TC01509

Appeal number: LON/2008/0450

VAT – MTIC – whether transactions connected to fraudulent tax loss – yes - whether Appellant knew or ought to have known – yes

FIRST-TIER TRIBUNAL

TAX

EARTHSHINE LIMITED
(IN LIQUIDATION) **Appellant**

- and -

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

TRIBUNAL: Mrs B Mosedale (Tribunal Judge)
Mrs L Salisbury (Tribunal Member)

Sitting in public in London on 18-22, 25-29 January, 1 & 2 February and 7-9 June 2010 and 8 & 9 March 2011

Mr P Green, Mr J Rivett and Ms A Cohen, Counsel, instructed by Maitland Walker, for the Appellant

Mr Collins, Ms R Marcus and Mr J Sharma, Counsel, instructed by the General Counsel and Solicitor to HM Revenue and Customs for the Respondents

DECISION

1. This appeal concerns input tax totalling £303,646.35 incurred by Earthshine Ltd ("Earthshine") on 7 deals which took place in July, October and November 2006. HMRC issued a decision letter on 15 February 2008 denying Earthshine the right to recover this input tax on the grounds HMRC considered Earthshine knew or should have known that the transactions were connected with the fraudulent evasion of VAT.

2. The Appellant denies that any of the deals were connected with fraudulent tax loss and that even if they were, denies that it knew or ought to have known of this.

3. Earthshine was incorporated on 29 October 2001 and registered for VAT, and commenced trading in mobile phones and computer chips. At that time the principal shareholder and director was a Mr Ed Buxton, whose involvement with the company had ceased by the time of the transactions at issue in this appeal. Mr Sharp bought a stake in the business in 2002 and became a director.

4. The Hon. Philip Knatchbull knew Mr Sharp through other business associations and Mr Sharp proposed he invested in Earthshine and Mr Knatchbull became a director in 2005. At the time of the transactions at issue in this appeal the directors of the company were Mr Sharp and Mr Knatchbull with each of them owning 50% of the shares (Mr Sharp's ownership was via a nominee company). Mr Henry Agoh was the company secretary.

Preliminary matters

Admission of the "Santok" spreadsheet

5. In his closing, Mr Green argued that the Tribunal should ignore an A3 spreadsheet which Mr Kendrick (witness for HMRC) claimed was given to HMRC by a company called Santok. The bundles before the Tribunal at the outset of the hearing contained only an incomplete copy of the spreadsheet which was evidentially useless. When this was realised, HMRC produced a complete A3 copy of the spreadsheet during the hearing.

6. At the hearing Mr Green made no objection to the admission of the full version of the spreadsheet and indeed accepted HMRC did not need to make an application to admit it because HMRC had disclosed the correct version as part of their voluminous disclosure and it was therefore already admitted: HMRC said the mistake was merely a photocopying error when the bundles were compiled. Therefore, the full version of the Santok spreadsheet was before the Tribunal in evidence.

7. However, in closing in March 2011, Mr Green said (although did not produce any evidence to support the allegation) that the A3 version had not been disclosed by HMRC to the Appellant and that the photocopying error occurred not merely when the bundles were compiled but when disclosure took place.

8. We consider Mr Green's objection, being made in closing and over a year after the spreadsheet was admitted in the hearing, is made too late. Had Mr Green objected

to its admission at the hearing in January 2010 (or even in June 2010) we could have considered whether it was properly disclosed to the Appellant: we could have looked at the original documents actually disclosed to the Appellant. But Earthshine did not do this. In conclusion, the A3 "Santok" spreadsheet was in evidence in front of us. Our findings in respect of this spreadsheet and its relevance to the hearing are set out in paragraphs 140-146 of our decision notice below.

Admission of the Mr Black/Mr Sharp email chain

9. As is recorded in the decision of this Tribunal *Earthshine Ltd v HMRC* TC00379 [2010] UKFTT 67 (TC) released on 12 February 2010 we ruled in favour of the admission in evidence of a chain of emails between a Mr Young (aka Mr Black) and Mr Sharp, the director of Earthshine. The reasons for that decision are explained in that decision notice and we do not repeat them here.

10. Nevertheless, Mr Green again at the hearing of closing submissions in March 2011 asked the Tribunal to exclude this evidence from our consideration on the grounds our decision to admit it was (in his opinion) wrong and wrong for the reasons he gave in opposing its admission in the first place.

11. Although in some cases it might be appropriate to ask a Tribunal to reverse a case management direction, where the issue is admission of evidence the only proper course of challenging that decision is to appeal against it. Earthshine chose not to appeal our decision and cannot have two bites at the cherry: it must now abide by our decision to admit the evidence.

12. In any event, we do not agree that our decision to admit the email chain was wrong: for the reasons given in our decision notice we consider it was right to admit it.

13. Mr Green also submitted to the Tribunal that we should disbelieve Mr Stone's evidence that he found the emails by chance during the course of Earthshine's hearing in January 2010 enclosed in a file belonging to another trader which Mr Stone was then preparing for a different hearing. The circumstances of the re-discovery of the chain of emails by Mr Stone is already a subject of a finding of fact by this Tribunal and recorded in our Decision of February 2010. It was not put to Mr Stone either at the hearing for the admission of the evidence (February 2010) or the later hearing of Mr Stone's evidence in the appeal in June 2010 that he was untruthful when he said he re-discovered the copy emails by chance. It is, therefore, not open to Mr Green to make this allegation against the witness as he has failed to give him the chance to refute it.

14. In any event, we see no cause to revise our opinion stated in paragraphs 19-21 of our Decision of February 2010 that Mr Stone was honest in his explanation of how he re-discovered the copy emails. Indeed, Mr Stone was cross examined for some one and a half days in June 2010 and we heard nothing that we found to be dishonest or unreliable in his evidence as explained in paragraphs 378-392 of this decision notice below.

15. We considered the emails as part of the evidence in front of this Tribunal (and the various witness' evidence in respect of them) and our findings in respect of them are explained below.

Unopposed admission of late documents

16. Mr Green objects in his March 2011 closing submissions that a number of other documents were admitted late to the hearing and this is true. Certain documents were admitted late but this was because the Appellant chose not to oppose their admission. It cannot now object that they were admitted.

Non-disclosure of decision log and means of knowledge submission.

17. Mr Green complains in closing submissions that certain internal HMRC documents, in particular the decision log and means of knowledge submission, were not disclosed in this case although they have been disclosed in other alleged "MTIC" cases. Recording as they do the opinion of the HMRC officers concerned, we consider these documents are of limited, if any, relevance to the issues before the Tribunal. In any event, crucially, Mr Green made no application for their disclosure at any time and cannot now complain.

Allegation of knowledge – was it pleaded?

18. In a nutshell Mr Green's submission is that the Appellant did not understand HMRC's case and in particular whether actual knowledge was pleaded against it when the decision letter was delivered, when the Statement of Case was delivered, nor at end of four rounds of evidence, nor at end of hearing. Mr Green says it is a well established principle of law that an allegation of dishonesty, even in a civil case such as this one, must be pleaded with sufficient particularity and put to the witness. We did not understand HMRC to dispute this proposition: but of course they did not agree that they had not pleaded actual knowledge with sufficient particularity.

19. Mr Green says that the statement of case only alleges "knowledge or means of knowledge" and that this is not a clear allegation of actual knowledge and therefore the Tribunal cannot make a finding to that effect even were it minded to so do. In the case of *Armitage v Nurse & Ors* [1997] EWCA Civ 1279 the Court of Appeal said that:

> "Fraud must be distinctly alleged and as distinctly proved….defendant knew or ought to have known is not a clear and unequivocal allegation of actual knowledge and will not support a finding of fraud. It is not treated as making two alternative allegations, ie an allegation that the defendant actually knew with an alternative allegation that he ought to have known, but rather a single allegation that he ought to have known."

20. The Appellant is, however, wrong to say knowledge was not distinctly pleaded in this appeal. Although the expression "knew or should have known" is used in the Statement of Case any ambiguity in this phrase is resolved by paragraph 33 of the Statement of Case under the heading "knew or should have known" where it says

> "[33]It is the Commissioners' primary case that the Appellant knew that its transactions were connected to fraud. This is an inference which the Commissioners invite the Tribunal to draw from the general awareness that the Appellant had of fraud in its trade sector, the specific warnings which the Appellant received, the entirely unreliable and commercially unviable due diligence it understood, and the commercial unreality of the transactions into which it entered.
>
> [34]The Commissioners' alternative case is that, on the basis of the same evidence, if the Appellant did not have actual knowledge that its transactions were connected to fraud it ought to have known of that fact."

21. Paragraph 33 of the re-amended statement of case is an unequivocal pleading of knowledge of fraud. The Appellant could not have been, and at the hearing clearly was not, under any misapprehension of the seriousness of the allegations made against it.

Allegations of knowledge – was it pleaded with particularity?

22. Mr Green's second point was that even if there was a pleading of actual knowledge (as we have found there was), it was insufficiently particularised. An example of insufficient pleading he points to is paragraph 29 of the Statement of Case which says "The Appellant failed to carry out credit or Companies House checks on several of its customers and suppliers" but the names of the customers and suppliers are not given.

23. We do not agree that the allegation of knowledge was pleaded with insufficient particularity. It is clear from paragraph 33 that HMRC are relying on all the matters set out by them in paragraphs 21-32, some 5 typed pages. These matters are set out in even greater detail in the witness statements of HMRC witnesses', especially Mr Kendrick's (which does cover the names of the companies on which credit checks or Companies House checks were not carried out).

24. An appellant cannot expect the entire content of a witness statement to be set out in the Statement of Case. We agree with Judge Wallace in *Late Editions Limited* [2009] UKFTT 166 (TC)*:*

> "We do not read the judgment [Lloyd J in *Mobilx*] as saying every allegation must be pleaded in detail in the Statement of Case. The crucial matter is that the appellant should have had a proper opportunity to deal with any material allegation. Cases such as this involve a mass of detail. It is unrealistic to expect every detailed allegation to be in the Statement of Case…." [para 148]

The Statement of Case is of necessity a summary of the evidence HMRC say their witnesses will give and the inferences which HMRC draw from it: we find it was given in sufficient particularity for the Appellant to be very well aware of HMRC's case long before the hearing. Indeed, there were about 4 rounds of witness statements being made in response to various points made by witnesses for each side before the hearing commenced. The Appellant knew the case against it.

Application to strike out paragraph 32.11 of HMRC's Re-amended Statement of Case

25. Mr Green asked the Tribunal to strike out paragraph 32.11 of the Statement of Case. This reads:

> "Moreover, the Appellant indicated to officers of the Commissioners that it employed a private investigator carry out its due diligence who was able to check HMRC and Metropolitan Police databases. Misuse of these databases is a criminal offence."

This paragraph appears at the end of a list of 10 other matters which HMRC state they "further" rely on to show knowledge .

26. We understand Mr Green's grounds for considering this should be struck out are that:

- It was unfair to Earthshine as, the Appellant said in making this application immediately before closing HMRC had set out to ambush Earthshine as (unknown to the appellant) Mr Stone had the emails and, alleged the Appellant, given false evidence when he said he had lost them but then found them during the January 2010 hearing and after Mr Sharp had given evidence;

- The late disclosure of the emails unfairly affects the Appellant's case;

- The pleading is un-particularised as it was not pleaded that Appellant must have known that Mr Young's use of police and Customs' databases was unlawful.

27. We do not accede to this Application. Firstly, if we allowed it the effect would be to prevent the Tribunal considering the email chain in evidence, contrary to our decision (*Earthshine Ltd v HMRC* TC00379 [2010] UKFTT 67 (TC)) that the email chain is relevant and should be considered.

28. Secondly, there are no good grounds on which it should be excluded from the pleadings. Mr Green puts forward the same reasons, which we have already dismissed in connection with his opposition to the admission of the email exchange. We dismiss them here for the same reasons. As explained in paragraphs 19-21 of our earlier Decision, we do not accept that HMRC deliberately set out to ambush the Appellant. We do not think the Appellant can even claim to be ambushed at all when it was the author or recipient of the emails in issue.

29. And although the admission of evidence is a balancing exercise in fairness to both parties, as stated before, this Tribunal will not give greater weight to the emails than they deserve just because of their dramatic and late appearance. Mr Green's particular concern appears to be any discrepancies between Mr Sharp's original evidence and the facts as shown in the email exchange should not carry undue weight with the tribunal when (in his view) they are caused by lapse of memory over time. The Tribunal has, of course, taken this into account when considering what the emails show and our conclusions are recorded at paragraph 402-421.

30. As to the claim it was unparticularised, inevitably, HMRC not having the evidence at the time the pleading was made, the pleading is less particular than it could have been had the email chain been available to HMRC at the time. It is inevitable that where evidence is admitted late it won't have been considered when the pleadings were drawn up. Fundamentally the question is whether Mr Sharp knew before his cross-examination in June 2010 the nature of the new allegation against him: taking into account what was said in the application for admission of the email chain in January 2010 we find he could not have been any doubt about this.

Terms and expressions and description of MTIC fraud

31. This case is one of many in which HMRC allege that the transactions were connected to MTIC fraud. Many previous tribunals and higher Courts have given a description of MTIC fraud. We rely on the descriptions given by Burton J in *R (Just Fabulous (UK) Ltd) v HMRC* [2007] EWHC 521 at paragraphs 5-7; by Lewison J in *HMRC v Livewire Telecom Ltd* [2009] EWHC 15 (Ch) at paragraph 1 and by Floyd J in *Mobilx Ltd (In Administration) v HMRC* [2009] EWHC 133 at paragraphs 2-3.

32. The simple missing trader fraud is described by Lewison J in *Livewire* at paragraph 1:

> "[1.] VAT fraud is a serious problem for national taxing authorities throughout the European Union. VAT fraud can take a number of forms. The particular form of fraud with which these appeals is concerned is known generically as missing trader intra-community fraud or MTIC fraud. This is a description coined by HMRC, but is generally used by those who specialise in this area. Even this generic type of fraud can itself take different forms:
>
> i) In its simplest form it is known as an acquisition fraud. A trader imports goods from another Member State. No VAT is payable on the import. He then sells on those goods to a domestic buyer and charges VAT. He dishonestly fails to account for the VAT to HMRC and disappears. The importer is labelled a "missing trader" or "defaulter".

33. Although this is the simplest form of the fraud it depends on the defaulter having a genuine buyer willing to purchase the goods. There is a more sophisticated version of missing trader fraud where the fraudster does not have a genuine market into which he can sell goods at the volume and price necessary to achieve the sorts of illegal profits he wants to make by failing to account for the VAT due. Lewison J describes this in his next paragraph:

> "ii) The next level of sophistication involves both an import and an export. A trader once again imports goods from another Member State. No VAT is payable on the import. Typically the goods are high value low volume goods, such as computer chips or mobile phones. He then sells on those goods to a domestic buyer and charges VAT. He dishonestly fails to account for the VAT to HMRC and disappears. The domestic buyer sells on to an exporter at a price which includes VAT. The exporter exports the goods to another Member State. The export is zero-rated. So the exporter is, in theory, entitled to deduct the VAT that he paid from what would otherwise be his liability to account to

> HMRC for VAT on his turnover. If he has no output tax to offset against his entitlement to deduct, he is, in theory, entitled to a payment from HMRC. Thus HMRC directly parts with money. Sometimes the exported goods are re-imported and the process begins again. In this variant the fraud is known as a carousel fraud. There may be many intermediaries between the original importer and the ultimate exporter. These intermediaries are known as "buffers". The ultimate exporter is labelled a "broker". A chain of transactions in which one or more of the transactions is dishonest has conveniently been labelled a "dirty chain". Where HMRC investigate and find a dirty chain they refuse to repay the amount reclaimed by the ultimate exporter."

34. A simple missing trader fraud relies on a genuine sale of goods into an open market. To commit the kind of sophisticated, organised missing trader fraud described above, however, the fraudster has to establish an artificial market. In this artificial market, the goods are bought and sold but there is no real market for the goods. For this type of fraud it is not even necessary for the goods to actually exist. It is possible but not essential for this fraud to work for the goods (if they exist) physically to go round in a circle ("carousel" fraud) as it is obviously more efficient and makes more money if the defaulter re-uses the goods in artificial chains as often as possible.

35. To create the necessary artificial market, the fraudster must organise a buyer at every step of the way: there is no genuine market. Third parties will not enter into the chain if they do not see a profit in it, so the fraudster must organise a sale at a profit for everyone who is to be a buyer in the chain. Logically it follows that the defaulter must ensure that the buffers and brokers do realise their profit: they will act as rational people and if they make a loss, they will not participate again. So if the fraudster wants to commit the fraud a second time with the same people, he must continue to organise every step of the transaction because there is no genuine market. As organising an artificial market must take effort, it is likely (but not essential) that the fraudster would use the same brokers and buffers again and again.

