



TC05587

Appeal number: TC/2012/10677

VAT- Input Tax- denial of input tax reclaim on basis of Kittel - whether appellant knew or ought to have known various transactions in electrical / computer goods were connected to fraudulent evasion of tax – no actual knowledge - means of knowledge satisfied in 2 out of 32 deals – appeal allowed in part

**FIRST-TIER TRIBUNAL
TAX CHAMBER**

LINK DISTRIBUTION (UK) LIMITED

Appellant

- and -

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

Respondents

**TRIBUNAL: JUDGE SWAMI RAGHAVAN
DAVID EARLE**

Sitting in public at the Royal Courts of Justice on 20-22, 25, 26 and 29 April 2016

Hywel Jenkins, counsel, instructed by CTM solicitors for the Appellant

**Vinesh Mandalia, counsel instructed by the General Counsel and Solicitor to
HM Revenue and Customs, for the Respondents**

DECISION

Introduction

- 5 1. The appellant is a wholesaler of electronic games and games consoles. It appeals against HMRC's decision of 31 July 2012 denying it the right to deduct input tax of £274,504.75 for the period 04/10 on the purchase of games consoles, televisions, satellite navigations systems and computer memory and £221,529.10 for the period
- 10 05/10 on the purchase of games consoles, televisions and computer memory on the grounds that the transactions in respect of which input tax was claimed were connected to fraud and that the appellant knew or ought to have known of that connection. The appellant denies that it has such actual knowledge or means of knowledge that its transactions were connected to fraud.
- 15 2. There are 32 transactions or deals in issue. With the exception of one transaction (Deal 17) the appellant accepts 1) HMRC have identified the correct supply chain 2) that a fraudulent tax loss has been proved in each of the chains (in three deals via acquisitions by a contra-trader). Where HMRC have provided evidence that a trader has acted fraudulently the evidence is not disputed. The issue in dispute is therefore principally whether in the 32 deals in question the appellant had knowledge or means
- 20 of knowledge of the connection to fraud.
3. In relation to Deal 17 while this has not been traced back to a tax loss, HMRC note that the transaction does not appear in the appellant's suppliers' records. HMRC's case is that if that transaction was capable of being traced back it would, on the balance of probabilities, trace back to an identified tax loss.

25 *Evidence*

4. We received written witness statements in advance and heard oral evidence which was cross-examined by the other party from the following witnesses:
- 30 (1) Mark Chisman – the HMRC officer responsible for the decision under appeal. He had also met and corresponded with the appellant in relation to its due diligence.
- (2) Craig Donaldson – director of the appellant
- (3) David Donaldson – director of the appellant.
- 35 5. In addition we received eight witness statements from HMRC officers who had been allocated responsibility for the various defaulting traders in the deal chains (and a further one from Mr Chisman in his capacity as officer responsible for the VAT affairs of the defaulting trader Real Time Prospects Ltd) and also a witness statement from Roderick Stone which provided an overview of Missing Trader Intra Community fraud (MTIC).

6. While HMRC sought to attack the credibility of both Craig and David Donaldson as witnesses of truth we were not, as we explain below at [16], persuaded that their evidence was to be disbelieved. That is not to say we accepted the entirety of their evidence at face value for the reasons discussed at [18].

5 **Law**

7. There was no significant dispute between the parties as to the relevant law and legal tests to be applied and we gratefully adopt the explanation of those as set out in the skeleton argument of Mr Mandalia, who appeared for HMRC, which we set out below with some minor adaptations.

10 8. In *Kittel*¹, the ECJ held that:

a) “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”; (at [55]);

15 b) “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 fraud must be regarded as a participant in that fraud”; (at [56]);

c) “that is the case, irrespective of whether or not he profited by the resale of the goods”; (at [56]); and

20 d) “that is because in such a situation the taxable person aids the perpetrators of the fraud”; (at [57]).

9. 28. The ECJ concluded at [61]:

25 “...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...”

30 10. There was no controversy around the significance of the fact that some of the chains were connected to fraud by virtue of being connected to contra-trader chains so we do not set out in the detail the excerpts from the authorities dealing with issues around the treatment of contra-trading.

11. As to the question of what the knowledge must be of, in *Megtian v HMRC* [2010] EWHC 18 (Ch), Briggs J held at [37] and [38]:

35 “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

¹ Joined Cases C-439/04 and C-440/04 *Axel Kittel v Belgium; Belgium v Recolta Recycling* [2008] STC 1537

abscond without paying tax, or that intention plus one or more multifarious means of achieving a cover-up while the absconding takes place.”;

5 “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
10 real world are not invariably susceptible, as a matter of law, to being carved up into self-contained boxes....”;

12. In *Mobilx Ltd, Blue Sphere Global Ltd and Calltel Telecom Ltd v HMRC* [2010] EWCA Civ 517, Moses LJ considered the issue of knowledge and observed:

15 a) “A person who has no intention of undertaking an economic activity but pretends to do so in order to make off with the tax he has received on making a supply, either by disappearing or hijacking a taxable person's VAT identity, does not meet the objective criteria which form the basis of those concepts which limit the scope of VAT and the right
20 to deduct (see *Halifax* § 59 and *Kittel* § 53). A taxable person who knows or should have known that the transaction which he is undertaking is connected with fraudulent evasion of VAT is to be regarded as a participant and, equally, fails to meet the objective criteria which determine the scope of the right to deduct.”; (at [43]);

25 b) “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,
30 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.”; (at [52]);

35 c) “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
40 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*.”; (at [59]);

45 d) “A trader who decides to participate in a transaction connected to fraudulent evasion, despite knowledge of that connection, is making an informed choice; he knows where he stands and knows before he enters into the transaction that if found out, he will not be entitled to

5 deduct input tax. The extension of that principle to a taxable person who has the means of knowledge but chooses not to deploy it, similarly, does not infringe that principle. If he has the means of knowledge available and chooses not to deploy it he knows that, if found out, he will not be entitled to deduct. If he chooses to ignore obvious inferences from the facts and circumstances in which he has been trading, he will not be entitled to deduct.”; (at [61]); and

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

13. As noted in the judgment of Lewison J, as he then was, in *HMRC v Livewire Telecom and another* [2009] EWHC 15 (Ch), at [123] and [125], it is not just the
20 knowledge of individual directors that is relevant in considering this question, it is the knowledge of the company which can include its senior employees.

14. Furthermore, as noted in the judgment of Floyd J in *Mobilx v HMRC* [2009] EWHC 133 (Ch), at [7], suspicious indications obtained by a trader from carrying out due diligence checks on its supplier are one, but not the only basis from which it may properly be inferred that a trader knew or should have known of its implication in
25 VAT fraud. All “reasonable precautions” may, in some cases, involve ceasing to trade in specified goods in a particular market, at least in the particular manner in which the trader undertakes that trade where, from other indications available to the trader, the trader knew or should have known that it is more likely than not that, despite all due diligence checking, any further goods traded in the same way will be implicated in
30 VAT fraud.

15. The Court of Appeal in *Mobilx* confirmed that the burden of proof in these proceedings lies with HMRC (at [81] of its decision). The standard of proof is the ordinary civil standard, proof on the balance of probabilities.

Facts

35 *Credibility of witnesses: Craig and David Donaldson*

16. HMRC say the evidence of Craig and David Donaldson was vague and plainly rehearsed with both repeatedly referring to having been told by HMRC that there was “zero risk of MTIC fraud” in their grey market supply chains rather than answering the question. It is suggested their evidence was wholly unsatisfactory and entirely
40 unreliable. By way of example HMRC say the information given to HMRC on the appellant’s VAT registration form and subsequent enquiries was incorrect and misleading as to the appellant’s trading activity and as to the supplies and purchases that it intended to make. Craig Donaldson was unable to explain why the VAT 1

Application for registration described the company's business activity as "computers and other information processing equipment manufacture" as it had never been the intention to manufacture computers and other information processing equipment, further he had incorrectly stated in response to HMRC's enquiry that the goods and services to be provided by the appellant were "sale and setup of computer systems".

17. HMRC also highlight that the statement of David Donaldson that Craig Donaldson had adopted in his evidence that Cube Enterprises Ltd, the company which Craig had worked for, was involved in the distribution of games consoles, games and other related products, was incorrect. In his oral evidence Craig Donaldson explained that Cube's main business was computer peripherals but that when he moved over to work for them he started a trading arm dealing with gaming consoles as well.

18. Although it is clear that the answers given on the form and in response to enquiries were not accurate in terms of mentioning activities in relation to which there was no intention to trade in and in omitting mention of certain products which were intended to be traded in, we are not persuaded this has the significance HMRC which suggest in terms of the reliability of the witness' evidence. Without having a picture of what the available trade classifications were, it is difficult to make an assessment of how far removed the classification given was from classifications which would have been more apt. We do not think the answers given reveal an intent to mislead, at best they indicate that the appellant had poor attention to detail in its communications with HMRC. While it is correct that a constant refrain in cross-examination was the view that the appellant had been told by Officer Chisman there was no risk of fraud meant that the appellant's evidence was not as comprehensive as it might have been, the witnesses did on the whole attempt to answer the questions which were put to them. There were some parts of their evidence which were inaccurate or speculative, but the inaccuracies can, we think, be explained by the difficulties in recollecting the fine detail some time after the event. To the extent certain evidence hinged on recollections recalled some time after the relevant events and to the extent it was inconsistent with documentary evidence, or strained plausibility we give it reduced weight. An example was the evidence as to reworking of products to change their specification for different markets (see [64] and [77]).

Background facts about Link Distribution (UK) Ltd ("Link")

19. The appellant was incorporated on 22 June 2007 (while its notice of appeal to the tribunal referred to Link Distribution Ltd and hence was registered with the tribunal with that name, its company name is Link Distribution (UK) Ltd). The directors were David Donaldson and Craig Donaldson.

20. When Link was incorporated its primary business model was to distribute PC components and peripherals to the UK and Europe. It had customers with turnovers ranging from £14 million to £242 million (Ebuyer) and suppliers with turnovers ranging from £20 million to £121 million (Northamber).

21. Between the period 13 July 2007 to 12 October 2007 Link invoiced approximately £200,000 worth of stock selling PC components and peripherals.

22. Link found a gap in the market by buying retail packages online and in demand Wii consoles and games and selling them separately enabling them to enjoy rapid growth.

23. In the period 03/08 the appellant's turnover was £1,287,342, in 06/08
5 £2,354,160, in 06/09 £2,211,250 and in 03/09 it was £3,572,789.

24. Although David Donaldson's evidence mentions there were times where the appellant could not fulfil the customers' request or sell suppliers' stock for other normal reasons such as the demand was not there or the price did not work we were not taken to any specific instances of such events and were therefore unable to make
10 any specific findings of fact as to when and to what extent such issues occurred.

The Donaldsons' backgrounds

25. Up until he became a director of Link in 2008 David Donaldson had no experience in the industry. He had 10 years' experience in sales. He had been a sales representative for Document Solutions Limited ("DSL"), a photocopier supplier
15 covering Huddersfield and South Yorkshire and handling major accounts. Before that he had variously been an apprentice footballer, a carpet salesman and had worked in a call centre for BT.

26. Craig Donaldson worked for a company called Cube Enterprises Limited ("Cube Enterprises") which dealt in PC components, peripherals and who were a "large system integrator" selling full PC systems. Before that, between 1998 and 2004, he
20 had worked for Real Time Distribution Limited for six years a large gaming and electronics distributor. Real Time was acquired by another company and Craig Donaldson was headhunted by Cube Enterprises. When he moved over to Cube he set up the trading arm and started to trade in games consoles as well as PC components.
25 He was sacked from Cube when his boss there discovered that he was looking to set up his own company.

