if he knew or should have known of a risk that his transaction was connected to fraudulent evasion of VAT? HMRC contends that the right to deduct may be denied if the trader merely knew or should have known that it was more likely than not that by his purchase he was participating in such a transaction. It contends that if it was necessary to show more than appreciation of a risk then the Court's decision in Kittel would not represent a development of the law and would fail to achieve the objective, recognized in the Sixth Directive, to which the Court referred at § 54…

56. 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 risk 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 it 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 a fraudulent evasion of VAT; that such transactions might be so connected is not enough." (§ 52)…

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 determine the scope of the right to deduct. The court preserved the principle of legal certainty; 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 if 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."

10. In *Red12 v HMRC* [2009] EWHC 2563 at [109] – [111] Christopher Clarke J said:

"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.

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 telephones 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.

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."

11. We had regard to Briggs J in *Megtian Limited (in administration) v HMRC* [2010] EWHC 18 (Ch) at [34], [37] and [38]:

"I do not read Lewison J's analysis of the issue as to what must be shown that the broker knew or ought to have known in a contra-trading case as amounting to a rigid prescription that, as a matter of law, such an analysis must be performed in every contra-trading case, such that it will be defective unless it identifies one or other of the alternative frauds as being that which the broker knew or ought to have known…

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.

Similarly, I consider that there are likely to be many cases in which facts about the transaction 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 inquiries. In my judgment, sophisticated frauds in the real world are not invariably susceptible, as a matter of law, to being carved up into self-contained boxes even though, on the facts of particular cases, including Livewire, that may be an appropriate basis for analysis."

12. The burden of proof in this type of case rests with HMRC; per Moses LJ in *Mobilx* (paragraph 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."

Issues

13. The issues to be determined in relation to the denial of input tax are:

(a) Was there a tax loss;

(b) If so, did this loss result from a fraudulent evasion;

(c) If so, were the Appellant's transactions which are the subject of appeal connected with that fraudulent evasion; and

(d) If so, did the Appellant know or should it have known that its transactions were so connected.

14. All four limbs were in issue. We should note that the Appellant referred to the four limb test as a mistranslation of *Kittel*. We did not accept that submission; the law to apply to appeals of this type is well known and in determining the issues we have applied the principles set out in the authorities referred to above and which were comprehensively summarised by Moses LJ in *Mobilx*.

Undisputed Background Facts

15. The Appellant was incorporated on 24 April 2003. Mr Stuart Barry Wright was and remained the sole director throughout the company's operation.

16. The VAT 1 submitted by Mr Wright on 30 August 2005 confirmed the company's business as the "supply of mobile phones and related products and services". The value of taxable supplies over the following 12 months was estimated as £13,200,000 with purchases from and sales to EC Member States.

17. The Appellant was registered for VAT with effect from 23 August 2005. The Appellant submitted a monthly return for period 03/06 on 21 April 2006 which made a repayment claim of £769,037.73. Thereafter the Appellant was placed on quarterly returns. The 03/06 claim was paid by HMRC without prejudice on or about 18 May 2006. On 5 July 2006 the 06/06 return was received which contained a repayment claim in the sum of £1,370,345.84. By letter dated 27 July 2006 the Appellant was notified of HMRC's decision to undertake verification of the relevant transactions in period 06/06. As a result of HMRC's decision to deny the 06/06 claim the 03/06 period was made the subject of an extended verification.

Transactions

18. In period 03/06 the Appellant entered into 2 purchase transactions involving mobile phones from JOS (UK) Limited ("JOS") which it sold on in a single sales transaction to PhoneTrade Aps in Denmark.

19. In Period 06/06 the Appellant entered into 3 purchase transactions involving mobile phones from JOS which it sold one in a single transaction to PhoneTrade Aps.

20. HMRC officer Norman Tuddenham was allocated the Appellant's case on 22 June 2006. Mr Tuddenham set out his tracing exercise in respect of the Appellant's transaction chains. The chain in period 03/06 was traced as follows:

United Traders (Portugal) – West 1 Facilities Management Limited – All Name Products Ltd – JOS (UK) Ltd – Appellant – PhoneTrade Aps (Denmark).

21. Mr Tuddenham noted that the goods, a total of 9000 Nokia 8800s, were sold on 30 March 2006 on two separate invoices by United Traders, West 1 Facilities Management Limited ("West 1"), All Name Products Ltd and JOS (UK) Ltd. The Appellant sold the goods together on a single invoice to PhoneTrade Aps.

22. Prior to the Appellant's acquisition of the goods, the parties in the chain added £0.25 to the purchase price for each handset giving each party a total profit of £2,250 on the transaction. The Appellant made £86 per phone reaching a profit before expenses on the whole transaction of £774,000.

23. The chain in period 06/06 was traced as follows:

United Traders (Portugal) – West 1 Facilities Management Limited – International Investment Services UK Limited – JOS (UK) Ltd – Appellant – PhoneTrade Aps (Denmark).

24. Mr Tuddenham noted that the goods, a total of 10,000 silver Nokia 8800s and 6,000 black Nokia 8800s, were sold on 31 May 2006 on three separate invoices by United Traders, West 1 Facilities Management Limited ("West 1"), International Investment Services UK Limited and JOS (UK) Ltd; two invoices for the silver phones and one invoice for the black phones The Appellant sold the goods together on a single invoice to PhoneTrade Aps who in turn sold the goods to Hunzie Electronics IDA, registered in Portugal.

25. The Appellant made a profit of £53 per phone on the black phones and £47.50 per phone on the silver phones which would have yielded a total margin of £793,000 on the transaction in comparison with the profit of £4,000 made by each of the traders earlier in the transaction chain.

26. In cross-examination Mr Tuddenham explained that the Appellant's repayment for period 03/06 was initially paid without any investigation into the period. He was asked about the tracing exercise he had undertaken:

"Q…the 03/06 deal…you have highlighted in the centre the invoice number, so you've identified the invoices from the transaction chain…

A. Yes

Q. Then also indicated the quantities, price points, net value and VAT

A. Yes…

Q. So there are a significant number of Nokia 8800s being sold from West 1 Facilities Management to All Name Products

A. Yes

Q. And that's just highlighting transactions from 27 March to 31 March

A. Yes

Q. Now, you may or may not be surprised to know that that total is 103,000 phones

A. Mm-hm

Q. So why did you choose four from the bottom or five from the bottom, invoice number 306 and 307?

A. Well, the first choice – I'm aware that there were some other deals. The first choice is that these are the ones that would have been given to Officer Lam…as those deals in question…

Q. …You could have picked line 159 and line 160, which actually gives 9,000 pieces, which is the number that Leeds Smith sold…

A….the deals that you sold, the date of the deals – was it 39 March?

Q. Correct

A. They were back-to-back deals where the goods came in and then you sold the goods and they were all at the same time…those ones were selected because they happened on the day you did your deal…I know the deals were done back-to-back and I know that Leeds Smith Consulting purchased on the same day and sold them on the same day. These are sales listings, these are the sales that West 1 made on those days. These ones here, the 28th and 29th…are the sales they made on the 28th and 29th, not on the 30th…

Q…you've taken a view that the transaction Leeds Smith took place in, these are the invoices that relate to, where in reality it could actually be different phones which also have different prices…You made an assumption

A. No. Well, in a sense one always does, but the deal for 06/06 on that day, that was a deal that we discussed...That's a deal we did discuss. My understanding of the deal, as we were discussing it, was that the goods had been offered for sale that day, so they would have been invoiced to you that day. The goods had only come into the UK on that day and left on that day

Q. Who gave you that assumption?

A. Who did? I believe you did, you were talking about back-to-back deals…I'm looking through the invoices I've got to match those criteria…I used all the

information I gathered both from the traders involved and that paperwork that I had to allocate the right – or to allocate the right officers to the right transactions…The West 1 ones, they are – they sold an awful lot of phones and they've been allocated to particular transactions. However all these telephones came from the same United Traders"

(Transcript 15 September 2014 pages 36, 46, 50, 61, 64 & 66)

27. Mr Tuddenham explained that the information he had gathered from his visit to the Appellant indicated that the invoices issued to the Appellant were issued on the day that the deal was conducted. Mr Tuddenham concluded that he had used the correct invoices to trace the deals in question and even if it were possible that two other invoices may relate to the deals, they were traced back through to West 1 and United Traders.

28. In re-examination Mr Tuddenham clarified that he had the purchase and sales listings for All Name Products and International Investment Services which confirmed his view that his allocation of goods and tracing exercise was accurate. Mr Tuddenham had looked at all of the purchases and sales around the date of the deals in question and was satisfied that his evidence accurately reflected the transactions. He added that the evidence of Mr Cole regarding payments further strengthened his view that the tracing was correct.

West 1

29. It was the case for HMRC that West 1 was a fraudulent defaulting trader. HMRC officer Fu Sang Lam gave evidence regarding West 1. Mr Lam explained that West 1's sales invoices dates 31 May 2006 create a default by the company's failure to submit a VAT return for the transactions carried out between 1 April 2006 and 21 June 2006 and in the absence of which an assessment was raised.

30. West 1 is a private limited company incorporated on 7 March 2000 under the name of Computer Solutions Direct Ltd ("Computer Solutions"). It changed its name to West 1 on 6 April 2001. The company was registered for VAT on 20 August 2000; the main business activity was described on the VAT 1 as "providing computer and software solutions and services". Mr Ryan David Foley was appointed as director on 26 February 2006 and company secretary on 10 February 2006. Mr Foley is also the principal shareholder. Prior to Mr Foley's appointment Mr Michael Owen McGrath was director from 27 January 2004 to 1 March 2006. Mr Lam noted that historically West 1 either submitted returns showing small net payments due to HMRC or small repayments due from HMRC. The net value of outputs declared increased significantly from £4,800 in VAT period 09/05 to £61,883,305 in VAT period 12/05 and £372,943,012 in 03/06.

31. HMRC had regular contact with the company. At visits on 1 February 2006 and 9 February 2006 Mr McGrath confirmed that the company did not carry out any inspections of the goods traded nor did they insure the goods. On 17 February 2006 the company was notified that deals it had undertaken had been traced back to tax

losses exceeding £1,500,000. A similar letter was sent on 24 March 2006 informing the company that all of its 38 transactions in January 2006 had been traced to fraudulent tax losses exceeding £12,500,000. In August 2007 HMRC notified West 1 that tax losses had been found in its transactions undertaken in 03/06 and 06/06.

32. In June 2006 West 1 was de-registered due to its failure to provide any evidence of making taxable supplies and failing to comply with a Regulation 25 Notice. In July 2006 sales and purchase invoices were provided which showed that West 1 had made more sales than declared on the 03/06 return and it had made EU acquisitions which were not declared on the return. HMRC adjusted the VAT return for 03/06 accordingly which had the effect of changing the declared repayment claim submitted into a large payment return with the net tax due to HMRC being £48,931,156.12, Mr Foley did not contact HMRC until October 2006 when he requested a duplicate return for period 06/06. To date this return remains outstanding. At a meeting with HMRC in November 2006 Mr Foley said he had purchased the company for £20,000 from Mr McGrath which was for the contacts Mr McGrath had made. He was offered stock to purchase which he then sold on, although he could not give the name of his contact at United Traders. His previous employment had been as an HGV driver though an agency, although he could not recall the name of the agency. Mr Foley provided some records for deals carried out in April, May and June 2006 and stated that he had carried out no transactions since June 2006. Mr Foley stated he thought he knew what acquisition tax was but no one had explained it to him. Further business records were requested, including evidence of export and import, VAT workings and a list of suppliers and customers.

33. Analysis of records provided for 03/06 showed West 1 acted as an acquirer, buffer and broker trader. There was also a distinct pattern of transactions with the standard rated transactions at 53.91% and zero-rated at 46.38% which was consistent with contra-trading. The declaration made by West 1 in May 2006 that net sales were £372,943,012 and net purchases were £372,383,712 was found to be inaccurate; net sales were £691,753,311 and net purchases were £681,377,476.

34. Analysis of the records for 06/06 revealed similar patterns of trading. On 18 October 2006 HMRC raised an assessment of £60,729,310 for output tax on sales not declared by West 1. Further assessments were raised in December 2006, August 2007 and December 2007. In October 2007 HMRC notified West 1 of its decision to deny input tax in respect of supplies of phone cards to the EU in 03/06 and computer chips to the EU in 06/06 on the basis that HMRC was not satisfied that the supplies actually took place.

35. On 7 September 2009 The Insolvency Service notified HMRC that Mr Foley had been disqualified as acting as a director on 17 February 2009 for a period of 13 years. The schedule of unfit conduct to the disqualification undertaking sets out the matters of unfitness as knowingly causing West 1 to undertake a method of trading which involved it in and put HMRC at risk of being subject to MTIC VAT fraud between 3 April 2006 and 21 June 2006, or being reckless or grossly negligent as to whether West 1 was concerned in such a fraud. To date the total value of unpaid VAT on identified transactions by West 1 amounts to £126,090,716.99.

36. In cross examination Mr Lam confirmed that Mr Foley had made contact with HMRC in November 2006. He explained that the company had already been de-registered by that point and there had been no contact with Mr Foley for a period of four months. Mr Lam confirmed that a visit report from a meeting with Mr Foley on 8 November 2006 suggested that Mr Foley did not have a significant level of knowledge about the industry or his VAT obligations.

37. Mr Lam clarified that the assessments raised against West 1 for periods 03/06 and 06/06 were the result of HMRC's decisions to disallow input tax on the basis that HMRC was not satisfied that the supplies had taken place. In re-examination explained:

"Q. Then your evidence…just so we can understand it, is that an assessment arose in due course because the view was taken, following verification in respect of this company, that the input tax side of it, the repayment claim element that balanced the acquisition, were in fact supplies that didn't take place…

A. Yes…and in relation to acquisition deals West 1 should have declared acquisition tax, and they didn't do that…so an assessment was raised…and the amount of acquisition tax is almost kind of equal to the input tax claim in relation to those deals that they purchased from the two suppliers, the UK supplier ACF and Lodgeway. So it's kind of trying to offset. But in fact we disallowed it on 31 October 2007, those UK deals.

Q. Because you took the view the supplies did not take place?

A. That's right."

(Transcript 10 September 2014 page 89)

38. The decision letter was issued to Mr Foley on 31 October 2007 and he did not appeal it. Mr Lam stated that HMRC initially treated West 1 as a contra trader and in 2008 it was deemed a defaulter. Mr Lam explained that assessments had been raised in respect of VAT due although there were periods which could not be assessed as HMRC was out of time; irrespective of whether an assessment was raised, the unpaid VAT represented a default by the company. Mr Lam did not look into the company's trading activities in the years prior to Mr Foley's appointment as director and therefore could not comment as to whether there were any anomalies in the returns submitted.

Findings on whether the tax loss was fraudulent and whether the Appellant's transactions connected with fraudulent VAT losses?

39. We began by considering the evidence relating to the tracing of the transaction chains in both periods undertaken by Mr Tuddenham. We were satisfied that the tracing was accurate; Mr Tuddenham had matched the goods, dates and quantities to invoices in HMRC's possession. As regards the date of the transaction, we were left in no doubt that the date on the invoices was correctly treated as the date the transactions took place; the sales and purchase listings and monthly deal logs of the

relevant traders corroborated the tracing exercise by HMRC and we were satisfied that those deals were correctly identified as the chains in which the Appellant featured and that the correct mobile phones were identified as those purchased and sold by traders in the chains. We found that the possible alternatives were limited and did not match the dates or quantities such as to undermine HMRC's tracing exercise. That the deals took place on a back-to-back basis was a fact that was confirmed by information given by the Appellant to HMRC in respect of period 06/06 and was confirmed by the evidence of Mr Cole in respect of payments which further corroborated the tracing of payments and participants in the chains.