36. It will be important to the fraudster (even where the broker is entirely independent of the fraudster) that the broker recovers its input tax (or at least believes that he will) because otherwise the broker will not buy the goods. A method of protecting the broker's input tax reclaim introduced yet a further level of sophistication. This is also described by Lewison J:

> "iii) In order to disguise the existence of a dirty chain, fraudsters have become more sophisticated. They have conducted what HMRC call "contra-trading". The trader who would have been the exporter or broker at the end of a dirty chain, with a claim to repayment of input tax, himself imports goods (which may be different kinds of goods) from another Member State. Because this is an import he acquires the goods without having to pay VAT. This is the contra-trade. He sells on the newly acquired goods, charging VAT but this output tax is offset against his input tax, resulting in no payment (or only a small payment) to HMRC. The buyer of the newly acquired goods exports them and reclaims his own input tax from HMRC. Again there may be

> intermediaries or buffers between the contra-trader and the ultimate exporter. The fraudsters' hope is that if HMRC investigate the chain of transactions culminating in the export, they will find that all VAT has been properly accounted for. This chain of transactions has conveniently been called the "clean chain". Thus the theory is that an investigation of the clean chain will not find out about the dirty chain, with the result that HMRC will pay the reclaim of VAT on the export of the goods which have progressed through the clean chain. I should add that HMRC do not agree with the label "clean chain" because they say that both chains are part of an overall fraudulent scheme."

37. It is not essential for sophisticated MTIC fraud – whether or not contra-trading is involved - that the buffers and brokers necessarily understand that they are not operating in a genuine market. Indeed it is Earthshine's case that even if HMRC prove that the transactions were connected to orchestrated fraud, that its directors were nevertheless at the time convinced their transactions were taking place on a genuine "grey" or secondary market for mobile phones.

38. HMRC allege that the transactions in this appeal are the organised sophisticated MTIC fraud, some involving straight "dirty" chains and some involving "clean" chains in contra trades.

Law

39. The European Court of Justice ("ECJ") ruled in *Axel Kittel v Etat Belge* (C-439/04) and *Etat Belge v Recolta Recyling SPRL* (C-440/04) in July 2006 that (paragraph 61):

> "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."

40. The Court of Appeal considered this in *Mobilx Ltd (In Administration)* [2010] EWCA Civ 517. At paragraph 47 Moses LJ (giving the leading judgment) said:

> "…. the objective criteria which form the basis of concepts used in the Sixth Directive form the basis of the concepts which limit the scope of VAT and the right to deduct under ss. 1, 4 and 24 of the 1994 Act. Applying the principle in Kittel, the objective criteria are not met where a taxable person knew or should have known that by his purchase he was participating in a transaction connected with fraudulent evasion of VAT.

41. It was not in dispute that to prove it was entitled to refuse the Appellant's reclaim of input tax, HMRC have to prove that, in respect of the all the deals at issue in this appeal:

- There was a tax loss;
- The tax loss resulted from fraudulent evasion;

- The deal was connected to that fraudulent tax loss; and

- The Appellant knew or ought to have known this.

Is Kittel part of English law?

42. In opening Mr Green made fairly lengthy submissions on why *Kittel* did not in his view form part of English law. In closing over a year later he recognised that this Tribunal is bound by the decision of the Court of Appeal in *Mobilx* (see paragraph 47 of that decision) that the principles set out by the CJEU in *Kittel* do form part of the VAT Act 1994. Mr Green reserves the right to argue, at least in respect of means of knowledge, the contrary in a higher court.

Does Kittel apply if fraud vitiates defaulter's transaction?

43. Mr Green suggested that *Mobilx* and/or *Kittel* cannot apply where but for the fraud the transactions would not have taken place. If we understand this argument correctly, it is that because (the allegation is) that these are organised MTIC fraud chains, the transaction on which the VAT was defaulted was artificially generated for the purpose of the fraud and is therefore vitiated by that fraud. Although the CJEU has ruled in *Optigen C-354/03* and then in *Kittel* that a transaction is not vitiated by fraud where at least one party to it did not know and could not have known of the fraud, the implication is that where both parties to the transaction do know of the fraud, it is vitiated and not a "supply" for the purposes of VAT. Therefore, we understand the argument is that, if HMRC show that the defaulter and Line 1 buffer knew of the fraud, the "transaction" between them is vitiated for fraud, there is no VAT, and no true VAT defaulted upon.

44. We cannot agree that this has any impact on the applicability of *Kittel*. The question is whether the Appellant has knowledge or means of knowledge of a connection to fraud: it does not matter whether it is true VAT defaulted upon or simply an amount of money fraudulently represented to be VAT. That our view is correct is clear from Schedule 11 paragraph 5 VATA 1994 which provides that simply by issuing a VAT invoice a person is liable to account for the "VAT" represented to HMRC. So even if the defaulter's "sale" to the line 1 buffer is vitiated for fraud, because the defaulter issues a VAT invoice, his failure to account for the sum represented as VAT (whether or not true VAT) will be fraudulent if he intended from the outset not to account for it. And that is the fraud to which HMRC allege Earthshine's transactions are connected.

45. It is true that the CJEU referred to "VAT fraud" and did not consider the question of a fraud of a sum merely represented to be VAT but not actually being VAT: in our view it is hopeless to suggest that the CJEU would have given a different answer if this point had been put to them. It is clear that the CJEU regards a sum of money as being VAT where a VAT invoice is issued even if no VAT supply takes place as they say as much in the case of *Stadeco BV* C-566/07:

> "In the light of the foregoing, the answer to the first question is that Article 21(1)(c) of the Sixth Directive must be interpreted as meaning that the VAT is due, pursuant to that provision, to the Member State to

> which the VAT mentioned on the invoice or other document serving as invoice relates, even if the transaction in question was not taxable in that Member State…..(paragraph 33)"

Means of knowledge

46. What did the CJEU mean when it said in *Kittel* at paragraphs 56 & 59 that it is clear that a taxpayer who "should have known" his purchase was connected with the fraudulent evasion of VAT "must, for the purposes of the Sixth Directive, be regarded as a participant in that fraud" and in these circumstances lose his right to deduct his input tax on that purchase?

47. Moses LJ in *Mobilx* went on to say at paragraph 60:

> "The true principle to be derived from *Kittel* does not extend to circumstances in which a taxable person should have known that by his purchase it was more likely than not that his transaction was connected with fraudulent evasion. But a trader may be regarded as a participant where he should have known that the only reasonable explanation for the circumstances in which his purchase took place was that it was a transaction connected with such fraudulent evasion."

48. He also said at paragraph 52 that a:

> "taxpayer [who] 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…"

and also that:

> "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".

49. At paragraph 61 Moses LJ said:

> "If he [the taxable person] 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."

50. We consider that in using the expression "means of knowledge" the CJEU does expect a taxpayer to take reasonable precautions and to make further enquiries where there are negative indicators. We think the right to recover input tax is matched by an objective duty to take reasonable precautions, and that where there is a failure to take reasonable precautions which would have revealed the connection to fraud, input tax is properly denied. In any event this is superfluous to our decision on "means of knowledge" as explained in paragraph 637.

Burden of proof

51. At the outset of the hearing in January 2010 HMRC advanced the view that the burden of proof of (lack of) knowledge or means of knowledge rested on the

Appellant. By the time of closing submissions, the Court of Appeal had issued its decision in *Mobilix* and HMRC did not dispute following this that the burden of proof for the *Kittel* test is entirely on HMRC. HMRC accept it is for them to show (if they can) that the transactions on which they denied the Appellant input tax recovery were connected with fraudulent evasion of tax and that the Appellant knew or ought to have known this.

52. If HMRC can not show this then the Appellant is entitled to recover the input tax at stake in this appeal.

Standard of proof

53. Mr Green's put the view that, firstly, as the allegation includes one of "knowledge" which is tantamount to an allegation of fraud which is a criminal offence, the allegations must be proved to the criminal standard (beyond reasonable doubt).

54. We do not agree. This is not a criminal trial: it is not even a case of a civil dishonesty penalty. Neither Earthshine nor its directors risk a criminal conviction or fine as a potential outcome of this hearing. This is a case about whether Earthshine meets the objective criteria for recovery of input tax. There are many criteria to be met before a trader can recover input tax (eg he must hold a valid invoice and the input tax must be attributable to an onwards taxable supply). Not knowing or having the means of knowledge of connection to fraud is one of the necessary criteria. This hearing is not tantamount to a criminal trial and the burden of proof is the normal balance of probabilities. This is not one the civil cases indicated by Lady Hale in *In re B* [2008] UKHL 35 (paragraph 69) whose nature is such that it is appropriate to apply the criminal standard of proof.

55. In any event nothing turns on this. Our findings on knowledge and means of knowledge set out at the end of this decision notice are to both the civil and criminal standard.

56. Mr Green's second point was that even if the standard were "balance of probabilities" nevertheless proof of fraud against his client or indeed against any of the companies mentioned in but not parties to this appeal would require cogent evidence.

57. *In re H* [1996] AC 563, 586 D-H Lord Nicholls said:

> "The balance of probability standard means that a court is satisfied an event occurred if the court considers that, on the evidence, the occurrence of the event was more likely than not. When assessing the probabilities the court will have in mind as a factor, to whatever extent is appropriate in the particular case, that the more serious the allegation the less likely it is that the event occurred and, hence, the stronger should be the evidence before the court concludes that the allegation is established on the balance of probability. Fraud is usually less likely than negligence."

58. We see this as a requirement, when assessing whether something is proved on the balance of probabilities, to consider all relevant matters, including as Lord Nicholls said, that fraud is usually less likely than negligence. But the standard remains the balance of probabilities.

59. In any event, the latest view expressed by the Supreme Court and binding on us was by Lady Hale in *Re S-B (Children) [2009] UKSC 17:*

> "…there is no necessary connection between the seriousness of an allegation and the improbability that it has taken place. The test is the balance of probabilities, nothing more and nothing less."

In any event, on the question of Earthshine's directors' knowledge, nothing turns in this appeal on the balance of probabilities. Our findings are to the criminal standard.

Circumstantial evidence

60. Mr Green states that in many parts of this appeal direct proof of what is alleged is missing: for instance, in respect of the question of "knowledge", he says there is no evidence of any communication or contact between Earthshine and the alleged defaulters. He is right: there is no such direct evidence of contact between Earthshine and the alleged defaulters.

61. In Mr Green's view this lack of direct evidence means there is no cogent evidence of knowledge and therefore it is impossible for the Tribunal to find that Earthshine had knowledge.

62. We do not agree that there must be direct evidence. Lack of direct evidence does not necessarily mean HMRC cannot prove its case: this tribunal considers, as it must, circumstantial as well as direct evidence. As Moses LJ said in *Mobilx* at paragraph 81-82

> "[81]HMRC raised in writing the question as to where the burden of proof lies. It is plain that if HMRC wishes to assert that a trader's state of knowledge was such that his purchase is outwith the scope of the right to deduct it must prove that assertion. No sensible argument was advanced to the contrary.
>
> [82] But that is far from saying that the surrounding circumstances cannot establish sufficient knowledge to treat the trader as a participant. …
>
> …….[84] Such circumstantial evidence, of a type which compels me to reach a more definite conclusion that that which was reached by the Tribunal in *Mobilx*, will often indicate that a trader has chosen to ignore the obvious explanation as to why he was presented with the opportunity to reap a large and predictable reward over a short space of time. ….."

We will look at the totality of the evidence, including circumstantial evidence, when assessing knowledge and means of knowledge.

Hindsight

63. In Mr Green's view, HMRC's case depends on hindsight and that the Appellant should be judged by what was known in 2006 and not what is known now. To an extent we agree the use of hindsight is inappropriate: the question of knowledge must be judged by what the Appellant knew at the time and not what they know now. Means of knowledge must be judged by what the Appellant should have known at the time and not on what ought to be known now.

64. However, in determining what the Appellant actually knew at the time it is proper for the Tribunal to look at circumstantial evidence (including everything that is now known about the deals) to determine what it was that the Appellant actually knew (or should have known) in 2006.

Original jurisdiction

65. Mr Green makes the point that at the time Mr Kendrick issued his decision letter denying Earthshine its input tax, it was issued (in Mr Green's opinion) on the basis of a misunderstanding of the law. As the Appellant was told at the hearing, this Tribunal does not have a supervisory jurisdiction: we are not reviewing the reasonableness or otherwise of HMRC's decision. We are exercising original jurisdiction and deciding afresh as a matter of law whether the Appellant has the right to recover its input VAT.

How to approach the *Kittel* test in contra-trading?

66. It is the Appellant's case that connection to and knowledge and means of knowledge of fraud must be approached differently in respect of transactions which HMRC allege were connected to contra-trade frauds rather then merely straight default chains.

Connection to fraud?

67. Lewison J in *Livewire* at paragraph 102-103 says:

> "102. In my judgment in a case of alleged contra-trading, where the taxable person claiming repayment of input tax is not himself a dishonest co-conspirator, there are two potential frauds:
>
> (i) the dishonest failure to account for VAT by the defaulter or missing trader in the dirty chain;
>
> (ii) the dishonest cover-up of that fraud by the contra-trader.
>
> 103. Thus it must be established that the taxable person knew or should have known of a connection between his own transaction and at least one of those frauds. I do not consider that it is necessary that he knew or should have known of a connection between his own transaction and both of these frauds. If he knows or should have known that the contra-trader is engaging in fraudulent conduct and deals with him, he takes the risk of participating in a fraud, the precise details of which he does not and cannot know."

68. In other words, HMRC must prove a connection to a fraud. If the contra-trader is fraudulent, it is enough to prove connection to the contra-trader. Either way it is sufficient to prove connection to the defaulter.

69. Mr Green suggests the fact that a dirty chain post-dates the clean chain means that connection cannot be proved. He says this presumably because the alleged broker has bought goods before the separate transaction takes place in which the defaulter defaults. On the contrary the Chancellor in *Blue Sphere* said that timing cannot affect connection:

> "….The process of off-setting inputs against outputs in a particular period and accounting for the difference to the relevant authority can connect two or more transactions or chain of transaction in which there is one common party whether or not the commodity sold is the same. If there is a connection in that sense it matters not which transaction came first. [paragraph 44]."

70. The Chancellor does go on to point out that the timing might impact on the broker's knowledge in a case where (as in *Blue Sphere)* the contra-trader was found to be innocent and the clean chain by implication not orchestrated for the purposes of fraud and we discuss this below. But timing does not affect *connection.*

71. That this is the law is also reflected in the Court of Appeal's decision in *Mobilx* where Moses LJ said at paragraph 62 that:

> "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…."

72. In conclusion, we do not agree with Mr Green that a precedent clean chain cannot be connected with a subsequent defaulter chain. In any event, if we are satisfied that the contra-trader acted fraudulently, HMRC would only have to show a chain back to the contra-trader. And if we were not so satisfied, HMRC would have to show a chain that linked the alleged broker to the alleged contra-trader, and a separate chain from the contra-trader to a defaulter, and that the VAT reclaim on the latter did offset the VAT liability on the former.

Knowledge and means of knowledge in contra-chains

73. Mr Green's further point is that (unless conspiracy is proved which it cannot be as it was not alleged) that Lewison J's decision means that HMRC must prove that Earthshine knew of a dishonest cover-up by the contra-trader (if we find there was one) or that Earthshine knew of the defaulter's default (if we find there was one). This is not how we read Mr Justice Lewison's comments (paragraph 67 above) which appear to be pointing out that with contra-trading there are (at least) two frauds and not just one. We do not read his comments as requiring that Earthshine know of the precise details of the fraud (eg that it was a contra-trade chain rather than a straight chain).

74. In any event, that that is the correct interpretation is made plain by Mr Justice Briggs in *Megtian:*

[33] Mr Patchett-Joyce's submission under Ground 3 was that, in the light of *Livewire*, it was necessary in any case where a disallowance of input tax was to be made good as against the broker at the foot of the clean chain in a contra-trading case to demonstrate, and for the tribunal on appeal to find, that the broker knew or ought to have known specifically of one or other of those two aspects of the underlying fraud. By contrast, Mr Patchett-Joyce submitted (correctly) that in the present case the tribunal had addressed the question of what Megtian knew or ought to have known as a single question applicable both to the straight transactions and the contra-trading transactions, without any such specific analysis in relation to the latter. Mr Patchett-Joyce was quick to point out that it was understandable that the tribunal took this course, bearing in mind that *Livewire* was decided shortly after it released its Decision in the present case. Nonetheless it was, he submitted, a fatal error of law, in relation to the contra-trading transactions.

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

[35] In the first place, Lewison J was, as he made very clear, addressing the question what had to be demonstrated against an honest broker who was not a dishonest co-conspirator in the tax fraud. In the present case, the tribunal's conclusion, after hearing oral evidence from and cross-examination of Mr Andreou, Megtian's shareholder and principal manager, was that Megtian knew that the transactions on which it based its claim were connected with fraud: see para 112 of the Decision. Participation in a transaction which the broker knows is connected with a tax fraud is a dishonest participation in that fraud: see below.