27. DSL questioned David Donaldson as to where his loyalties lay giving him an ultimatum but also said they were interested in the opportunity to work with Craig Donaldson and David Donaldson in the new venture. Steven Cavanagh was David
30 Donaldson's boss at DSL and a director there. Steven Cavanagh and his brother David Cavanagh invested £30,000 with their wives to obtain a third share, as did David Donaldson. Craig Donaldson also received a third share but did not invest money to get it. Craig Donaldson resigned as a director because, it was difficult for the appellant to get a credit facility given Craig Donaldson's debts to HSBC.

35 28. Link first started trading at the office where David Donaldson had worked at DSL in Bradford in a makeshift space. DSL owned a warehouse opposite that they used for storage and refurbishing of machines. A sub-let was taken out in Unit 23.

29. In 2008 the appellant brought in a further employee, Fraser Blakemore. Mr Blakemore had three years' experience as product manager (consoles & software,
40 blank media, PDA's, gadgets and batteries) for Ebuyer.

30. In mid-2009 the Donaldsons bought out the Cavanagh brothers.

31. Craig Donaldson is a 26% shareholder with his wife owning 24%.

32. The premises comprised of a warehouse which was about 16,000 square foot; it could hold 40-50 pallets, it doubled in 2009 and as the date of the hearing had triple the capacity it originally had.

Staff set up

33. In 2010 the persons working in sales and purchasing were David Donaldson, Craig Donaldson and Fraser Blakemore. There was one member of accounts staff and two to three people working in the warehouse. Each sales person was responsible for their own "paper" due diligence (described in more detail at [114] below) which was then submitted to the accounts staff member who sent the paper due diligence to HMRC Redhill and who also sought a validation on the European Commission's website (referred to as a "Europa" validation). Sales staff worked on commission. They had a relatively low basic and their commission worked on a sliding scale basis so for £6,000 to £10,000 profit they would get 10%, £10,000 to £18,000, 15% and £18,000 plus, 20%. The profit was that which was allocated to the sales rep's sales. Although David Donaldson did not have any customer or supplier contacts, Craig Donaldson, and later on Fraser Blakemore did.

34. Craig Donaldson was in charge of the cashflow and the general day to day running of the business.

VAT registration and returns

35. The appellant applied for VAT registration on 2 July 2007. The intended business activity stated on the electronic VAT application for registration was "to distribute PC components and Peripherals." The business address given was the home address in Keighley of David Donaldson. The company was not making taxable supplies but estimated the value of its taxable supplies in the following 12 months to be £250,000. It indicated the value of goods likely to be bought from EC member states in the next 12 months to be £100,000 and the value to be sold to them of £125,000. The appellant was registered for VAT with an effective date of 1 August 2007.

36. In a request for information dated 28 August 2007 the appellant was asked whether it provided goods or services and if so exactly what these were. Craig Donaldson answered the next day that it did, and that the goods and services were "Sale and set up of computer systems."

The deals under appeals

The period 04/10 and 05/10 Return

37. The Appellant's 04/10 VAT return was submitted on 5 May 2010. The Appellant declared the following trade:

5 “VAT reclaimed on purchases £ 402,485.29
Total Value of Sale £2,176,772.00
Total Value of Purchases £2,304,968.00
Total Value of Supplies to EC £ 525,786.00
Net repayment due £ 149,283.84”

38. The Appellant's 05/10 VAT return was submitted on 2 June 2010. The Appellant declared the following trade:

10 “VAT reclaimed on purchases £ 298,766.01
Total Value of Sale £2,066,133.00
Total Value of Purchases £1,711,899.00
Total Value of Supplies to EC £ 135,944.00
Net repayment due £ 26,409.28”

15 *Transaction chains*

39. The 32 transactions upon which the right to deduct input tax is denied, were all concerned with the purchase of games consoles, televisions, satellite navigation systems and computer memory. The details of the product, date of purchase, supplier and customer are set out in the annex to the decision. The suppliers in the various deals may be summarised as follows:

Supplier	Deals
Bluestar Trading Ltd	1, 2, 3, 4, 5, 6, 12, 16, 17, 19, 22
Zen Trade Ltd	7, 8
Johnson's Consultancy Ltd	9, 23, 30
Cybacomms International Ltd	10
The Manual People t/a TMP Distribution	11, 18, 20, 25, 26
Affilia Ltd	13, 27
Grandbyte Computers Ltd	14
Fonestation Ltd	15
Northern Computer Services Ltd	24
Impact Technologies UK Ltd	21, 28, 29, 31, 32

Transaction patterns

40. The chains of supply in each of the deals (apart from deal 17) (with the defaulting trader set out in bold) and details of whether the customers were UK or non-UK were as follows.

41. Deals 1-6: **T-Sterling Traders Ltd** > Northwell UK Ltd > Bluestar Trading ltd > Link. Link sold to UK customers (Ebuyer – deal 1, Vogue Distribution Ltd – deal 2, Creative Distribution Ltd, deals 3, 4 and 5, Powerplay Direct Ltd – deal 3, GLS Game Distribution Ltd – deal 6) and to non UK customers Norrod Computers BV – deal 4,
5 Marc Intelligent Systems – deal 4, B&G Informatica – deal 5, Diffusione Elettronik SAS – deal 5, and Al-Fayaz Sattar Gen Trading – deal 6.)
42. Deals 7 and 8: **Pridefields Ltd** > Zen Trade Ltd > Link. Link sold to UK customers: Creative Distribution ltd – deals 7 and 8, Diverse Electronics Ltd – deal 8, GLS Games Distribution – deal 8. Non UK customer Marc Intelligent systems- deal
10 7.
43. Deal 9: **T-Sterling Traders Ltd** > Northwell UK Ltd > Bluestar Trading Ltd>Johnsons Consultancy ltd>Link > (UK customer) Creative Distribution Ltd.
44. Deal 10: **Vision Autos Ltd.**>Globe Trade International Ltd. > Cybacomms International Ltd. > Link> (Customer abroad) Incoparts BV.
- 15 45. Deal 11: **Bond Traders Ltd.**>The Manual People Ltd t/a TMP Distribution> Link > (UK customer) Technology Supplies International ltd.
46. Deals 12,16, 19 and 22: **Falcon Logisitics Ltd.** > Northwell UK Ltd > Bluestar Trading Ltd.> Link (UK customers Creative Distribution Ltd – deals 12,16 and 22, Revive Corporation – deals 12 and 16, Vogue Distribution Ltd – deal 12, Ebuyer- deal
20 19, Perfect Computer Systems ltd. – deal 22, Click Entertainment ltd – deal 22, X-bite Ltd – deal 22, Compudal Ltd – deal 22) and customers abroad Al-Fayaz Sattar Gen Trading – deal 12, and Bre.MA S.R.L – deal 12).
47. Deals 13 and 27: **Redbond Services Ltd.**>Westmill Trading Ltd.>Affilia Ltd> Link > customer abroad KuzeyLodos Bilisim.
- 25 48. Deal 14: **Falcon Logistics ltd** > Northwell UK Ltd > Bluestar Trading ltd > Grandbyte Computers Ltd.> Link > customer abroad: DCS Aps.
49. Deal 15: **Pridefields Ltd.** > Globetrader International Ltd. > Fonestation Ltd. > Link > UK customers: Click Entertainment Ltd, Worldwide Digital Ltd. Perfect Computer Systems Ltd., customer abroad Diffiusionne Elettronik SAS.
- 30 50. Deals 18,20,25 and 26: **Realtime Prospects Ltd.** > The Manual People ltd t/a TMP Distribution > Link > UK customer: Skream ltd – deal 18, Creative Distribution ltd – deal 20, Active Ventures UK Ltd. – deals 25 and 26.
51. Deals 23 and 30: **Falcon Logistics Ltd.** > Northwell UK Ltd. > Bluestar Trading Ltd. > Johnsons Consultancy Ltd > Link > UK Customers: Skream Ltd.- deal 23,
35 Creative Distribution Ltd – deal 30, and Diverse Electronics Ltd – deal 30.
52. Deal 24: **Ecotrade UK Ltd.** > Northern Computer Services Ltd. > Link > (UK customer: Skream Ltd.)

53. Deals 28 and 29: **Falcon Logistics Ltd.** > Northwell UK Ltd. > Bluestar Trading Ltd. > Impact Technologies UK Ltd. > Link > UK customer Revive Corporation Ltd: deal 28 and customer abroad Square International – deal 28 and 29.

54. Deals 21, 31, and 32: **Intekx Ltd.** > Changing Commodities Ltd.>Gemini Technology Ltd. > Impact Technologies Ltd. > Link > UK customers Creative Distribution Ltd – deal 21, The Hut.com – deal 21, Revive Corporation Ltd. – deal 21, Mobbila Ltd. – deal 31 and Diverse Electronics Ltd – deal 32.

Nature of customers:

55. The appellant sold to retailers but also to other grey market traders. In the April 2010 period grey market traders included Diverse Electronics, Click entertainment: AV Promotions, Shebang, B&G Informatica, Revive Corporation, and Trader Online. The retailers were: Ebuyer (e-tail), Xbite, TheHut.com, Diffusione Elettronik SAS, VW Digital, Vogue distribution, DCS Apps, and GLS games distribution. Some traders were both grey market and retail traders: Creative Distribution, and Powerplay Direct.

Way in which deals constructed

56. A lot of business was done over the telephone and also on MSN messenger. The majority of customers and suppliers used MSN and Skype as a means of contact. David Donaldson's evidence was the MSN / Skype details were obtained through telephone contact and that they also advertised in a magazine called MCV. A lot of people contacted Link as well.

57. When MSN merged with Skype the records of the chat history was lost. In terms of conducting business with those abroad Craig Donaldson explained that while he did not speak any language other than English he was able to have a "perfect conversation" with anybody in Europe when it came to using on-line chat over Skype / MSN.

58. The appellant also bought and sold stock using IGT (International General Traders) which is a web-based application. There were grey market traders, not just based in the UK but also in the EU and customers and suppliers further afield in the Far East who were on IGT. However it was not the case that all traders were on that database.

59. The appellant asked each of its suppliers and customers to fill out an account application form. These contained terms and conditions but for many of the deals there was an error in that the terms and conditions had been cut and paste from Cube Enterprise's documentation and the name had not been changed to Link's.

60. Some suppliers had their own terms and conditions printed on the back of their invoices. Most suppliers to Link did not include any terms and conditions of sale on their invoices – including Bluestar. The topic of when title to the goods passed did not come up in the appellant's phone conversations with its suppliers and customers.

5 61. For most of the deals the appellant arranged with the supplier for goods to be delivered to its own warehouse for inspection. It did however occasionally use freight forwarders. While the appellant did not have a written contract in place with them the services were provided according to the freight forwarders' standard terms and conditions.

62. The appellant was fully insured with a Marine Cargo Policy covering all export shipments in the event of damage, loss, theft or loss.

Plugs

10 63. Some of the deals involved the appellant selling EU spec games consoles in the UK. The only difference in specification between a UK and an European console was its power adapter: the European product would require a 2 pin CEE-7 Europlug whereas the UK product would require a 3 pin BS 1363 plug. "Reworking" a product to make it suitable for the relevant local market therefore required a replacement power lead (a C7 figure-8 or C13 kettle lead) with the required plug. The appellant
15 offered a "reworking" service when reworking a UK or EU specification console was a more cost effective option than buying the originally desired specification.