40. As to whether West 1 was a fraudulent defaulter, we considered the authorities to which we were referred by both parties which showed that differently constituted panels in this Tribunal have reached different conclusions. However we are not bound by the authorities to which we were referred and we have reached our own conclusion on the evidence before us. We were wholly satisfied that West 1 had defaulted; tax due remains unpaid and the assessments raised by HMRC have not been challenged. As to whether the defaults were fraudulent, West 1 failed to keep proper records, failed to provide HMRC with information requested and failed to account for its acquisition deals in its return for 03/06. The director Mr Foley was an HGV driver with no previous experience in the industry yet the company reached what was, on any view, a substantial level of trade and turnover in a short time, the increase in turnover in less than 9 months increasing by over 1,000,000%. There was no contact from the company for a number of months and a large number of the company's transactions which were investigated were traced to tax losses and fraudulent traders. We were satisfied that the deals were artificially contrived and, in the absence of any explanation for the many features of its trading which did not in our view reflect legitimate and commercial business, we concluded that the nature of the company's trading was indicative of fraud.

Did the Appellant know, or should it have known that the transactions in this appeal were connected to fraud?

41. The evidence in the case was substantial; the following is intended as a summary of the features highlighted by the parties.

The Appellant's Awareness of MTIC fraud

42. Mr Tuddenham outlined the contact between HMRC and the Appellant during which the nature and extent of MTIC fraud had been discussed. He noted that an HMRC visit report dated 17 November 2005 from a pre-registration visit two days earlier recorded Mr Wright as stating that he had de-registered earlier in the year to protect his company from hijack. The visiting HMRC officer recorded that *"Mr Wright was previously registered and trading in mobile phones, came out when J&S [Joint and Several] provisions introduced and main customer Carphone Warehouse came out of business."* Mr Wright had also been provided with HMRC guidance such as Public Notice 726 and Public Notice 700/52.

43. Mr Wright explained that the Appellant traded in this period under the name of Phonetrade UK. He started in the mobile phone industry in 1983, prior to the start of the current Cellular telephone networks. Mr Wright was initially employed as a Business Development Manager selling "BT Radiophones" and "Securicor" Interconnect phones. In the past 29 years Mr Wright has held senior positions with a number of key mobile phone businesses in the UK, including Vodafone JV business, official Voadafone and Cellnet Network Service Providers. He has negotiated significant wholesale supply agreements with Nokia, Motorola and Siemens and understands the nature and make up of supply chain contracts, marketing support, retro and pricing in detail. In the early 1990s Mr Wright owned a business that became one of the first in the UK to export large quantities of Motorola phones to Hong Kong telecom. He imported tens of thousands of mobile phones into the UK from France and Spain and developed an export business for over supply stock back into Hong Kong and China.

44. Mr Wright set up the Appellant in early 2002 after leaving First Mobile Group which had successfully floated on the Hong Kong stock market with share options. It was initially set up as a telecoms business consultancy offering supply expertise to the Telecom Industry. Mr Wright explained that the Appellant quickly developed into a trading business in early 2002. He ran the business from separate ground floor offices at his home address. The business was later joined by another wholly owned business, Phonetrade UK Ltd in order to ring fence the Appellant's relationship with Carphone Warehouse. Mr Wright had contacts in the industry, one of whom was Mr Charles Dunstone, the CEO and founder of Carphone Warehouse and a number of his senior managers. In cross-examination Mr Wright explained:

"A…It developed from a standing start. The quantities I dealt with initially from Carphone Warehouse were relatively small, maybe a thousand a week. That then built up over the two or three years I was trading with them.

Q. Just so we understand the different entities that you controlled, there was Leeds Smith initially, a sole trader, set up with a VAT registration number?

A. Yes

Q. You also, is this right, set up Leeds Smith Consulting Ltd in 2003, and that took over the VAT registration that had been you trading as Leeds Smith Consulting?

A. It's the same business, it was just incorporated.

Q…We also know about PhoneTrade UK Ltd…That was an incorporated company that also got a VAT registration number?

A. Correct

Q. What was the purpose of that, just help us so we understand the difference?

A. When I first started trading or when I was approved by Carphone Warehouse, there was an approvals procedure for companies to be authorised suppliers to

Carphone Warehouse, and it went through their legal team and their credit control department, so the decision wasn't based on approval of Leeds Smith Consulting as a business by the contacts I had, it was approved by their legal department – that was based on the initial set-up of the business, which was basically me trading as.

In terms of changing that going forward, Carphone Warehouse weren't comfortable with a new entity because they weren't taking new suppliers on, so in terms of changing the entity from a trading house to a limited company, it would have presented a problem for their legal team at the time. So I ring-fenced the Carphone Warehouse business with the Leeds Smith Consulting trading as, which they later agreed to it being incorporated, and then decided to trade outside Carphone Warehouse with a separate business entity, which was PhoneTrade UK, which also became the trading style in terms of the name of the business going forward, whether it was Carphone Warehouse or any other supplier…

Q. But as far as trading is concerned, your position is that in fact it was the name PhoneTrade that you used?

A. Effectively, it was one business with two entities"

(Transcript 24 September 2014 page 10 -13)

45. At a visit to the Appellant on 26 January 2006 it was noted by HMRC that Mr Wright understood the risks in his trade sector and a discussion took place as to the prevalence of VAT fraud in the industry.

46. After the Bond House decision Mr Wright explained that he decided in 2005 to re-enter the market and concentrate on the export market with higher margins. The UK to UK trade was effected by a large number of participants who were happy to work on smaller margins of between 25p and 50p per box.

47. Mr Wright's written evidence explained that he was aware of fraud within the industry and how important it was to trade with genuine businesses and that there were fraudulent elements that would look to target the supplier end of the chain. He subsequently stated in his witness statement:

"I am aware of Missing Trader Inter Community fraud in my industry. However I am not 'fully aware of its nature and extent' which would indicate a detailed expert knowledge and a level of knowledge that only officers with HMRC would be aware. I am sure the fraud takes many numerous, complicated and varied forms and is well outside my level of knowledge…I did not have a high degree of awareness of MTIC fraud as the term is a recent one of many HMRC fraud terms."

48. In cross-examination Mr Wright stated:

"I was aware that there was fraud within the industry. I'd had visits from HMRC at various entities I'd been involved with.

Q. Right. So help us. When were you first made aware of what we now know as MTIC fraud…

A. The mobile press had a lot of information ongoing on a regular basis. I suppose in terms of a direct…

Q. Direct or indirect, when did you first learn about these people ruining your industry?

A. Probably some time in the 90s."

(Transcript 24 September 2014 page 14)

49. Mr Tuddenham also highlighted the fact that Mr Wright had been involved in the mobile phone business since 1983 with a company which was a mobile phone wholesaler buying and selling in the UK. Mr Wright was a member of the Federation of Technological Industries ("FTI"), an organisation which represents many traders in the mobile phone and computer chips industry. The Appellant's sales invoices issued for the relevant transactions also stated under "Conditions of Trade":

"Phonetrade UK makes reasonable checks to avoid VAT fraud and expects its suppliers and customers to do the same."

50. Mr Tuddenham highlighted the Appellant's application for an FCIB account which included a document entitled "Special VAT Certification" which was completed and signed by Mr Wright on 13 January 2006 and in which a number of statements had been certified, including the following:

"131.3 We will undertake reasonable commercial checks to: (a) consider the legitimacy of customers and suppliers; (b) ensure the commercial validity of the transactions and (c) ensure the goods will be as described by our supplier.

131.5 That we are not aware of and have no reasonable grounds to suspect that some or all of the VAT payable in respect of the supply to us, or by us, of telephones (and related parts and accessories) or computers (and related parts, accessories and software) has or will go unpaid.

131.7 That we have taken and will continue to take…steps…

131.7.1 To insure integrity of our suppliers - …

131.7.1.1 Determine the suppliers' history in the trade

131.7.1.2 Determine if normal commercial arrangements are in place for the financing of the goods

131.7.1.3 Determine if the goods are adequately insured

131.7.1.4 Determine if there is adequate recourse if the goods are not as described

131.7.2 To insure the commercial viability of the transactions we –

131.7.2.1 Determine if there is a market for this type of goods…

131.7.2.2 Determine if normal commercial practices have been adopted in negotiating prices for the goods

131.7.2.3 Determine whether there is a commercial reason for any third party payments

131.7.3 To insure that the goods we are purchasing/selling do exist and will be as described by the supplier we –

131.7.3.1 Take reasonable steps to insure that the goods do exist

131.7.3.2 Determine whether the goods are of a type previously supplied to us

131.7.3.3 Determine whether the goods are in good condition and not damaged"

51. Mr Tuddenham noted that Mr Wright had been involved in other companies through which he would have acquired an awareness of MTIC fraud. Prior to setting up the Appellant Mr Wright was the director of Leeds Smith Consulting, Westrade and Phonetrade (UK) Ltd.

52. Phonetrade (UK) Ltd was VAT registered from 1 May 2002 to 1 July 2004 and generated a turnover of approximately £151,000,000 per annum buying and selling mobile phones from and to other UK based traders. There were five visits to the company by HMRC at which the issue of fraud within the industry was discussed.

53. Leeds Smith Consulting was a business which traded in mobile phones. It was a sole proprietorship which was registered for VAT in 1 April 2002 and de-registered on 31 October 2004. There were three visits to the company by HMRC at which MTIC fraud was discussed. On 15 April 2003 the business was sent Budget Notices 14/03, 15/03 and 17/03. Budget Notice 14/03 details the extension of security powers if a business represents a direct risk to the collection of VAT, Budget Notice 15/03 advises of how HMRC intended to tackle some VAT fraud through new joint and several liability provisions and Budget Notice 17/03 explains how a business requires a higher standard of evidence to be entitled to an input tax deduction. On 10 April 2003 Mr Wright telephoned HMRC to ask if there was a definitive list of checks that should be carried out in light of Budget Notice 15/03; he was advised that there was no such list.

54. Mr Wright explained that the Appellant was incorporated in 2003 with the same VRN and he developed a brand name in the UK as Phonetrade UK with a separate VRN as the public face of the business.

Commercial Checks

55. Mr Tuddenham noted that at the pre-registration visit to the Appellant Mr Wright told HMRC officers that he would only deal with traders he had dealt with before. Mr Wright kept a file of records comprising the due diligence undertaken and which he provided to Mr Tuddenham.

56. Mr Wright set out in his witness statement that he was aware of the importance of checking the bona fides of trading partners. He personally visited suppliers and customers to support his due diligence and added to it as the business developed. In cross-examination he explained:

"The focus would have been on the customer and the supplier and making sure that they were genuine entities.

Q. Right. Did you not want to know more about how it worked, this fraud?

A. The fraud? Not particularly, it's not something I was involved in.

Q. But if you're in a genuine business and a genuine industry making a healthy living, whether for yourself or for your company, and you learn that a fraud has entered into the market that's particularly targeted at, amongst others, your goods, type of goods that you trade, isn't that something that you want to be very anxious to understand so that you can avoid it?

A. You work on the premise that the deals you conduct are genuine unless information comes back to you to suggest it's not. None of the businesses I ever worked for or supplied goods to or from ever gave any feedback that there was an issue with those transaction chains, even up to the point that I was trading in 2006. So whilst you may have an awareness of what's happening in the marketplace, unless there's any information that suggests that transactions you were involved with included some element of fraud, you assume what you did was correct.

(Transcript 24 September 2014 page 16)

57. Mr Wright emphasised that the trade he had undertaken with Carphone Warehouse had not been linked to fraud. He stated:

"I was aware of the checks that HMRC required and I was in regular contact with HMRC and the process and legal team at Carphone warehouse in terms of being compliant and being aware of what checks needed to be placed. I wasn't particularly interested in how the fraud worked, other than whether it worked any differently than a trader not paying his VAT…I was aware that HMRC had given a couple of names to the fraud that was going on. One was circularity, another was non-economic trade. The current one is obviously means of knowledge.

Q. And presumably you were aware of the action taken by the Commissioners in respect of non-economic activity, trying to deny where they found circularity?

A. Yes

Q. How did you learn about that?

A. Trade press…

Q. No one at Carphone Warehouse indicated that there were any difficulties in those transactions?...

A. No. The feedback we got on a monthly basis – and HMRC did line checks on those transactions – was there were no missing traders in the chains in the transactions I dealt with…after the event there were some issues at Carphone Warehouse with some of their trades…

Q. Did it not have a major impact on the way you approached your transactions and your trading that someone of the nature of Carphone Warehouse had been caught up in MTIC fraud, or so it seemed?

A. Well, based on the fact that Mr Naghibossadat had been arrested and Mr Geoffreys had been arrested, it transpired it was unfounded. They'd been arrested, they were released and they weren't charged. I think Mr Naghibossadat's case went to court and didn't start, it was thrown out…

Q. Did you not learn that there were deals that gave rise to that arrest that traced back to fraud?

A. at the time, no…

Q. Did you not take steps to find out as to what on earth was going on with Carphone Warehouse, bearing in mind that you were supplying them in the same way as those who had apparently led back to defaulting traders?

A. I discussed with Mr Naghibossadat and Mr Geoffreys after the event what surrounded the transactions. Whilst they suggested there were a number of transactions, they didn't highlight from which supplier they came from. I don't believe any of those transactions related to Leeds Smith's transactions and it proved that the allegations against both gentlemen were unfounded. It was a big story in the press at the time and it seemed at face value to be a publicity stunt"

(Transcript 24 September 2014 page 21, 24 & 25)

"Q. Can you assist us as to how it is that CPW were telling you that Customs were singling out checks in relation to your transactions but plainly hadn't been singling out other transactions because they traced to fraud?

A. I assume they were checking all the transactions. Some of the visit reports from Mr Staniforth in 2002 were from particular requests, which included Carphone Warehouse transactions.

Q. You also appreciate, don't you, that if something is done on a monthly basis…then one is not necessarily going to be able to determine whether there is a fraudulent

defaulter in a transaction chain because fraudulent defaulters take time to default. One doesn't know until one gets to the end of their VAT period and they don't submit a return, or they disappear, or they submit a fraudulent return, one simply doesn't know, does one, so…

A. Not in every case

Q. So it's a limited check?

A. But over a period of time I would have thought it would then go back…I don't know how HMRC conducted their checks with Carphone."

(Transcript 25 September 2014 page 30)

58. Mr Wright went on to say that the feedback he received from Carphone Warehouse at the end of each month on line checks conducted by HMRC, none of which had indicated missing traders at the end of the Appellant's supply chains.

59. Mr Wright explained that the Bond House decision and his discussions with traders up to 2005 gave him the impression that traders believed *"the arena was safer to come back into"* (transcript 24 September 2014 page 44). Mr Wright went on to say that he did not believe the issues were any different as they had been in previous years although *"I was aware I would probably need to ramp up the due diligence that we took up…because Customs were obviously spending more time in terms of looking at the transactions that took place"* (transcript 24 September 2014 page 48). Mr Wright stated that his due diligence was not carried out simply for the benefit of HMRC *"but there was some factor within that that was for the benefit of Customs. Customs put an undue onus on traders to do ever increasing numbers or parts of due diligence…I was prepared to do anything HMRC wanted me to do"* (transcript 24 September 2014 page 51).