[36] Secondly, Lewison J acknowledged that in many if not most cases of contra-trading, the clean chain and the dirty chain were likely to be part of a single overall scheme to defraud the Revenue. As he put it, at para 109 “Indeed it seems to me that the whole concept of contra-trading (which is HMRC's own coinage) necessarily assumes that to be so.”

[37] In my judgment, there are likely to be many cases in which a participant in a sophisticated fraud is shown to have actual or blind-eye knowledge that the transaction in which he is participating is connected with that fraud, without knowing, for example, whether his chain is a clean or dirty chain, whether contra-trading is necessarily involved at

> all, or whether the fraud has at its heart merely a dishonest intention to abscond without paying tax, or that intention plus one or more multifarious means of achieving a cover-up while the absconding takes place.
>
> [38] Similarly, I consider that there are likely to be many cases in which facts about the transaction known to the broker are sufficient to enable it to be said that the broker ought to have known that his transaction was connected with a tax fraud, without it having to be, or even being possible for it to be, demonstrated precisely which aspects of a sophisticated multifaceted fraud he would have discovered, had he made reasonable inquiries. In my judgment, sophisticated frauds in the real world are not invariably susceptible, as a matter of law, to being carved up into self-contained boxes even though, on the facts of particular cases, including *Livewire*, that may be an appropriate basis for analysis.
>
> [39] It follows in my judgment that the tribunal did not in the present case make any error of law in approaching the question what Megtian knew or ought to have known on the general rather than segmented basis for which Mr Patchett-Joyce contends. Ground 3 accordingly fails.

75. In conclusion, we disagree with Mr Green. It is not necessary that HMRC prove that a broker knew (or ought to have known) of the details of the fraud such as whether it was a straight chain or contra-chain, or that they knew the identity of either or both the contra-trader (if there was one) or the defaulter. The question is whether an alleged broker knew of the connection to (alleged) fraud and *not* whether they knew the identity of anyone involved in the (alleged) fraud. Indeed, even if a broker is proved to have known its transactions connected to fraud, there is no reason to suppose that the broker necessarily knew who were its suppliers' suppliers, the identity of any defaulter, nor if the chain its purchase facilitated was a defaulter or contra chain.

Conspiracy must be proved?

76. Mr Green further suggested that the Tribunal should approach the question of Earthshine's knowledge or means of knowledge differently when the chain involved a contra-trader, in particular he said that unless HMRC could prove actual knowledge the input tax could not be denied: means of knowledge was insufficient. He also suggests that unless HMRC can prove an alleged broker is a party to a conspiracy with the alleged contra-trader, a tribunal cannot find knowledge of fraud. (In this case conspiracy was neither pleaded nor put to Earthshine's witnesses so such a finding would not be open to us).

77. Mr Green relies on the views expressed in the High Court by Lewison J and the Chancellor. Lewison J in *Livewire* (cited above) went on to say that *if* the contra-trader was not acting fraudulently then it would be necessary to prove that the claimant (in the clean chain) knew of the defaulter's fraud in the dirty chain:

> "107. there is an evidential or factual difficulty in proving a connection with fraud in a case of contra-trading, where the contra-trading is not part of an overall scheme to defraud the Revenue…."

78. The Chancellor in *Blue Sphere Global Ltd* [2009]EWHC 1150 (Ch) repeated Lewison J's comments with approval. On the facts of the particular case in front of him, and in particular the Tribunal's finding that neither the claimant nor the contra-trader was a party to fraud, he found it could not be said that the claimant ought to have known of the fraud before it took place:

> "54. The Tribunal rejected any allegation of conspiracy involving BSG [ie the claimant] or Infinity [ie the contra trader]. It rejected the suggestion that BSG had been manipulated. It acquitted Infinity of fraud. If Infinity did not know of the fraud when it happened and was not party to any arrangement that it should happen, how could BSG have known of any fraud before it happened? No amount of due diligence undertaken in respect of Infinity, Universal or Alimpex could have revealed it. And if BSG could not have known, how could there be circumstances from which it could properly be concluded that BSG ought to have known?
>
> 55. In my view it is an inescapable consequence of contra-trading that for HMRC to refuse a reclaim by E [the claimant] it must be in a position to prove that C [the contra-trader] was party to a conspiracy also involving A [the defaulter]. Although the fact that C is party to both the clean chain with E and dirty chain with A constitutes sufficient connection it is not enough to show that E ought to have known of the fraudulent evasion of VAT involved in the subsequent dirty chain. At the time he entered into the clean chain there was no such dirty chain of which he could have known, nor was the occurrence of such dirty chain inevitable in the sense of having been pre-planned"

79. We note that in *Blue Sphere* the Tribunal's finding was that the contra-trader was not a party to the conspiracy and therefore the Chancellor pointed out it would seem to be impossible that a broker who was not a party to the conspiracy could possibly know of the fraud by the defaulter. This seems entirely logical where the clean chain precedes the dirty chain, and where the finding of fact is that the dirty chain is not pre-planned because the contra-trader is not a party to the conspiracy. But the comment was very much limited to those particular findings of fact in that case.

80. Where the facts, however, are that the dirty chain and clean chain were orchestrated and planned in advance then it logically follows that the question of the knowledge of the broker is simply as put in *Mobilx* at paragraph 82*:* "a trader is not entitled to ignore the circumstances in which his transactions take place if the only reasonable explanation for them is that his transactions have been or will be connected to fraud". The Chancellor in *Blue Sphere* did not suggest otherwise. Conspiracy does not have to be proved.

81. Mr Green did not draw our attention to the Upper Tribunal decision of Lewison J in *Brayfal*: he could not have done so as it post-dated his submissions. We have nevertheless considered it. In this case, Lewison J says as follows:

> "[16] The members [referring to the members who gave the majority decision in the FTT decision against which he was hearing the appeal] began their detailed reasoning by saying that the clean chain (in which Brayfal found itself) was created before the dirty chain (§ 138). This was a vitally important point. In order for deduction of input VAT to be withheld, HMRC must prove, having regard to objective factors, that the taxable person, *at the time of his transaction*, knew or should have known that his transaction was connected with fraud. Where the impugned transactions are transactions in the clean chain this presents evidential problems for HMRC. As the Chancellor pertinently asked in *Blue Sphere Global Ltd v HMRC* [2009] STC 2239: how can a trader who is not part of a conspiracy *know* of a fraud before it happens? If there is a regular course of conduct in which the trader knows that his transactions are connected with subsequent transactions that he knows *ex post facto* are fraudulent, there may come a time at which he can be credited with knowledge of the future. But that is not the case that HMRC advanced in this case. Moreover, in the present case, as the members pointed out all Brayfal's transactions were in the clean chain where every member correctly dealt with its VAT (§ 149). Thus the members' findings in §§ 138 and 149 were also relevant to, and supportive of, their rejection of the case based on actual knowledge. In a subsequent passage (§153) they said that HMRC were not aware at the relevant time that there was anything amiss with Future; so that Brayfal was "most unlikely" to have been aware. Mr Black drew attention to § 152 in which the members said: "Question 3 is, in our view, the one the Commissioners have to prove. They have already accepted that Brayfal was not a dishonest co-conspirator (see [22]) so must show that it had "the means of knowledge at the time of entering into its transactions that they were connected to the fraudulent tax losses"."
>
> [17.] He said that the members had wrongly jumped from "no conspiracy" to "means of knowledge" without addressing limb 1 of the *Kittel* test: namely actual knowledge. In my judgment this paragraph must be read in context. The relevant context is that the whole Tribunal had already found that Brayfal was not aware that it was involved in the scheme; and that since the dirty chain was created after the clean chain actual knowledge and conspiracy are likely to be interchangeable concepts. I do not, therefore, consider that on the facts of this case this paragraph reveals a legal error."

82. Is Lewison J saying anything different here to what was said before? It is clear that he is repeating what the Chancellor said in *Blue Sphere* about it being difficult to prove knowledge of a connection to fraud in a clean chain in certain circumstances. But what the Chancellor actually said was

> "If Infinity [the contra trader] did not know of the fraud when it happened and was not party to any arrangement that it should happen, how could BSG [the appellant/broker] have known of any fraud before it happened?"

83. As already mentioned the comments of Lewison J in *Livewire* and the Chancellor in *Blue Sphere* were confined to the situation where the contra-trader was not a party

to the fraud and therefore by logical implication the clean chain was *not* at the time it took place a part of the conspiracy to defraud. In *Brayfal* Lewison J must have intended his comments to be consistent with what he and the Chancellor had said earlier particularly as he referred to the Chancellor's comments.

84. Further, to extend the perceived evidential difficulties to a case where the contra-trader *was* a party to the conspiracy, and therefore logically one where the clean chain was as much a part of the conspiracy as the dirty chain, would make no sense. Where the clean chain is as much orchestrated as the dirty chain, it must logically look exactly the same to the broker at the end of the chain. As an example of this, it may be that in organising the fraud the fraudster tells each trader from whom to buy and at what price and to whom to sell at what price. In a normal or straight MTIC, if the broker knows that he has been told from whom to buy at what price and to whom to sell at what price, a Tribunal might conclude that he has actual knowledge that the transaction was connected to fraud. The same must be true in a contra-trade where both the clean and dirty chains were planned: if the fraudster has informed all traders (including the broker) of the deal details in advance this will give the broker as much knowledge of the connection to fraud as it would if it was a straight chain. *But* if the contra-trader was innocent, the clean chain would not have been planned and the broker would not have been told in advance the details of the deal. He could not know, as there would be nothing to know.

85. We refer to Mr Justice Briggs' explanation of the position in *Megtian* already set out about which makes the same point and is of course binding on this Tribunal.

86. Therefore, we consider that Lewison J's comments in *Brayfal*, were, like the dicta of his in *Livewire,* restricted to a situation when the contra-trader was not a party to the conspiracy. If Mr Justice Lewison's comments were not intended to be so restricted, then they are at odds with what the Chancellor said in *Blue Sphere* and we prefer (for the reasons explained above) the Chancellor's view.

87. In conclusion, in respect of the transactions in this appeal alleged to involve contra-trading, if we find the alleged contra-trader was in fact a knowing party to the fraud or even if we find that the 'clean' chain was as much organised as the 'dirty' chain, then we will approach the question of the Appellant's knowledge in the same way as we would if the allegation was that the connection to fraud was through a direct chain to a defaulter and as set out in paragraph 80 above. If HMRC do not show the contra-trader was a party to the fraud, nor that the clean chain was organised, then we would agree with Mr Green that absent proof that Earthshine was somehow 'in the know' about the defaulter's intended default it could not and would not have known from the circumstances surrounding its own transactions that there would be a connection to fraud for the simple reason that there would not be a connection.

88. Having dealt with the law applicable to this appeal, we move to consider the facts.

Were the transactions connected to fraudulent tax loss?

89. It was HMRC's case that Earthshine's purchases (and sales) of mobile phones which are the subject of this appeal were connected to fraud. They sought to show connection by proving that the mobile phones purchased by Earthshine were purchases at the end of chain that traced back to a fraudulent defaulting trader. So the "connection" element was a trail of invoices and/or purchase orders and/or stock releases relating to the same mobile phones traded from seller to buyer down a line to Earthshine and beyond. They also sought to rely on banking evidence to show a financial connection.

90. In *Kittel* the CJEU required connection. We consider that connection sufficient for *Kittel* is established where HMRC can prove that the Appellant traded in the same goods as were used to commit the fraud. We also consider that a chain of invoices which relate (or purport to relate) to the same goods is enough to establish connection. Mr Green did not consider that there was a "connection" if it could not be shown that the defaulter actually sold the goods ultimately purchased by the broker.

91. We do not agree with Mr Green. This is because the fraud alleged is MTIC fraud and MTIC fraud relies (as explained above) on invoices establishing the holder's right to recover the VAT charged on it. MTIC fraud works whether or not the invoices are issued in respect of genuine transactions in goods. MTIC fraud works even if the goods don't exist at all or, if they do, they are not traded by the defaulter So in our view it is enough for HMRC to demonstrate a chain of invoices in order to demonstrate "connection": they do not in addition need to show that the goods actually were traded. This point is relevant to Deal 4 where we find that the company at the top of the chain of invoices (DBP) was not actually part of the chain of goods.

92. We also consider that connection sufficient for *Kittel* is established where HMRC can show that the money paid at one stage was related to a payment at an earlier or later stage (in that it funded it or was funded by it). However, the CJEU in *Kittel* only required that connection to a fraud be proved: even if (say) at the start of a chain only money and no goods moved, if that movement of money was part of a fraud and if HMRC can prove that Earthshine's transactions were connected to that movement, than we find that is sufficient to prove connection to fraud.

93. Earthshine did not accept that its purchases were connected to fraud and so we set out below our findings on the evidence and to which sales and purchases we have found Earthshine's purchases connected. For ease of reference for us as much as the parties reading this we have set out a schedule showing the connections we have found proved on the evidence and this is set out below. A later section deals with the question of whether this connection to various transactions was a connection to fraud.

Connection and contra-trading

94. The alleged connections divide neatly into two: HMRC allege that the first four deals connect directly to defaulting traders, in that their allegation is that the phones traded by (or at least invoiced by) the defaulting trader were the phones ultimately traded in by Earthshine.

95. In respect of the last three deals HMRC allege that they connect directly to a contra trader in that their allegation is that the phones traded in by the alleged contra trader (A-Z in all three cases) were the same phones as ultimately traded in by Earthshine. In addition they allege that these deals are "connected" to fraud because the sale of the phones ultimately traded in by Earthshine off-set a VAT repayment claim by A-Z that would have otherwise have arisen on a chain of separate goods which would ultimately have traced back to a defaulting trader.

Evidence of connection

96. There is no dispute between HMRC and Earthshine on the question of from whom Earthshine bought the mobile phones. Earthshine's case is that it has no knowledge of its suppliers' supply chain and can only challenge the evidence which HMRC have produced. We have accepted HMRC's evidence where the invoice and/or purchase order chain relates to the same description of goods in sufficient quantities at the "right" price and on the same date as more likely than not (in the absence of any other evidence) to be the chain from which Earthshine's seller obtained the goods sold to Earthshine.

97. The quantity: In one of the chains the quantity purchased by Earthshine is less than the quantity traded by the companies higher in the chain. We consider it is a feature of normal trading that a vendor might split a purchase between a number of buyers. It is HMRC's case, of course, that this is not normal trading but MTIC fraud. We find the splitting of consignments is also likely to be a feature of MTIC fraud. This is because the soon-to-be missing trader imports (or purports to import) large consignments to maximise the VAT take as quickly as possible before it is deregistered. The consignment may then be split for despatch by a number of different brokers because the broker (whether or not the broker knows or has the means of knowing of the fraud) can only despatch a consignment for which it has the capital to fund the VAT for which he will expect to be out of pocket until HMRC refunds the VAT.

98. In conclusion, split consignments do not give an indication one way or the other whether this is MTIC or normal commercial trading and it certainly does not indicate that the purchase from the supplier is not a part of a larger consignment purchased by that supplier. It is not a contra-indicator of connection.

99. the price: If HMRC are right and these chains are MTIC fraud chains then in our view it is inherently unlikely that any sale will show a loss. This is because if it is MTIC fraud the deals will be pre-arranged and no one would deliberately enter into a purchase combined with a sale where it was certain to realise a loss. Where the alleged chain shows a loss, this is likely to indicate that HMRC have not identified the correct chain of sales and purchases or, if they have, that the chain is not fraudulent. In practice all the connections in the alleged chains show a price increment (normally but not invariably) very small. The only exception is on the money (not invoice) chain on Deal 1 and we deal with our findings on this in paragraphs 116 and 119.

100. The description. We found that not all sales invoices and purchase orders describe the goods in the same way and some of the invoices and purchase orders

carried very little detail while some carried considerably more. In general, the invoices at the start of the chain rarely give more of a description than "Nokia N70" whereas the invoices later in the chain (especially Earthshine's) carry considerably more detail.

101.Earthshine's invoices carried in addition handset codes: we address this later in this decision notice. None of the other invoices or purchase orders carry this information but not surprisingly Earthshine did not dispute that the purchase orders from their customers and the invoices from their suppliers relate to the exact goods Earthshine bought despite the absence of handset codes on these purchase orders and invoices.

102.Where the descriptions in the invoices and purchase orders of the goods are not identical this may be because they relate to different batches of goods. We consider this in relation to each alleged chain of goods. In general, if the other evidence suggests the chain of invoices and purchase orders relate to the same goods, we do not find this contra-indicated where the descriptions of the phones are consistent albeit in greater or lesser detail. For instance, we find there is nothing inconsistent with the goods being the same batch of goods if described as "Nokia N70 Central Euro Spec" on one invoice and "Nokia N70, Brand New, Sim Free, C/E Spec" or even just "Nokia N70" on another. The descriptions are not inconsistent.