20 64. Although we accept that products can be reworked in the way suggested, there was insufficient evidence before us to find that in any of the deals in question that products had in fact been reworked by the appellant. Given the large quantities of goods involved, the logistical issues and expense of providing replacement leads for each product, we find reworking would be a time consuming exercise. Taking account of what we were told about the number of warehouse staff we find it unlikely that the reworking service would have been taken on lightly particularly if there was a short turn around at the appellant's warehouse.

25 65. Some deals involved EU spec goods being bought in the UK and then sold back into Europe. Deal 14 was an example of EU spec goods bought from Grandbyte in the UK being sold back into Europe. Some deals involved EU spec goods being sold to UK retailers e.g. Deal 6 (the paperwork for which is described in more detail below).

Anomalies in description on customer purchase order and the appellant's invoice

30 66. As highlighted by HMRC there were various examples in the deal documents where Link's paperwork specification did not reflect the customer / supplier requirement.

67. In Deal 3 (with Bluestar Trading as the supplier), the customer purchase order from Creative Distribution specified (UK) stock as follows:

35 "Nintendo Wii Console With Sports Resort & Motionplus (UK)
(BLACK) /Wii"

68. The appellant's invoice contained the following in the description box:

"GAME1115 – Wii sports pack + Sports Resort + Motion plus (Bla “

69. David Donaldson's explanation was that there was limited space on the version as it appeared when printed out so "black" because of the character limit would become "bla". His evidence was that if one were to go on to the actual computer system used
5 by the warehouse the full description could be seen and that the warehouse workers would have been able to use the computer record to see if there was anything wrong. If there was and the goods were not as per the spec then payment would not have been made. Having examined a number of the appellant's invoices we noted that there did not appear to be any invoice descriptions which went beyond the number of
10 characters contained on the description box above.

Anomalies between what is said in commercial documents and inspection reports

70. Deal 6 - Bluestar Trading's Purchase Order dated 15 April 2010 stated "Nintendo Wii White with motion controller UK spec". Link's purchase order dated 15 April 2010 stated "GAME11092 – Wii sports pack +Sports Resort +Motion plus". Global
15 Freight Systems Inspection Report (marked in manuscript "15/4") described the goods as follows in manuscript:

20 "500 White Sport Resort Pak Good condition Made in China
Contents – console, console stand, stand plate, remote, Strap, motion plus, Nunchuk, Sensor Bar , Sensor Bar Stand, Power supply, AV Cable, Euro Con Plug, 3 Tapes, 2 batteries, remote jacket, discs, printed materials."

71. Bluestar's Purchase Order suggested the goods were UK spec whereas the inspection report suggested the goods were EU spec.

72. The units were sold on subsequently to GLS Games Distribution, Click
25 Entertainment, GLS Games Distribution, Al-Fayaz Sattar General Trading (none appear in their documents to have specified UK stock).

73. If the appellant had ordered UK stock then it is odd that they did not query the inspection report. If they had ordered EU stock then it is odd that they did not query why a UK retailer (GLS Game Distribution) would want EU stock as opposed to UK
30 stock (we accept the appellant would not have known what stock Bluestar had specified in Bluestar's purchase order.)

74. Deal 7 – Zen Trading's invoice stated the following: "Goods to be A1 condition PLEASE CHECK THE ABOVE STOCK/SPECS/QTY MATCH Once inspected we shall make payment to GBP ACCOUNT in full...". The reference to Zen making a
35 payment was an error given Zen was the supplier.

75. This deal is also an example of buying what David Donaldson conceded in cross-examination to be UK spec and selling into Europe (Marc Intelligent Systems). But it was also a deal where the inspection report, which was drafted in very similar terms to the one above by the same author and in the same format, had stated the product came
40 with a "Euro Con Plug" yet where the goods were also being sold to UK customers.

76. *Deal 8* –This was another deal involving two UK customers Creative Distribution and Diverse Electronics but where the inspection report from Global Freight Systems referred to “Euro Con Plug”.

5 77. David Donaldson was adamant the goods were UK spec but accepts he did not go back to Global Freight to query their inspection. We do not see how he can be so sure so many years after the event. We prefer what appears to be the near contemporaneous evidence of the inspection report and find the goods were EU spec goods.

10 78. *Deal 32* is another instance of anomalies in specification and/or paperwork: the customer wanted UK specification, the supplier supplied EU specification. There is no mention of specification in the appellant’s report. David Donaldson in his answers to cross-examination suggested the product might be one where it did not matter because it was powered through a USB port but in that case the question arises as to why the supplier and/or customer would go to the trouble of specifying EU or UK
15 stock. Conversely if he was incorrect on it being powered through a USB then the mismatch between what the customer wanted and what the supplier supplied ought to have appeared odd in any case.

Gaps between purchase and sale to customer

20 79. There were eight deals where the sale to the customer was before the purchase from the supplier (1, 2, 7, 15, 19, 20, 21, 32), twelve where the sale and purchase were on the same day (3, 4, 9, 10, 11, 13, 14, 17, 18, 22, 23, 31), seven where the sale was the next day (8, 24, 25, 26, 28, 29 and 30), and five deals where the gap was greater than a day (5, 6, 12, 16 and 27).

25 80. Deal 10 (supplier Cybacomms and customer Incoparts) was an example of a deal where the appellant had committed to sell products (the purchase order from the customer was received on 19 April 2010) but where the appellant had not put its purchase order through until a day later on 20 April 2010.

Other business

30 81. Following a request from HMRC in the summer of 2009, the appellant provided monthly schedules of its transactions to HMRC. To the extent they reflect the underlying paperwork supplied for the deals under appeal and as no challenge was mounted against them we accept they provide a reasonably accurate record of the transactions that the appellant entered into.

35 82. David Donaldson highlights that in the period 04/10 and 05/10 there were a further 68 separate purchase transactions conducted using the same methods and procedures and unconnected to fraud. HMRC did not seek to impugn these or the other reported transactions which were not under appeal. On the basis of the evidence and submissions before us while we are unable to make a positive finding that the reported transactions were *not* connected to fraud we recognise that it has not been
40 suggested, and no evidence was put forward, to enable a finding to be made that the

other transactions the appellant undertook and which are not the subject of this appeal, were connected to fraud.

- 5 83. The monthly schedules provided us with the opportunity to consider the types of goods, prices, and quantities bought and sold in order to put the deals under appeal in the context of the other business that the appellant transacted.

Comparison with other transactions in same period as those under appeal

04/10 – type of supplier? – goods? – quantities? – amounts? – gaps?

- 10 84. There were 20 transactions with retailers, involving games consoles and games, the highest amount being for two lots of £89,000 with Game Store on 19 April 2010 for a total of 1600 DSi units which were then sold piecemeal (212 + 72 on the same day but then the remainder in smaller quantities through to 7 July 2010). The majority of purchases from retailers were however for smaller transactions under £13,000. A lot of the transactions were same day sales, or deals where the goods are sold within a short space of time, including the £89,000 transaction on 19 April 2010.

- 15 85. There were five transactions with official distributors (Koch Media) and (Centre Soft) – the Koch Media ones were for larger amounts e.g. on 14 April 2010 800 DSI XL for £111,023.40 and sold within short period (15 April to 21 April) to multiple customers.

05/10 - type of supplier? – goods? – quantities? – amounts? – gaps?

- 20 86. There were 26 transactions with retailers, involving in particular games and consoles, mostly under £14,000, and many with same day sales, small gaps. There were two transactions with distributors – Koch Media – DSI XL for approximately £14,000 and on 24 May 2010 for approximately £25,000 –where the goods had been pre-sold to Diffusione Electronik on 17 May 2010.

- 25 87. There were four other transactions with another grey market trader: Lucky Technology Limited – some were for large amounts e.g. one was for £71,000 (550 Nintendo Wii Console units bought on 14 May 2010 and sold the same day to Creative Distribution).

Comparison with transactions in previous periods

- 30 88. In 03/10: there were 18 transactions with national retailers – a lot for small amounts but some were for significant amounts e.g. from Game store on 5 March 2010, 3 x £96,000 of DSi , was sold on the same day. There were 13 transactions to official distributors the highest being for £68,000, but most were for smaller amounts. The products were mostly games and games consoles, and the sales were made the
35 same day or within a couple of days. There were 14 grey market purchases which included purchases from different grey market traders to the suppliers involved in the deal chains under appeal, and some of which were for large amounts and conducted over a short space of time (e.g. with Micom International Ltd on 3 March 2010 for

1150 Will sports packs for £179,040, 750 of which were sold the same day to various customers and the remainder over a period until 29 March 2010).

89. In 02/10 there were 16 transactions with national retailers – the maximum being £59,000, most were smaller – there were 17 transactions with official distributors –
5 some for large amounts e.g. around £50,000 – on 17 Feb 2010 – (Gem Distribution) – where part of the goods were sold the day before on 16 February and another part on 22 Feb 2010.

90. In summary there were examples of transactions for relatively large amounts with national retailers e.g. Gamestore or official distributors e.g. Koch Media where goods
10 were pre-sold, sold same day or close thereafter. The national retailer and official distributor transactions were generally for smaller amounts but there were examples of transactions involving larger amounts.

Knowledge of customer's customer, or supplier's supplier?

91. Deal 10 was an instance where the customer, Incoparts- a Dutch company
15 divulged details of its customer by specifying that the goods should be shipped to Incoparts' customer in Paris. In his evidence David Donaldson said it was "not uncommon" in the industry for a customer to reveal their customer. In a visit from HMRC's Lanyard team on 8 April 2010 David Donaldson is recorded as saying that Link never knew who their customer's customer was and if they did they would sell
20 direct. The inconsistency was put to David Donaldson in cross-examination – he clarified that in 99.9% of Link's business they did not know who the customer was.

92. There was also an instance where it appears one of the appellant's suppliers inadvertently divulged who its supplier was: goods from Grandbyte retained packaging with details of Bluestar.

25 *Dealings with HMRC / meetings / due diligence*

93. There was extensive correspondence and dealings between the appellant and HMRC including visits by HMRC to the appellant on 12 December 2007 and 27
March 2008, 9 January 2009, 4 June 2009 and on 4 June 2010.

94. In the context of explaining delays to the appellant's VAT registration, HMRC set
30 out in its letters of 12 September 2007 and 2 October 2007 that they were performing more rigorous checks due to the VAT system being under attack and due to bogus applicants applying for VAT registration with the deliberate intent to commit fraud.

95. Following a questionnaire completed by Officer Joanne Preston on 20 December
35 2007, a "repayment inhibit" was set. The appellant's application for registration was allowed on 4 January 2008 with effect from 1 August 2007.

96. The appellant was sent letters on 14 January 2008 (which enclosed Notice 726) and 27 January 2008 which mentioned the nature and scale of MTIC fraud.

97. On 27 March 2008 HMRC Officers Dean Foster and Laura Hartnell met with Craig Donaldson and Steven Kavanagh. Craig Donaldson confirmed he had not read the notice.

5 98. On 9 December 2008 Officers Chisman and Preston met with Craig Donaldson. Mr Donaldson said his main suppliers were Game, HMV and Dabs.com, that his main customers were Creative Distributions and that he was buying bundle deals on consoles and selling the component parts separately at a higher price. In relation to due diligence as well as checking with Redhill he maintained that he checked customers' and suppliers' credit histories. He confirmed he had read Notice 726 (see
10 [113]).