<u>Jos (UK) Ltd</u>

60. Mr Wright had visited Jos at its principal place of business. The offices were rented and a trade reference from the landlord indicated that Jos also rented furniture. A visit report provided by Mr Wright was dated 30 march 2006 which is the date of the Appellant's first deal with Jos; Mr Tuddenham highlighted that it was unclear whether the visit report was completed on that date or whether that was the date of the visit. The report set out details of the company, documents seen and the home address of one of the directors. A letter of introduction from Jos has a faxed date stamp of 29 March 2006. Bank details were obtained and Europa checks carried out on the company's VAT number on 30 March 2006 and 31 May 2006. Verification of the VAT number had also been requested via Redhill at 16:53 on 30 March 2006 however no response was received until 7 April 2006.

61. An Experian Limited Company Basic report and Directors and Secretary report formed part of the due diligence. Mr Tuddenham noted that no credit limit was registered and the registered address given for the company differed to that on the letter of introduction. On 29 June 2006 passport details of one of the directors, Mr

Ghattaura, were received; the date of birth was 1 year earlier than shown on the Experian report. In his written evidence Mr Wright stated that the passport was used to verify the director details and was checked against other information provided; the passport was correct and the company check document was a typo.

62. The Appellant produced a copy of Jos' VAT return for period 12/05. Mr Tuddenham noted that although it showed that Jos was trading at sufficient volume for the relevant transactions, despite a turnover of £23,000,000 only a very small payment of tax was made to HMRC which is indicative of a buffer trader and should have put the Appellant on notice. Other documents provided as part of the due diligence were: a copy of the company's letterhead, a photograph of the outside of the office, a copy office bill, certificate of incorporation and certificate of registration. These are all time dated on the fax header as being sent on 30 March 2006 at 18:03.

63. Mr Wright was asked about his visit to Jos in cross-examination:

"Q. Right. So you were content just to wait until you got a decent offer and then go on a visit; is that it?

A.Yes. If it looked like a transaction was going to happen, they were expecting the stock the next day, I'd found a customer who was prepared to buy the stock. At that point it was worth making a visit.

Q. It doesn't give you an awful lot of time to assess –

A. No, it doesn't…

Q…So you went on this visit on 30 March. What information did you have about Jos by the morning of 30 March?

A. I can't recall the exact information I had, but I had company details. I didn't announce the visit, I went there speculatively. They said the stock was coming in that day, so I turned up to make sure the company existed…

Q. So on the morning of the 30th, you're sat in Yorkshire saying Phonetrade Aps seem to be interested in some silver Nokia 8800s and these people that contacted me earlier in the month and faxed through some contact details, they appear to be offering them, I don't know much about them or indeed anything about them, but I'll jump in the car, get on the train, what did you do?

A. Car

Q. Got in the car and drove from West Yorkshire to Birmingham to visit Mr Ghattaura and Mr Caddick. As it happens, they were in?

A. Mr Caddick was. Mr Ghattuara wasn't.

Q. Right. You sat down with him, was he a bit surprised to see you or not?

A. He was

Q. Did that concern you?

A. No, because the whole idea of the visit was it was unannounced

Q. But did it concern you that he was happy to trade with you without visiting you?

A. I don't think I thought too much about that. I was concerned with my transaction and my visiting him…

Q. Where's the record of this hour long visit and discussion where you assessed his due diligence and knowledge of the market?

A. Here, the visit report…

Q. How does this help us with your discussion with him about his knowledge of the market and his due diligence?

A. The discussion with him about his due diligence and the market was for me, it was my understanding of what he did, it wasn't to evidence later on. I wanted to understand he knew what he was talking about in terms of the market place and that the company stacked up.

Q. So why did you need this one page then?

A. Just to reference that I'd made a visit…so it's in the file that I've done the visit""

(Transcript 26 September 2014 page 103 - 108)

64. Mr Wright stated that enough time was given to allow the deal to be checked and completed *"from initial conversations formalising the documents on 29th and the visit and checks on 30th with the concluding of the transaction late on the 30th"*. He added that the "*information received matched the previous information I had gathered from previous calls but the due diligence supplied on the 29th formalised the info."* He highlighted that Jos was not a missing trader and no due diligence could have avoided directly trading with a trader who intended to go missing at a later date.

65. HMRC officer Helen Marie Harris gave evidence regarding Jos which was registered for VAT with effect from 15 October 2004 and incorporated at Companies House on 6 October 2004 with Mr Satwinder Singh Ghattaura appointed as the sole director and Johns Smith as Company Secretary. Waybe Caddick took over as Company Secretary on 1 November 2004. The trading activities of the company at Companies House were described as "*wholesale of other household goods not elsewhere classified."*

66. Ms Harris described how the company's trading pattern changed over a period of time with only UK to UK sales being made in 2005 then during the period ending 31 March 2006 Jos made one EC supply amounting to £1,300,000 of a total £30,000,000

worth of net sales. In the period ending 30 June 2006 the total net sales amounted to £105,000,000 including £13,400,000 of EC sales. Acquisitions in that period amounted to £10,600,000.

67. Ms Harris clarified in oral evidence that Jos' return for period 06/06 was received on or about 2 August 2006. Examination of the records produced by the company officials indicated that it carried out 170 deals of which 10 were broker deals in June 2006, 148 were buffer deals in the three month period April to June 2006 and 12 were acquisition deals in June 2006. The records indicated that in period 06/06 the company was involved in contra trading. Verification of the chains of transactions identified tax losses in all 10 of the broker deals and the acquisition deals were not contained on the company's return. Tax losses were identified in 99 of the 148 buffer deals and the full deal chain in respect of some of the transactions remains unknown as records were not available.

68. Ms Harris highlighted the following features in support of the decision to deny the company's claim for input tax:

(a) No inspections of goods were arranged and IMEI numbers were not provided for the goods traded;

(b) No written contracts were entered into with customers or suppliers;

(c) Due diligence was deemed inadequate, for instance checks were carried out after the deal had taken place;

(d) The company had a history of making and continued to make 3rd party payments;

(e) The company did not make or receive payments in respect of its broker deals in January 2007 stating that it was due to the closure of its FCIB account and until other traders received their repayments from HMRC no payments could be made;

(f) The company made £1 per item on all broker deals regardless of the items and quantities of goods traded;

(g) Mr Ghattaura had links to other companies involved in the wholesale of electrical goods. One such company of which he was manager, AMS Abigails, which traded in the wholesale of mobile phones, went missing with a debt of £2,600,000.

69. In respect of the 10 broker deals input tax was disallowed and Jos advised by letter dated 7 December 2006.

Phonetrade APS (Denmark) ("Phonetrade")

70. Mr Tuddenham was advised by Mr Wright on 14 August 2006 that he already knew the director of Phonetrade, Henrik Sorenson from previous dealings and having met at a trade show in 2002. HMRC officer Jayne Wood who was Mr Tuddenham's manager between May 2006 and July 2007 was also present at the meeting. Ms Wood gave evidence in which she described the procedure within HMRC for extended verifications and decisions by the MTIC technical team in respect of denial of input

tax. Ms Wood also confirmed in her statement that she had no notes of the meeting on 14 August 2006.

71. Mr Wright explained that Mr Sorenson was known to him and they had spoken a number of times prior to the deals after meeting at a trade show in Frankfurt.

72. The documents forming the due diligence included a fax dated 15 March 2006 with a covering letter including bank details and Danish VAT registration number, membership details from the IPT website, a Europa check dated 30 March 2006 and a request to Redhill for verification of the VAT number dated 30 March 2006 although no reply was received until 7 April 2006.

73. An Experian check was made on the company and the Appellant produced an International report and the Limited Company Basic Report dated 29 March 2006 which showed a credit limit of 60,000 Danish Krone (approximately £6,000) although Mr Tuddeham accepted that no credit was given to the company by the Appellant.

74. Mr Wright visited the company in Denmark on 14 June 2006 which appeared from the visit report to be based at the director's home, although Mr Tuddenham noted that this is at odds with the supplier/customer checklist which under the "Home Address" section stated "No".

75. In cross examination Mr Wright was asked about the visit:

"Q. …You weren't concerned to visit your customer before you did deals with him?

A. No, I wasn't

Q. Any point in visiting afterwards?

A. Just to add to my due diligence files

Q. For what purpose, yours or Customs?

A. Both…

Q. But the point is this, isn't it, Mr Wright? Very simply, the time to work out whether this man is going to involve you in MTIC fraud or not is before you do the deals?

A. But how would a visit to his home address office give me any indication whether the transaction beforehand was MTIC fraud?

Q. Well, why bother going at all then?

A. Because I was looking to add to my due diligence files

Q. But if you took the view that it made absolutely no difference to your judgment on MTIC fraud, what's the point in flying to Denmark?

A. Because part of the discussions that traders were having is that you have to add more to your – know your customer. This is part of what I had to add

Q. So in other words this was done for Customs and not for you trying to avoid fraud?

A. In effect, I would have been happy to carry on trading with Henrik without the visit, so in essence the pictures and the visit confirmation added to my due diligence file, which is for the benefit of Customs."

(Transcript 26 September 2014 page 144 – 145)

76. Mr Wright disputed telling Mr Tuddenham at the meeting on 20 December 2006 that he had previously traded with Phonetrade Aps. In cross-examination of Mr Tuddenham, Mr Wright stated:

"Q…If I just confirm that there was no trade between Phonetrade and –

A. I wrote down – that was part of my note, it must have been part of some discussion, and I'd left the visit with the impression that there had been trade before…"

(Transcript 15 September 2014 page 116)

ASC Worldwide (freight forwarder)

77. Mr Tuddenham noted that the due diligence in respect of ASC demonstrated little more than the fact that it was a legal entity. He highlighted the value of the goods in the relevant transactions and the absence of any evidence to show discussions about issues such as shipping had taken place. Mr Tuddenham noted that insurance, storage and security are not mentioned nor is there any confirmation of inspection methods.

78. The documents provided by way of due diligence included the company's Certificate of Incorporation, VAT registration and an Experian Limited Company Basic Report. A Europa check had been carried out on the VAT number on 31 March 2006.

79. Mr Tuddenham queried why no steps had been taken to ascertain how ASC was going to carry out inspections of the goods. Had Mr Wright made further enquiries he would have discovered that ASC had no storage facilities but stored the goods at hauliers involved in the movement. The Appellant was satisfied on the basis of a faxed A4 inspection report despite the value of the goods exceeding £13,000,000. The Appellant was seemingly unaware that ASC sub-contracted their activities and therefore had no knowledge of how ASC appointed hauliers, where the goods were stored and how the goods were inspected.

80. Mr Wright stated that the choice of freight forwarder was the choice of Jos or its supplier; the main criteria is to confirm the legal entity. He noted that there was no requirement by HMRC to check the freight forwarder in 2002 – 2004 when the onus was on the supplier and customer. He stated that when dealing with ASC it had

explained that stock was inspected by an in-house arranged inspection company. The inspection was confirmed by phone and later by fax. Mr Wright relied on the fact that the checks on ASC were above and beyond those he had carried out in previous trades. In cross-examination Mr Wright stated:

"I'd worked on the premise that everything was genuine intil I saw an indication that it wasn't. How would I know that they were colluding together?

Q. Well, why don't you, for instance, start by taking very great care in looking into the freight forwarder that I think you haven't used before and the inspection agent that I think you haven't used before?

A. The inspection agent was appointed by ASC…I wasn't aware they were using a third party. It was an in-house inspection and I did checks on ASC in the time that was available to do those transactions

Q. What time was that?

A. A couple of hours

Q. Right. So seeking to avoid MTIC fraud, having no previous experience with this freight forwarder, rather than lose the deal you failed to do any substantial checks to see what this freight forwarder is about, what their practices are, whether they use their own inspection agents?

A. When I had a conversation with ASC when I first spoke to them, the gentleman I spoke to came across as being knowledgeable about the industry in terms of the products and what was involved in the inspection. Nothing he said alerted me to any issues with that freight forwarder. The pricing they were quoting was within what I'd paid previously, the ship and insure rates were in line with what I'd been quoted previously. I had no reason to suspect it was anything other than genuine."

(Transcript 25 September 2014 page 95)

81. Mr Wright explained that there is always an element of risk in anything you deal with and that as the March 2006 transaction had been carried out without any issues there was no reason to believe that the May 2006 deal would be any different. He stated that he had checked the existence of the company, which is more than he used to do in 2002 and 2003 and he believed this was enough.

<u>*Nature of trade*</u>

82. Mr Wright stated that he had no reason to suspect that the transactions were anything other than the purchase and sale of genuine stock in an open market; a trade in the manner and style that he had completed successfully over 570 times in the previous four years of trading.

83. Mr Wright advertised widely through the key trade press such as Mobile Magazine, Mobile News, GSM Exchange and IPT. Mr Wright explained that he knew

the product, the market and market prices which enabled him to negotiate and make deals. All goods were supplied only when paid for in full which excluded trade with certain UK customers who required credit. The trade in 2002 to 2004 was UK to UK where the acknowledged margin was 50p to £1 per box:

"Q. …Breaking that down, you made consistently, save in certain instances where you made much greater margins, and you put that down to holding stock, you had previously made consistently margins of either 50p or £1, or occasionally a bit more, but always multiples of 50p. Is that an accurate summary of your trading?

A. It was in that ballpark…

Q. That was the standard practice, you tell us. That's decidedly odd, isn't it? You're in a competitive market in 2002 and yet everybody agrees that the mark-up to add in this trade is either 50p or £1. What's going on there?

A. That was the norm in the industry

Q. What does that mean?

A. I don't know. That's what traders charged…

Q. So do we have three then in your multi-million pound turnover, three deals which aren't multiples of 50p?

A. the ones you've highlighted, yes

Q. I mean, that's bizarre, isn't it?

A. No. Why?

Q. Because if you are in a competitive market eking out the best margin you can, one would expect to see a whole range of price differentials, wouldn't one?

A. But there us a whole range of price differences

Q. But they're all multiples of 50p, except for three examples, which is 75p, 60p and I've forgotten the other one, forgive me

A. I don't see the issue…I always try to achieve the best margin I could get, coincidentally they were in multiples of 50p

Q. That's a plain indication that this market is not acting competitively and at arm's length, isn't it?

A. No…"

(Transcript 24 September 2014 page 88 & 93)

84. The introduction of joint and several liability brought about a suspension in the Appellant's trading in new stock as it did the Appellant's biggest customer Carphone Warehouse. Throughout that time Mr Wright kept in touch with key clients and fellow traders. He also received notification of an attempted hijack of one of his VAT registered businesses by a bogus trader and immediately called HMRC officer Mr Mendes to advise of this fact. Mr Wright later cancelled the VAT number to avoid a repeat.

85. Mr Tuddenham highlighted in cross-examination that he had seen no evidence of negotiations between the Appellant and its trading partners. He explained he had looked at different price points for phones but noted that there was no evidence of negotiation *"between yourselves and your customer"* (transcript 15 September 2014 page 115). Mr Wright stated that there was detailed negotiations on price by telephone on each occasion with the customer. The suppliers' price had limited negotiation in the deal as *"it was available at a price take it or leave it"*.

86. Mr Tuddenham also noted in cross-examination that:

"There was no loss in those deals that you did. There was no difficulty in setting up the case, it came up and it came up for sale on that day, it was managed to be sold in that day, all the handsets that had come up to the one trader."