103.Further, we do not find it indicates that the phones were not the same where they are referred to in the same chain as "European specification" or "standard European specification" or "central European specification". The evidence from Mr Fletcher was that the words "euro spec" and "central euro spec" were not used by Nokia. Further it is apparent that the terms were used interchangeably by the parties in these chains of goods and so we find:

- Earthshine's purchase order on deal 4 refers in one part to "EURO SPEC: English/French/German/Italian languages" and in another to "Standard European specification";

- Sunico's purchase order in deal 2 asks for phones with "Standard European Specification" and "Central European Software (English, French, Italian, German, Spanish etc)

- Earthshine's purchase order in deal 1 refers to "Central European Specification" but its invoice in the same deal refers to "Standard European Specification"

104.There is a slight discrepancy on the "MHZ" ascribed to the phones where mentioned. TTW requires phones with 900/1800/1900 MHZ, whereas OHM refers to phones of 850/900/1800/1900 MHZ. It was not suggested to us and we do not find that this means there is any material difference between the phones.

105.Where the specifications do not appear to be consistent we consider whether the documents do in fact relate to the same phones, as described in relation to the affected deals below.

Deal 1 EAR 142

106.invoice chain: There is an invoice and purchase order for all the stages in this alleged chain up to and including Parfums. All the purchase orders carry the same date of 13 July with the exception of OHM's at the end of the chain which is dated 14 July. We do not know how many phones Parfums purchased but they sold 1,999 as did all the traders down to Owl. New Way, however, only sold 1,000 phones to Earthshine and the chain thereafter relates to only 1,000 phones. The price increments are of the type seen elsewhere in this appeal: no one makes a loss & the increments are of small amounts except in the hands of Earthshine.

107.(We note in passing that the Parfums sales invoice to Highbeam records the sale as 1,000 Nokia N70s at £172.50 but the reference to 1,000 is clearly an error and 1,999 were actually sold. The purchase order from Highbeam was for 1,999 at £172.50 and the Parfums' invoice total was £405,172.31 which is £172.50 + VAT multiplied by 1,999.)

108.As discussed above, there is nothing inherently odd in the purchase by New Way of 1,999 phones and the sale of 1,000 of them to Earthshine. Whether this is ordinary commercial trading or MTIC fraud, splitting loads makes sense. We note that the 1,999 phones sold to New Way by Owl were the same specification as the 1,000 sold by New Way to Earthshine on the same day and that the phones were all held at Interken Freight Forwarders Ltd. On the balance of probabilities and in the absence of any evidence of any other sales or purchases by New Way, we find that the 1,000 sold to Earthshine comprised part of the 1,999 purchased by New Way from Owl.

109.We note that OHM's purchase order is dated one day later but find, due to the identity of specification and quantity and the fact that Earthshine's invoice is also dated 14 July 2006 that it is more likely than not that it relates to the same stock.

110.Parfums, Highbeam and Owl (and New Way in its invoices) describe the phones as "Nokia N70". Mana describe the phones as "Nokia N70 sim Free GSM phone". The other companies which issued invoices and purchase orders used more detailed descriptions as the following table sets out:

New Way (PO)	**Earthshine**	**TTW**	**OHM**
Nokia N70	Nokia N70	Nokia N70	Nokia N70
Sim free	Sim free	Sim free	
	Never locked	Not sim locked	
	New		Brand new
Central European specification	Standard European specification (Central European Specification on PO)	European specification	Euro specifications
		900/1800/1900 Mhz handset	GSM 850/900/1800/1900 Mhz handset
		Full language pack with 9 languages	Central European software
		European warranty	International warranty
English books	Manuals	English manual	Manual
			Software CD
	Battery	Battery	Battery

	Charger	Headset Charger English keypad 2 pins adapter	Charger
5 in a box		5 or 10 pieces in a box	
Clean stock		Original Nokia seal Packing without marks or stamps	

111.We find that there is nothing inconsistent with these various descriptions being descriptions of the exact same phones (we have explained above why we attach no significance to the variations between Central European/Standard European or the slight difference in MHZ specified).

112.In conclusion, the Tribunal finds that this purchase of mobile phones by Earthshine comprised the same phones as were bought in the chain of sales and purchases of mobiles which traced back to Parfum and forward to OHM as set out in the table below (at paragraph 172) and as alleged by HMRC. They are connected by a chain of invoices and because they bought and sold the same goods. This is sufficient "connection" for the purposes of the test in *Kittel*.

113.Money chain: The banking evidence produced by Mr Broadsword shows that immediately on receipt of the £405,172.31 on 13 July 2006 from Highbeam due on the invoice in the above chain, Parfums paid out of its FCIB account 3 lots of £100,000 and a further payment of £90,304.75 (total £390,304.75) to Snowrix. Snowrix on receipt of these four sums immediately paid out £390,804.50 to Global Mobile. On receipt of this sum into its FCIB account, Global Mobile immediately paid out £388,805.50 to On Line. The following day, On Line paid out what appeared to be an unrelated sum of £20,000. Its next transaction was a wire from its FCIB account to Jyske Bank A/S in Denmark to an account in the name of Sunico A/S of £387,806.00.

114.All these payments appear to be connected in that the FCIB accounts show the payments "in" on one line and "out" on the immediately following line of the account. They all occur on the same day except as mentioned above. They are also in similar sums and no other sum in or out of the accounts is of the same sort of value. So prima facie they appear to us to be connected but we consider this in detail.

115.The fact that Parfums broke up its payment into four does not seem countra-indicative the payments' connection: we find all payments to Snowrix on the evidence of its FCIB account for 12-14 July 2006 were broken up into round sums of £100,000 with a following balance whether made by Parfums or another FCIB account holder and we presume this is how Snowrix liked to be paid. However, if the Parfums payment to Snowrix was connected to the phones Parfums sold to Highbeam this would give Parfums an apparent profit of £14,867.57 which is quite high at approximately £7.50 per phone (the highest profit margin for an alleged buffer in these chains was £4 per phone).

116. The payment *by* Snowrix to Global Mobile was £499.75 *more* than that received from Parfums, which would at first glance suggest they were not connected as the deal would be loss-making for Snowrix. We note, however, that this sum is 25p multiplied by 1,999 (the number of phones in the deal) which would be a coincidence if the payment was not connected to this chain and that Snowrix and Global Mobile had a relationship apart from this payment as evidenced by other payments between them on the day before and the day after this transaction.

117.The difference in the payment by and to Global Mobile was £1,999 which equates to £1 per phone and would be a coincidence if these payments were not releated to the chain of 1,999 phones.

118. The difference in payments by and to On Line was £999.50 which equates to 50 per phone and would be a coincidence if these payments were not related to the chain of 1,999 phones. Further, on its wire transfer to Sunico, On Line describes the payment as "PYMNT FOR 1999 X N70".

119.Taking into account that these payments were (a) all linked in time, each taking place immediately (or virtually immediately) after the previous one, (b) that all payments with the exception of the one made by Parfums are in whole units or fractions of 1,999; and (c) that the first payment in the chain (by Parfums) relates to the invoiced chain of 1,999 N70 phones and the last in the chain (the payment to Sunico) also relates to 1,999 N70s, we conclude that on the balance of probability, despite the apparent small loss by Snowrix and large profit of Parfums, that it is a chain of payments connected to the invoice chain outlined in paragraphs 106-112.

120.We also note that this evidence is corroborated by our later findings (see paragraph 238) that the deals at issue in this appeal were orchestrated and that Sunico was at the top (and bottom) of other chains and in particular chain 2 (see paragraph 172). It is therefore not surprising that chain 1 should also be found to trace back to Sunico.

Deal 2 EAR 143

121.There is an invoice and purchase order for all the stages in this alleged chain from Alertec's sale to Sunico's purchase. These documents all carry the date of 19 or 20 July. Indeed, all the invoices carry the date of 20 July except the one from Letting Solutions which is dated the previous day. Nevertheless, we are satisfied that on the basis of these documents the identical 1,000 phones are traded from Alartec down the chain to Sunico. This is because this part of the alleged chain consistently relates to 1,000 Nokia N70s traded within a 2-day period at price increments seen elsewhere in this appeal. Further, it is clear that Letting Solutions' purchase on 19 July was linked to Cobra's sale on 20 July as they both pay their supplier a £20,000 deposit on 19 July (even though Cobra's purchase order and invoice are dated 20 July). Further, Letting Solutions' sale is linked to LMC's purchase because the purchase order on 19 July was for 3,000 phones but in the event it seems only 1,000 were supplied with Letting Solutions issuing a credit note on 21 July for 2,000. Sunico's purchase order was originally for 3,000 phones (amended by hand to 1,000) and Earthshine's original pro forma invoice was for 3,000 phones (a new one was issued on the same day – 20 July

– for 1,000). It is unlikely that all these companies could have entered into two deals for 3,000 identical phones which happened then to be reduced to a deal for 1,000: therefore we conclude on the balance of probability that all the deals Alartec – Sunico involve the same 1,000 phones.

122.We bear in mind that Letting Solutions' payment of the balance to Cobra on 21 July refers to invoice number 292 when the correct invoice number is 293. However, taking account the linking factors mentioned above, and in particular that the payment is exactly the right amount to discharge Letting's liability to Cobra on invoice 293, we conclude that it is more likely that the reference to 292 is a simple typing mistake for 293 rather than that the payment related to a separate transaction.

123.We considered whether the description of the goods in the contracts were consistent. Alartec and Vescon describes the phones as "nokia N70". Cobra describe the phones as "nokia N70 Central Euro Spec". Letting Solutions describe the phones as "Nokia N70 Brand New, Sim Free, C/E Spec". LMC reverts to a description of "nokia N70" on its invoice but its purchase order is (as are Earthshine and Sunico's documents) more detailed, as set out below:

LMC (PO)	**Earthshine**	**Sunico**
Nokia N70	Nokia N70	Nokia N70
Sim free	Sim free Never locked	
Brand new	New stock	New
Central Euro spec	Standard European specification	Standard European specification
		900/1800/1900 Mhz handset
		Central European software
		International warranty
	Manuals	manual
	Battery	battery
	Charger	travel charger
Unmarked boxes		

124.We do not find anything in these descriptions which indicate that it is not the same phones being traded: the descriptions vary in details but they are consistent. (We have already mentioned that we attach no significance to "central European/standard European).

125.In conclusion, the Tribunal finds that this purchase of mobile phones by Earthshine comprised the same phones that were bought and sold in the chain of sales and purchases of phones which traced back to Alartec and forward to Sunico as set out in the table below (172) and as alleged by HMRC. This is sufficient "connection" for the purposes of the test in *Kittel*.

126.In addition, HMRC alleged that Alartec's sale to Vescon was connected by a chain of banking transactions back to Sunico.

127.As with chain 1 (EAR 142), there are payments into accounts with an immediate withdrawal of a similar amount. We find on the basis of the banking evidence that on 19 July Alartec received £20,000 from Vescon and (with one intervening payment of £230,00 to another company) then paid £20,000 on the same day to DTM. On 21 July, Alartec received £182,041.25 from Vescon and immediately paid £181,747.50 to DTM. DTM received £20,000 from Alartec on 19 July and on the same day pays £20,000 to Paris 2000. DTM received £181,747.50 from Alartec on 21 July and on the same day immediately paid £181,160.00 to Paris 2000. Paris 2000 received £20,000 from DTM on 19 July and made a wire transfer of £20,000 a few transactions earlier but on the same day. We have no evidence of to whom this was paid. Paris 2000 received £181,160.00 from DTM on 21 July and immediately paid out £177,000 by wire transfer to Sunico's UBS account.

128.We find that this payment by Alartec to DTM is connected to the chain of invoices Alartec to Earthshine and beyond as not only is there close proximity in time and amounts to the payments, we have found elsewhere in the same chain a £20,000 deposit was paid on 19 July. On the balance of probabilities the payments are therefore related.

129.With regards DTM the payment of the balance to Paris 2000 occurs immediately after the receipt from Alartec. However, the payment of the £20,000 two days earlier has three intervening transactions. These all relate to £230,000. Immediately before the receipt of £20,000 from Alartec, DTM received £230,000 from Alartec. It then pays this to Paris 2000. Paris 2000 then immediately repays this sum to DTM who then pays it to a company with account number 203351. We find it more likely than not that these payments have nothing to do with this appeal but relate to another transaction involving Alartec, DTM and a company with account number 203351 (the payment to Paris 2000 appearing to be a mistake which was immediately rectified). On the basis that (a) as with elsewhere in this chain a deposit of £20,000 was paid and (b) that the balance was paid out immediately and without intervening transactions and (c) and that a small profit is made we find it more likely than not that the payment by DTM to Paris 2000 relates to the payment to it from Alartec and beyond to the chain of invoices Alartec to Earthshine and beyond.

130. We find Paris 2000 received a deposit of £20,000 from DTM which appears to relate to a slightly earlier payment out on the same day of £20,000 to an unidentified recipient. Nevertheless, we find that the payment to Sunico of the £177,000 is more likely than not to be connected to the payment from DTM of the £181,160 due to their proximity and the fact it leaves Paris 2000 with a small profit. We have no direct evidence of to whom Paris 2000 paid the £20,000 deposit as HMRC did not produce a copy of the relevant wire transfer (but rather one that related to what we find an unrelated transfer of £10,000 to DRT Vertriebs GmbH as a deposit on 1,500 N70s). However, we note that like the £177,000 this sum was paid by wire transfer (although it is clear Paris 2000 paid some other companies this way too) and that the £177,000 was described as "Paris pay Sonico (sic) Final 1K N70". This indicates that Paris

2000 did pay a deposit to Sunico as the "final" implies it was a balancing payment. Bearing in mind (a) proximity in timing and amount of the balancing payments from DTM and to Sunico and (b) because there is evidence Paris 2000 did pay Sunico a deposit and (c) because the balance was described as being in respect of 1,000 N70s (the subject of the invoices), we find it more likely than not that Paris 2000's payment to Sunico was related to the chain of money movements outlined above and the chain of goods Alartec to Earthshine and beyond.

131.Mr Green points out that the invoice trail goes cold with Alartec and we cannot be sure that this chain of payments necessarily relates to the invoice chain for deal 2. He points out that there are a lot of transactions shown on the banking evidence and we do not have the banking evidence for all of the surrounding days. We have considered these points but reject them. The proximity of amounts and payments through a chain of 4 FCIB accounts and on to a wire transfer to Sunico suggests to us that the various players waited to receive payment and then immediately made a related payment out. That this is correct is corroborated by a similar chain of deposits occurring 2 days earlier and that the final payment to Sunico identifies the same kind and quantity of phones as the subject of the deal. We are only dealing in probabilities and we have concluded that this chain of finance is more likely than not to be connected with the chain of invoices in Deal 2.

132.We note in passing that the chain as we find it to be is based on the evidence in front of us. We do not entirely agree with Mr Collins' interpretation of it. He considers that the payment by Paris 2000 to Sunico (outlined above) indicates Sunico sold the phones to Paris after purchasing them from Earthshine, whereas for the reasons given above we find that Sunico sold the phones to Paris 2000 at the start of the chain. This is largely because of the timing: the money moved in reverse order to the goods so that the person at the start of the chain was paid last. We also find that the transfer of £10,000 by Paris 2000 to DRT Vertriebs had no connection to the appeal.

Deal 3 EAR 144

133. This alleged chain is very long. The entire alleged chain relates to 1,000 Nokia N70s. From the sale to Cirex by Phone City and the sale to Santok by New Order there is an invoice and purchase order to support every alleged sale. All are dated 19 July with the exception of New Order's purchase order and invoice which are dated 20 July. However, New Order's pro forma invoice is dated 19 July and K N Exports' invoice is numbered NOT 17 which number also appears on New Order's purchase order dated the next day. We conclude that they are linked. Further, the price increments in this chain are of small regular amounts as per the schedule below. We find that HMRC have proved this chain and that Santok's purchase was connected to Phone City's sale.

134.There is also a chain of invoices and purchase orders from a sale by LMC to Earthshine to a purchase by OHM. All relate to 1,000 Nokia N70s, The purchase orders and invoices in this alleged chain are dated 20 July 2006 with the exception of TTW's purchase order which is dated 19 July and its invoice and OHM's purchase order which are dated 25 July. The price increases at each sale. Earthshine did not

dispute that the phones it bought from LMC were the same phones as the ones it sold to TTW and so we find. In the absence of any evidence of any other sales by TTW, we also find that the 1,000 Nokia N70 phones it purchased from Earthshine on 20 July and released to it by Earthshine on 21 July in MITT Luxembourg were the same ones as the 1,000 Nokia N70s sold to OHM 4 days later still held at MITT Luxembourg.

135. These connections are in some cases supported by other evidence such as releases and banking details. We do not refer to all this detail but have taken it into account when reaching our conclusions that the links are made out.