99. Following a further visit to return documents that had been taken HMRC wrote to the appellant on 21 April 2009 to explain that the appellant's repayment claim for the period 03/09 had been selected for verification. The letter mentioned HMRC's strategy for tackling the fraud involved, but was not restricted to, "checks on all UK
15 businesses involved in the transaction chains (including making all reasonable enquiries into claims, and testing the information given in support of the claims) and enquiries of the fiscal authorities in other EC Member State." The aim of the process was described as "to establish the facts, and the true nature of the relevant transactions...".

20 100. On 4 June 2009 Officer Chisman met with Craig Donaldson at the appellant's premises. Craig Donaldson discussed various matters relating to the operation of the business. Certain of these matters (for instance that 95% of the appellant's purchases were from retailers such as Koch Media (the authorised distributor of Nintendo in the UK), Game, HMV and Amazon) are relied upon by HMRC by way of putting into
25 context Officer Chisman's positive comments on the appellant's due diligence and some were conceded by the appellant to be inaccurate (that stock was paid for before it was shipped / transported, that there were contracts with customers and suppliers and that the appellant took the product out of the box to view and record serial numbers.)

30 101. Following a telephone query from Craig Donaldson (in which he mentioned that he knew about carousel fraud having seen details of it in the newspapers) Mr Chisman stated that he would have to check the information he had been sent and verify that the deals had not started at a tax loss.

35 102. On 22 June 2009, following a query from Craig Donaldson, Mr Chisman confirmed in an e-mail dated 23 June 2009 that his decision to repay for 03/09 had been approved by a colleague.

103. On 7 September 2009 Mr Chisman recorded in an internal HMRC note deleting the "repayment inhibit" that:

40 "This trader is not considered to be MTIC anymore as I have verified there repayment claim. The trader buys supplies of games consoles, game and accessories from retailers and authorised distributors of

console good. It therefore has been verified that the VAT in it's supply chains has been paid to HM Treasury.[sic]"

104. On 15 October 2009 Mr Chisman told Craig Donaldson on the phone that his 09/09 VAT return had been flagged for verification.

5 105. On 20 October 2009 Craig telephoned Mr Chisman to ask what was happening with his 09/09 repayment. Mr Chisman advised (as was confirmed in his note of the telephone conversation) that he had visited the appellant and that he "did not consider at the moment that his company presented any risks of MTIC fraud".

10 106. The return was amended and the changes explained in a letter dated 27 October 2009.

107. The "Extended verification" of 03/09 was therefore something of a misnomer as Mr Chisman did not trace all of the deals. The decision to repay the input tax on 03/09 was made by reference to the potential exposure or risk to the revenue.

108. On 22 June 2009 Mr Chisman e-mailed the appellant stating:

15 " ...I encourage you to continue with the good due diligence practices your company is currently operating...".

109. On 20 October 2009 a telephone conversation took place between Mr Chisman and Craig Donaldson. Officer Chisman's note recorded that he had informed Craig Donaldson that he had visited the appellant and that he did not "...consider at the moment that his company [the appellant] presented any risks of MTIC fraud."

20 110. In response to a query on 14 January 2010 from Craig Donaldson for verification of a company in Ireland and whether it was "ok to trade" with the company Officer Chisman replied the same day:

25 "HM Revenue and Customs cannot advise you as to whether you should or should not trade with a company as it is your decision whether to do so based on the information you hold about that company.

30 It is up to you whether to carry out due diligence on companies you trade with and to satisfy yourself that any company you deal with is not involved in trading goods on which VAT has not been properly paid within its supply chain..."

111. On 26 May 2010 HMRC notified that the VAT repayment for the period ending 04/10 had been selected for verification.

Warnings / Notice 726

35 *Appellant's reaction to warnings notices*

112. Craig Donaldson confirmed he was fully aware of the contents of Notice 726. In cross-examination he explained he became aware of it probably within a year / year

and half of setting up the business. He understood why it was that HMRC could not tell the trader exactly what checks should be undertaken.

113. Notice 726 clearly covered at page 4 the scope of the various goods under consideration in the deals and in which the appellant was dealing. At 2.3 the Notice explained how the MTIC fraud worked and that the fraud “relies heavily on the ability of fraudulent businesses to sell goods or services to other businesses that are complicit in the fraud, prepared to turn a blind eye, or not sufficiently circumspect about their trading connections...”. The notice contained examples of what HMRC considered to be reasonable steps to take to enable the trader to “establish the integrity of [its] customers, suppliers and supplies” and at 4.6 why it was not possible for to give a definitive checklist as this would merely enable fraudsters and those willing to turn a blind eye to ensure they could satisfy the list. At 6.1 the notice gave examples of indicators that could alert the trader to the risk the VAT would go unpaid including for example the customer’s / supplier’s history in the trade. HMRC cross-examination of the appellant’s witnesses referred in particular to: being contacted by a buyer and seller within a short space of time with offers to buy/sell goods of the same specifications and quantity, the supplier offering deals with no commercial risk e.g. no requirement to pay for goods until payment received from the customer, high value deals with no formal contractual arrangements, high value deals offered by a newly established supplier with minimal trading history, low credit rating etc. In a section entitled “viability of the goods described by your supplier” the notice gave the examples which included: “Do the goods have UK specifications yet are to be exported? Is your supplier unwilling to provide IMEI or other serial numbers? What recourse is there if the goods are not as described. In 6.2 a number of checks were recommended. In addition to obtaining certificates of incorporation and VAT registration, signed letters of introduction on headed paper, verification of VAT details with HMRC it was suggested to obtain credit checks or other background checks from an independent third party, to insist on personal contact with a senior officer of the potential supplier, making an initial visit to their premises wherever possible and to check details provided against other sources.

Due diligence

114. As described by both Craig and David Donaldson the due diligence conducted by the appellant consisted of “paper” due diligence and due diligence which stemmed from personal and/or industry knowledge. The paper due diligence took the form of:

- 35 (1) Link’s data form
- (2) Certificate of registration
- (3) Certificate of incorporation
- (4) HMRC VAT valid registration confirmation
- (5) Europa VAT validation.
- 40 (6) Certified copy of passport
- (7) Signed letter of introduction

115. At the relevant time the appellant did not scan in and scan out every single console as it does now (it did this in response to tax losses being identified in chains.).

116. In addition the appellants relied on the comfort drawn from making personal contact and previous dealing either they or their employees had had with various suppliers and customers. For instance they were aware Fraser Blakemore had bought from Bluestar and Affilia previously when he worked at E-buyer, and he had also brought on board suppliers and customers such as Creative Distribution, Xbite, Curveball Leisure, and Worldwide Digital.

117. In the next section we consider the information relating to each of the suppliers in the deals under appeal: we set out more details of the due diligence performed and what it revealed, the extent of the appellant's prior dealing with the suppliers and customers, and where applicable (where due diligence had not been performed and to the extent we had relevant evidence) what it would have revealed.

Due diligence and facts relating to suppliers and customers

Affilia Ltd (Deals 13 and 27) – first appeal deal 22 April 2010

118. The appellant's data form dated 11 November 2009 referred wrongly to Cube Enterprises. The company type was checked as "public limited company" (it was not). The form stated there were three employees and the turnover was 1-2 million. The trading and delivery addresses referred to a trading estate in Wolverhampton. The effective VAT registration was 1 August 2006, the trade classification was "wholesale computer, peripheral and software". The company was incorporated on 30 March 2006. In its letter of introduction the company described itself as a "Computer and Electronic Components Distributor." HMRC's VAT validation was dated 14 October 2009. The Europa validation was dated 19 May 2010.

119. The first deal with the appellant appeared to be on 11 November 2009. It involved a purchase of 993 pieces of McAfee security suite software bought for £102,775.50 (incl VAT) and sold the same day to a non-UK customer, Karadeniz, for £92,944.80.

120. On 12 November 2009, the appellant bought 1400 pieces of McAfee internet security suite software for £144,900 (incl VAT). It sold them on 17 November 2009 to Karadeniz for £131,026.00.

121. The data form for the appellant's customer, Kuzeylodos Bilisim Teknolojileri, in the deals under appeal was dated "13012010" (it was not clear whether this was meant to refer to 13 December 2010 or whether it was a typographical error in relation to another date given it post-dated the appellant's first transactions showed the company commenced trading / was incorporated on 15 October 2009 – it had five employees and a turnover of \$10,000,000. The first deal appears to be – purchase from Affilia Limited (McAfee internet security suite) on 5 February 2010 for £137,475 (incl. VAT) and then a sale of the whole amount to Kuzeylodos on 9 February 2010 for £121,680. There was another deal on 16 February 2010 this time with a one day

gap for buying for £211,500 selling on 17 February 2010. The next sale was the one on 22 April 2010 which is a deal which is under appeal.

Bluestar Trading Ltd (Deals 1-6, 12, 16, 17, 19 and 22) – first appeal deal 6 April 2010

5 122. The company was incorporated on 23 January 2003. The VAT certificate of registration showed the certificate was issued on 3 November 2009 and a trade classification of “other telecommunications activities”. A VAT validation request was made on 15 February 2010.

10 123. The data form which wrongly referred to Cube Enterprises dated 23 July 2009 showed the number of employees as 2 and the turnover as £50 million. The trading and delivery addresses were “Suite 6C, Britannia House, Leagrave Road, Luton Beds”..

15 124. It is unclear when the first deal with Bluestar took place. The data form was dated 23 July 2009, a VAT validation was done on 15 Feb 2010 and also earlier HMRC meeting notes refer to the appellant dealing with Bluestar but from the transaction records it appears a deal was not done until 1 April 2010 (1000 Wii sports pack bought for £142,762 and sold the same day to Ebuyer on for £148,050). As regards that customer there were lots of smaller deals (under £10,000) with E-buyer in the preceding month.

20 ***Cybacomms international Ltd (Deal 10) – first appeal deal 20 April 2010***

125. The data form (which wrongly referred to Cube Enterprises) was signed by the financial controller Graeme Davis and dated 18 February 2010. It showed the director as David Whisson and gave details of the financial director and bought ledger contacts. The number of employees and turnover boxes were filled “n/a”.

25 126. The address was 911 Green Lanes, London. The VAT certificate had an effective date of 17 August 2004 and gave a trade classification of “retail mobile phones”. The certificate of incorporation was dated 19 November 2003. The letter of introduction (a fax) was dated 17 February 2010 – it explained the company also dealt in electrical goods including photographic equipment. It contained an invitation to the appellant
30 to make any necessary checks on the company that the appellant felt appropriate.

127. The Europa validation was dated 23 February 2010. HMRC’s validation was dated 25 February 2010.

35 128. A credit report from Risk Disk dated 20 May 2010 (after the date of deal 10) stated the credit limit as £0 and risk as “credit rating is suspended”. There were no turnover figures. Trade debtors increase from £1,002,000 on 30 November 2005 to £8,207,000 on 30 November 2006 and £8,260,000 on 30 November 2007.

129. The first deal with the appellant appeared to have taken place on 23 February 2009. It involved a purchase of 425 Cannon Digital cameras £215,230.63 (incl VAT)

– sold to Hana Malta Ltd on 25 February 2009 for £190,825.00. The next deal took place on 2 March 2010 for digital SLR cameras of £240,640 (incl. VAT) selling to Hana Malta for £213,200.

5 130. Contained in various new documents which the appellant was permitted to adduce at the hearing was an e-mail dated 20 February 2009 from Fraser Blakemore to cybacomms@aol.com stating:

10 “Hi I found you in IPT trading directory and was just wondering if you deal in games console products. We deal with these products day to day and are very interested in making new business partners for both Buying and Selling. We have in stock at the moment over 1k of Nintendo Wii UK spec.”