(Transcript 14 September 2014 page 116)

87. It was put to Mr Tuddenham that the Appellant had historically made losses in 21 of its 571 deals undertaken between 2002 and 2006 totalling £113,664. Mr Tuddenham stated:

"I wouldn't say that you would necessarily always make a profit on every transaction you do. As for the losses, I don't know what context they were losses. I haven't gone through these records. It may well be losses on some phones to the same customer where he's made profits on other, I don't know. But I think that the ease of the transaction, the fact he was able to find a trader to buy the phones at the same amount for a good price on the same day from the same person is the thing that makes it –"

(Transcript 15 September 2014 page 117)

88. Mr Wright was cross-examined about the fact that he had not previously traded with either Jos or Phonetrade Aps. He agreed that he did not know the supplier but stated he had known of the customer for a number of years and that it existed:

"Q. It's a pretty big step for your first deal, isn't it, to act as an exporter after this period of time of caution?

A. No. It was a large transaction, it wasn't large in the scheme of transactions I'd completed previously.

Q. But it involves a repayment claim, which, acting as a UK/UK trader wouldn't have done, would it?

A. No, I was a net payer to HMRC each month

Q. Yes. So that was a pretty big step, you'd not done it before?

A. No, true.

Q. And you told us that you'd thought about doing it back in 2002, but it hadn't been possible, and your concern at that time had been MTIC fraud; is that right?

A. Mm-hm

Q. Here we are, I think we've agreed that you understood MTIC fraud had got worse, and your first step is to act as a repayment trader?

A. Yes

Q. It's a big step, I suggest

A. Yes

Q. Big risk if you're being careful and cautious about re-entering this market. And you add on to that the fact that they were people you'd never traded with.

A. I knew of the customer for a long time, I knew he had a trading history from the correspondence I'd received in error from warehouses in the UK. The supplier was a new supplier."

(Transcript 24 September 2014 page 85)

89. As to the lack of contracts, Mr Wright was asked:

"Q. Okay. You then go on to mention lack of contracts. Are you aware that the trading style of Leeds Smith had differed in any way, shape or form in the years it traded and that HMRC were aware of how Leeds Smith traded in the past in terms of insurance and contracts? It was never an issue before, but it seems to be highlighted now as an issue going forward.

A. Yes.

Q. Again, another situation of looking at the deal after the event.

A. There were no contracts in this, it was all arranged on the day, or there or thereabouts on the day. There was no contract, there were no discernable terms or no discernable thought of what happened if something went wrong."

(Transcript 15 September 2014 page 119)

90. Mr Wright agreed that his understanding was:

"…wherever the goods are, whether they be in Europe or Feltham, was that everybody essentially contracted with each other to sell the goods but nobody actually did the deal until the customer in Europe paid…

A. It's a chain of transactions that the release moves up following the payment…

Q. If you don't pay your supplier, you don't have either the control of the goods or the title?

A. No

Q. And your customer knew that, did he?

A. Everyone in the industry knows. That's how the industry works…

Q. In any genuine commercial transaction, I suggest, there are two transacting parties, one of whom has title to the goods and the other of whom either pays for those goods and then gets title or gets credit from the person they're buying from…and gets title. But that's not the position here. You have a whole sequence of companies or individuals, none of whom have title, all of whom are promising to hand over title and release the goods to their customer, a promise they can't necessarily keep because they haven't got title in the first place. It's just nonsense, isn't it?

A. That's how the industry operates

Q. again, that's the answer to everything, isn't it? 'That's how the industry operates'. The industry didn't make any sense if that's how the industry operated, I suggest. Does it?

A. It's an anomaly of the mobile phone industry with wholesale and grey market.

Q. An anomaly?

A. Compared to a market where maybe you're selling a caravan.

Q. I suggest it's more than an anomaly. It makes absolutely no sense whatsoever, Mr Wright, and no legitimate contracting party would be willing to enter into a transaction, knowing that its supplier didn't have title to the goods and may not get title to the goods.

A. But that's what happened."

(Transcript 25 September 2014 page 182 – 183)

91. Mr Wright relied on the fact that the Appellant had previously traded in the same manner and he contended the manner of trade and commercial checks were, if anything, more robust than had been in earlier years. He stated that he has never used

written contracts since the early 1990s and even then only in the form of Letters of Credit. Mr Tuddenham's response in cross-examination was as follows:

"The deals that Leeds Smith conducted before were like buffer deals where they were buying and selling quickly without – there wasn't any of the big repayments that there was in these last deals. To that extent the trade was different. And there wasn't a formal…contract that would detail these terms and conditions…what might happen if something went wrong or what was expected of other people."

(Transcript 15 September 2014 page 119)

92. Mr Wright contended that HMRC had approved his due diligence procedures. We heard evidence from HMRC officer Paul Staniforth who had contact with Mr Wright as a sole trader trading under the name Leeds Smith Consulting. Mr Staniforth confirmed that, contrary to Mr Wright's assertion, he had not checked the Appellant's due diligence nor authorised repayment of the 03/06 return as he was not a member of the relevant team at that time.

93. In cross-examination Mr Staniforth stated he could not recall whether he had traced all the chains of transactions of Leeds Smith Consulting in 2002 and early 2003 but stated that he had carried out verifications for that period and provided information to HMRC officers dealing with other traders in the chains of supply. Mr Staniforth exhibited a number of visit reports. One visit took place on 26 November 2002 and Mr Staniforth's notes forming part of the visit report recorded:

"…No insurance was needed as the goods remained in the warehouse and their insurance covered the stock held. I was also informed that no stock was ever returned…From the record of transaction the trader and declarations appears credible, however there seems to be none of the usual commercial practices in place, i.e. insurance, credit checks or any returns procedure."

94. In oral evidence Mr Staniforth clarified that:

"we're looking at the invoices received and issued and they matched the return submissions that had been put in…At that point in time there was no means of knowledge case to be submitted. It hadn't even been established at that point. We were primarily looking at the missing trader end of the transactions and trying to trace back to the missing trader and tackling those…At that point in time I don't think we were denying"

(Transcript 17 September 2014 page 21 & 25).

95. Mr Staniforth went on to explain that at the time of the visit on 3 October 2002:

"We were simply comparing the returns to the invoices that had been received, so the returns that had been submitted were credible, and at that point in time no deals had been traced back to a missing trader at that point, which is the time that report was written."

(Transcript 17 September 2014 page 27

96. Mr Wright explained that the commercial practices quoted by Mr Staniforth in 2002 are not required in back to back trading and that the Appellant, along with many legitimate traders, were still trading the same way in 2006 yet in 2006 these practices suddenly became an issue and indicator of fraud.

Wholesale Procedure document

97. At a visit to the Appellant by HMRC on 26 January 2006 Mr Wright provided HMRC officer Mr Waxman with a document entitled "Wholesale Procedures". The Appellant described the document to Mr Waxman as a comprehensive written guide to trading methods, although Mr Tuddenham noted that in a letter to HMRC dated 2 March 2007 Mr Wright described the document as an "*internal staff training document."* A revised copy was provided to Mr Tuddenham in December 2006.

98. Mr Wright explained that during 2005 he started to develop the document for his commercial bankers to give them more comfort after repeated requests from HMRC to close the accounts. He stated that it was also intended to be used for internal training as the business developed and grew. The versions (vi and viii) in HMRC's possession were not those used during the trading in periods 03/06 and 06/06 but were superseded in early 2006. Mr Wright contended that he had advised at the meeting with Mr Tuddenham that the document had been updated.

99. In cross-examination Mr Wright expanded on how the document was produced:

"Q…So even earlier than January 2006 you had sufficient knowledge and concern about the issues in respect of MTIC fraud to be able to produce in document; is that right?

A. Yes

Q. Let's be clear. In your opening submissions you make reference to JDI

A. Yes

Q. The implication being that you'd effectively cut and pasted this document from JDI; is that right?

A. Impex (?) Telecom, who went on to become JDI

Q. And the gentleman behind JDI is someone you're associated with?

A. And Impex as well

Q. And you borrowed his procedures document

A. Yes

Q. But you'd obviously put some thought into it yourself. This isn't just their document, is it?

A. No, it primarily is their document and I cut and pasted some other parts and points, and that was an ongoing process over the following three or six months.

Q. We can see about release of goods, insurance, freight forwarders, price testing, and so it goes on. So by the time that you produce that in January and, as you say before that in November, you had a pretty good understanding of the issues about MTIC fraud; is that right?

A. I was aware of some of the issues with MTIC fraud. This document deals with a number of other issues which the company would need to be aware of moving forward, which MTIC fraud was one part of. So it's not based just on the MTIC part of trading."

(Transcript 24 September 2014 page 128)

100. Mr Waxman gave evidence in which he confirmed he had carried out a post registration visit to the Appellant on 18 January 2006 to establish its trading activities. At that time trading had not commenced. Mr Wright provided a copy of the Wholesale Procedures document and stated that he intended to follow the procedures when undertaking wholesale deals. Mr Waxman agreed that he had told Mr Wright he would review the document and raise any questions he had with Mr Wright however this did not happen as Mr Waxman left the role two weeks later.

101. As part of his extended verification Mr Tuddenham reviewed the document he received and noted that Mr Wright carried out transactions without fully complying with his own approval procedures in respect of suppliers. He made the following observations:

(i) "Section 1: New Customer and Supplier Set Up" states that part of the Appellant's procedure was to deal with companies that have traded *"for at least a period of one year or more"* although the same section also indicates that new companies could be accommodated if a meeting is held. The information obtained by the Appellant in respect of Jos does not appear to show that it had been trading for over one year. Mr Tuddenham accepted that the Experian report showed the date of incorporation as October 2004 but noted that there is no information to demonstrate that the company traded throughout that period. The VAT return for 12/05 shows that Jos was trading as at 1 October 2005. In addition Jos' membership date on the IPT website is dated 24 March 2006 which gives no indication as to the company's trading history.

(ii) Under Section 2 entitled "Customer and Purchase Orders" the Wholesale Procedure document sets out that customer and purchase orders should be subject to inspection of goods and IMEI checking and the purchase order should specify requirements such as *"new, sim free, language(s), UK or European plug etc."* Mr Tuddenham noted that the 03/06 inspection report did not set out any detail as to what the inspection entailed. He also highlighted that in 06/06 IMEI

numbers were not scanned and the Appellant allocated the stock to Phonetrade at the same time it requested a 100% inspection of the stock; Mr Tuddenham queried in those circumstances what benefit the report would provide if the Appellant had already allocated the goods to its customer.

(iii) Under "Section 3: Goods Inspection and IMEI Scanning/Box Stamping" the Appellant's document states that inspections would be carried out at freight forwarders by an independent company/agent prior to accepting title or making payment. It specified that 10% of the IMEIs are scanned by the inspection company and sent by email to the Appellant and that the Appellant would make available where approved by the supplier or freight forwarder *"a stamp/sticker to be placed randomly upon the outer cartons of the phone packaging"*. Mr Tuddenham noted that the transaction that took place on 31 May 2006 did not meet any of the criteria specified. In a telephone call on 4 September 2006 Mr Wright told Mr Tuddenham that he had no control over the choice of independent company carrying out inspections. He stated that they were appointed by the freight forwarder and that he was unaware of any IMEI scans or whether the stamp he issued to the freight forwarder was ever used.

(iv) At Section 8 "VAT Responsibilities and Communication" the document states that the Appellant wishes to present a *"very positive profile to the VAT authorities"*. Duplicate IMEIs are said to be worthy of *"rejecting the entire shipment"* however Mr Tuddenham questions the substance of this statement given that no IMEI numbers were collected.

(v) Section 10 addresses insurance of stock and states that *"the stock is to be insured by the freight forwarder."* Mr Tuddenham noted that there was no evidence that the freight forwarder insured the stock and at a visit to ASC it confirmed that goods were not insured at its premises and were only covered by limited goods in transit cover up to £500,000 while being transported. Mr Tuddenham noted that the value of the goods in the Appellant's transactions far exceeded the level of insurance. In a fax to ASC the Appellant asked for the goods to be insured however Mr Tuddenham noted that no insurance paperwork was provided to Mr Wright.

102. Mr Tuddenham noted the Appellant's contention that the two versions provided by the Appellant in January and December 2006 were superseded in early 2006. Mr Tuddenham highlighted that he written to the Appellant on 15 February 2007 stating:

"Wholesale Procedures Document. Many thanks for this document. We have several of these documents and you assured me that the copy you forwarded me was the working document for the business. If not, can you forward me the working document that was used for the deals."

103. Mr Wright did explain that the version said to be used at the time of the deals was not either of the versions provided in 2006. He responded as follows:

"this document has been with hMRC in an earlier form for over a year. The document was given to Tim Waxman."

104. The fact that HMRC had the incorrect version was first raised by Mr Wright in his witness statement dated 13 August 2012. Mr Tuddenham reviewed the revised version and highlighted the following:

(i) There was no longer a requirement to check how long a supplier or customer had traded. The revised version referred to the fact that an "unannounced meeting" between the parties should take place before a transaction;

(ii) Under section 2 the references to scanning IMEI numbers with a view to rejecting duplicates are replaced by a search for "Phonetrade" stamps;

(iii) The earlier version made reference to the Appellant's requirements being summarised *"within our latest terms and conditions. This should include a clear legal obligation in the event of the supply chain causing any VAT issues"*. This was omitted from the revised version;

(iv) The revised version under section 3 no longer required inspections to be carried out at the freight forwarders but instead states "*in line with the freight forwarders normal procedure with either in-house/subcontracted out at the freight forwarders facility or facility of its shippers*";

(v) The revised version states *"we currently do not scan IMEI numbers"* whereas the earlier version referred to scanning 10% of goods *"where available or directed by HMRC…"* with the results to be emailed to Mr Wright;

(vi) The revised version concentrates on looking for the Phonetrade stamp which according to Mr Wright's witness statement was not a check that was undertaken until the 09/09 VAT quarter.

105. Mr Tuddenham noted that the revised version reflected the actual events more accurately than the earlier version. However the checks are not as robust as those set out in the earlier version. Mr Wright stated in cross-examination that he could not recall the reasons for adding or removing parts of the document. As to why the updated version had not bee supplied to Mr Tuddenham, Mr Wright stated in cross-examination:

"The discussion we had in December was a general discussion. Mr Tuddenham found the document in the file and was going through how I'd generated that document and was picking up on anomalies within the document…and was asking if this was my document or how I generated the document. There was no discussions on going through separate points within that document. It was a discussion on he'd found the document and those irregularities in that. I said that wasn't the document at the time so I sent another document. At that time, I didn't realise Mr Tuddenham was going to go through with a fine tooth comb every single point in that document. I just assumed he wanted that copy for his file, so I pulled out a copy that was in my file. It wasn't a

way of me trying to give him the wrong document on purpose, I didn't know the process he was intending to do on that document and I was surprised when he went through the length he did after that.

Q. He wrote to you, didn't he...'we've had several of these documents and you assured me that the copy you forwarded me', in other words version 3 that you'd sent through in January, yes?

A. Mm-hm

Q. 'was the working document for the business. If not, can you forward me the document that was used for the deals that you have done in this registration.' Right. Take that in stages. You told him that this was the copy that was the working document for the business.

A. Absolutely not

Q. So that's a plain lie, is it?

A. Absolutely

Q. Or certainly a misunderstanding by Mr Tuddenham

A. Yes

Q. So you read that letter and you thought, 'heavens above, that's nonsense'…yes? So he carries on: 'If not, can you forward me the document that was used for the deals that you have done in this registration'…You're already no doubt, hackles out, because he's plainly misquoted you, you say, and you think 'the first thing I have to do is forward him version 5', yes?