136. The description of the product given by Phone City, Cirex and Data Solutions is "Nokia N70". As with other deals, further down the chain more detail is given about the phones. TGT refers to them as "Nokia N70 Central Euro spec Sim free". Outer refers to them as "Nokia N70 – (Sim free – Central European Software Specification)." Further down the chain some of the dealers include more detailed specifications and we reproduce this is table form below. The exception to this increase in detail is Santok whose purchase order describes the phones as "Nok. N70 European Spec 3 pin charger English manual". Another exception is LMC who merely refers to "Nokia N70".

KN Exports (PO)	**KN Exports** (invoice)	**New Order**	**Earthshine**	**TTW**	**OHM**
Nokia N70 Sim Free	Nokia N70 Sim Free	Nokia N70 Sim Free Never locked	Nokia N70 Sim free Never locked	Nokia N70 Sim free Never sim locked	Nokia N70
Brand new stock		Brand new	New stock,	New	
Silver handset	Handset All black in colour	GSM H/sets Standard in colour	Original handset	Handset 900/1800/1900 Mhz	850/900/1800/ 1900 mhz
Euro language pack	Euro language pack	Latest software	Standard European specification/ English/ French/German/ Italian languages	European specification. Full language pack with 9 European languages	Euro specifications. Central European software (German, French, Spanish, Italian, English etc) 1 software CD
Euro warranty	Euro warranty	Full [EU] Central European Warranty		Original European warranty. 24 months factory warranty. No welcome message on phone	1 international warranty
		(English)	Original manuals	S W English and French manuals	1 manual
			Original battery	Battery	1 original

					battery/batteries
2 pin charger	2 pin chargers		Original charger	Headset Charger	1 original charger
				European original, Nokia 3 pins adapter	
Boxed and banded	Original boxes. No stamps or markings	Boxed and banded 5 or 10 per box	No HMRC stamps	Original nokia master packaging without any stamps or writings. No logos on handsets & box, original box, all Nokia origin, standard Nokia 5 or 10 pieces in a box with original nokia seal Made in Finland	

137. As already said in relation to deals 1 & 2, the descriptions of the phone, although they vary considerably, nevertheless more likely than not describe the same phones at least in the sense there is nothing (apart from the matters discussed below) inconsistent in the description from one supplier to another.

138.K N Exports' purchase order is for silver phones and its invoice is for black phones. Is HMRC right to link its purchase from Outer to its sale to New Order taking this inconsistency into account? We take into account the identity of date and quantity and the apparent £1 per phone profit and the absence of evidence of any other sale by K N Exports. We also take into account that New Order's only requirement was that the phones' colour be "standard". We find the inconsistency in K N Exports' description of the phones' colour was more likely than not to be simply a mistake. We find the link from Outer to K N Exports to New Order to be proved as alleged by HMRC.

139.Santok's purchase order refers to phones with a 3 pin charger and an English manual. As it contains virtually no other information the impression given is that Santok wants phones that will work in the UK. However, the documents produced by its supplier's supplier (K N Exports) refers to 2 pin chargers. Are they the same phones? The link New Order to Santok is evidenced by a purchase order, a pro forma invoice, an invoice, a release note and shipping instructions as well as bank reports of payment. The payment made by Santok on 20 July is by its narrative linked to the reference number of Santok's purchase order of 19 July and New Order's invoice cites the same reference number. So despite the discrepancy in details we find that the phones which were supplied to Santok were the same as those sold by New Order and K N Exports on these invoices. (The phones had 3-pin chargers – see paragraph 510 below).

140. Are the two chains linked? There is no invoice or purchase order or release note between Santok and LMC. The only evidence of a link produced by HMRC was a spreadsheet which Mr Kendrick said he obtained from HMRC's electronic folder system for Santok and which set out their deals carried out in July 2006. The Appellant challenged the origin of the spreadsheet.

141. Mr Kendrick's evidence was that he had spoken to the officer for Santok who had told him that Santok sent it to him electronically. He also informed the Tribunal that he had seen on the electronic folder (and mistakenly thought he had disclosed) a covering email from Santok to their VAT officer saying something like please find enclosed our monthly figures. He said he spoke to Santok's VAT officer and queried why he had not asked for Santok's invoices and was surprised to be told that it had not been requested because it did not relate to an export by Santok.

142. The spreadsheet shows a purchase and sale on a single line and we find clearly indicates that the goods purchased were then sold on. In other words, the stock sold on one line was the same stock as shown purchased on the same line of the spreadsheet. Sometimes the stock purchased was broken into smaller amounts and sold on to a number of buyers: again this appears to be clearly indicated by the layout of the form as the buyers are on consecutive lines. The 8th purchase is shown as 1,000 Nokia N70s from New Order on 20 July on invoice number NOT/511/104121/NOT17 at a unit price of £174. This is entirely consistent with the documentary evidence produced by HMRC of the sale by New Order to Santok but does not tell us who provided the spreadsheet. The same line of the spreadsheet shows that Santok sold these phones to LMC on sales invoice number 112949 on 20 July at £177 per unit. This is the "missing link". The information cannot be verified as HMRC have not produced any other evidence of a sale by Santok to LMC. We can see that the information is consistent with a sale to LMC in that the price is £177 and LMC sell on to Earthshine at £178, giving LMC a "normal" £1 per phone profit. We can also see that the information is consistent in that it also shows that LMC paid Santok in two tranches, £99,982.99 on 27 July and £107,969.00 on 1 August (although Santok appears to have paid its supplier on 20 July).

143. But this does not tell us who compiled the spreadsheet and therefore how accurate it is likely to be. If the spreadsheet was produced by Santok, as HMRC claim, then we would have every reason to consider it to be correct as Santok should know about its own deals. If, however, as alleged by the Appellant, it was a spreadsheet compiled by HMRC after the event we would want to see the underlying evidence before being satisfied it was correct.

144. Mr Kendrick's second-hand evidence is that it was obtained from Santok and that Santok and not HMRC created it. We have no reason to doubt Mr Kendrick: we found him to be a good witness but it is nevertheless only second hand information. The Appellant points out that the word "contra" appears on the spreadsheet and makes the point that "contra-trading" is an HMRC phrase coined by HMRC to explain a particular type of MTIC fraud and would be most unlikely to be used by Santok. We agree that Santok would be most unlikely to use the word "contra" to indicate contra-trading. However, "contra" is a word with a number of meanings and we find it was

used on the spreadsheet in the context of meaning a *set-off* of money. Wherever it appears on the spreadsheet we find it indicates that a payment due from Santok was set-off against an earlier or later receipt due from the same person (invariably a company called Genuine Solution). It appears only in the columns relating to payment and was clearly not used in the sense of MTIC contra-trading.

145. In conclusion, we find nothing in the use of the work "contra" to indicate that the spreadsheet was not produced by Santok. Indeed, "contra" seems considerably more likely to have been used by Santok, than HMRC, in the context it was used as a monetary set-off, as HMRC would have been aware of the word's connotations. We found Mr Kendrick a good witness and although his evidence is second hand we accept he believed with good reason that the spreadsheet was produced by Santok. Lastly, we note that the two chains do "fit" together in the sense the quantities and price increments are right. On the balance of probabilities, we conclude the spreadsheet was produced by Santok.

146. As it was produced by Santok, we find it was more likely than not to be accurate and therefore we find, that the phones sold by New Order to Santok were on the same day then sold on to LMC and by LMC to Earthshine. The two chains are in fact the same chain of goods.

147. Beyond Phone City, HMRC allege a short continuation of the chain to Sunico. The only evidence to support this is banking. On 21 July, immediately after the receipt of £200,043.75 from Cirex, Phone City pays £199,397.50 to a company called Silus. There are no other payments by it of a similar amount on the same date and we find on the balance of probabilities the payment to Silus is more likely than not to relate to the payment from Cirex. In saying this we take into account banking evidence in this chain where the links are supported by invoices and purchase orders and other chains in this appeal where the linked payments *in* normally occurs immediately before the payment *out*. On the same day and immediately after receiving the £199,397.50 Silus makes a wire transfer to Sunico of £197,000. It makes no other payments of similar amounts, and taking into account the juxtaposition of the payment out to the payment in, we find that Silus' payment to Sunico is linked to its receipt from Phone City. We also take into account that the narrative on the wire transfer to Sunico is "1000 N70" which reinforces our view that it is more likely than not that this payment is connected to Phone City's sale of 1,000 Nokia N70s down a chain to Earthshine and beyond to OHM.

148. In short, we find the chains as alleged by HMRC to be proved and we have set out below in the table at paragraph 172 the connections we have found proved.

149. We note that in any event that, even were we not satisfied that the chain was as alledged by HMRC, but that all we could be certain of was that Earthshine had bought from LMC and sold to TTW, we would have been satisfied that there was connection to fraud. This is because (irrespective of the question of knowledge) Earthshine, LMC and TTW have all been shown to have entered into transaction chains engineered for the purpose of fraud (putting aside for the moment the question of knowledge) and none that weren't: see paragraphs 237-238 below in which it is our

finding that all the deal chains were orchestrated. It was not suggested that there was anything different about deal chain 3 (eg that it was negotiated in a different fashion) and the profit margins appear similar to those of other, orchestrated deal chains. So *if* we had not accepted the Santok spreadsheet as originating with Santok we would have found on the balance of probabilities that nevertheless deal chain 3 was orchestrated for the purpose of fraud and that it connected back to a fraudulent VAT default as that is by far the most likely explanation of how the chain came into being even though the defaulter could not be identified.

Deal 4, EAR 145

150.The evidence on this chain is complex: there is a chain of release notes, a chain of invoices and a chain of payments. We deal with each in turn.

151.chain of invoices

152.There is a chain of invoices and purchase orders from DBP's sale to Vescon to Earthshine's sale to Sunico. They all relate to 1,499 Nokia N70s. The price increments (as shown in the chart below at paragraph 205) are similar to those seen on other chains in this appeal. In many cases there is additional evidence (such as banking and release notes) of the chain. All the invoices and purchase orders are dated 21 July with the following exceptions. Black Country's purchase order is dated 21 June. This appears to be a mistake: its supplier declaration is dated 21 July and its FCIB payment is dated 26 July. LMCs' purchase order is dated 24 July. Again this appears to be a mistake in that it was mis-dated as its reference number is quoted on Letting Solutions' invoice dated 21 July 2006. LMC's invoice is also dated 24 July. Again this seems to be a mistake in that Earthshine bought the goods on 21 July and has a CMR dated 23 July.

153.We considered the description of the phones, which varied on the various invoices and purchase orders and whether, despite the above evidence, it indicated that it was the not the same phones supplied along this alleged chain of invoices.

154. DBP describes the phones as "Nokia N70 Sim Free Handset". Vescon and Black Country describes the phones as "Nokia N70". Letting Solutions describe the phones as "Nokia N70, Brand New, Sim Free, C/E Spec". LMC described them as "Nokia N70" on its invoice but used more detailed description on its purchase order, as noted below. Sunico's purchase order contains the detail listed below but its sales invoice of 31 July refers merely to "Nokia N70 Standard European Specification".

LMC (po)	**Earthshine**	**Sunico**	**Paris 2000**
Nokia N70	Nokia N70	Nokia N70	Nokia N70
Sim free	Sim free Never locked		
Brand new	New stock	New	
	Original handset	Handset 900/1800/1900 mhz	

Central European Spec	Standard European specifications	Standard European specification. Central European software (English French/Italian/German/Spanish, etc) 1 international warranty	Central European specification Warranty
	Original manuals Original battery Original charger	1 manual Original battery Headset 1 original 2-pin travel charger, etc	
No customs stamps or removed	No HMRC stamps		No customs stamps or removed stamps

155. As already said in relation to deals 1-3, the descriptions of the phones, although they vary considerably in the details, nevertheless appear to describe the same phones in the sense that there is nothing inconsistent in the description from one supplier to another.

156. By itself this does we find make a connection in the *Kittel* sense through a chain of invoices which purport to relate to the same goods from DBP down to Earthshine and beyond to Sunico.

157. The chain of invoices shows that the same goods were sold by DBP down a chain to Earthshine and then to Sunico. Other evidence in the form of release notes corroborates that invoice chain only up to Vescon . It shows that DBP did not in fact at any point have even purported control or ownership of the goods despite issuing an invoice purporting to sell them.

158. An invoice dated 31 July 2006 from Sunico to Paris 2000 shows that on 27 July Sunico sold 1,499 Nokia N70s to Paris 2000 for despatch to Pauls Freight in the UK (arrival date 28 July). A CMR (tied to this invoice by a handwritten annotation) dated 27 July shows that Sunico despatched via Kuhne & Nagel 1,400 Nokia N70s to Pauls Freight back in the UK. The handwritten annotation refers to a second CMR impliedly for 99 phones. There is also a purchase order from Paris 2000 to Sunico dated 28 July for 1,499 N70s at £296,802.00 (ie a unit price of £198). It specifies delivery will be 28 July so appears to be clearly linked with the CMR of the previous day.

159. Were these the same phones? We find it is the same quantity and type and freight forwarders (Kuhne & Nagel) and a mere 3 days after Sunico received them. In a commercial world it is unlikely to make sense for Sunico to buy phones from the UK and then immediately re-despatch them to the UK although, we note, the price per unit was £198 so the deal would have been profitable (they paid £189 per unit). And in the world of MTIC it makes a great deal of sense. Either way, we find it more

likely than not based on this evidence that the same phones sold by Earthshine were re-imported into the UK by Sunico 3 days after the phones were sold to them by Earthshine.

160.chain of release notes

161.The release notes referred to above are dated 21 July and produced by Pauls Freight. There are also some release instructions signed by some of Pauls Freight's clients. We find from these releases that DRT shipped on hold into the UK and then released 1,499 Nokia N70s to Paris 2000 on 21 July. We note that these were held on 4 pallets, as were the phones shipped by Earthshine in this deal and stated to be of very similar weight. We find Paris 2000 released 1,499 N70s to Alartec on the same date. These appear to be the same phones as the release note carries the same reference number as the one from DRT to Paris 2000 (although with the addition of a suffix "A").

162.Alartec released the goods to Vescon the same day. Again we find that they were the same goods as they are specified as 1,499 N70s and the release note carries the same reference number but with the addition suffix of "B".

163. The release notes compiled by Pauls Freight continue, each specifying the goods as 1,499 N70s and the release note carrying the same reference number but with an additional suffix of the next letter in the alphabet. We find the same goods were released by Vescon to Black Country, by Black Country to Letting Solutions, by Letting Soluutions to LMC, and by LMC to Earthshine. Earthshine then releases the goods for "RD EXP" which we find indicates road export which is consistent with Earthshine's CMR and other documents produced by Pauls Freight.

164. There are then some three instructions sent by LMC to Pauls Freight variously dated 26 and 27 July confirming that the goods should be released to Earthshine.

165.Mr Green suggested that the release notes might relate to a different set of 1,499 phones than the invoices. This cannot be right. Earthshine did not buy two sets of 1,499 phones on the same day. In the absence of any evidence that Earthshine bought another batch of 1,499 N70s from LMC, the 1,499 N70s released to Earthshine by LMC on 21 July must be the same as the 1,499 N70s purchased by it from LMC on LMC's invoice dated 24 July (and Earthshine's purchase order EAR 145 dated 21 July 2006). Therefore the goods the subject of the release notes are clearly identical to the goods the subject of the invoice chain outlined above.

166.In summary we find that Earthshine's purchase and sale of goods is connected up a chain of release notes relating to the same goods all the way back to DRT, and indeed that the phones sold by Earthshine on EAR 145 were the same phones shipped into the UK on 21 July by DRT/Paris 2000. We find that the invoice chain took a different route to the goods.

167. We summarise these findings in the table below at paragraph 172. The table shows that the cahin splits above Vescon as the link to DBP is on the invoice and money chains; the link Vescon to Alartec is based on the release notes. For reasons

explained above in paragraph 89-93 an invoice chin, a chain of goods or a chain of money is sufficient connection for *Kittel.*

168. Earthshine despatched the goods on 23 July to MITT Luxembourg (via Kuhne & Nagel) for Sunico, their customer, and released them to Sunico the day after they had arrived, which was the day on which Sunico paid Earthshine.

169. chain of payments

170. Like the chain of release notes, the chain of payments is not identical to the invoice chain. We find each company paid the invoiced amount. Sunico paid Earthshine on 24 July, Earthshine paid LMC on the same day. LMC did not pay Letting Solutions until 27 July. Letting Solutions paid Black Country, Black Country paid Vescon, and Vescon paid DBP all on 26 July.

171. The chain of payments we find traces back beyond the invoice chain. DBP's receipt of the invoice amount is immediately followed by a payment out of a very similar but slightly lower amount to a Daniel Hof. Daniel Hof's receipt of the money from DBP is followed by an immediate payment out of a very similar but slightly lower amount to Paris 2000. Paris 2000's receipt from Daniel Hof is followed by an immediate wire transfer to DRT Vertriebs. That this is the correct chain of money is bolstered not only by the proximity of the payments but also that (a) the similar sums of money (b) that money goes to Paris 2000 and on to DRT who on the evidence of the release notes are parties to this chain of goods and (c) the narrative on the wire transfer to DRT is "Paris pay DRT 1499 N70".