131. David Donaldson’s evidence was that Simon Warren, a director of another supplier (the Manual People) who had “free-lanced” for Link (see [148]), had recommended Cybacomms.

15 132. As for the customer, Incoparts, this was a company based in the Netherlands; it commenced trading on 31 March 1998, it had 15 employees and a stated turnover of £200 million. The appellant had had previous deals with it on February 2010 in much smaller amounts e.g. £29,904, £15,300 and £7,038. The products in those transactions were games consoles.

20 ***Fonestation Ltd (deal 15) - 27 April 2010***

25 133. The data form referred correctly to Link and was dated 15 January. The address was given as PCL Building. The number of employees and turnover boxes were not completed. The VAT registration effective dated 7 December 2005, and the trade class was “other retail new goods specialised store”, incorporated on 8 November 2005. The letter of introduction explained the company:

“originally exported mobile phones to the Europe and Middle East markets. Recently the company has widened its product range to include games platforms.”

30 134. HMRC’s validation was given on 19 January 2009 and the Europa validation was requested on 25 May 2010. The first deal appeared to be for 89 Sony PS3s for £14,870 which were sold on 26 Feb 2009 and 17 March 2009. There was a further deal on 13 March 2009 (referring to various Nintendo DS Lites, Sony PS3 £23,000). There was a further deal on 4 March 2010 – 300 Wii sports pack bought for £45,296 and sold to three buyers on 18 March 2010 (to 2 of the buyers) and on 22 March 2010
35 to the remaining one.

Grandbyte Computers Ltd (deal 14) – first appeal deal 22 April 2010

40 135. The data form correctly referred to Link. It was dated 17 October 2008 and mentioned Viren Solanki as the Director. The number of employees was stated to be three. No figure for turnover was given. An office address in Kingsbury was given as both the trading address and the delivery address. The VAT certificate was effective

5 date 1 June 1998, an amended certificate was issued on 18 July 2007, and the trade classification was “other computer related activities”. The company was incorporated on 9 May 1997. The letter of introduction referred to being able to deliver anywhere in Europe within 24 hours and far east Hong Kong and America within 48 hours. The HMRC validation was dated 21 May 2010. The Europa validation was given on 25 May 2010.

10 136. The first deal with the appellant appeared to be on 2 March 2010: the purchase of Sony PS3 slimline and PS3 blue for the amounts of £113,208.90 and £45,543 respectively which were sold on to Skream, Dream distribution and Vogue between 2 March 2010 and 5 March 2010. The next deal was for an amount £98,773 where the goods were sold between 10 March and 6 October 2010 to various customers.

137. The appellants knew Mr Solanki well; they had attended race events together and Mr Solanki had attended at one of the Donaldsons’ family occasions.

15 ***Impact Technologies UK Ltd (deals 21,28, 29, 31 and 32) – first appeal deal 25 May 2010.***

20 138. The data form correctly referred to Link and was dated 26 April 2009. The employee and turnover boxes were not completed. The trading and delivery address was given as 18 Olive Street, Heywood, Rochdale. The effective VAT registration was 21 December 2008. The trade class was: “computer consultancy activity”. The company was incorporated on 31 December 2008. The HMRC validation was dated 8 July 2009. The Europa validation was given on 25 May 2010. The letter of introduction referred to the company being established in 2008 but then later referred to: “...with over 10 year industry experience”.

25 139. The first deal with the appellant appears to have been a purchase of 140 Nintendo DS Lite – bought on 20 November 2009 for £10,948 and sold on 26 November 2009 to Click Entertainment for £12,236.00. There were lots of large value deals subsequently.

140. Craig Donaldson said he met with the director of Impact at his warehouse in Lancashire and also that the director had visited the appellant’s warehouse.

30 ***Johnson’s Consultancy Ltd (deal 9, 23, 30) – first appeal deal 19 April 2010***

35 141. The customer form referred incorrectly to Cube Enterprises. It was dated 11 November 2009. The company was stated to have had one employee and a turnover of two million. The Trading address appeared to be residential. The VAT effective date was 1 September 2009, the trade class “wholesale electronics and telecoms equip”. The company was incorporated 1 May 2007. The letter of introduction was clearly from a residential address. The HMRC validation was dated 12 November 2009, and the Europa validation was dated 8 June 2010.

142. The first deal appeared to have taken place on 23 March 2010 – a purchase of 1000 Wii sports pack for £145,700 which were then sold on 29 March and 30 March 2010 for £129,974.98 and £19,856.33.

5 143. David Donaldson and Fraser Blakemore had met with the director at a trade exhibition.

Northern Computer Services Ltd (deal 24) – 21 May 2010

10 144. The customer form was dated 17 May 2010 and stated the company had four employees and turnover of £126,099. A business trading address was given. The effective VAT registration was 1 April 1999, and the trade class was listed as “other computer related activities”. The company was incorporated on 8 August 2001. The HMRC validation was dated 3 June 2010. The Europa validation was given on 17 May 2010. A website printout of 4 February 2011 states the company had:

15 “...been involved in the Business IT Sector for over twenty years... We are an Accredited Sage Business Partner and then there are various sections outlining the sage related products and services offered.”

145. The first deal was the one under appeal which took place on 21 May 2010 for 496 slimline Sony PS3 £113,354.60 which were sold the same day to Skream for £117,725.60.

20 ***The Manual People t/a TMP Distribution (deals 11, 18, 20, 25 and 26) – first appeal deal 20 April 2010***

25 146. The customer form (referring to Link) was dated 1 March 2010. The director was stated to be Simon Warren. The trading address was given as “The Stables, 138 Kingsland Road, London” and stated that the five employees had a turnover of £12 million. Unusually two trade references were asked for on the form and two names were given (E-Buyer) and Danwood in Lincoln. There was no evidence before us that trade references had then been sought by the appellant but also no evidence as to what would have been revealed if they had been. The effective VAT registration was 1 March 2007, and the company was incorporated on 8 January 2007. The letter of introduction explained the company was founded in 2007 and that it specialised “in the wholesale and distribution of high end branded electrical products such as mobile phones, MP3 players, TV’s, LCD’s games consoles and software.” It explained how logistics was an important factor and with location being an important factor the company had recently relocated to Central London “Here we have placed our sales team, warehousing, accounts and customer service all under one roof”. HMRC’s VAT registration letter was dated 25 March 2010. The Europa validation request was made on 5 March 2010.

40 147. The first deal with the appellant was for manuals: – 2 x 700 operations manuals at £563.50 each on 14 August 2009. Then on 5 March 2010 the appellant bought 1050 Sony PS3 slimline £240,581 (which it sold to Creative Distribution) on 4 March 2010 for £245,207.81.

148.Simon Warren came to work for the appellant for a period on a “free-lance” basis sourcing suppliers for the appellant.

Zen Trade Ltd (deals 7 and 8) – first appeal deal 19 April 2010

149. There was no data form. The VAT registration was effective from 1 March 2009, with a residential address in Feltham given and the trade class was stated as:
5 “Wholesale computer peripheral and software. The company was incorporated on 23 May 2008. HMRC’s validation was dated 15 April 2010 (after the trade). The Europa validation was dated 14 April 2010.

150. The first deal appears to have been on 14 April 2010 (with same day sales through
10 to 26 April 2010) for 1000 wii sports pack for £142,468.75 and 630 for £93,086.44).

151. David Donaldson’s evidence was that Craig Donaldson had met with the proprietor at the premises (it was not established where the premises were).

Officer Chisman’s evidence on mark-ups

152. Officer Chisman’s evidence set out a table showing the average mark-up for each
15 trader in the deals under appeal. His evidence reveals the following features: The appellant’s mark-up was greater than any of the other traders in the chain and that this was the case whether the onward supplies were to UK or non UK customers. The mark-ups of the “buffers” have decreased when non-UK sales are removed from the average mark-up figures. The purchases from Bluestar Trading Ltd have a consistent
20 mark-up structure with Northwell (described as the “first-line buffer” always having a small mark-up) and in 7 out of 10 deals selling at a mark-up of £0.25 per unit and Bluestar having a “steady mark-up” of between £1.00 and £2.50 per unit. In addition his evidence notes that the price Bluestar sold Nintendo Wii sports Resort Bundles for was between £121.29 and £126.50 and was consistent across the four suppliers of the
25 product to the appellant during the period with the price ranging from £121.25 to £127. The price paid appears to have little bearing on the mark up achieved. The evidence also notes the low mark up (£0.25) for Northwell (UK) Ltd.

Roderick Stone OBE’s evidence

153. Mr Stone, an employee of HMRC was involved in applying their strategy to
30 combat MTIC fraud. His witness statement covered his views on MTIC fraud, how it worked (distinguishing at the outset between MTIC acquisition fraud (where the importer fails to account for VAT due on standard-rated supply to its UK-based customer), and MTIC carousel fraud where there is fraudulent extraction of revenue from the UK Treasury), typical features of the fraud, the grey market and described
35 HMRC’s measures against MTIC fraud.

154. As regards typical features of MTIC fraud, the norms he noted include the fact that buffers were always able to purchase goods for less than the broker (although as an aside we note this feature is also consistent with each business along a supply chain seeking profit), buffers undertook no process to add additional value and

incurred minimal if any costs of sale, buffers did not seek to maximise profit by selling at market price (price broker and onward customers achieve), the broker did not buy from the cheapest source in UK, the broker had EU customers but did not maximise profit by buying in the EU and selling direct, the overseas customer did not profit maximise, and that invoices were showed in pounds sterling. As regards this latter point, we noted that in Deal 10 with the EU customer Incoparts the goods were priced in sterling. However other deals e.g. with Square International were priced in euros.

155. In MTIC neither buffers nor brokers offered credit; they retained ownership until the customer pays under a retention clause, however Mr Stone observed that a clause such as this does not guarantee security especially where no specific record of goods has been kept.

156. One feature he noted in relation to MTIC tainted transactions is that the supplier does not provide the purchaser with packing lists or with serial numbers.

157. Mr Stone describes the secondary or grey market as the flow of new goods through distribution channels other than those authorised or intended by the manufacturer or producer. According to him, the circumstances which give rise to such opportunities arise from manufacturer subsidies (“box-breaking” whereby good bought retail in the UK may be sold at a higher price in another country), arbitrage trading (difference in prices of products in different countries), demand driven opportunities (either under-estimated demand - goods then have to be sourced not from the usual channels, or over-estimated demand – goods dumped in other markets). He noted that in order for there to be supply in a legitimate grey market it would be necessary for the items to end up with a consumer through a retailer rather than being imported into the UK by one wholesaler, passing through the hands of several more wholesalers, then being exported to a wholesaler abroad, and possibly being imported into the UK again in a carousel pattern by yet another wholesaler.

158. His evidence, (of fact, given he was not giving and did not purport to give expert evidence), was not challenged by the appellant. His witness statement, which we read and considered, helped by setting out the general background on the nature of the fraud and HMRC’s verification process (which provided context for the evidence on the appellant’s due diligence). But beyond those matters, we did not find the evidence to assist to a significant degree in enabling us to make relevant findings of fact simply by dint of the statement not being challenged: the witness statement was a generic one, the features put forward as characteristic of MTIC fraud were in some cases irrelevant to the circumstances of the appeal (e.g. in relation to Alternative Banking Platforms), where potentially relevant they were, in any event, or could have been, put forward more appropriately by way of submission by the Respondents and accordingly considered by us in that guise, or they were features the relevance of which the tribunal could reach its own view on having appreciated the nature of the fraud and the normal functioning of markets (e.g. the relevance of there being an end customer to the legitimacy of a grey market).