A. No

Q. Why on earth not? It's what he asked you to do

A. Because I answered that. I can't remember where the letter is in response, but I was dealing with…I responded to the letter and I was responding to other parts. At this particular point, we had been involved in meetings and discussions for a number of months now and it was at this particular point where, rightly or wrongly, I was getting annoyed with the transaction process that was taking – the process that was taking in terms of verifying the transactions…

Q. Where in the letter does it say, 'And by the way, you're talking nonsense, the document I forwarded to you, I did not assure you was the relevant one, please find attached version 5'?

A. It doesn't

Q. No, it doesn't, does it

A. No

Q. Version 5 was not the document you were using at the time. The reality is you weren't using any document at the time, were you, because you didn't even comply with the document…version 5, I suggest, wasn't even in existence in February of 2007. You've come up with version 5 as a response to Mr Tuddenham's evidence once this decision to deny was made and you appealed

A. No

Q. The first we heard of version 5 was 2012, wasn't it, in response to Mr Tuddenham's witness statement?

A. That's the first time I evidenced it

Q. You've made it up since, haven't you, Mr Wright?

A. I'm prepared to let Mr Letherby have the computer it was made on. I'm sure he can find the file time and date it was completed…

Q. …There are some changes…you're just dumbing down this document, aren't you? You're just making it easier to comply with. You're effectively making it look a lot more like what actually happened in March and May of 2006, aren't you?

A. But wouldn't that be the case if I was making changes based on what I intended to do?

Q. It's a simple question. You're making it look more like what happened in March and May 2006. Yes or no?

A. Or isn't what happened more like what was included in the procedures?

Q. Mr Wright, you are amending this document. Let's leave when you did it, you're amending this document to make it easier to comply with, aren't you? Whether it's retrospective or not?

A. I made changes that were relevant to the market at the time…

Q. It says 'VAT validation'. Critical company checks. VAT validation et cetera at a time late on the day of the transaction.'

A. I did the Europa check

Q. Is this to cover the fact that you didn't fax Redhill until 16:50 something, I think, in your first deal?

A. No

Q. Other differences, just going through. Customer and purchase orders, you've upped the limit from 2.5 million to 7.5 million. Is that because of the first deal?

A. No. It's on the idea that the transaction sizes may be bigger.

Q. Why did you think in March, when you did version 3, it was going to be 2.5 million, you presumably got your savings and your bank facility up and running and ready by then?

A. It would have been based on the parcels of stick we'd been offered previously. If, as you say, it was based on a transaction I'd completed, I'd have changed that to 5 million…

Q. 'We currently do not scan IMEI numbers.' You hadn't even started…trading

A. Yes, we don't scan IMEI numbers. Version 6 has now got IMEI numbers in…

Q. Insurance of stock. In version 3 it was 'At the present time stock is to be insured…' That's become 'Stock is to be insured by the freight forwarder under normal terms… the responsibility for insuring the goods whilst in transit from the freight forwarder warehouse is the title holder's.' That looks rather like it's to cover the fact that it's been pointed out to you that actually there wasn't any insurance covering the goods in transit and you've now adopted the suggestion that it's up to the customer, despite the fact that you're shipping the goods?

A. No, it's to cover the fact I didn't offer my customers insurance…

Q. Version 5 is a recent fabrication, isn't it?

A. No, I said earlier it was the one that was in force and created prior to the first transaction."

(Transcript 26 September 2014 page 72, 77, 81, 91 & 93).

Turnover and grey market

106. Mr Tuddenham highlighted the remarkable level of profit achieved by the Appellant. In period 03/06 the profit was £774,000 and in period 06/06 the profit was £793,000. Mr Tuddenham noted that the Appellant failed to query whether this level of profit was too good to be true and whether the only reasonable explanation was that the deals were part of a contrived scheme to defraud the revenue.

107. In cross-examination Mr Tuddenham added:

"A. I think I was talking about the trading conditions that are operating within the thing where people make very small profits selling from one to the other very quickly, in/out, in/out, and then all of a sudden it's a great big profit, it stands out like a sore thumb…the profit that was made by Leeds Smith in both returns, both tax periods, was massively greater than the other profits that were made by the other traders with the same product…

Q. But isn't the point about the fact that you believe that the chain was contrived, that the margin has no influence on that, has no effect on that? If Leeds Smith had made £1, the VAT reclaim would have been identical? If Leeds Smith had made £1,000, the VAT reclaim would have been exactly the same? There's no difference with the claim that Leeds Smith made based on—it's not related to the profit in the box.

A. There's no reason for it to be that large. In fact, there's every reason for it to be less. In fact there's every reason within the situation that we find ourselves, where the customer knows who the supplier is, for Leeds Smith not to be involved, for them to point the deal out to whoever their customer is, and for them then to go and avoid Leeds Smith and just buy it from Leeds Smith's supplier. So the fact that a lot of money is – a lot more money is charged by Leeds Smith because they're exporting – I don't understand why, because they're an exporter, they get to make that much money.

Q. Because isn't there an issue with the exporter having to effectively wait for the VAT to be repaid?

A. Lots of companies export things that they purchase and which they've got VAT on and they don't say to the customer, 'I'm making it that much more expensive because I've got to pay somebody else's VAT'."

(Transcript 15 September 2014 page 100, 108)

108. Mr Wright was asked about the profit made in the first transaction:

"Q. So the amount that you sold for, even taking into account the VAT, was more than the amount that you purchased for, having paid the VAT in the UK; is that right?...

A. Yes

Q. So in fact you didn't have to fund any VAT for that transaction, did you?

A. No

Q. You made a profit even before you got your VAT repayment claim. That's remarkable, isn't it?

A. The price I charged Phonetrade Aps was the 573. When I was negotiating the price with Jos, it wasn't based on the figure that includes VAT.

Q. I didn't say it was. I'm just saying that in fact you managed to achieve a margin that meant you could sell to Europe, where you say these great margins are available, without having to front up the VAT.

A. In that case, it did, not in the 06…

Q. Well, didn't it occur to you as rather odd that you were in this position and yet there were all these people that you understood from all your contacts were just bumbling around making 25p when they could be making almost £100?

A. 86, I think

Q. 86, forgive me. £86 compared to 25p. It's massive, isn't it?

A. It's a big difference

Q. Your explanation hitherto has been, well, that's what you get when you can afford to front up the VAT

A. No, I said one of the consequences of entering the export market, when looked at excluding that one transaction, would be you would normally need to fund the VAT. Now, other mobile phones I looked at prior to these transactions didn't present the same margin…

Q. You see, I suggest that your case to date has been it's all about being able to supply the VAT and that's why you can get the bigger margin. That's not made out here

A. No, I suggested that a cost of entry to becoming an export trader over an extended period of time was that at some point you would need to fund the VAT element of a transaction, as I did in May…

Q. …Your witness statement, paragraph 53 'The exporters usually make a much higher margin as they are funding the VAT until the repayment at a later date…' You now say the exporters make a much higher margin because of the price to where they're selling, but they can only do so if they can fund the VAT. Is that what you're saying now?

A. As a general overview of exporting."

(Transcript 24 September 2014 page 140)

109. Mr Corkery gave evidence regarding the gray market. HMRC made a late application to admit the evidence in place of the witness statement of Mr Fletcher that had been previously served. HMRC accepted that the application was made late but submitted that the evidence was clearly relevant to the issues in the case and Mr Fletcher had, since preparing his witness statement, left employment with KPMG. The delay in serving Mr Corkery's evidence arose from HMRC having to identify a new expert and obtain witness statements for a large number of appeals. Mr Wright objected on the basis that he would need time to prepare cross-examination of Mr Corkery and he noted the detailed nature of Mr Corkery's statement and exhibits relied upon.

110. We considered the submissions of both parties and bore in mind the over-riding objective to deal with cases fairly and justly. We found the lateness of the application

was a factor weighing in the Appellant's favour. However the potential prejudice of the lateness was the lack of time for the Appellant to prepare which we were able to address by amending the timetable and ensuring that Mr Wright was given ample additional time throughout proceedings to consider the evidence. The Appellant raised issues in Mr Wright's witness statement which were also addressed by Mr Corkery. In those circumstances we concluded that it was in the interests of both parties that the evidence should be admitted in order that HMRC could address those issues and Mr Wright had the opportunity to cross-examine upon them.

111. Mr Corkery, a partner at Ernst and Young, gave evidence regarding grey market trading patterns. He explained that he had been instructed to address a number of topics which included an understanding of economic principles that drive markets, an understanding of the mobile market in the UK and the application of economic principles in that context.

112. Mr Corkery confirmed that he had not worked in the wholesale mobile phone market in 2006 nor was he employed by UK wholesale distributors or companies in that market segment but he had worked for Vodafone both in the UK and overseas, BT, Virgin and Lebara. Mr Corkery made the point that it was not necessary to have been in the operations of a company in order to make informed decisions but rather one needs to understand the economic characteristics of a market and then apply those characteristics to make decisions. Factors such as the length of the deal chain, the existence or otherwise of value added, the profit motive and the incentive to disintermediate are all factors governed by economic principles.

113. Mr Corkery considered the arrangements of the Appellant's transaction chains to be inconsistent with the workings of a competitive market. He highlighted the number of traders involved in the chains and the fact that both chains originated with a company in Portugal and sold through four UK based companies before being exported from the UK to the EU. Mr Corkery explained the basis of his view noting that the shipment to the UK and then to the EU incurred cost and that profit was made by a number of traders in the chain without an apparent added value. Even where goods were retained at a freight forwarder costs were incurred *"when the assets are destined to return to where they started with profits being charged, costs incurred and time being spent"* (transcript 23 September 2014 page 61)

114. In cross examination Mr Corkery explained:

"The fact that it arrived in the UK in and of itself doesn't strike me as unusual if the price in the UK is higher than the price somewhere else, after taking into account additional costs and risks and so on. The fact that it's a two pin plug suggests it's potentially for a European destination anyway and the fact that it comes in and then goes back to Europe suggests that, to my mind, there are in principal terms far more economically rational commercial arrangements that follow that allow one to have shorter chains, higher profits and a more economic solution."

115. Mr Corkery clarified that his evidence related solely to the characteristics of the two deal chains under appeal; he had not considered the transactions undertaken by

Mr Wright in previous years nor had he considered whether the two deals under appeal were representative. Mr Corkery considered the price at which the Appellant acquired the goods and sold them to be inconsistent with the ruling market price; in cross-examination he explained:

"…My comment relates to the fact that a market price will be determined for the handset and the number of steps in this particular deal chain will have no bearing on that market price directly. So either the market price has changed rapidly in the course of a day but that deal has still been struck, or the price paid is different to the price sold by such a margin that the market price can't be both."

(Transcript 23 September 2014 page 68)

116. Mr Corkery was cross-examined as to the effect on market price of fact that the broker trader has to fund the VAT element of the transaction:

"Q. But is that not a reflection on Leeds Smith's position in the transaction chain that part of that transaction involved financing £575,000 worth of VAT before that VAT is repaid and that a trader earlier in the chain could(?) [sic] then take advantage of that market price because it wouldn't have had the funds to fund that VAT?

A. I'd suggest that the ability to fund the VAT would invite market entry but in and of itself won't add value to the end customer. So for the Appellant to make a margin that's 300 times larger than other entities in the deal chain would suggest that those other entities would have a very strong incentive, and given the relationships and ways of connecting and sharing information we've discussed, but the opportunity to disintermediate...funding the VAT is not something that customers value and therefore will not be willing to pay for, it's a working capital point…"

(Transcript 23 September 2014 page 69 & 71)

117. Mr Wright set out in his written evidence that exporters were able to make a much higher margin than others in the chain as they are funding the VAT until a repayment is made at a later date. However in cross-examination he stated:

"…I think traders were able to supply export customers and one of the costs of entry to do that was obviously having cash flow to be able to support the reclaim. It would be uneconomic for Leeds Smith as a business, making 50p a box, to fund £50/£60 a box in VAT.

Q. Because the impression that one got from your cross-examination of Mr Corkery and your witness statement is that it's because of the need to fund the VAT that these margins are available.

A. That's one of the costs of entry, to be able to do that…

Q. Right. So it has nothing to do with the fact that you need to fund the VAT that allows you to make these margins?

A. No, but being able to fund the VAT is the difference between companies who can do those transactions and companies that are unable to do those transactions."

(Transcript 24 September 2014 page 131)

118. As to the grey market, Mr Wright explained that phones have staged release dates and are not all released in all markets at the same time:

"Where they've got price advantage in some markets, they will lead to an early adoption in those markets.

Q. Which is why I asked you whether you had done any research as to whether there were different release times in mainland Europe for the Nokia 8800 and you said you hadn't. Why not?

A. I didn't feel it was relevant at the time

Q. Well, it would indicate that there might be a genuine reason for this opportunity, which involves goods going out in a circle from mainland Europe to the UK and back out again, wouldn't it?

A. The requirement for the phones was the fact that there was a demand coming from European customers and one who actually purchased

Q. So your raison d'être as a businessman was: there's somebody who's willing to buy these phones, I can make a profit, therefore, unless I'm told otherwise, I will assume that this is not an MTIC fraud?

A. No. That's got to be the raison d'être for every business. If you can sell a product and make a profit, that's your business. If any indicators come up through the checks that you need to take on during the process of that transaction chain that suggest alternatives, then at that point you decide not to so the transaction, which I did at times and is evidenced through the – if I see IMEIs I've seen before, I will not take the stock"

(Transcript 24 September 2014 page 164)

"A. …I don't profess to know about the market situation in those countries. I supply stock from the UK to a Danish customer for delivery in France or Holland.

Q. And you have no idea whether or not that's a legitimate opportunity or not?

A. In terms of the transaction, you work on the premise that it's legitimate until you see evidence that it's not."

Transcript 25 September 2014 page 46)

Insurance

119. Mr Tuddenham noted the lack of evidence to show the goods were insured. Mr Wright had told him that verbal confirmation of insurance had been given by ASC. However Mr Tuddenham explained that the Appellant gave a confusing account as to whether there was insurance in place or not and how the goods were insured given that the issue of legal ownership and title was unclear:

"Leeds Smith thought it had insurance. Mr Wright spent a lot of time and some effort, trying to explain how he did have insurance, how he was get it from ASC, but then it later transpired that he didn't have insurance, although he said he thought he had insurance…the situation around insurance was a little bit confused because Leeds because Leeds Smith Consulting Ltd insisted that it did have insurance when I went to visit them."

(Transcript 15 September 2014 page 124)

120. Mr Wright confirmed that there was no insurance for the goods; he stated that he had made an error in not chasing the insurance certificate but had been assured that it would be posted. He was under the impression that insurance was included in the paid to ASC. Mr Wright explained that the stock was not owned by the Appellant and the issue of title and insurance was not an area he needed to cover although GIT was said to be included in the handling fee. He added that insurance would be the responsibility of the title holder.

IMEI numbers

121. Mr Tuddenham queried why the Appellant did not collect IMEI numbers which uniquely identify a phone and would have enabled the Appellant to ensure that the phones traded corresponded to the declared make and model and were not traded more than once.

122. Mr Wright contended that collecting IMEI numbers is not reliable in terms of the collection methods and the use of NEMESIS by HMRC exclusively when it is not available to other traders. The Appellant did not collect them and did not say that it would. He added that IMEI numbers are not unique; approximately 10% are duplicated and the numbers are easily changed. In support of this Mr Wright exhibited an article

123. HMRC officer Rod Stone gave evidence regarding typical features of MTIC fraud, its effect and extent and HMRC's measures to combat it. Mr Stone acknowledged that a small genuine grey market existed at the relevant time. Mr Wright disputed that IMEI numbers were unique, as asserted by Mr Tuddenham. In an email to HMRC dated 23 August 2006 Mr Wright explained:

"I did not collect IMEI numbers for that deal as I explained and the reason given was the notes from the FTI lawyer where HMRC refused to give traders access to the manufacturers database HMRC used to check numbers…I have heard this led to traders having their input tax withheld on the basis of incorrect IMEIs"

124. In oral evidence Mr Stone explained:

"Q. The suggestion has been made in the course of this hearing that the Nemesis system was of limited value, to say the least, because in fact it was known, it is suggested, that retail boxes often had different IMEI numbers to those listed on the outside of the cartons.