Summary of chains

172. We provide here a table summarising the deal chains which we have gound proved. Where the company is shown in italics the evidence which we found proved the connection did not include invoices eg the connection was shown by banking evidence or release note evidence.

Deal 1 EAR 142	**Deal 2 EAR 143**	**Deal 3 EAR 144**	**Deal 4 EAR 145**	
		Sunico		
		Silus		
Sunico		Phone City		
On Line	*Sunico*	Cirex		*DRT*
Global Mobile	*Paris 2000*	Data Solutions	*DRT*	*Paris 2000*
Snowrix	*DTM*	TGT	*Paris 2000*	*Daniel Hof*

Parfums	Alartec	Outer	*Alartec* DBP
Highbeam	Vescon	KN Exports	Vescon
Mana	Cobra	New Order	Black Country
Owl	Letting Solutions	Santok	Letting Solutions
New Way	LMC	LMC	LMC
Earthshine	**Earthshine**	**Earthshine**	**Earthshine**
TTW	Sunico	TTW	Sunico
OHM		OHM	Paris 2000

Deal 5EAR 149

173.There is no banking evidence on the last three deals as it seems Mr Brownsword was only instructed to look at Earthshine's July deals.

174.Deal 5 concerned 1,000 Nokia 8800 sirocco phones. MS Enterprise sold them to A-Z on 26 October 2006. On the same day A-Z sold them to New Order. There is a purchase order from New Order to A-Z on 30 October, on the same day New Order sold the goods to Earthshine, and on the same day Earthshine sold the goods to Sunico.

175.Bearing in mind the date discrepancy, were the goods sold by New Order to Earthshine the same as those it purchased 4 days earlier from A-Z?? The purchase order is dated 30 October, 4 days late, but relates to 1,000 Nokia 8800 sirocco at £407.00 per unit which mirrors A-Z's invoice of 4 days earlier. The goods were also held at Hawk. Further, New Order's purchase order dated 30 October refers on its face to A-Z's invoice dated 26 October 2006 by its reference number 1365. This clearly links them. Indeed, New Order's purchase order also refers to Earthshine's purchase order number, thus clearly connecting Earthshine's purchase to A-Z.

176. MS Enterprises' and A-Z's documentation contains almost no specification: New Order's specification has some detail. Earthshine's and Sunico's documentation carries more details. As before specifications are not identical but they are not inconsistent either.

177.The chain also shows regular, small increments in price for A-Z and New Order, with a greater per unit price increment for Earthshine which is also consistent with the other chains in this appeal.

178.We find it is more likely than not that the goods sold by invoice EAR 149 were the same goods which New Order purchased from A-Z and A-Z from MS Enterprises, as alleged by HMRC and we therefore find this chain proved.

Deal 6

179. This deal comprised 1,000 Nokia N80s and 700 Nokia N73s. Earthshine's purchase order (150) to New Order and its sales invoice (150) to Sunico are dated 23 November 2006. New Order's invoice to Earthshine is also dated 23 November. Its purchase order to A-Z is dated the day before but clearly relates to the same goods as it refers to Earthshine's purchase order number (150) thus linking Earthshine's

purchase to A-Z's sale. It is also in the same amount of goods and at the "right" price (ie showing a small increment on sale to Earthshine).

180.Despite its purchase order being dated 22 November (and referring to Earthshine's purchase order which was dated 23 November) the goods were released to New Order (as evidenced by release notes) by A-Z on 21 November. A-Z sold the goods on two invoices: both are similarly dated 21 November. The question therefore arises whether these were the same goods as it appears A-Z sold them to New Order before New Order ordered them? We find they were: the documents consistently relate to goods of the same description and quantity and in any event New Order's purchase order dated November 22 refers to A-Z's two invoices of the previous day by their reference numbers (1379 and 1380). A-Z's purchase was, we find, from MS Enterprise because it also was of the same description and quantity of goods, sold on two invoices dated 21 November, and A-Z's release note to Pauls clearly relates the purchase from MS Enterprise to the sale to New Order.

181.We therefore find deal chain 6 proved as alleged by HMRC.

Deal 7

182.Deal 7 involved 1,100 Nokia 9300i phones. Earthshine ordered these from New Order on 29 November and sold them to Sunico by an invoice (152) dated the next day. New Order's invoice to Earthshine is also dated 30 November. New Order issued a purchase order for the phones to A-Z on 30 November. That they were the same phones is clear because this purchase order refers to Earthshine's purchase order by number (152). A-Z invoiced the phones to New Order on 30 November and that these are the same phones is clear as New Order's purchase order carries A-Z's invoice number (1385). We find A-Z purchased these from MS Enterprise on 30 November as identically described phones are invoices by MS Enterprise to A-Z on that date.

183.We therefore find deal chain 7 proved as alleged by HMRC.

Summary of deals 5-7

184.We find that Earthshine's purchase and sale of goods in deals 5, 6 and 7 was connected to A-Z Mobiles, and beyond to M.S. Enterprise, in that they are connected via a short chain of invoices and purchase orders and further that they are connected because it was the same goods sold by MS Enterprise to A-Z to New Order and by New Order to Earthshine. Earthshine sold the goods to Sunico.

185.The following table summarises the chain (identical for each deal):

Sunico
Deal 5, 6 & 7

MS Enterprise
A-Z
New Order
Earthshine

186. There is the question whether Earthshine's purchase and sale in these three deals were connected to an unidentified defaulter. We deal with this question below under "tax loss" in relation to our findings about A-Z Mobiles. Having resolved the question of to what transactions, goods, money movements and invoices Earthshine's purchases were connected, we move on to consider whether the deal chains to which its purchases were connected were fraudulent and to help decide that, we consider whether the chains were orchestrated or arose in a genuine commercial market.

Were the deal chains orchestrated?

187.It was HMRC's case that the chains were orchestrated. This was expressly stated in the decision letter written by Mr Kendrick and implicit in the description of MTIC fraud given with the Statement of Case. A great deal of evidence was heard on this issue, in particular the evidence on whether or not Earthshine's deals were in a grey market.

188.It is important that this Tribunal determine the question of whether the deals were orchestrated. It affects the issue of whether there was fraud: if the chains were orchestrated what would be the reason for this if it was not to facilitate fraud? It affects the issue of knowledge as well: if the chains were orchestrated, did the Appellant know this? We will consider these questions later but first address the question of fact of whether they were orchestrated transactions or took place in a genuine commercial market.

Probability

189.Mr Stone's evidence is that only 179 traders have registered for the reverse charge on trading mobile phones and computer chips. This suggests the true grey or secondary market for mobile phones is very small. It cannot be said that this small number is the result of many traders going out of business due to having had input tax withheld: the reverse charge means that if there is a genuine market the VAT no longer has to be funded out of the trader's capital and, in any event, were there a genuine market there would always be a solvent business to exploit it.

190.His evidence also shows that although £21 billion worth of mobile phones were exported in January to June 2006 this had fallen to £2.1 billion for the next six months (the six months in which the deals at issue in this appeal took place).

191.Mr Green's inference from this evidence is that it shows all the fraudulent trades had fallen off by the second half of 2006 so that Earthshine's deals must have been on the genuine grey market.

192.We cannot agree. The evidence there was a considerable falling off in mobile phone trading in mid-2006 strongly suggests that much of the earlier trade was fraudulent but nevertheless it does not mean that none of the trading in the latter half of 2006 was fraudulent. MTIC trading in mobile phones did not become impossible until the introduction of the reverse charge in 2007. MTIC fraud in mobile phones was still possible in the latter half of 2006 and we need to look at the evidence of and surrounding Earthshine's transactions to determine whether or not its trades were in a genuine secondary market or not.

Commercial reality

193. None of the companies in the chains which we have found to be proved involved a manufacturer or authorised distributor of mobile phones. None of the phones appear to have been sold on to a retailer who has actually used them in its retail trade. Indeed the evidence is that in deal 2 and deal 4 the goods circulated: Sunico in Deal 2 and Paris 2000 in Deal 4 re-purchased goods they had only just sold.

194.The trading was all back to back and none of the traders in the chain took physical possession of the goods: they remained in the hands of the freight forwarders.

195.None of the traders made a loss on the deal (with the possible exception of Snowrix in Deal 1 as discussed above in paragraphs 116 & 119). Yet if they were buying speculatively some losses on some deals would be expected: and some very high profits would also be expected. From the small but regular profit margins we conclude they were not buying speculatively. As they were not buying speculatively, and not "adding value" by improving the goods or breaking bulk, we can see no commercial rationale for how so many traders could sell on the same goods on the same day at a profit, at each stage necessarily increasing the cost of the goods.

196.Further it was clear from Mr Sharp's evidence (eg that Earthshine would have to wait for its release until payment had gone up the chain) and from some of the documents (eg invoices pre-dating release notes) that goods would be sold before possession was transferred. Indeed, we did not understand it to be in dispute (& it is shown by the banking evidence) that it was the position that no one in the chain of invoices would release the goods to their buyer until they had been paid and no one would pay until their buyer had paid them. This means the person with legal title at the top of the chain was prepared for its goods to be sold on many times, and to allow a third party (Earthshine), with whom it had no contractual relationship and of whose identity it would not have been aware if this was a genuine situation, to export the goods out of the country all at a time when it, the legal owner, had not been paid. The legal owner would normally have to wait several days for payment as the goods had to be shipped and then inspected by Earthshine's buyer before Earthshine's buyer made payment.

197.We do not think a rational commercial business owning the goods would agree to transact on this risky basis.

Re-export

198.All the chains end in a despatch by Earthshine to the Continent. We find that in addition the goods in four of the chains (4,5,6 & 7) were (or were purported to be) acquired in the UK a few days earlier.

199.On chains 5, 6 (both sets of goods) & 7 the evidence of this is the VAT free invoice from MS Enterprise which was a French VAT registered company. If genuine, this indicates that MS Enterprise despatched the goods from the Continent to A-Z in the UK.

200. On Deal 1, 2 & 3 there is no documentary evidence that the goods were imported/acquired although it is clear due to the banking evidence that *payments* for the goods passed between companies based on the Continent.

201.On Deal 4 the documents show that DRT shipped on hold the goods into the UK on 21 July 2006. Earthshine shipped them out to Sunico two days later.

202.We find no commercial rationale for how, if we assume that these were genuine transactions, goods available on the Continent at one price, would be transported to the UK (with insurance and freight costs) and sold through a number of companies (all making a profit) and few days later be back at an attractive price on the Continent. On the other hand, it makes perfect sense for the goods to travel back and forth from the Continent to facilitate a MTIC fraud.

Low Markups

203.Many of the participants in the chains which we have found to be proved had very low markups, sometimes as low as 25p. For such low profits we consider the traders could have been doing little in the way of "business" other than issuing paperwork. If they had incurred any real overheads in the way of staff, storage, insurance, or inspection costs then we find the trades would have been unprofitable. Indeed, Mr Sharp indicated in his evidence that he did not expect his sellers to have carried out proper due diligence or inspection. We infer that no such expenses were incurred by the buffers.

204.We do not find this indicative of trading on an open market. Traders in a true market would have had no guarantees: they would not wish to purchase stock unless they were sure it was in saleable condition. Lack of insurance and inspection we find means that the participants in these chains knew that goods were never going to be returned as not up to specification.

Patterns in mark ups

205. We find that the mark ups show patterns which would not be explicable if this was trading on an open market rather than a "market" organised for the purposes of MTIC fraud. The following table shows the price increments in pound per unit:

Deal 1		**Deal 2**		**Deal 3**		**Deal 4**	
				Silus			
				Phone City			
On Line	0.50			Cirex	0.25		
Global Mobile	1.00			Data Solutions	0.25		
Snowrix	(0.25)			TGT	0.25	Paris 2000	
Parfums	7.43			Outer	1.00	Alartec [DBP]	
Highbeam	0.50	Vescon	0.25	K N Exports	1.00	Vescon	0.25
Mana	0.50	Cobra	0.80	New Order	1.00	Black Country	1.00
Owl	2.50	Letting Solutions	4.00	Santok	3.00	Letting Solutions	4.00
New Way	1.00	LMC	1.00	LMC	1.00	LMC	1.00
Earthshine	10.50	**Earthshine**	10.50	**Earthshine**	10.00	**Earthshine**	11.00
TTW	2.50			TTW	4.50	Sunico	

206.On the alleged contra-trades, A-Z's profit varied from 0.25p per phone to 1.00 per phone. New Order consistently made a margin of £2 per phone in all 3 transactions. Earthshine's profit was £16 in 5, £10 in 6(a), £9 in 6(b) and £9 in deal 7.

207.A clear pattern in the mark-ups is that it is Earthshine (the exporter) who makes a significant profit. Looking at the issued invoices, the buffers' (except the penultimate

buffers) profit is considerably lower: consistently 25p or 50p or 80p or £1 or £2 per phone. This only makes sense if they have virtually no expenses or overheads. Another pattern is that the penultimate buffers in the straight chains (Owl, Letting Solutions and Santok) make a significantly larger profit than other buffers.

208.The patterns make no sense in a commercial world. In a commercial world with risk we would expect to see fluctuating profits and the occasional loss. The higher profits of the exporter would make sense if the goods were manufactured in the UK and the only way of getting them to the continent was to transport them across the Channel. But this is not the case. Not only is it clear in half of the chains that the goods originated on the Continent, none of them were manufactured in the UK.

Length of chains

209. In the four "straight" chains, deals 1-4, the chains of invoices were very long; the chains of money movements were even longer. Virtually all the deals took place on the same day. The chances of a genuine commercial situation arising where so many traders buy and sell exactly the same goods without undertaking any work in respect of them on the same day and always at a profit seems highly unlikely to us. The phones in the hands of the last trader would be much more expensive than in the hands of the first trader and much less easy to sell into a retail market. If Sunico or TTW genuinely wanted phones to sell on a retail market on the Continent, why wouldn't they buy them from the person at the top of the chain at a much cheaper price?

210.This is particularly the case where all traders advertise on public websites and there is no need for secrecy of identity. We find that seven of the traders in Deal 1, five in deal 2, six in deal 3 and five in deal 4 were all members of the IPT (International phone traders) a web based platform for trading mobiles. We find this means that the various traders could have made connections with each other and cut out the intermediaries and that in a true commercial environment it is very likely this would have happened.

211.If the chains were for the purpose of MTIC fraud, however, their long length makes sense. This is because the intervening buffers put distance between the broker and defaulter, making it harder for the broker's deal to be linked to a fraud. And irrespective of whether the broker actually knew of the connection to fraud, the orchestrator of the fraud would have a vested interest in protecting the position of the broker. This is because to make the fraud work (as explained above) he needs brokers willing to enter into these sort of deals, and brokers (innocent or knowing) would soon cease to be willing if HMRC refused to refund the VAT from previous export deals. So unless the orchestrator protects the position of the broker, he would have to constantly identify a new broker and brokers in general would be much less willing to participate. Long chains were likely to be viewed by the orchestrator as protecting the position of its brokers.

Comparative length of chains

212. The chains in the four "contra" chains, deal 5-7, were, in contrast very short. It looks a little more like a chain that could arise in a normal commercial situation.

However, a shorter chain also makes sense in the world of MTIC where the chains connect to a contra trader. This is because the organiser of the fraud is using the contra-trade rather than the length of the chain to protect the position of the broker.

213.We conclude that while the length of chain in deals 5-7 do not of themselves (because they are short) indicate MTIC fraud was at the root of them, nevertheless the fact that the four chains connected to a defaulter were long and the three chains connected to a contra were short does indicate that *all* the chains were contrived. If the chains were not contrived, it would be a matter of chance whether a chain which connected to a defaulter or contra were long or short: the fact that it is the long chain which invariably connects to a defaulter and a short chain invariably connects to a contra is an indicator all 7 chains were contrived for the purpose of MTIC fraud.

Circularity in chains

214. Genuine commercial trades would end in the sale of the phones into a retail market. There is no evidence whatsoever that any of the phones traded by Earthshine were ever sold into a retail market.

215.On the contrary, we find that in some chains the goods were traded in more than once by the same company. In deal chain 2 we find Sunico both sold and then re-purchased the same goods at a much higher price (it bought them from Earthshine on 20 July but had sold them earlier to Paris 2000 although not paid until 21 July – see the banking evidence in 130-132). In deal chain 4 we find Paris 2000 released goods to Alartec on 26 July which it then re-purchased from Sunico (on 28 July). We cannot see any commercial rationale for this bearing in mind that the deals were back to back so that in deal 2 Sunico must have agreed to sell the goods at the lower price to Paris 2000 at the same time as it was agreeing to buy them back at a much higher price from Earthshine.

216.On the other hand, circularity makes a great deal of sense in the world of MTIC. Re-using the same goods to commit the fraud time and time again makes it considerably more lucrative.