Parties' submissions

159. HMRC's case is that the deals were contrived as can be seen from the nature of the deal chains, the short timescale and back to back nature; they were put together by parties for whom commercial reality was irrelevant, and the risk of non-payment non-existent. The appellants knew the transactions under appeal were connected to fraud, or they ought to have known they were connected to fraud.

160. They emphasise that the tribunal should look not just at the circumstances of the particular deals under appeal but at the various evidential strands in combination: the history and background of the appellant and the due diligence that was undertaken.

161. Having received various warnings and notices the appellant was aware of the characteristics of MTIC fraud but proceeded with the deals nevertheless.

162. As regards the characteristics of the goods they were easily transportable, high value, bought in large quantities, traded between wholesalers in UK often with no end user. None of the supplies were from manufacturers or authorised distributors. As regards the characteristics of the transactions HMRC highlights the following:

(1) Back to back - goods largely traded in the space of one day

(2) inadequate information on invoices as it was unimportant to customers and suppliers whether the goods were European spec or UK spec and there were no serial numbers which was unusual if there had been disputes about what had or had not been delivered. There were also anomalies in the paperwork as between the invoices and inspection reports.

(3) Disregard as to terms and conditions for high value deals. The appellant used a "customer form" for suppliers and for many deals one which did not even refer by name to the appellant.

(4) The appellant traded European spec goods within the UK and exported UK spec goods outside of the UK.

(5) lack of clarity of title,

(6) There was a general lack of commercial reality:

- Customers and suppliers immediately found on or around same day in wholly unexplained circumstances – there was no difficulty finding seller with goods at right price or finding a customer for same description at right price on the same day or within days

- It was implausible that deals could be found with such ease and that profits could be made. The appellants referred to the IGT database but there was no explanation of "value added" the appellant was supplying and why they would be in any better position than any other grey market trader to make a profits. Where the appellant was buying from a grey market trader it would have known that there were several steps in the chain between them and the original manufacturer. Suppliers would want to minimise the length of the supply chains.

- Goods removed from UK without the appellant paying the supplier (faith in creditworthiness incredible)
- Losses were non-existent
- Extraordinary turnover despite no commercial risk, or adding any value to product or the supply chain
- Commercial checks on suppliers/ customers and freight forwarders wholly inadequate
- Inspections carried out provided information which was vague, and not meaningful as to goods bought and sold.
- On one occasion the details of a customer's customer (which in a commercial market would have been extremely sensitive) were divulged in that the appellant was told to ship goods to the address of the customer's customer.

(7) As regards due diligence this was inadequate and amounted to window dressing. The appellant did not do the non-exhaustive list of checks set out in Notice 726. Basic paper checks and reference to knowing the suppliers and "industry knowledge". It was not done for commercial reasons – trade references and credit checks were not performed. Proper records were not kept which would have been important if there had been a change of personnel. On occasions the appellant proceeded with a deal even though it had not received an answer in relation to the VRN check from HMRC.

163. The appellant refutes the suggestion that it knew or should have known the deals under appeal were connected to fraud. Its case is that the various indicators of fraud which HMRC referred to were equally present in the many transactions the appellant had reported which had not been challenged as being linked to fraud. For instance many of these were also conducted within a short time frame, EU spec goods were traded in the UK and UK spec goods traded outside the EU, blanks left in customer info forms were not untoward and were present in "non-fraud" transactions too. The appellant continued to supply details of its transactions to HMRC – why, the appellant argues, would they do this if they had actual knowledge of fraud? The appellant emphasised that actual knowledge and means of knowledge must be judged at the time the deal was done. The appellant had no information on what was happening further up the supply chain beyond the position of its immediate supplier. There was no suggestion by HMRC that the purchases made by the appellant were at a price that would have revealed that there was anything untoward to the appellant. A large part of the appellant's case in relation to the adequacy of its due diligence rested on the complimentary nature of Officer Chisman's feedback on the appellant's due diligence.

40 Discussion

164. The typical mode of operation, participants and jargon of MTIC fraud have been described repeatedly in an array of tribunal and appeal cases (see for instance Floyd J

in *Mobilx Ltd (In Administration) v HMRC* [2009] EWHC 133 at [2]-[3]). The Revenue's witness, Mr Stone, describes in detail the variants of the fraud which ranges from a simple acquisition fraud to the more sophisticated MTIC carousel fraud where goods real or purported are circulated and in some cases re-circulated through a chain of traders, the object of the fraud being for the UK broker to obtain a repayment of input tax on goods removed to the EU or exported abroad.

165. We start by noting, as we remarked at the hearing, that there was not in this case the series of classic MTIC deal chains with removals from the UK to another country in the EU. With the exception of deals 10, 13, 14, and 26 the deals involved UK customers, and were split between different customers. The majority of deals were split between UK and EU customers or UK and non UK non EU customers. As regards the significance of whether customers were non-UK EU or non-UK non EU we note that while the fraud works equally between those two sorts of customers, using a non-UK non-EU customer abroad in principle makes the carousel version of the fraud more complex to engineer and requires more steps as the goods would then need to be imported into the EU in order to be then acquired by a supplier in the UK.

Was Deal 17 connected to fraud?

166. Deal 17 concerned a same day purchase and sale of Nintendo Wii white consoles in the amount of £63,000 on 10 May 2010. The purchase was from Bluestar Trading Limited and the sale was to Fulcrum General Trading. The transaction did not appear in Bluestar Trading Limited's records and HMRC were unable to trace the transaction back any further. Mr Mandalia, for HMRC, asks the tribunal to note that it is beyond co-incidence that out of the 32 transactions under appeal Bluestar Trading is the appellant's immediate supplier in 11 transactions and that in 10 of those the deals trace back to a direct tax loss (Deals 1, 6, 12, 16, 17, 19 and 22). Bluestar Trading also feature in another six transaction chains which also trace back to a tax loss. It has, HMRC say, always been open to the appellant to put before the tribunal evidence from Bluestar, a supplier in respect of whom the appellant maintains it had "industry knowledge" of in relation to the transaction.

167. Mr Hywel for the appellant points out that it is not known where Bluestar were sourcing their goods from in this deal and submits that unless the tribunal can be satisfied that Bluestar only purchased in "dodgy" supply chains then the Tribunal could not come to the conclusion this was a fraudulent supply chain as well.

168. However that submission overstates the relevant standard of proof which is on the balance of probabilities. Taking account of the following we find that on the balance of probabilities the appellant's purchase in Deal 17 was connected with fraudulent loss of tax:

- (1) the similarity in the nature of the goods, to other transactions involving Bluestar in which fraud was detected in the supply chain;
- (2) the proximity in time of Deal 17 to the other deals in which fraud was detected;

(3) the absence of any evidence of other deals between the appellant and Bluestar in which it had been demonstrated that there was no fraudulent loss of tax;

5 (4) that the absence of traceable records in relation to the provenance of a supply was, given the desirability of making traceability more difficult from the point of view of facilitating the continued use of a fraudulent supply chain, all other things being equal, more consistent than not with a transaction chain being connected with fraud;

10 (5) that the prevalence of fraud in Bluestar's supply chain tended to support a finding that any due diligence it had conducted was ineffective; and,

(6) the inherent desirability from a fraudster's point of view of re-using suppliers that had already been used successfully without detection whether unwittingly or otherwise in a fraudulent chain of supply.

15 *Contrivance?*

169. As noted above a number of the chains end with customers in the UK or have a combination of non UK and UK customers. Only a small proportion involved sales which were only to non UK customers. A number of the sales to UK customers were to UK retailers. We think this feature points against the fact that all of the chains were
20 contrived as a UK retailer would be left with stock which it would have to be able to sell in a real market. The greater number of customers would also make it less likely the transactions were contrived as more participants would be involved. The other aspect which points against the whole of the chains being contrived was that for some of them amounts were sold off in differing quantities over a period of time. Further to
25 the extent the object of contriving transactions in order to commit a fraud was the repayment claim, the insertion of UK customers would represent an inroad into the profit that might otherwise achieved if the goods had instead been removed to the EU or exported outside the EU.

170. With the benefit of being able to look at the transaction patterns it appears that the
30 upper reaches of the chains before the goods got to the appellant look to be contrived in that the chains of supply are lengthy and a number of grey market traders appear repeatedly but at a different stage of the supply chain. It was not submitted that the pricing of the deals was artificial by HMRC however, and there was insufficient evidence before us to so conclude. In relation to the observations Mr Chisman made
35 on patterns of mark-up HMRC did not seek to rely in their submissions at the hearing on what if any significance these observations had to HMRC's submission on contrivance or in relation to actual knowledge.

Conclusion on actual knowledge

171. In addition to the implausibility of a commercial market in the transactions under
40 appeal HMRC refer to the following features indicating actual knowledge on the part of the appellant: the trading history of the suppliers, that suppliers were allowing goods to pass without receiving payment, that such high value deals did not have

formal contracts, that there no enquiry into the history of the trade in goods and the credit history of those in the supply chain. The unexplained anomalies in the documentation are such that no legitimate trader is likely to have wanted to trade with the appellant.

5 172. We are not however satisfied that it may be inferred that the appellant had actual
knowledge of fraud. The appellant in the majority of the deal chains sold to UK
customers. The pattern of transactions was not notably dissimilar from those which
are not under appeal. It is not implausible that a market existed; there are in the other
10 transactions clearly transactions for large amounts in electrical goods which take
place over a relatively short period of time. Not all the traders were on IGT so this
was not a market where there was necessarily perfect information and therefore price
arbitrage was possible without adding value to goods. It has not been suggested that
every transaction where buying and selling to a grey market trader is connected to
15 fraud. The fact that a number of the sales were to UK customers who were UK
retailers is more consistent with the transactions taking place in a legitimate grey
market than an artificial or contrived one constructed by way of an organised MTIC
fraud. The way in which the appellant did business, taking account not just of the
deals under appeal but the very many other transactions which were not challenged,
20 namely by putting out feelers for what a purchaser would want and then finding a
seller or vice versa did not seem implausible to us. As the appellant pointed out,
HMRC were not suggesting that the appellant had bought goods in the deals under
appeal at prices which were not a market prices. The lack of a formal contract, the
lack of attention paid to the detail of whose terms and conditions should apply,
25 whether they made sense, whether product specifications were fully and accurately
reflected in the accompanying paperwork were features which were just as consistent
with the appellant acting in a high risk fashion and seeking to turn a quick profit.

Conclusion on means of knowledge

173. In terms of the due diligence performed by the appellant our general impression is
that the appellant performed what might be described as a “tick box” approach, going
30 through the documents that they knew HMRC would insist upon. They were not
rigorous in their approach as can be seen from the fact that they did not insist on the
data forms being fully completed. There were also occasions (deals 7 and 8 with Zen
Trade, deal 14 with Grandbyte and deal 24 with Northern Computer services Ltd) –
where the appellant was more concerned about going ahead and doing the deal rather
35 than waiting for HMRC to do the verification. (Although as pointed out in re-
examination Grandbyte was verified about 12 months before – the status of a supplier
might have changed in the intervening period so we are not persuaded that point
provides an answer). On the other hand we lacked evidence upon which to make a
finding that had the appellant waited for an answer that the answer would have
40 disclosed something untoward. The exception being in relation to deal 24, where the
appellant proceeded with the deal with Northern Computers Ltd despite being told by
HMRC that it awaited further verification.