A. No, that's why they were always inspected or compared, or they should have been, as part of the process.

Q. Do you have any experience of the frequency of retail boxes being different to the IMEIs on the outside of a carton?

A. I'm not aware of it ever happening….

Q. …It's also been suggested that IMEI numbers were not unique.

A. Yes, they were. This has been raised before. There's a confusion over the cloning of IMEI numbers. Basically…phones are stolen, the IMEI number is cloned. In this particular case, of course, we were dealing with new stock that came direct from manufacturers and therefore there wasn't the case of duplication…

Q. (Mr Holden) …I think there was a suggestion earlier on that the manufacturers could duplicate IMEI numbers.

A. There's no interest or there's no benefit for the manufacturer to duplicate it, sir, because the IMEI number is so important, it's the way that phones are blocked, so we've had manufacturers obviously having thefts of stock, large scale theft of stock, but what they can do is block the phones straightaway. They can only do that if the IMEI numbers are unique…I'm not aware of any duplication of IMEI numbers at all. As I say, one of the other things to bear in mind is that when the new legislation was introduced in, I think it was 2004, to do with the cloning of IMEI numbers ---it was not for the purposes of HMRC, but it was to deal with the theft and cloning of mobile phones and they made cloning of numbers illegal. What the manufacturers sought to do was to make what they called a hardened or strengthened IMEI number to ensure that there wasn't duplication. It's well documented, sir…

Q. (Mr Foulkes) …I think that there was a report or a newspaper article referred to in support of this suggestion…

A. I have sent that document. It's a very old document, a newspaper report. At the time that they wanted to introduce new legislation to deal with cloning, one of the difficulties were the networks, O2, Vodafone and co, and asking them to block IMEI numbers, and that's where the article generates from…

Q. It quotes BT Cellnet saying that…'10 per cent of IMEI numbers are not unique'

A. That's because they've been cloned, madam. So what was happening was the networks were seeing several phones with the same, or more than several phones, several phones with the same IMEI number because those phones had been stolen and cloned. Therefore, if you were going to block the IMEI number at the network, you

would be blocking perhaps the phones of innocent people or at least one innocent person…All these networks eventually agreed that the blocking was worthwhile and they signed up to the agreements and they do block IMEI numbers."

(Transcript 19 September 2014 pages 72 – 77)

Inspections

125. The inspection report for 03/06 was provided by Chas Mortimer based at an address in Kent which relates to a company called Mototrans (Kent) Ltd of which Mr Charles Mortimer is the director. The Appellant was charged £0.10 per unit for checking the phones. Mr Tuddenham highlighted the absence of any evidence to show what the service entailed. At a visit to Mr Mortimer by HMRC in May 2007, Mr Mortimer stated that he had never heard of ASC until they contacted him out of the blue and that he had not carried out any more work for ASC after March 2006.

126. In period 06/06 the Appellant did not request an inspection prior to its sale of the goods. The request was contained on a fax which allocated the goods to its customer. Mr Wright believed the goods were stored at ASC's premises when in fact they were held at DMC Transport in Feltham. Inspection of the goods was purported to have been carried out by ETT Inspections; Mr John Williams signed the report as director. Mr Tuddenham noted that there is no trace of ETT Inspections having a VAT registration at that address. However a company called Euro Team Transport Limited was VAT registered at the address and Mr John Williams was the director. The same VAT number is quoted on the ETT Inspection invoice. Mr Tuddenham was unable to contact ETT Inspections. The rent on the premises in May 2006 was paid by Peaches Transport. Mr Dunster from Peaches Transport told Mr Tuddenham that Mr John Williams worked from time to time as a driver for Peaches Transport.

127. Mr Tuddenham noted that the Appellant did not conduct any due diligence on the inspection companies and in an email dated 23 August 2006 Mr Wright confirmed that he had no knowledge of the method used for inspections. In cross-examination Mr Tuddenham stated:

"The inspections in the freight forwarder's, nobody knows what was done, how they were done…Nobody knows how they were done, there's no evidence to show that any inspection was – that Leeds Smith Consulting took a direct hand in trying to decide what inspections would consist of. Mr Wright told me what he thought inspections would be, should be, but there's no evidence to show that Mr Wright, Leeds Smith Consulting, communicated that to ASC or to inspecting companies. Indeed, Mr Wright did give us this wholesale procedure document; it talks about inspecting companies and proving you're inspecting companies, but nothing was ever done on that...I don't know what the inspectors were supposed to do. The point is, neither did Leeds Smith Consulting know what the inspectors were doing because they never asked to see what the inspectors were doing. We had a conversation some time in, I think, November 2006, Mr Wright and I, or it might have been September, where he painted a rather gloomy scenario around how he couldn't actually influence what inspectors are supposed to be doing…There's a conversation about inspectors and what

inspectors are supposed to be doing. I think, if I remember correctly, which I do, it says that Leeds Smith Consulting felt that they didn't have much influence over what inspectors did…Leeds Smith Consulting told me what that would entail and then told me later that they didn't know what it entailed because it just happened."

(Transcript 16 September 2014 page 36 & 38)

128. Notes of a visit report on 26 January 2006 recorded that the merits of IMEI numbers was discussed and Mr Wright had observed that "*check limited and element of trust involved"*. Mr Tuddenham's note of a telephone call on 4 September 2006 recorded the following:

"…the inspections – the most recent report is from ETT but the previous one was not. He has no influence over who they use, or hasn't in the past, and only requests that checks are made…Doubts that he would have any recourse to inspectors if anything went wrong…"

129. An email from Mr Wright to Mr Tuddenham dated 23 August 2006 stated:

"Inspection

Upon confirmation that the goods are held at the warehouse I asked for an inspection. From that point I await the inspection report and the cost is added to my bill…their methodology would have need to be discussed with them directly even though we discussed around how it would work…

Insurance

I had been given a verbal confirmation from ASC Worldwide Ltd on the 30.3.06 all costs, £1 per unit for ship and insure…I had asked for a copy of the insurance policy at the time but still await its supply…"

130. Mr Wright explained that faxed confirmation of the inspection report arrived after the deal was completed but verbal confirmation had been received from ASC. In cross-examination Mr Wright was asked about the purpose of the inspections:

"Q. You need a written document, something to protect you if your customer comes back and says 'these have just arrived in Paris and they're nothing like you told me they were'?

A. No. Phonetrade Aps has to do it's own inspection…I didn't rely on Jos' confirmation of what the stock was. You have to do your own inspection.

Q. In which case why do you bother doing one at all

A. To make sure the stock matched what was told to me by Jos UK

Q. But if you rely on the fact that your customer's doing an inspection before those goods leave the warehouse, you don't need to do one, do you, because, if it's wrong, they'll come back and say 'I'm not giving you the money'?

A. I didn't need to and in a lot of the cases in 2002 I didn't do inspections and relied on the customer being happy with the stock and paying for the goods. This was just added to what I did moving forward.

Q. You didn't need to do it at all then

A. In 2002, no

Q. In 2006 why did you need to do it? Help us

A. Paperwork to add to the due diligence

Q. So this is an anti-fraud measure, is it?#

A. It's another step in the process of linking the paperwork."

(Transcript 25 September 2014 page 111)

"A needed an inspection report and I got an inspection report"

(Transcript 25 September 2006 page 164).

Payments, circularity and IP addresses

131. HMRC officer Richard David John Meynell gave evidence regarding the copying of the computer's hard disk drive and removable media from the FCIB. Mr Meynell confirmed that he made two visits to Holland to obtain the material; on the first visit he obtained the external LaCie hard drive ("the Dutch material") which was obtained following the Dutch investigation into the FCIB and on the second he obtained a back-up copy of the FCIB server based in Paris ("the Paris server material") which the Paris tax authorities made available to the Dutch.

132. HMRC officer Cole gave evidence regarding the information obtained by Mr Meynell from the FCIB. The data obtained from Bankmaster Plus (the Dutch material) showed the flow of monies between traders. From 1 May 2006 the Paris server material included IP addresses from which payments was made and the start and cessation of the logging on session.

133. Mr Cole traced the two transactions through the FCIB, which was used by all of the traders in the transaction chains. Mr Cole confirmed in evidence that he was able to follow the payments in the transactions and noted a pattern in that the payments were received and immediately paid out. Mr Cole explained that he used several points of reference to trace the payments including invoices, the date, amount, company involved and narrative for payment.

134. In respect of the 03/06 transaction Mr Cole traced the money flow in a circle as follows:

Korowai Business Invest ("Korowai") – Phone Trade Aps – Appellant – Jos – All Name Products Ltd – West 1 – United Traders - Korowai

135. In respect of the 06/06 transaction which involved 6,000 black Nokia 8800s and 10,000 silver Nolia 8800s Mr Cole traced the money flow in respect of the black phones in a circle as follows:

Hunzie Electronics IDA ("Hunzie") based in Portugal – Phone Trade Aps – Appellant – Jos – International Investment Services Ltd – West 1 – United Traders - Hunzie

136. Mr Cole noted that following the final payment from United Traders to Hunzie, United Traders also made a further payment to Hunzie. The second payment appears to have been used to fund the payment made by Hunzie to Phone Trade Aps for the silver Nokia 8800s which followed an identical circular money flow.

137. Mr Cole provided a second statement in which he set out his additional analysis of the IP addresses, timings and log in/log out information in respect of the deal on 31 May 2006. He explained that the information is only available for transactions completed after 1 May 2006 and therefore in respect of the 03/06 transaction the information is limited to the timings of payments in the chain which were all made within a twenty minute window.

138. Mr Cole's evidence in respect of the transaction in 06/06 was that all payments in the chain, including that made by the Appellant, originated from the same IP address and all payments in the chain were completed in respect of the payments for the black Nokia phones in 24 minutes and in respect of the silver Nokia phones in 21 minutes. .

139. Mr Cole was asked in cross-examination about the accuracy of the tracing exercise and EB (Electronic Banking) reference numbers:

"Q. The electronic bank reference number is generated by FCIB's banking system for every transaction and it's a chronological number. So it seems odd, the list of transactions you state follow a completely different electronic banking reference number transaction chain.

A. I can't answer that. All I can say is that I traced the money and it did go in that circular route…

Q….the transactions you were looking at weren't actually the ones involved in this tribunal case.

A. If we were to look at the actual exhibits and the statement in this particular case, I can't see how it could be any other payment other than the ones I've identified….I think it might be easier to go through the statement, where it shows that the money

was paid out, and in some cases that money couldn't have been paid out unless the previous money had been paid in from the previous company or – previous company in the chain…because there wouldn't have been sufficient funds into the account…I stand by what I'm saying here in terms of these payments, that they are for the invoices that I've looked at…

Q (re-examination)So even before you had the timing information, it was clear to you, you say, that it must be that the order of the bank statement is chronological

A. that's right

Q. So it follows your evidence a moment ago that the EB references are not necessarily chronological because they can't both be right; is that the position?

A. That's the position."

(Transcript 19 September 2014 page 14, 20 – 21 & 24)

140. HMRC officer Andrew Letherby, a Certified Information Systems Security Professional, produced a detailed report on the forensic analysis of the FCIB banking servers. The areas of dispute arising out of his evidence can be summarised as follows: the integrity and accuracy of the banking data and its capture, the issue as to allocating IP addresses for payments and whether EB numbers uniquely identify money movements and are sequential.

141. Mr Letherby confirmed in oral evidence that he had no doubts as to the integrity and accuracy of the information copied from the FCIB servers from which HMRC carried out its analysis. He stated:

"…I took the Paris server, rebuilt it, extracted the data from it incrementally and tested it to make sure that it was forensically accurate and complete, verified it and cross-verified it against the back office ledgers of the bank to confirm the accuracy and reliability of the data. So in that way, I can say that the material provided for Mr Cole was forensically accurate and complete and assuming that he has transposed that data accurately into his table, that would be a fair representation of the data that has been extracted from the bank servers."

(Transcript 23 September 2014 page 96)

142. On the issue of EB numbers Mr Letherby explained:

"…So the FCIB system issued EB reference numbers from a unique sequential store, so 2 came after 1, and each time a customer requested a transaction, it would be issued the next available EB reference number. However customers didn't actually have to commit that order, submit it to the bank to be processed at the time they created it, so there are circumstances where a customer may have come on early, completed the details of a transaction, and that can be completed by the customer themselves, signatory, or in fact an agent who's authorised on that account, a clerk to the account can complete the details of a transaction in advance and it would be

issued an EB reference number at that point. It would then be held until the signatory, the authorised signatory or signatories to the account, had authorised the transaction and submitted it to the processed. So in that way, you can get transactions that are posted into the account on a date and time that appears anomalous because it's not in sequence, the EB numbers aren't in sequence, but in fact it's simply because the transaction was posted for processing at a different date from the time at which the order was originally started on the system."

(Transcript 23 September 2014 page 115)

143. As to IP addresses Mr Letherby provided 6 reasons why two or more individuals may have the same IP address:

- The users were located at the same physical location and sharing the same Gateway connection to the Internet;
- The users were connecting remotely to another "shared" computer and therefore sharing the same Gateway connection to the Internet;
- The users were connecting remotely to a server which was co-located with other computers in a "shared hosting" company and sharing the same Gateway connection to the Internet;
- The users were connecting remotely to a common Proxy Server sharing the same Gateway connection to the Internet;
- The users connected using a common mobile data connection from a common provider, using a mobile data device issued in a common geographic region;
- Simple co-incidence.

144. In cross-examination Mr Letherby explained:

"…It's probably easier to think of it in terms of a telephone exchange. If you think about a telephone number, that telephone number has to be unique because otherwise, if I want to call someone, if two people have the same telephone number, I might reach one or other of them. So in a similar way, on the Internet, IP addresses are unique. What that means in these circumstances is that at the time that that Internet address was recorded, it was unique on the Internet and it referenced a particular device or server on the Internet.

Now, as I've said previously and I mention in my evidence, it's possible that that wasn't actually the end point device, so the laptop or the computer that was actually issuing the command, that could have been sitting behind another server, and it could be that this is that server's IP address. Without knowing the allocation of this IP address at that time, it's not possible to tell the circumstances. However, there are only half a dozen causes why that might be the case…all of them are referentially similar in that for those to be the same, it either had to be the same device or there had to be another device in the way that had that IP address."

(Transcript 23 September 2014 page 98)

145. As to the likelihood of the users being at the same physical location Mr Letherby's view was that users being in the same physical location, such as different offices in the same building, could share common IP addresses, however if users are physically located in separate places they cannot receive the same IP address.

146. As regards connecting remotely to another "shared" computer, Mr Letherby considered it very unusual for two companies in a "customer and vendor" relationship to share such a service as it potentially compromises business confidentiality and security practice, however two or more companies may have made such an arrangement which would require a co-operative relationship over and above that usually seen in business.

147. To achieve the same IP address shared hosting would require each of the traders to have, by coincidence, hosted their servers with a common provider which he considered unusual but not impossible for companies trading in many different countries.