217.We also note that Sunico appears in all the chains: either it supplies the goods at the start of the chain or it buys from Earthshine at the end (and in deal chain 2 it does both). This would be a remarkable coincidence if the deals were in a commercial environment and this is therefore yet one more reasons for concluding that they were not.

Patterns in chains

218.There are patterns in the chains. The last 3 chains were identical: MS Enterprise sold to A-Z, who sold to New Order, who sold to Earthshine, who sold to Sunico.

219.Although less obvious, there are patterns in the first 4 chains. LMC is always (where it appears) selling direct to Earthshine; Letting solutions (where it appears) always sells to the last buffer. TTW always sells to OHM.

220.Repetitive patterns in chains make sense in the world of MTIC because the orchestrator of the fraud may well find it easier to stick with a few well used chains involving companies the orchestrator has used to facilitate an earlier MTIC fraud.

221.Repetitive chains appear in the commercial world where there is a distribution chain in which goods move in an predictable pattern from the same manufacturer to the same distributor to the same wholesaler and on lastly to the same retailer. There is no suggestion (and certainly no evidence) that that is what happened here. The Appellant claims it was trading on a kind of commodities market and trading on price differentials. If so, the repetitive patterns, particularly pronounced in the last 3 deals, make no sense: it should have resulted in entirely random chains.

Discrepancies in chains

222.As outlined above in paragraphs 166-167, there were discrepancies in deal chain 4. Although DBP purported to supply 1,499 N70 phones to Vescon, and was paid for them, it did not in fact import the goods nor have any control over them. DRT imported them, released them to Paris 2000, who released them to Alartec who released them to Vescon, by-passing DBP. Alartec had possession of the goods and released them to Vescon, but did not invoice DBP nor was it paid for them.

223.It seems Paris 2000 was content to release the goods via a different chain to the chain of payments. Paris 2000 also was not UK VAT registered despite (on the evidence of the release notes) its liability to register because it made supplies of goods located in the UK.

224.In a genuine market it makes no sense for a trader such as Alartec to supply goods without being paid, or for DBP to be paid without supplying goods. In a genuine market Paris 2000 would register for UK VAT in order to be able to off-set the VAT it should have paid on its acquisitions. These oddities, however, make perfect sense where at least some of the companies are in collusion with each other for the purpose of creating the illusion of a genuine market. If the companies are in collusion, it does not matter that the physical goods are split from the invoice and money chain, and in a VAT fraud it does not matter if a company "trading" in the UK is not VAT registered as they will not be incurring real input tax.

Specification of phones

225. As is apparent from the tables in paragraphs 110, 123, 136, and 154 above, mobile phones have detailed specifications.

226.Mr Fletcher explained in some detail the importance of knowing whether a phone being purchased was "sim free", "never locked" new or original, the language of the manual, the language of the key pad, the software supplied, the warranty (it was vital to know region of warranty as Nokia did not offer global warranty). Other issues, he said, might well be important to some purchasers such as the colour and the place of manufacture.

227.We accept his evidence that a commercial purchaser would have specific requirements about the sort of phone which was required and we did not really

understand Earthshine to dispute this. On the contrary, it was Earthshine's case that the detailed specification was contained in the handset codes and/or IMEI numbers.

228.However, we find many participants in these chains traded *without* specifying the phones in which they were dealing. In many cases the invoices or purchase orders merely identified the phones as 'Nokia N70s'. This lack of interest in the precise specification of the goods being traded is cogent evidence that the chains were not commercially driven.

229.We find that the trades were back to back and that traders only arranged to buy when they had a sale lined up. So we would expect a trader, having discovered what its buyer wants to buy, to require its vendor to supply the exact specification that its buyer has demanded. This did not happen. The specification in the purchase order from their buyer to a trader in this chain does not routinely mirror the purchase order given to the trader's vendor. We find that where invoices or purchase orders give more detailed specification of the phones in the same chain, although the specifications are not inconsistent, they are nevertheless not identical. The tables set out at 110, 123, 136 and 154 only have to be read to see the many differences. For example, Earthshine in Deal 3 wanted standard European specification with English French German and Italian languages. Its vendor refers only to "latest software".

230.Further many of the invoices and/or purchase orders refer to Central European or standard European specification. We accept Mr Fletcher's evidence that this was meaningless in that Nokia did not have a central or standard European specification.

Use of sterling

231. In some of these chains, we have found it proved that the same goods later or previously traded in by Earthshine were (or were purported to be) traded between companies on the continent. For example, in deals 1 & 3 TTW sells to OHM and in Deal 4 Sunico sell to Paris 2000. The invoices for these trades were in sterling.

232.It makes sense to keep trading in sterling if the trades were to facilitate MTIC fraud and the phones, just despatched out of the UK, are about to be returned to the UK and a new series of sterling transactions. Mr Green's view was that it made sense for commercial trading too as it would be a way of avoiding currency exposure. But this is only true if Paris 2000 or OHM were intending to sell in sterling: in a genuine commercial transaction they must have intended the phones for a retail sale on the continent and keeping the currency in sterling we find makes no sense.

High value

233. Mr Green made the point, with which we agree, that the quantity traded in the deals at issue in this appeal did not even come close to approaching an unrealistic number of phones (such as exceeding the total actually manufactured), which if it did might well be an indicator of fraud. However, the fact that the value traded in did not come close to the total phones actually manufactured does not indicate that it was not fraudulent: it is neutral.

Dishonest freight forwarder

234. We had unchallenged evidence from Mr White, an HMRC officer, that he searched vehicles on ferries going to the EU where the loads had been inspected by A1 (the freight forwarder used to store the goods at issue in this appeal) and whose CMRS show high value electronic goods yet the vehicles only contained items such as cardboard or animal feed.

235. There is no suggestion that the goods the subject of the deals in this appeal did not exist: on the contrary there is ample evidence that they did exist and we find that they did. The point of Mr White's evidence is that A1 (or an employee of A1) prepared what they may have known to be false CMRs in other deals not related to Earthshine.

236.We consider this evidence is of no value to the Tribunal. It shows A1 may have been dishonest: it does not mean that that all transactions with which A1 was connected were necessarily part of an MTIC fraud.

Conclusion

237.In conclusion, we found no credible explanation for why traders in these chains were always able to sell them on at a profit other than that the chains were orchestrated. There was no retail market, no manufacturer or authorised distributor in the chains. The trader at the top of the chain took an enormous and inexplicable risk by allowing a trader, the identity of which it should not have known if these were genuine deals, to export goods out of the country before it was paid. The goods were imported from the Continent and sold back there a few days later at a higher price: there is no explanation of how this would repeatedly happen in a genuine market. There are patterns in all of the chains and circularity in two of them that only makes sense if they were orchestrated. There were discrepancies in Deal chain 4 where the money and the goods follow two different chains of buffers: and although this is restricted to deal chain 4, that chain involves many companies involved in the other chains. Leaving aside Earthshine, as we deal with its concern with specification later in the decision notice, none of the other traders appeared to have much of an interest in the specification of what they were buying although they were trading in phones with great variations in specification, and those that did include a detailed specification in their purchase orders did not require their suppliers to supply a mirror specification to that requested by their customer. The deals could not have been commercially driven.

238.The evidence as set out above is overwhelming that all 7 chains at issue in this appeal were orchestrated for the purpose of MTIC fraud and so we find. We cannot say who orchestrated the chains. Sunico is proved to have been selling at the top of two of the chains in which it re-purchases at the bottom. While there might be an explanation for this in the genuine market (although it is difficult to think of one) we have found these chains were not genuine. The only explanation can be knowing involvement by Sunico. The same is true of Paris 2000. We note also that Sunico was recorded by Earthshine as suggesting that it be allowed to orchestrate deals for them, substantiating our finding it was knowingly involved in fraud: see paragraph 551.

The evidence of Mr Fletcher

239. Mr Fletcher is now a principal advisor at KPMG with extensive experience in the mobile phone industry, working in an accounting/finance capacity for service providers and mobile network operators. He had experience of the secondary market for mobile phones elsewhere in the world but not in the UK although he had carried out research in respect of it.

240. Mr Fletcher's evidence was much criticised by Appellant, and his independence as an expert challenged (he was described as "loyal"), and his expertise in the subject area doubted. It was suggested his evidence was not careful or candid. The Appellant did not agree with what Mr Fletcher said about the grey market for phones in the UK; they considered him wrong to consider that no useful information on mobile phone specifications could be gleaned from IMEI numbers or handset codes; they considered him wrong to say the description "central European specification" was meaningless.

241. The Tribunal finds the Appellant's criticisms of Mr Fletcher unjustified. We found Mr Fletcher to be a careful and reliable witness and expert in the area covered by his witness statement. He explained that although he had direct experience of the secondary market in mobile phones elsewhere in the world, he had no direct experience of it in the UK, which for the reasons he gave, confirmed by Mr Stone's evidence referred to in paragraph 189 above, and which we accept, is very small.

242. We found Mr Fletcher was able to reply convincingly to a very long cross examination. We found the answers he gave described consistent and rational market behaviour and for this reason was likely to be right. His overall conclusion that Earthshine was not trading on the secondary market we find is correct: it is corroborated by the entirely independent evidence set out in paragraphs 193-238 above. We accepted Mr Fletcher as an expert in the field of mobile phone trading. We go into this evidence in more detail in paragraph 248-259 below.

243. We found Mr Fletcher to be an honest witness. After the original hearing in January 2010, Mr Fletcher submitted a fifth witness statement in which he explained that his previous evidence on handset codes had been made under the false impression that the language specification document he was shown by Nokia under a non-disclosure agreement was a general one and related to all Nokia's phones. It was Mr Fletcher's evidence, which we accept as we found him overall to be a very careful and honest witness, that he thought it was of general application as it was given in response to a question from him about Nokia's general specification and there was nothing on the document (he said) to indicate it was restricted to one model. Having later been told by Nokia the document related to only one handset model, he sought to retract some of the detail of his evidence on the meaning of handset codes but stood by his overall conclusions and in particular that central or standard European specification had no meaning in the context of Nokia phones.

244. Mr Green submits that Mr Fletcher's retraction of this small portion of his evidence shows his evidence overall is unreliable. We do not agree .

245.We found Mr Fletcher to be a careful witness who chose to stick closely to his area of expertise: for example, he would not given an opinion on whether undoing the manufacturer's seal on a mobile phone box would necessarily devalue the phone. We found no hint of partiality: for example although it was his stated opinion that Earthshine's transactions did not take place on the secondary market, he did not draw the conclusion that it was therefore fraudulent.

246.Mr Fletcher refused to disclose the source of some of his information on handset codes on the basis it was the subject of a non-disclosure agreement with Nokia. The appellant said they were seeking disclosure from Nokia but they made no application to the Tribunal for disclosure. We do not find this affects Mr Fletcher's overall credibility: he was open with the Tribunal that he was not disclosing the report. We agree with Mr Green, however, that without the document his evidence in respect of it could carry no weight.

247.For the reasons explained below (paragraphs 544) we accept Mr Fletcher's evidence that it is not possible for anyone other than Nokia to determine a phone's specification from its IMEI number or handset code and that "central" or "standard" European specification is meaningless in the context of Nokia phones.

The grey market in mobile phones

248.Mr Fletcher's evidence on the grey market was very extensive but in brief was as follows. A grey (or secondary) market in phones existed in 2006 but it was very small. He identified 4 types of grey market in mobile phones in 2006:

- Box breaking;
- Arbitrage
- Volume shortages
- Dumping

249.Box-breaking is where the UK retail price of the phone is (due to subsidies) less than the wholesale price so a business might seek to buy the phones retail and sell them wholesale. This is difficult as retails phones can normally only be bought individually in a retail shop, and as the purchase of the phones is so labour intensive box-breakers need to employ a very large staff. The phones are then normally sold abroad in countries with lower subsidies (ie a higher retail price).

250.The Appellant agreed that their business was not box-breaking. Apart from other factors, Earthshine did not buy the phones retail, it did not accumulate stock and the phones were often EU specification and *not* suitable for use in the UK.

251.Mr Fletcher described the practice of arbitrage arising from where the phone manufacturer sets different prices in different territories. An authorised distributor in one territory might sell phones via an intermediary to an authorised distributor in a higher priced territory. Nokia sets the same price across all territories, and although

there might be limited opportunities for arbitrage due to currency fluctuations, this was very unlikely in 2006. Mr Fletcher says in order to maintain the possibility of profit with arbitrage there will be only one intermediary in the chain, and the phone specification will be very precise. Earthshine's deal chains did not match this model: the chains were very long, contained no authorised distributors and on many of the trades the specification was not precise.

252.Mr Fletcher also described a grey market where a distributor can source volume shortages in a market faster than the OEM (original equipment manufacturer ie Nokia). This only works where a distributor is holding stocks speculatively and the specification of the phone will be very precise and relatively small numbers of handsets involved. The distributor would have a good relationship with the multiple network operator (customer).

253.. Mr Knatchbull agreed that Earthshine did not trade in the "volume shortages" grey market nor did it seek to.

254.The fourth type of grey market described by Mr Fletcher was dumping which occurs where authorised distributors want to off-load surplus stock. His evidence was that the authorised distributor would often dump at a loss and would normally dump into another territory. It would trade on detailed specifications of the phone. Earthshine's deal chains did not have these characteristics as an authorised distributor was not involved, some of the phone specifications were very imprecise, and the phones remained in the same territory (ie Europe).

255.Mr Sharp disagreed with this evidence and said Earthshine was taking advantage of a secondary market which arose when authorised distributors over-ordered phones and dumped unwanted stock onto the grey market (he did not like the term "grey" market but we consider it interchangeable with "secondary" market).

256.We agree with Mr Fletcher that the deal chains which concluded in Earthshine's transactions did not have the characteristics of chains arising through dumping: no authorised distributor was involved and in most of the invoices in the chain the description of the phones were not specific enough. The question of whether Earthshine knew or ought to have known that it was not trading on a genuine market is one which we address in the second half of this decision notice.

257.Mr Fletcher's opinion was that Earthshine was not trading in the "white" market and it was highly unlikely that it was trading in the grey market either as the deal chains lacked the characteristics of any of the above grey markets. The Appellant's criticism boiled down to saying that Mr Fletcher's evidence must be wrong because in the Appellant's opinion it was trading on the secondary market. We do not agree.

258.We accept Mr Fletcher's evidence. Most importantly Mr Flectcher was clearly right to say the Appellant's deals were not on the grey market because this is the conclusion we have reached based on specific evidence about the chains in which the Appellant traded (see paragraphs 248-259) and entirely independently of Mr Fletcher's generic evidence about the grey market in phones. We also accept his

evidence as he had a great deal of experience of the market and what he said accorded with logic. Markets don't just happen. There is no happy market, commodities or otherwise, where a business can continually be guaranteed of buying at one price and selling at a high without in some way adding value or taking a risk. Constant steady profits for doing very little other than issuing invoices is not consistent with commerce.

259. Having concluded that the deal chains with which Earthshine's purchases and sales were connected were orchestrated, we go on to consider whether they were connected to fraudulent evasion of VAT.

Connection to fraudulent evasion of VAT?

260. As stated above, to justify its withholding of the input VAT claimed by Earthshine, HMRC must prove that Earthshine's transactions were connected to fraudulent evasion of VAT. We have looked at the 7 purchases by Earthshine in the preceding paragraphs of this decision notice and concluded that these purchases were connected to the chains as set out above. We find connection to fraudulent evasion of VAT is made out if HMRC in addition prove that somewhere in the proved chain there was evasion of VAT.

261. The question of fraudulent evasion is often split into two: was tax due to the exchequer left unpaid (the tax loss), and if so, was it unpaid due to fraudulent intent? This is done, no doubt, because tax can be left unpaid without fraudulent intent. In MTIC cases, however, it does not always make sense to treat it as separate questions because the evidence that there is fraudulent tax loss may be the same: the chains were orchestrated. The overwhelmingly likely reason for this was to enable fraud to be committed.

262. Was tax left unpaid? On the question of whether tax was left unpaid, do HMRC have to prove that the taxpayer who was alleged to have defaulted on payment of VAT at the top of each chain was an importer.

263. As explained by Mr Justice Clark in *Red 12 Trading Limited* [2009] EWHC (CH) at paragraphs 81-84 in classic MTIC the defaulter will be the importer. This is because in order to make money the fraudsters rely on the VAT free status of acquisitions into the UK. However, it is not necessary for the defaulter to actually acquire goods (ie to "import" them into the UK from the European Union): the fraud is as effective if the defaulter buys from someone else who is the acquirer and neither of them account for VAT.