Unsatisfactory due diligence and its relevance

174. In our view the Donaldsons' reliance on personal knowledge, and industry reputation was misplaced. A reasonable business person would know that due diligence would require a combination of personal checks but also independent verification. On those occasions where the appellant's directors made visits to a supplier or had personal knowledge of them we think this would not provide comfort to a reasonable business person who would, we think, appreciate that they the director would not be in any unique position to detect fraud or not from a personal meeting, that it would be necessary to take a step back and look at all the circumstances and that this would also involve equipping themselves with as much third party and independently verifiable information about the company as was reasonably possible. Endorsing a set-up where sales staff who were incentivised by profit related commissions to make as many sales as possible were also responsible for carrying out the due diligence was also a systemic flaw.

175. It is also no answer to refer to the fact that some of the traders were thought to be known to Fraser Blakemore from his previous role. Mr Blakemore was not called as a witness and we are therefore unable to make any finding as to the level of prior due diligence and extent of dealings he had with the suppliers. In any case it is difficult to see how the fact that an employee had dealt with a supplier when working with another company could provide comfort as to the integrity of his or her contacts without knowing whether those previous transactions had been shown to be unconnected with tax loss.

176. The appellant accepts that various visits took place and that Notice 726 was given and understood by its directors. But it argues the generic warnings of fraud were outweighed by the impression conveyed by Officer Chisman that the risk of fraud was small. They highlight that as at 7 September 2009 when the repayment inhibit was removed, Officer Chisman knew the appellant purchased on grey market, used freight forwarders, and traded back to back with EU spec goods at times. The due diligence was more than sufficient given the risk and was complimented by Officer Chisman. The period 03/09 was subjected to verification, the repayment of the claim in full entitled the appellant to assume that no fraud was detected in any of its supply chains and that therefore its due diligence had successfully excluded any problematic suppliers. Supplies included those from grey market traders including Fonestation who was a supplier in one of the deals. The appellant obtained letter of introduction, copies of VAT certificates, companies house certificates, and undertook Wigan number verifications on each supplier prior to trading. The appellant also refers to various longstanding personal relationships or trading history that it had with suppliers.

177. HMRC say the appellant's reliance on Officer Chisman's opinion is misconceived in that it was based on misleading information and given against a different backdrop of majority OEM (original equipment manufacturer) / authorised distributor transactions. In any case Mr Chisman's e-mail of 14 January 2010 made it clear that it was for the appellant to carry out due diligence and satisfy itself that any company it traded with was not involved in trading in goods upon which VAT had not been properly paid within the supply chain. In reply, the appellant highlighted that Officer

Chisman was receiving monthly spreadsheets (he had confirmed he received the ones for June, July and August 2009 and accepted in cross-examination that he would have reviewed them. They maintain that between April 2009 and September 2009 Officer Chisman had seen the appellant was purchasing from Bluestar Trading, Fone Station, Overture Trading (connected to TMP), and the manner in which the appellant bought grey market stock. Its level of due diligence was no different in the 03/09 period to what it was in the 04/10 and 05/10 period.

178. In our judgment, while the appellant places much store on the endorsement given by Officer Chisman, and while it is a factor that may be taken into account it did not absolve it from continually reassessing what was required to avoid entering into transactions which were connected to fraud. In our view the appellant's reliance on what Officer Chisman said is mis-placed. Taking all of what was said, as at the time of the transactions, following verification again in 09/09, and what Officer Chisman had said in January 2010, a reasonable business person would have not taken Officer Chisman's earlier statements as definitive and would still want to make sure that all reasonable precautions were being taken. The appellant was not routinely doing the due diligence (credit checks on suppliers and customers) that it said it was doing. The appellant cannot reasonably have held the view that Officer Chisman's compliments were founded on a thorough review of the due diligence that had actually been undertaken. That is not to say that what Officer Chisman said is to be ignored, just that it does not carry the significance that the appellant maintains it should.

179. However the unsatisfactory nature of the due diligence does not mean HMRC's case is made out, and as HMRC rightly concede due diligence is not the be all and end all but a factor amongst all the others to be considered. As the appellant submits there must be evidence of what it is that would have been discovered if the due diligence a reasonable business person would have performed was in fact carried out. Although this submission did not refer to any authority it is we note consistent with the approach adopted by the Upper Tribunal in *S&I Electrical Plc v HMRC* [2015] UKUT 0162 (TCC) (see [74] where the UT noted there had been no evidence before the FTT in that case on what the further investigations would have revealed.)

180. The relevance of the cursory nature of the appellant's due diligence is that it did little to protect them against the risk that their transactions would be found to be connected to fraud.

181. The following factors which point towards a finding of means of knowledge are common to all of the deals. (1) The characteristics of the goods, (2) the lack of enquiry into or recording of serial numbers, (3) The fact there were no losses made, goods shipped without payment, instances where the appellant was unable to dispose of goods or significant periods where the appellant was unable to construct deals because it could not match buyers with sellers (4) The lack of interest on the part of suppliers in establishing terms and conditions for high value amounts.

182. In certain deals it was also apparent that there were discrepancies in paperwork, that EU spec goods were traded in the UK, and that UK spec goods were sold to EU customers or abroad to non-EU customers. While these latter features are more

consistent with the supply in question being connected to fraud than not, given the evidence that it was possible without undue difficulty or great expense to adapt the specification of a console, and that the existence of a grey market was not disputed, the significance of such features as indicators of fraud, although not to be discounted entirely, was diminished.

183. HMRC point to the short intervals between transactions / back to back and goods being removed before payment to supplier made. As we have said above this pattern of transactions was also present in deals which have not been challenged. The timing of transactions does not seem to us to be implausible given the way in which the appellant constructed its deals in such a way that it did not proceed with a purchase or sale until had it had some indication that goods would then be correspondingly sold or sourced.

184. Although much was made in cross-examination about it being odd that a supplier would allow its goods to be removed before title had passed we do not think that was as odd as HMRC were making out. It is true that the fact a supplier would allow goods to be delivered before payment connotes commercial risk / trust on the part of the supplier but once the delivery had been made the supplier would not know what then happened to the goods in the period before payment. There was no evidence that e.g. the appellants knew that their supplier had “allowed” goods to be shipped abroad because there was no evidence that the supplier knew that this had happened. The more relevant indicator is the propensity of a supplier to extend credit to the appellant in the first place.

185. Similarly in relation to HMRC’s submission that the appellant failed to consider or ignored the fact that a supplier did not expect payment for goods until payment was received from the customer, there was no evidence indicating that the supplier had specifically agreed that the appellant’s payment for the supply could be deferred until the customer had made its payment. Again the more relevant factor is that the supplier was simply prepared to extend credit to the appellant. The fact that trade credit is extended while certainly a factor to consider, as with all of the factors, has to be assessed within the particular factual circumstances it occurred. For instance it appears to us given the appellant’s trading history that it could well have developed some standing as a wholesaler in the games console sector and that it was not inconceivable that for instance a less well-known supplier who wanted to break into the market might extend credit as a sweetener. Also to the extent a pattern of dealing was established with a supplier who made good on the offer of credit and paid up, then a credit extension that was odd the first time it was offered might become more commercially plausible over a continued course of dealing.

186. While many transactions were back to back the explanation for this does not seem implausible and it carries less weight than it might otherwise do. Although we have concluded that the appellant’s due diligence was inadequate, with the exception of the specific deals mentioned below, it is not clear what information that would have tended to show connection to fraud would have been established had reasonable due diligence been carried out.

187. We must take a step back and look at both the factors which on the face of it are indicators of fraud, and those which even if not individually consistent with fraud might nevertheless add to the cumulative picture of factors which then stands to be assessed in the round. Our conclusion is that while the circumstances would put a reasonable business person on notice that there was a risk, and in some cases a high risk of the majority of the deals being connected to fraud, the cumulative picture vis à vis the particular suppliers would not however go as far as showing that the appellant ought to have known there was a connection to fraud and that the circumstances were such that the only reasonable explanation for the transaction in which it was involved was that it was connected to fraud. As the appellant highlights, and as is clear from *Mobilx*, knowledge of a risk of a connection to fraud is not sufficient. Taking account of the other business the appellant was carrying out, both in the VAT periods under appeal, and beforehand we note that the appellant was conducting transactions with other grey market suppliers, and on occasions with official distributors and retailers in amounts, and quantities in a way that makes it difficult to say that many of the deals under appeal stood out as atypical.

188. In relation to certain deals there are however certain features which we set out below, which when considered together with the “baseline” matrix of facts present in all the deals above, push the analysis into the territory of “ought to have known”. These are transactions where, even if some of the individual factors (e.g. those mentioned above such as in relation to back to back transactions, or errors over paperwork and lack of clarity on terms and conditions) may have a reasonable explanation when viewed in isolation, when we stand back and look at the circumstances in their totality we conclude that a reasonable person ought to have concluded not simply that the transactions risked, or were probably, connected to fraud, but that the only reasonable explanation for them was that they were connected to fraud.

189. **Deal 10** with Cybacomms was one such transaction where we find the appellant ought to have known the transaction was connected to fraud:

(1) There was an adverse credit report for this supplier which revealed large (an eightfold increase between 2005 and 2006) and spiky shifts in trade debt. Although the credit report dated 20 May 2010 post-dates the deal (which took place on 20 April 2010) the information relating to trade debtors was historical and would have been equally apparent from a credit report if one had been sought at the time of the transaction. While it cannot be ruled out that the credit limit listing of £0 and statement that the credit rating was suspended only materialised in the period after 20 April 2010 and preceding 20 May 2010 it seems unlikely to us on the balance of probabilities that the credit report would have appeared healthy only a month before such adverse conclusions were drawn.

(2) There were unexplained switches of product type – the previous product Cybacomms had dealt with in the information disclosed had been mobile phones. The initial deals were in cameras to a non-UK customer and the deal under appeal was in satnav devices.

(3) The deal involved a non UK customer with whom the appellant had only done much smaller deals previously and also a customer who, unusually, was prepared to divulge details of its customer.

5 (4) The deal was priced in Sterling even though it was with a customer who was based in a country which used the Euro. That was all the more unusual given Incoparts' customer was also based in a country which used the Euro. The customer, who from its disclosed turnover, which was significant, would have had greater bargaining power than the appellant yet was prepared to assume the exchange rate risk rather than put this onto
10 the appellant.

(5) The correspondence between the appellant and Cybacomms (see above at [130]) revealed that in the space of three days having it appears been approached out of the blue by Link with an enquiry that related specifically to games consoles, Cybacomms was prepared to go from
15 knowing nothing about the appellant to doing three high value deals (totalling £646,910.63) in a different product type (cameras).

190. A reasonable business person would have found it incredible that a trader with such a dire credit status could source high value deals through legitimate supply chains. He or she would have questioned why such a supplier, having had no history
20 with the appellant, would have been prepared to trade with the appellant, and in so rapid a fashion, high value amounts of product which the appellant had not even approached the supplier about.

191. In relation to the deal under appeal, even if it was the case that the appellant had developed a reputation as a trader who dealt in games consoles there was no credible
25 explanation for why Cybacomms would be prepared to extend credit of £248,000 to the appellant in a product it did not normally deal with. The customer, IncoParts was also a significant operator with a huge disclosed turnover. It ought to have appeared very odd that an EU customer interested in acquiring large quantities of Satnav devices for its own customer would appear on the scene fortuitously allowing a deal
30 to be constructed with the appellant with whom it had previously only carried out relatively small value deals in a different product. This was a deal which had the hallmarks of one that was "too good to be true".