148. Proxy servers are used on the internet as a means of anonymising communication because the IP address received at the destination will be that of the Proxy server. Mr Letherby considered a common shared Web Proxy unlikely, but possible. However this would suggest that the users wished in some manner to attempt to deliberately anonymise their communications as no other benefit is derived from such usage. To do so required access to a common computer (the Web Proxy) and a co-operative relationship over and above that usually seen in business. For each user to have randomly selected the same 3rd party Web Proxy would require significant coincidence.

149. Mr Letherby considered that it was unlikely, but not inconceivable, that a company based overseas would have a UK mobile data device which it used regularly to connect from overseas as the availability of such UK devices in other countries is limited.

150. As to coincidence, Mr Letherby did not accept that this was a reasonable explanation for the same IP address across multiple accounts, across consecutive or near consecutive transactions due to the frequency of the event.

151. Mr Letherby was asked about the Appellant's contention that it used a software program which hid the IP address through a proxy server and which changed the false IP displayed every 60 seconds. He explained that this would fall within the category of connecting remotely to a common Proxy Server:

"A. So the system that's being alluded to here is what's known as a multi-proxy. The concept behind it is that it rotates the IP address of the end-user multiple times within a given period. This is asserted at 60 seconds. And in such circumstances, that would cause the IP address which was presented to the server the other end to change every 60 seconds to another proxy server. So in this circumstance, effectively you might

have half a dozen proxy servers and the connection would be bounced between different IP's and would show a number of different IP addresses…

Q. So there would be a proxy server between Paris and the computer in West Yorkshire?

A. Yes. In these circumstances, what I would expect to see is every 60 seconds within the FCIB connection logs, IP logs, I would expect to see a different IP address every 60 seconds, were this the case…

Q. …it appears to be on 31 May that between 16;34 and 17;47 it's the same IP address registered at those four different sessions. And we're told that the IP address was being changed every 60 seconds. Are you able to help us with the likelihood of that occurring, given that particular example?...

A. So given the examples, presuming that these are representative of sessions where the user was connected consistently and using this idea of multi-proxy, I would deduce that it was either incorrectly configured or incorrectly installed or wasn't functioning, because there is a consistent IP address, so this is not consistent with the use of a multi-proxy in these connections…It may be that it's a single proxy server, but it's certainly not as described, a multi-proxy that's cycling through a different IP address every 60 seconds."

(Transcript 23 September 2014 pages 101, 102 & 108)

152.In cross-examination Mr Letherby was taken to an example of a logging off time of 16:56:19 was given with the same time shown as the logging in time with different IP addresses which he said was consistent with switching over to a different IP address.

153.Mr Letherby was also questioned as to whether it was possible to open two accounts simultaneously:

"Q…I think the point that's being made…is that it can't be the same computer. If you've got two accounts open at the same time, they must be from different computers. Does that follow or not?

A. No, that does not follow at all. It's perfectly possible to open – at this time it would have been – windows on browsers, multiple sub-pages on browsers weren't common. So to achieve multiple online sessions at any one time, you would open multiple instances of an Internet browser. So there's no reason why a single computer can't open multiple instances of a web browser and set up concurrent sessions, authenticating with different user authentication to the same server. Certainly FCIB at that time didn't preclude that activity either…It's entirely possible that the same computer could open two sessions on two browsers and separately authenticate two concurrent sessions…

154. In cross-examination Mr Letherby confirmed that he had found nothing within the records to indicate that the system incorrectly recorded IP addresses, to the

contrary his analysis where machines were seized for the purposes of criminal prosecutions indicated that the recordings were accurate. He also reiterated that the FCIB server did not block multiple sessions on a single machine and had seen direct evidence of this being done through the analysis of multiple computers connected through the same gateway. Mr Letherby explained that although it is not possible to do this today, *"the threat landscape on the Internet was significantly different in 2006. I can say that FCIB did allow it"* (transcript 23 September 2014 page 142).

155.Mr Wright disputed the evidence; he submitted that the information did not show that all payments were made from the same IP address but rather that the system had logged an IP address that is the same. Mr Wright said that he had made the payment from his home in West Yorkshire and printed out confirmation of receipt and payment at the time. Mr Letherby was shown the document, MT104, but stated it was unclear when or where it was printed out and this could have been done at a later date.

156.Mr Wright explained that he used a software programme which hid his IP address through a proxy server. The software changed the false IP address displayed every 60 seconds. He contended that the FCIB evidence showed traders in the chain logging on before another trader had logged off which suggested that the same computer could not have been used as this would be impossible.

157.In cross-examination Mr Wright was asked about the IP addresses:

"Q. Your account was operated from two IP addresses on that date (May)…So somebody's looked between 15:24 and 15:25 at your bank account. Somebody's looked again at 16:34 to 16:35. Somebody's looked between 16:55 and 16:56:19, and then we've got that coterminous log-in session…where the other IP address logs on immediately afterwards, and then that logs off and, a few minutes later, the payment's made from the common IP address. The the other IP address has another couple of looks and then the other IP address, the common IP address, makes the payment.

Mr Wright is this you having a look to see what's going on to see whether the money's come into your account yet? And then somebody else, to whom you've given your details, making the payments, as they've made all the payments in these two circles?

A. No

Q. You say you had software that used to change your IP address?

A. Correct

Q. Every 60 seconds?

A. Yes

Q. That doesn't add up with this information, does it, as Mr Letherby said?

A. Well, there was an issue with the –there's still and issue I think, with the IP address because I logged on to my account to make the payment and Mr Letherby says that IP address is registered in Birmingham.

Q. Mr Letherby's evidence was that the IP address used to make the payments was a Telewest broadband server. You might be right about Birmingham, but it's a UK server, Telewest became Virgin. All right? That is the evidence. That server sent all the payment commands for the whole two circles, which explains, doesn't it, how they can all happen so quickly. Because it's all being engineered from the same place?

A. No, because as I said to Mr Letherby, on research I've done, which he says was different in 2006, which I don't believe, is that you can't open multiple windows in a bank account…I can't answer for the IP address. I know I made the payment, Mr Tuddenham's seen me be able to log on, so I can log on, so why would I give the payment instructions to someone else?

Q. Because you're part of a scheme and someone's controlling the money because the money's obviously very important in this and somebody wants to be able to control the flow of funds so it goes round in a nice circle as swiftly as possible and your MTIC scheme is complete. That's what's happening here, isn't it?

A. No

Q, There's simply no other explanation for it

A. The other explanation is the IP address is wrong."

(Transcript 26 September 2014 page 191- 193)

Submissions

158. Both parties provided detailed and lengthy written closing submissions which we will not set out in any great detail; the following is intended as an overview of features highlighted by each.

159. HMRC highlighted the following features of the evidence as relevant to the issue of knowledge or means of knowledge on the part of the Appellant:

- The Appellant's awareness of MTIC fraud through Mr Wright in his capacity as director of the Appellant, his experience in other companies such as Phonetrade (UK) Ltd, Leeds Smith Consulting (sole trader) and contact with HMRC;

- The Wholesale Procedure document supplied by the Appellant further demonstrates the Appellant's understanding of fraud within the industry. HMRC also submitted that Mr Wright's evidence on this matter undermined his credibility;

- Circularity of funds is not representative of legitimate, arm's length commercial trading but rather is indicative of a highly orchestrated and contrived scheme of which each participant must be aware;

- Mr Wright's evidence was inconsistent and lacked credibilityon a number of topics;

- The use of the same IP address for all payments in the 06/06 transaction;

- Inconsistency with features of legitimate grey market trading;

- The enormous profit margin achieved by the Appellant;

- The lengthy deal chains where participants added no value;

- The lack of evidence of negotiation;

- The lack of formal terms and conditions;

- Release of goods with no title;

- Lack of insurance;

- Inadequate due diligence; and

- Inadequacy of inspections.

160. On behalf of the Appellant Mr Wright highlighted the following matters:

- The Appellant conducted hundreds of transactions, none of which have ever traced back to a missing trader and the due diligence for the transactions under appeal was greater than that in earlier years;

- A greater or lesser knowledge of the industry does not increase or dilute the knowledge required of the transactions in question; knowledge of fraud generally must be balanced against the experience of previous years where no fraud was encountered;

- The Appellant could not have known of circularity in the payment chain unless it was an architect or co-conspirator in the scheme; it was neither;

- Use of the FCIB by so many traders does not indicate fraud;

- The banking information contains a number of anomalies such as the fact that HMRC were unaware what information was recorded on the bank's system at the time of the transaction – the information was only obtained some years later. Furthermore the Appellant was not given access to the servers in question;

- Mr Wright is an expert with over 30 years experience in the mobile phone industry. By comparison Mr Corkery has no first hand experience of the mobile industry; his evidence was bizarre and primarily based on the ideas and theories set out in a book written in 1985 by Potter;

- There is evidence in the form of the Appellant's previous 570 transaction which supports the fact that traders in UK-UK deals were willing to accept low margins of 50p or £1;

- There is no evidence to show the "normal" length of a deal chain;

- Evidence of price negotiation exists in the form of moving price points over a two month period;

- Having or not having insurance is not an indication of fraud;

- The Appellant was not required to keep IMEI numbers and never purported to have collected them;

- HMRC officer Palmer traced approximately 300 transactions by Carphone Warehouse, including those of the Appellant and no negative checks were advised to the Appellant;

- There is no evidence that the Appellant's 570 earlier deals were fraudulent;

- The due diligence conducted by the Appellant was sufficient. The Appellant highlighted that, inter alia, as regards Jos the Appellant does not conduct trade references as the relationship is built on performance delivery. In respect of PhoneTrade Aps the Appellant had previous contact with the company and regularly received misdirected bills from freight forwarders due to the similar trading name with the Appellant's company.

The Decision

Findings of fact on whether the Appellant knew, or should have known, that its transactions were connected to fraud.

161. We considered the law, oral and written evidence and submissions of both parties carefully in reaching our conclusions. Our approach to the evidence was to disregard any opinions expressed by the officers and we bore in mind that in considering the issue of knowledge we should only take account of information known to Mr Wright during the relevant period.

162. We were satisfied that Mr Wright had a detailed understanding of the mobile phone industry and the fraud prevalent within it. Such knowledge came not only from Mr Wright's significant experience in the trade but also contact with HMRC via the Appellant and other companies in which Mr Wright was a company officer. We found that Mr Wright, at times, sought to minimise his understanding of VAT fraud within

the sector which was wholly inconsistent with his evidence as to his understanding of the implications of the *Bond House* decision, the steps taken by HMRC to combat fraud and Mr Wright's own view that he could be considered an expert in his field.

163.Mr Wright prayed in aid the transactions he had undertaken between 2002 and 2004, which amounted to in excess of 500. We did not find that this assisted either parties' case as we were not provided with the details of those transactions and therefore we could not undertake any meaningful analysis or comparison in that regard. Mr Wright's assertion that he was told by someone at Carphone Warehouse that the deals were not traced back to fraud was unsupported by evidence and we attached little weight to it. Similarly, Mr Wright's contention that an HMRC officer had given evidence in an appeal before this Tribunal (differently constituted) that the transactions had been verified was not a matter in respect of which we were provided with any supporting evidence, such as the transcripts which Mr Wright told us he had read. Each case must be decided on its own facts and we took the view that it would be improper and imprudent to attach any weight to this. Our approach has been to look at the evidence before us in relation to the two deals under appeal and reach our decision accordingly.

164.We found Mr Wright's approach to commercial checks generally did not reflect the action of a legitimate businessman seeking to avoid connection to fraud. On several occasions Mr Wright made clear that the purpose of checks undertaken were for the benefit of HMRC and we were satisfied that the documents obtained by way of due diligence were no more than window dressing for the purpose of satisfying HMRC. As Mr Wright himself acknowledged on one occasion, the documents did no more than to establish a legal entity; they provided no assistance in the consideration of the legitimacy or otherwise of a transaction.

165.We considered Mr Wright's evidence that he would have been content to trade with, for example, Phonetrade Aps without the due diligence documents obtained. However there was no evidence to demonstrate what consideration or analysis of its trading partners was undertaken by the Appellant in order to assess whether the transactions were legitimate. Mr Wright accepted in evidence that there was limited time in which to assess Jos as a trading partner and we were satisfied on the evidence before us that not only was the time limited but that there was no cogent evidence to support any assessment of the company having being undertaken so as to satisfy the Appellant as to the veracity of the deals. Mr Wright's assertion that he had no reason to suspect otherwise reflected, in our view, Mr Wright's attitude that it was the duty of HMRC, or someone else, to notify him if the transactions were not legitimate. When viewed in the context of Mr Wright's understanding of fraud within the industry we were satisfied that the information obtained by Mr Wright would be wholly inadequate to form an opinion as to the risks involved in trading with Jos or Phonetrade Aps and that no proper steps were taken to ascertain the extent of any such risk. We concluded that this approach to the transactions, worth substantial sums of money, is a factor that indicates either Mr Wright's knowledge that the transactions were contrived because in reality they did not involve any such commercial risk or his willingness to turn a blind eye to that fact. In our view, the due diligence, such as it was, was designed to satisfy HMRC and to be relied on by the Appellant in the event

of HMRC building, as the Appellant described it, a "means of knowledge" case against him.

166.We did not find the evidence as to mark-ups made on UK-UK transactions between 2002 and 2004 assisted us in reaching our decision on knowledge or means of knowledge; as stated earlier we had no detailed information pertaining to these transactions and for that reason we make no findings of fact in that regard.

167.The absence of documents we would expect to see in any arm's length commercial transaction was striking; there was no evidence in the form of emails, faxes or letters showing negotiations, offers and counter-offers or correspondence about delivery and payment. Mr Wright's evidence painted a confusing picture as far as title and payment were concerned and we found his explanation that this was how the industry worked wholly unconvincing; in arm's length transactions of substantial value Mr Wright's evidence that payment went one way up the chain as title passed down the other way lacked credibility. We found the evidence regarding insurance was inconsistent and lacked credibility; Mr Wright initially told HMRC he had insurance for the goods and would obtain a copy of the policy document, it later transpired that there was no insurance at which point Mr Wright stated that he had been verbally assured to the contrary by ASC, subsequently Mr Wright contended that insurance was a matter for the title holder of the goods. That any reasonable businessman seeking to protect himself from fraud would be unaware or fail to ensure whether or not goods of such significant value were insured lacks credibility. We concluded that the Appellant could have had no reasonable belief that insurance was in place. We were satisfied that each of these factors, both taken together and in isolation, indicated knowledge on the Appellant's part that the transactions were orchestrated.

168.The Wholesale Procedure document clearly demonstrated the Appellant's understanding of the types of checks that could be undertaken to assist in avoiding connection to fraud. We found Mr Wright's evidence on this matter unconvincing. We were left with no credible explanation why Mr Wright had failed to give HMRC the version purportedly in use at the time of the transactions, particularly when the letter from Mr Tuddenham to the Appellant dated 15 February 2007 clearly stated that Mr Wright had provided an assurance that the version provided was the working copy. Moreover Mr Wright did not refer to or provide the updated version until 2012. We did not accept Mr Wright's evidence that he did not realise that Mr Tuddenham would analyse the document in detail; Mr Wright was fully aware that an extended verification of the relevant transactions was being undertaken by Mr Tuddenham and he understood the relevance and importance to that verification of documents such as due diligence checks and, we concluded, the wholesale procedure document. Furthermore Mr Wright's evidence as to why important features of the earlier versions had been removed was vague and wholly unconvincing. We rejected Mr Wright's evidence that the document had been amended to reflect what he intended to do, there being no cogent evidence as to why his intentions had changed between the time of providing the document to HMRC and updating the document. We concluded that it was highly likely that Mr Wright had amended the document to reflect how the transactions had taken place. That said, there are a number of reasons why Mr Wright

may have done so, for instance to bolster his case or to help his repayment claim, and we did not find that our conclusion on this matter indicated knowledge or means of knowledge on his part. We did conclude, however, that having identified a number of checks and procedures as playing an important role in transactions, Mr Wright's failure to ultimately adopt many of these features without explanation indicated that either he was aware that the transactions were connected to fraud or that he was willing to turn a blind eye to the fact and therefore such checks were unnecessary.

169. Mr Wright's evidence that he was able to make a significant profit on the deals as a result of his role as exporter did not withstand scrutiny. We accepted that the Appellant would not have known of the prices paid by other traders in the chains but Mr Wright was aware of the price at which he purchased and sold the goods. We adopted the comments of Judge Bishopp in *Calltel Telecom Ltd v HMRC* [2007] UKVAT V20266:

> *"(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".*

170. In our view the profit, for instance in 03/06 having purchased the goods for £487 per unit and sold them at £573 per unit, bearing in mind that the transaction was back to back, the Appellant simply identified a buyer and seller and did not otherwise add value to the chain and taking into account Mr Wright's significant experience of the mobile phone trade, was quite obviously too good to be true. The Appellant's apparent failure to consider or query this is a matter which we found indicative of his knowledge that the transactions were contrived or, at the very least, should have put the Appellant on notice.

171. As regards the evidence of Mr Corkery, we accepted the evidence that the higher margin made by the Appellant as compared with others in the chain was not due to the fact that the Appellant, as exporter, could fund the VAT, evidence which Mr Wright accepted. The evidence regarding general aspects grey market and features of the deals such as lengths of deals chains were not matters which were necessarily known to the Appellant at the time and we did not find this assisted us in reaching a decision as to the Appellant's knowledge or means of knowledge.

172. We noted the anomalies in respect of inspections of the goods, for instance in 06/06 the inspection was requested at the same time as the goods were allocated to the Appellant's customer and we queried in those circumstances what use a report would be at that point. We also noted that the verbal report the Appellant told us was received before the faxed copy would provide limited comfort if something was found to be wrong with the goods and the Appellant had no documentary evidence to rely on. However our main observation on this point was that it was clear from the evidence that the Appellant knew little, if anything, as to who carried out the

inspections, what the inspections entailed and how they were carried out. We formed the view that this was reflective of the Appellant's attitude to the transactions because he knew that the deals were contrived.

173.We were satisfied that the FCIB data was accurate and reliable and that it demonstrated circularity of payments which supports the existence of a highly orchestrated fraudulent scheme extending beyond the fraudulent defaulters. However we took the view that circularity, of itself, did not indicate knowledge on the part of the Appellant. In relation to the evidence regarding IP addresses in 06/06, we found the evidence of HMRC compelling. We accepted Mr Letherby's evidence that the data as a whole did not support the Appellant's assertion that he used software which changed the IP address of his computer every 60 seconds or that, if such software was used, it had not been correctly installed or configured. We also accepted Mr Letherby's evidence that multiple windows of a bank account could be opened. We found Mr Wright's evidence as to the software he told us he used was vague and unconvincing and we did not accept his opinion regarding the opening of multiple windows. We concluded from the evidence that the payments made in the transactions under appeal came from the same IP address, all being made within a short space of time and moving in a circle. We inferred from the evidence that the payments were controlled from one source; that being so, the only conclusion we could reach was that the Appellant was aware of this fact.

Conclusion

174. We were satisfied that HMRC had established fraudulent tax losses and that there was an orchestrated scheme for the fraudulent evasion of VAT connected with the transactions which form the subject of this appeal.

175. We concluded that in respect of the periods under appeal the Appellant knew, through Mr Wright, that the transactions were connected with the fraudulent evasion of VAT or that the factors set out above would at the very least support a finding of means of knowledge. We were satisfied that the evidence indicated Mr Wright's knowledge of the fraud or, in the alternative, his turning a blind eye to the only reasonable explanation being that the transactions formed part of an overall scheme to defraud the Revenue. There is no single circumstance from which we have inferred that the appellant knew or should have known of the connection with fraud. We have considered all the circumstances and whether, on balance, we are satisfied that the appellant knew or should have known of the connection with fraud.

176. The appeal is dismissed.

Strike out application

177.A further matter arose shortly before the hearing which resulted in HMRC applying to strike out the part of the appeal relating to 03/06. The Appellant subsequently went into liquidation on 14 August 2008 having previously been in administration. The liquidator assigned, or as HMRC contend purported to assign, the right of action in the appeal to the Appellant. The Liquidator wrote to the Tribunal on

3 September 2014 stating that *"…in the absence of any funding, or evidence and information from the director, Mr Wright, the company remains unable to oppose the application by Howes Percival to strike out."*

178. HMRC contend that the 03/06 period, which is an appeal against an assessment to the VAT previously repaid without prejudice and prior to extended verification is governed by the judgment of HHJ Pelling QC in *re GP Aviation Group International Limited (In Liquidation)* [2013] EWHC 1447 (Ch) *"re GP Aviation")* in which the Court held that the right to appeal against an assessment to tax is not property capable of being sold within the meaning of the Insolvency Act 1986. HMRC contend that the liquidator could not therefore assign conduct of the appeal to the company's former director and Mr Wright does not have the authority or standing to pursue the appeal. Mr Wright does not accept this to be the position.

179. It was agreed that given the proximity to the hearing when this matter was raised together with the fact that the evidence relating to the 03/06 period is relevant to the 06/06 period irrespective of our decision on the strike out application, we would determine the application as part of our decision. We should note that in its skeleton argument dated 20 August 2014 HMRC observed that *"an order preventing the present Appellant pursuing the appeal against the 03/06 assessment does not prevent the Directors of Leeds Smith Consulting Ltd from participating in the appeal by making submissions, and providing information and documents. However the ultimate conduct of the appeal can only rest with the Liquidator of the company."*

180. In *re GP Aviation* HHJ Pelling QC stated (at [8], [10], [26], [27], [28] & [31]:

"Issues:

The Respondents contend that the most appropriate and practical direction would be one that requires the Applicant to assign the appeals to the Respondents. The Applicant whilst maintaining the position that he will act in accordance with the directions of the Court, submits that there are a number of difficult legal and practical issues that in reality prevent this course from being adopted. It is common ground that the issue between the parties raises four sub-issues being:

i) Whether the right to appeal against a tax liability constitutes the "property" of the Company ("Issue 1");

ii) Whether the Applicant has power to "sell" such property ("Issue 2");

iii) Whether the exercise of such a power will be effective to assign the right to appeal ("Issue 3"); and

iv) Whether it is proper for the Applicant to assign the right to appeal ("Issue 4")…

The power to conduct the appeal is not of itself capable of assignment – see (most recently) Ruttle Plant Limited v. SSEFRA …per Ramsey J at [43], following earlier authority to similar effect including Grovewood Holdings Plc v. James Capel & Co

Limited [1995] Ch 80 per Lightman J at 89G. Thus the Applicant can have power to assign the appeals only if the right to appeal is property capable of being sold within the meaning of Paragraph 6 of Schedule 4. It is this issue that was the principal one argued by the parties before me...

I have come to the conclusion that a bare right of appeal of the sort I am now considering is not property within the meaning of the IA…

First, the classical definition of a chose in action is that identified by Channel J in Torkington v. Magee [1902] 2 KB 437 at 430 – that it is an expression used to describe "… all personal rights of property which can only be claimed or enforced by action and not by taking physical possession". A bare right to appeal against what would otherwise be a liability does not satisfy this definition. It is not a right that must be claimed by action. It is a right that is unconditionally conferred on the Company (in this case) by operation of statute. It is not a property right that can only be enforced by action. That is a cause of action and a bare right to appeal does not fall within the scope of that concept either…

As Lord Hoffmann put it … "… what is assigned is the chose … the existence of a remedy or remedies is an essential condition for the existence of a chose …but that does not mean that the remedies are property in themselves, capable of assignment separately from the chose." Lord Hoffmann defined a chose as being "... something capable of being turned into money …" and "… the assignee either acquires the right to the money or he does not. If he does, he necessarily acquires whatever remedies are available to recover the money …". A liability does not satisfy this requirement. If that is so, it is difficult to see how a right vested in the person otherwise liable to appeal can have such status. Aside from that, a right of appeal relating to an estate in which the proposed assignee of the right to appeal has no proprietary interest is not something capable of being turned into money in this sense. It is akin to assigning a remedy without the right in respect of which the remedy exists.

All this leads me to conclude that a bare right to appeal is not property within the meaning of s.436 of the IA. A right of appeal available to a bankrupt is one that the bankrupt loses locus to bring or maintain once he or she is adjudicated bankrupt because the only assets out of which the underlying liability can be met have vested in the trustee and not because the right is a chose that vests in the trustee. The trustee has a statutory right (but not the obligation) to exercise any right of appeal that the bankrupt might have had as and from the moment at which the bankrupt is made the subject of a bankruptcy order. Similarly a right to appeal available to a company in liquidation can only be exercised by the office holder once appointed because he she or they then become the only agents of the company entitled to do so. Again however that is not the result of the right to appeal being treated as a property interest."

(emphasis added).

181.We have already set out our findings of fact on the evidence in respect of both periods under appeal which has, or would have but for the strike out, resulted in the appeal being dismissed in any event. For that reason we will deal with this matter

briefly. The Court's ruling in *GP Aviation* is clear and binding upon us. Given the Liquidator's written confirmation that HMRC's application to strike out the appeal in respect of period 03/06 is not opposed we grant the application.

Costs

182.There was a further dispute between the parties as to the costs of preparing the bundles. However following *Eclipse Film Partners No. 35 LLP v HMRC* [2014] EWCA Civ 184 *("Eclipse")* the Tribunal issued Directions on 28 August 2014 which directed that both parties produce one set of bundles and copies of that set. The Direction also warned that a failure to comply may be dealt with by way of an order for costs reflecting unreasonable conduct, as per Moses LJ in Eclipse at [22]:

> *"The good sense of ordering that one set of the bundles be prepared is obvious. It would have been a recipe for chaos and not good case management for one party to prepare bundles with the documents on which it sought to rely and for the Revenue to prepare a different bundle containing those documents on which it sought to place reliance. It would have been open to the FTT to order that both parties prepare a single set of bundles, leaving it to them as to how that was to be done and, should there be obduracy on the part of one or the other, to make further directions to resolve any dispute. Had the FTT made that order, both sides would have borne the costs of their contribution to the single sets of bundles, just as both sides would have had to contribute to the cost of a single expert or, as they did, to the cost of transcripts. But this is not what happened. Eclipse 35 had already agreed to prepare the bundle and the question of expense arose only because of the Revenue's insistence on the insertion of a large number of documents, leading to ever more files. If this proves to be unreasonable then it will be open to the FTT to say so since the question of the conduct of the Revenue has been adjourned."*

183.As there was no agreement between the parties, HMRC ultimately bore the costs in order not to jeopardise the hearing. No contribution has been made by the Appellant. In closing submissions the Appellant submitted that the costs of copying should be 1 – 2p per sheet and that the Appellant should bear 20% of the costs. HMRC submitted in response that there was no formal quote from a reputable company taking into account the confidential nature of substantial parts of the evidence to support the Appellant's submission. HMRC maintain that the figure of 10p per sheet is proper, reflecting the time and work involved, and no good reason has been advanced by the Appellant as to why it should not contribute 50%. In order to reach a agreement, HMRC offered on 5 September 2014 to compromise at 6p per sheet if the Appellant paid 50% of the costs.

184.We should note that the Appellant referred to an interlocutory costs order made by Judge Bishopp in 2009 which related to a hearing to determine a stay application bythe Appellant which was subsequently dismissed. The order was considered at a directions hearing on 24 September 2012 by Judge Gort who indicated that the order would not be varied and therefore a sum of £2,700 was payable under the old rules; to

which both sides acceded. Judge Gort directed that thereafter the appeal fell under the new rules:

> *"UPON the Respondents' concession that the 2009 Rules should apply to all aspects of these proceedings it is so directed."*

185. The suggestion from the Appellant, as we understand it, is that the order by Judge Bishopp, and confirmed by Judge Gort was erroneous and the sum should be offset against the costs of preparing the bundles. We note that Judge Bishopp's direction was not appealed, nor was that of Judge Gort who gave further consideration to it; moreover the Appellant confirmed it did not wish to challenge the matter further. In those circumstances we see no basis for interfering with it.

186. As regards the costs of preparing the bundles, the Supreme Court in *Eclipse* confirmed the position as follows (at [6] & [10]):

> *"With one exception, it would therefore appear that, at least under rule 10(1), the FTT can only make two types of costs order. The first is a wasted costs order under sub-para (a), and the other is an order for costs where a party has behaved unreasonably under sub-para (b). The one exception is under sub-para (c), which envisages that there will be no such limitation on the FTT's jurisdiction to award costs if two conditions are satisfied - namely (i) the proceedings are a "Complex case" under Rule 23, and (ii) the taxpayer has not served a request (within the requisite 28-day period) that there should be no potential liability under rule 10(1)(c).*
>
> *Thereafter, Eclipse and the Revenue agreed directions for the procedure leading up to the hearing. The FTT duly made those directions, which included in para 13 a direction that the parties should try and agree an appropriate bundle of documents, which should be prepared by Eclipse, who were to serve three copies on the Revenue and three copies on the FTT…."*

187. In this appeal, HMRC invite the Tribunal to use its powers under Rule 10(1)(b) of the FTT Rules and order costs on the basis of the Appellant's unreasonable behaviour to reflect the lack of co-operation in trying to reach agreement on the issue of costs. It is clear to us that HMRC made numerous efforts to agree the matter, yet the Appellant failed to engage in reasonable discussions nor take any steps to offer an alternative other than to assert that numerous unnamed companies would copy the bundles at a cheaper rate. The Direction issued on 28 August 2014, which was not appealed, directed that:

> *"Both parties produce one agreed set of bundles and copies of that set. Failure to comply with this direction by either party may be dealt with by an order for costs reflecting unreasonable conduct."*

188. The distinction to be drawn between this appeal and *Eclipse* is that in the latter appeal *Eclipse* was liable for the preparation of the bundles. In the present appeal both parties are jointly responsible. In our view the Supreme Court's comments at [24] are relevant:

"…the fact that things could have been arranged so as to achieve the same result as the Order is irrelevant to the outcome of this appeal. As Moses LJ pointed out in para 22 of his judgment, the FTT could have ordered both parties to prepare the Bundles jointly, in which case there would have been a powerful argument for saying that Eclipse could have recovered the £108,395.48 which they now claim, simply on the basis of a contribution between two jointly liable parties. But that is not what happened here: Eclipse were liable for the preparation of the Bundles, and it is not sensibly possible to characterise the Order as having any effect other than requiring the Revenue to pay some of Eclipse's costs, an order which was precluded by rule 10(1)."

(Emphasis added)

189. In those circumstances it seems to us that HMRC are entitled to recover the costs of preparing the bundles on the basis of the FTT's Direction which gave the parties joint responsibility to prepare the bundles. However, should it be necessary to determine the issue we have concluded that the Appellant's behaviour in respect of the issue of costs of preparing the bundles was unreasonable and an order for costs reflecting a 50% contribution is appropriate.

190. 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.

JUDGE DEAN
TRIBUNAL JUDGE

RELEASE DATE: 28 JUNE 2016