192. The other deal which the appellant ought to have known was connected to fraud was **Deal 24** which was with Northern Computer Services Ltd. It was the first deal,
35 and a large value deal at that, with a company who had:

- (1) no history in the product area of games consoles (the information disclosed suggested the supplier specialised in SAGE related products) and
- (2) whose disclosed turnover was incredibly low compared to the amount
40 of the deal in question and involved a same day sale. A reasonable business person would we think have had commercial doubts as to the ability of the supplier to fulfil such a large order and would we think have seen as a red flag that a small supplier with no history in the relevant product area was able to source product in a large amount relative to the

supplier's turnover. Further this was a deal where the appellant proceeded despite HMRC not being in a position to verify the trader by the time of the deal – the fact that as at the time of the transaction the trader was unverified by HMRC is a further circumstance that adds to the cumulative picture that it was not safe to deal with the supplier.

5

Conclusion

193. Deal 17 was, on the balance of probabilities connected to fraudulent tax loss. The appellant did not have actual knowledge the deals under appeal were connected to fraud. It had means of knowledge deals 10 and 24 were connected to fraudulent tax loss but did not have such means of knowledge in relation to the remainder of the deals under appeal. The appeal is allowed to that extent.

10

194. This document contains full findings of fact and reasons for the decision. Any party dissatisfied with this decision has a right to apply for permission to appeal against it pursuant to Rule 39 of the Tribunal Procedure (First-tier Tribunal) (Tax Chamber) Rules 2009. The application must be received by this Tribunal not later than 56 days after this decision is sent to that party. The parties are referred to “Guidance to accompany a Decision from the First-tier Tribunal (Tax Chamber)” which accompanies and forms part of this decision notice:

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**JUDGE RAGHAVAN
TRIBUNAL JUDGE**

25

RELEASE DATE: 12 JANUARY 2017

ANNEX

Deal	Purchase: Supplier Date Quantity and Product Price + VAT	Sale: Customer Date Quantity Net price + VAT where indicated
1	Bluestar Trading Ltd 6/4/10 1000 Wii Sport Resort Bundle Pack black £121,500 + £21,262.50 VAT	Ebuyer 1/4/10 1000 £126,000 + £22,050 VAT
2	Bluestar Trading Ltd 7/4/10 1000 Wii Sport Resort Bundle Pack black £121,500 + £21,262.50 VAT	Vogue Distribution 6/4/10 250 £31,250 + £5468.75 VAT The Hut.com Ltd 7/4/10 750 £94,125 + £16,471.87 VAT
3	Bluestar Trading Ltd 8/4/10 1314 Wii black with Motion Controller £158,250 + £27,693.75 VAT	Creative Distribution Ltd 8/4/10 1266 £158,250 + £27,693.75 VAT Power Play Direct 12/4/10 48 £6,048 + £1,058.40 VAT
4	Bluestar Trading Ltd 14/4/10 500 Wii black with Motion Controller £60,750 + £10,631.25 VAT	Creative Distribution Ltd 14/4/10 420 £52,500 + £9,187.50 VAT Norrod Computers BV 14/4/10 50 £6,403 Marc Intelligent Systems SLU 15/4/10 10 £1,365 Click Entertainment 15/4/10 20 £2,520
5	Bluestar Trading Ltd 14/4/2010 300 DSI XL Brown £35,100 + £6,142 VAT	B&G Informatica 21/4/10 76 £9,282.64 Diffusione Elettronik SAS 19/4/10 96 £11,751.36 Creative Distribution Ltd 28/4/2010 £8,737.50 + £1,529.06 VAT Click Entertainment 13/5/10 £6,254 + £1,094.45 VAT
6	Bluestar Trading Ltd 15/4/2010 500 Wii white with motion controller £63,000 + £11,025 VAT	GLS Games Distribution (UK) 26/4/10 124 £16,120 + £2,821 VAT Click Entertainment

		<p>29/4/10 72 £9,432 + £1,650 VAT</p> <p>GLS Games Distribution 05/05/10 20 units £2,600 + £455 VAT</p> <p>Al-Fayaz Sattar Gen Trading LLC 06/05/10 284 units £38,056</p>
7	<p>Zen Trade Limited 19/4/2010 1000 Wii sport resort bundle black £121,250 + £21,218.75 VAT</p>	<p>Marc Intelligent Systems SLU 14/4/10 10 units £1,365.00</p> <p>Creative Distribution Limited 14/4/10 990 units £123,750 + £21,656.25 VAT</p>
8	<p>Zen Trade Limited 19/4/10 600 Wii sport resort bundle white £79,222.50 + £13,863.94 VAT</p>	<p>Creative Distribution Ltd 20/4/10 528 units £68,560.80 + £11,998.14 VAT</p> <p>Diverse Electronics 22/4/10 50 units £6,537.50 + £1,144.06 VAT</p> <p>GLS Games Distribution 26/4/10 52 units £6,760 + £1,183 VAT</p>
9	<p>Johnson's Consultancy Ltd 19/4/10 500 Wii £63,500 + £11,112.50 VAT</p>	<p>Creative Distribution Ltd 19/4/10 500 units £64,925 + £11,361.87 VAT</p>
10	<p>Cyabcomms International Ltd 20/4/10 1000 Navman Mio Satnav GPS £ 248,000 + £43,400 VAT</p>	<p>Incoparts BV 20/4/10 1000 units £259,500 delivered to Paris Trading & Consulting SARL (£263,500)</p>
11	<p>The Manual People t/a TMP Distribution 20/4/10 600 Samsung LCD TVs £139,200 + £24,360 VAT</p>	<p>Technology Supplies International Limited 20/4/10 600 units £146,400 + £25,620 VAT</p>
12	<p>Bluestar Trading Ltd 21/4/10 1000 Nintendo Wii sport resort bundle pack white £126,500 + £22,137.50 VAT</p>	<p>Al Fayaz Sattar Gen trading LLC 06/05/10 216 units £28,944</p> <p>Creative Distribution Ltd 07/5/10 180 units £23,310 + £4,079.25</p> <p>BREMA S.r.l 07/5/10 270 units £36,587.70</p>

		<p>Revive Corporation 10/5/10 250 units £32,312.50</p> <p>Vogue Distribution Ltd. 7/5/10 84 units £15,600 + £2,730 VAT</p>
13	<p>Affilia Limited 22/4/10 7000 Server memory £196,000 + £34,300 VAT</p>	<p>Kuzeylodos Bilisim 22/4/10 7000 units £204,120</p>
14	<p>Grandbyte Computers Ltd 22/4/10 150 Sony PSP GO £16,275 + £2,848.13 VAT</p>	<p>DCS ApS 22/4/10 150 units £17,700</p>
15	<p>Fone Station Ltd 27/4/10 Nintendo Wii SP SR MP Black £17,150 +£3,001.25 VAT</p>	<p>Diffusione Elettronik SAS 19/4/10 20 units £2,655</p> <p>Click Entertainment 15/4/10 10 units £1,260 + £220.50 VAT</p> <p>Diffusione Elettronik SAS 04/05/10 20 units £2,610.20</p> <p>Click Entertainment 04/05/10 30 units £3,780 + £661.50 VAT</p> <p>Worldwide Digital Ltd 07/05/10 20 units £2,560 + £448 VAT</p> <p>Perfect Computer Systems Ltd 13/5/10 40 units £4,980 + £871.50 VAT</p>
16	<p>Bluestar Trading Limited 07/05/10 916 Nintendo Wii SP SR MP £113,584 + £19,877 VAT</p>	<p>Revive Corporation 11/5/10 536 units £69,278 + £12,123.65 VAT</p> <p>14/5/10 180 units £23,265 + £4,071.37 VAT</p> <p>14/5/10 180 units £23,265 + £4,071.37 VAT</p> <p>Creative Distribution Ltd 20/5/10 20 units £2,597 + £454.48 VAT</p>
17	<p>Bluestar Trading Limited 10/5/10 500 Nintendo Wii SP SR MP £63,000 + £11,025 VAT</p>	<p>Fulcrum General trading LLC 10/5/10 500 units £67,000</p>
18	<p>The Manual People t/a TMP Distribution</p>	<p>Skream Ltd 10/5/10</p>

	10/5/10 500 PS3 slim 120GB £99,500 + £17,412.50 VAT	500 units £101,500 + £17,762.50 VAT
19	Bluestar Trading Limited 12/5/10 499 Sony Playstation PS3 120GB £99,800	Ebuyer 11/5/10 499 units £101,047.50 + £17,683 VAT
20	The Manual People t/a TMP Distribution 13/5/10 629 Nintendo Wii Solus £69,504 + £12,163.29	Creative Distribution Ltd 12/5/10 629 units £72,278.50 + £12,823.74 VAT
21	Impact Technologies UK Ltd 12/5/10 992 Wii Fit Plus console including balance board £53,072 + £9,287 VAT	Creative Distribution Ltd 12/05/10 500 units £28,500 + £4,987.50 VAT The Hut.com 14/05/10 100 units £5,600 + £980 VAT Revive Corporation Ltd 27/05/10 391 units £21,309.50 + £3,729.16 VAT
22	Bluestar Trading Ltd 17/5/10 700 Nintendo Wii SP SR MP £84,903 + £14,858.03 VAT	Creative Distribution Ltd 12/05/10 500 units £60,645 + £10,612.87 VAT Perfect Computer Systems Ltd 13/05/10 140 units £17,430 + £3,050 VAT Click Entertainment 17/05/10 3 units £378 + £66.15 VAT Diverse Electronics 27/05/10 4 units £510 + £89.25 VAT Xbite Ltd 27/05/10 20 units £2,520 + £441 VAT Compudal Ltd 02/06/10 33 units £4,026 + £704.55 VAT
23	Johnson's Consultancy Ltd. 19/5/10 100 PS3 120GB Slimline £19,600 + £3,430 VAT	Skream 19/5/10 100 units £20,300 + £3,552.50 VAT
24	Northern Computer Services 496 Sony Playstation 3 21/5/10 £96,472 + £16,882 VAT	Skream 21/5/10 496 units £100,192 + £17,533 VAT
25	The Manual People t/a TMP Distribution 20/5/10 570 Samsung TVs £130,815 + £22,892.63 VAT	Active Ventures UK Ltd 21/5/10 570 units £131,100 + £22,942.50 VAT
26	The Manual People t/a TMP	Active Ventures UK Ltd

	Distribution 24/5/10 428 Samsung TVs £98,226 + £17,189.55 VAT	25/5/10 428 units £98,440 +£17,227 VAT
27	Affilia Ltd 24/5/10 6500 units Server memory £182,000 + £31,850 VAT	Kuzeylodos Bilisim 25/5/10 6500 units £189,540
28	Impact Technologies UK Ltd 25/5/10 200 Sony PS3 £42,000 + £7,350 VAT	Square International 26/5/10 46 units £9,936 Revive Corporation 27/5/10 154 units £33,264 + £5,821.20 VAT
29	Impact Technologies UK Ltd 25/5/10 44 Sony Playstation £8,624 + £1,509.20 VAT	Square International 26/5/10 44 units £9,018.68
30	Johnson's Consultancy Ltd 26/5/10 500 Nintendo Wii £63,500 + £11,112.50 VAT	Creative Distribution Ltd 27/5/10 372 units £48,174 + £8,430.45 VAT Diverse Electronics 27/5/10 128 units £16,608 + £2,906.40 VAT
31	Impact Technologies UK Ltd 27/5/10 300 Nintendo Wii £15,450 + £2,703.75 VAT	Mobbila ltd 27/5/10 300 units £16,500 + £2,887.50 VAT
32	Impact Technologies UK Ltd 28/5/10 500 Nintendo Wii £25,830 + £4,520.25 VAT	Diverse Electronics Ltd 27/5/10 500 units £26,430 + £4625.25 VAT