264. Normally if the defaulter was not the acquirer but purchased the goods in the UK then it would normally have a VAT credit and the VAT lost to HMRC would (normally) be much less than the unaccounted for output tax. But if the true "acquirer" was not VAT registered, or did not chose to treat the sale as subject to VAT, then the defaulter, even thought not an importer, would nevertheless acquire the goods free of VAT and without any legal right to a VAT credit (having no proper VAT invoice). If it then sold the goods, it would be in the same position as the true acquirer: able to disappear with 7/47ths of the sale price. So, as Mr Justice Clark says, it is not necessary to show the defaulter actually brought the goods into the UK:

> "In order to justify denial of the right to deduct input tax there must be knowing participation in a transaction connected with fraudulent evasion of the tax. If that is established, the right is lost. It would be inconsistent with that principle, and an unmerited boon to fraudsters, to require that the authorities prove that the defaulter was the original importer."

265. It follows from this that where there is proof that the defaulter was the importer in the chain this is clear proof of tax loss. But if the alleged defaulter has entered into transactions and gone missing without accounting for that VAT in

circumstances where it was likely either it or its supplier (or its supplier etc) imported the goods then this is also evidence of tax loss: it does not have to be proved that the defaulter actually was the importer.

266. But it seems to us that although the defaulter does not have to be the importer, we nevertheless have to be satisfied that the fraudster obtained the goods free of VAT (if the goods existed). It is the VAT free acquisition of goods in the UK which makes the fraud lucrative. But the other side of this coin is the fact a person defaults (in circumstances where it was clear they always intended to default) itself may well be evidence that there was a VAT-free acquisition (by the defaulter or its supplier) because otherwise the default is unlikely to be sufficiently lucrative.

267. In conclusion we find that defaulting on tax liability in circumstances where no claim is made for a tax credit is likely to mean (subject to other evidence) that the defaulter was the acquirer or purchased the goods without paying VAT from an acquirer, and the tax loss is the output tax for which the defaulter failed to account.

268. We note Mr Green's argument that (he says) the test is not whether HMRC has suffered a loss on the balance of probabilities: HMRC has either suffered a loss or it has not. We do not agree with this analysis. Whether HMRC has suffered a loss is a simple question of fact. As with all questions of fact, we determine it on the balance of probabilities.

269. We also note that it was an agreed fact between the parties that HMRC has not withheld input tax from any other company in the alleged chains.

270. Was the tax left unpaid with fraudulent intent?

271. Mr Green suggests it is hopeless for HMRC to suggest they can prove fraud because they cannot adduce evidence that an alleged defaulter intended to abscond with the VAT. It is certainly the case that there is no direct evidence of the alleged defaulter's intent. But we can, if appropriate, infer it from circumstances.

272. To show that the loss was fraudulent, HMRC needs to show criminal intent by the alleged defaulters. Failure to pay tax that is due is clearly not necessarily fraudulent: businesses with the best of intents can fail with unpaid VAT liabilities. It is fraudulent where the taxpayer intended to incur the VAT liability without meeting it. Although we consider the evidence in each individual case, it seems to us that issuing a VAT invoice but failing to either declare the liability or account for it is likely to indicate fraudulent intent on the part of the person who issued the invoice. This is because it seems highly improbable to us that someone could issue an invoice with a VAT charge showing on it without knowing that they needed to both declare and account for that VAT to HMRC.

273. Despite this being the case, in respect of the four alleged defaulters below, the officers giving evidence failed to exhibit the invoices issued by them: instead they produced a schedule of invoices. While we do not doubt the officers' bona fides, the invoices ought to have been produced and without them we are lacking primary evidence. Nevertheless, where no invoices were produced evidencing HMRC's claim

that the alleged defaulter charged millions of pounds of VAT which they then failed to declare on their VAT return, we have considered whether there was other evidence of fraudulent intent. We consider that fact the chains were orchestrated, would (unless there was contra-indications) mean that they were orchestrated with fraudulent intent.

274. Does the fraudster have to be identified?

275. Our view is that the fraudster does not have to be identified: *Kittel* does not require the fraudster to be identified: merely that a fraud is proved.

276. Does the fraud have to be successful?

277. As we have said, in some chains a defaulter has not been identified by the Tribunal. Where the defaulter cannot be identified but we have nevertheless inferred that fraud was intended from circumstances surrounding the transactions, do we need to be and can we be satisfied that the fraud was not only intended but successful?

278. Firstly, the Tribunal works in probabilities and not certainties. MTIC fraud relies on an invoice charging VAT but the issuer of that invoice not accounting for the VAT to HMRC. Where we cannot identify the defaulter, we have no primary evidence they issued an invoice and defaulted, so there is always the possibility that they *did* account for the VAT. However, we take the view that when an elaborate and artificial chain of transactions is put in place for the purpose of fraud, then it is considerably more likely than not that the defaulter would have done has intended, and issued a VAT invoice without returning and accounting for the VAT. So we find as a fact that wherever we find a chain orchestrated for the purpose of fraud, that that fraud took place.

279. Secondly, as a matter of law, we do not think that the intended fraud has to be proved to be successful: under *Kittel* the right to input tax recovery is lost where there is knowledge or means of knowledge of connection to fraud: we cannot see why someone the CJEU considers to be a participant in fraud would have a right to input tax deduction just because the fraud was not proved to be successful.

280. Various officers (named below) gave the evidence for the various alleged defaulters and contra traders. Mr Green criticises HMRC for not calling the officer who was assigned to the trader at the time of the deals but rather the officer with current responsibility for the trader. If HMRC do not call witnesses who can give the testimony necessary to support HMRC's case, then HMRC, who have the burden of proof, will fail to make out their case, and for the Appellant that is not a cause for complaint.

281. In practice, we found the failure to call the officers at the time makes no difference. The evidence of fraud is often that a trader has issued a VAT invoice and failed to return that VAT on its VAT return (or indeed failed to make a VAT return). Either the then or current VAT officer can equally give this evidence.

Deal 1 - Parfums

282.Officer Read gave the main evidence on this company and we find as follows.

283.Parfums was registered for VAT on 6 October 2003. Its original business was cosmetic and toiletry items. It had a very small turnover in 2003 and 2004 and most of 2005. It made nil VAT returns for 2004 and 2005 and 02/06. Hearsay evidence is that the director of Parfums attempted to sell the company in mid-2006 but the sale fell through. Nevertheless, this is his explanation for the large number of invoices issued in Parfums' name: the would-be buyers hijacked his VAT registration. HMRC have assessed a dummy registration number for Parfums as they consider the VAT registration number was hijacked and used for sales of over £28 million to Highbeam and to Blue Star. The company was deregistered in July 2006.

284.Mr Read exhibited schedules of the invoices issued in the name of Parfums but not the invoices. The only invoice in evidence before the tribunal was the one in Deal chain 1. This alone was in the sum of £405,000 and we find was not returned by Parfums on a VAT return.

285.Mr Green makes the point that the evidence of the hijack is weak: HMRC are essentially relying on the director's word that he knew nothing of the large numbers of invoices issued by Parfums. While we agree with Mr Green's point, it makes no difference to our finding of fraud. Parfums may or may not have been hijacked: what is clear is that the director of the Parfums *or* someone purporting to be Parfums issued the invoice in Deal Chain 1 and did not account to HMRC for the VAT on that invoice. That person – even though we cannot be sure who it was - acted fraudulently because they charged VAT without declaring it. And we have already found that Earthshine's purchase and sale was connected (by a chain of purchases as set out in the table) with that particular invoice.

286.In any event our conclusion set out in paragraph 237-238 above is that all the deal chains the subject of this appeal were orchestrated and did not take place on the open market. We find that MTIC fraud is the overwhelmingly likely explanation for the orchestration of such long and complicated deal chains which did not reflect any genuine market demand for the goods the subject of them. We cannot identify who orchestrated the fraud but we are in no doubt that deal chain 1 came into existence for the purpose of fraud. On the evidence we have we are sure that Parfums – or the person purporting to be Parfums if it was hi-jacked – acted fraudulently. They never intended to (and did not) account for the VAT on the invoice at the start of deal chain 1 because the intention was to commit fraud.

287.There is no direct evidence of acquisition of the goods the subject of deal chain 1 by Parfums or the person purporting to be Parfums. We are nevertheless satisfied that the goods were acquired (or purportedly acquired) because, as we have said, the deal chains were orchestrated. It would be pointless to orchestrate a deal chain *unless* VAT fraud was the object of it. It therefore follows that Parfums did not have input tax to offset against its output tax. In any event it made no claim for input tax offset.

288.We find that there was tax loss because the VAT charged on that invoice at the start of deal chain 1 was not accounted for to HMRC and there was no input tax to offset because of an actual or purported acquisition. The tax loss was, as we have found, fraudulent.

289.As we have already found in paragraph 112 Earthshine's purchase was connected to Parfum's invoice and is therefore connected to this fraudulent tax loss.

Deal 2

290.Officer Carr gave the main evidence on Alartec and Officer Raglan gave the evidence on DTM and we find as follows.

291.Alartec was registered for VAT on 10 March 2006. We had hearsay evidence that in June 2006 HMRC visited Alartec and were informed some 7 deals had taken place involving mobile phones and multi-media players. These 7 deals involved some £5million. In July 2006 Miss Carr spoke with the personnel of the trader at least 3 times and was handed some trading records. The company was de-registered on 31 July 2006 for abusing its registration and has not lodged an appeal against this. The trader told Miss Carr one of their suppliers was DTM, but said they had never visited them even though the company was situated only a mile away.

292.Alartec's VAT return for the 3 months to 06/06 shows sales of nearly £44million and purchases of a slightly lower figure. Its return also shows that it made supplies to the EU of £4million and a VAT reclaim for some £44,000. The return for the next month (July 2006) shows sales and purchases in virtually identical figures of around £20million but only declares slightly less then £5,000 as VAT due. Alartec did not produce the records to support these returns. The invoice issued by Alartec in Deal Chain 2 involved VAT of over £30,000.

293.HMRC assessed Alartec to nearly £4million in VAT in February 2007. The assessments were based on invoices which were not produced to the Tribunal. Alartec has gone into liquidation without paying or appealing the assessment.

294.On the basis of this information we find that HMRC have not proved that Alartec failed to account for the VAT on the invoice it issued in deal chain 2. It did make a return for July 2006 in which it declared some £20million in sales.

295.Nevertheless, of course, bearing in mind our finding in paragraph 237-238 that this chain, like all the other chains in this appeal were orchestrated for the purpose of fraud, Alartec was part of a fraudulent chain. Its position, more likely than not, was as the first line buffer.

296. DTM was incorporated in October 2005 and VAT registered on 1 March 2006. It was de-registered on 28 June 2006. Its VAT 1 described it as a catering supplier but it traded only in electronics. It has not made any VAT returns. There is hearsay evidence that HMRC officers were never able to contact any company officers. From evidence of release notes, we find DTM acted as an acquirer in some chains. HMRC say they discovered invoices issued by DTM held in the records of other traders and

have issued assessments based on these totalling over £23million. The invoices on which the assessments were based were not produced to the Tribunal and we agree with Mr Green that this is highly unsatisfactory and further, the assessments themselves (without the invoices on which they are based) do not prove that DTM did issue the invoices as alleged by HMRC.

297.Nevertheless, there is the hearsay evidence from Alartec that their supplier was DTM and there is the banking evidence that Alartec *paid* DTM (see paragraph 127). Even though there was no invoice we find DTM did supply Alartec.

298.We are also satisfied, as explained in paragraph 237-238 that deal chain 2 came into existence and was orchestrated for the purpose of defrauding HMRC. We are satisfied that because it was engineered for that purpose, there would have been a defaulter who issued a VAT invoice without accounting for the VAT and the fraud would have been successful. We are satisfied that that defaulter would not have incurred input tax because otherwise the fraud would be insufficiently lucrative: we cannot be sure that an actual or only a purported acquisition took place.

299.We do not consider that we have to identify who the intended defaulter was. However, we conclude it was more likely to have been DTM even though no invoice was identified because Alartec's trading pattern appears more like that of a buffer and there was primary evidence in the form of release notes that DTM had in other deal chains imported goods. Further, DTM paid Paris 2000 which did not have a UK VAT registration and therefore could not be the acquirer or defaulter.

300. Mr Green suggests we cannot find fraud because Mr Kendrick's opinion was that the defaulter was Alartec while another HMRC's officer's (Miss Raglan's) opinion was that DTM was the defaulter. The Tribunal does not base its decision on the opinions on the facts given by witnesses of fact. We assess the evidence and come to our own conclusions. Our conclusion is that DTM was the defaulter in deal chain 2.

301. We find that there was tax loss because the VAT charged on an invoice issued by DTM (which must have existed although not produced to the Tribunal) at the start of deal chain 2 was not accounted for to HMRC and there was no input tax to offset because of an actual or purported acquisition by DTM. The tax loss was, as we have found, fraudulent.

302.As we have already found in paragraph 129 Earthshine's purchase was connected to DTM, it purchase is therefore connected to this fraudulent tax loss. As set out in paragraph 238 we are also satisfied Sunico was knowingly a party to the fraud (thought not the defaulter) and Earthshine's sale was connected to Sunico's purchase and sale.

Deal 3 - Phone City

303.Officer Wanat gave the main evidence in relation to this company and our findings are as follows.

304.Phone City was registered for VAT on 1 February 2005 and de-registered on 25 July 2006. The company dealt in mobile phones and air time contracts. Its turnover for the first year exceeded £72million and carried on increasing. In 05/06 it submitted a repayment claim for nearly £1million, with a return showing sales of over £181million and purchases in a similar figure. In its next and last period it reclaimed a quarter of a million in VAT. Despite requests no evidence was produced to support this reclaim and the directors eventually agreed they would not pursue it. The decision to deny its reclaim has not been appealed.

305.The company's officers provided only slow and partial responses to Officer Wanat's frequent requests for records. Miss Wanat assessed the company for undeclared VAT on sales in period 05/06 of over £2million based on invoices issued by the company (but not produced to the Tribunal) and this has not been appealed by the company now in liquidation.

306.The two directors of the company agreed with the Insolvency Service that they would be disqualified as directors of any company for 12 years because they recklessly or with gross negligence allowed the company to be put at risk from MTIC fraud with a result the company owes over £33million in unpaid VAT, by making sales of electronics within the UK in excess of £225million and despite specific advice from HMRC, failed to undertake adequate due diligence.

307.We have already said that we agree it is unsatisfactory that HMRC have not produced the invoices issued by the alleged defaulters. Nevertheless we are satisfied that Phone City acted fraudulently because that is by far the most likely explanation for the exponential increase in "sales" when coupled with the director's acceptance their behaviour (although not an acceptance it went beyond recklessness/gross negligence) caused a huge loss in VAT to HMRC and coupled with their failure to evidence reclaims that they had made.

308. We are not satisfied that Phone City was the defaulter: it did make VAT returns and may have included its sale to Cirex on those returns. Mr Green questions whether HMRC have proved that Phone City was the acquirer and we agree that this is not proved either. We find, based on the financial evidence referred to in paragraph 147 that Phone City obtained the phones from Silus, who obtained them from Sunico. Sunico was not UK VAT registered and cannot have been the defaulter or acquirer. Silus, about whom we know nothing, may have been the defaulter. Either Phone City or Silus must have been the defaulter.

309.Our conclusion is that although it is not proved who was the defaulter, we are satisfied that this deal chain was orchestrated and therefore we are satisfied it was orchestrated for the purpose of fraud. As explained by Clarke J in *Red 12*, we do not have to be satisfied who was the acquirer.

310.We are satisfied that there was a fraudulent tax loss and that Earthshine's purchase in deal chain 3 was connected to it because it was connected to both Phone City and Silus' participation in that chain. We have found Phone City was a knowing participant in fraud. If Silus was the defaulter, it must also have been a knowing

participant. Earthshine's purchase was also connected to Sunico's participation in the chain and we have found that Sunico was a knowing party to fraud (see paragraph 238). For all these various reasons we are satisfied that Earthshine's purchase was connected to fraud.

Deal 4 – DBP

311.The main evidence in respect of this company was given by Officer Strachan and our findings are as follows:

312.Derwyn Building and Painting Contractors Limited was incorporated in 2001 and VAT registered in 2004. At the end of 2005 it changed its name to DBP Trading Limited and diversified from building into electronics wholesaling. Its VAT returns show it to be in a modest way of business 05/04 through to and including 05/05 where the sales are shown as about £52,000. In 08/05 its sales increased to £16million. Purchases are an almost matching equal figure. The pattern continues in its next 2 returns. Sales of about £22.5million for 11/05 are matched by the purchases figure. For 02/06 the sales and purchase figures are virtually identical at just short of £101million. By mid-June 2006 the company's turnover exceeded £323million.

313.It was de-registered on 1 August 2006. We find on Mr Strachan's evidence that there seemed to be no genuine base to the business. Huge sales were achieved with virtually no expenditure of effort or business presence or need for employees nor any need for advertising. Requested records were not produced or only produced belatedly. It traded with a person purporting to be a company which it was not and was either unaware of this or did not care as it undertook no due diligence checks. Its turnover was huge but its profits were very low per unit and it never made a loss. It only traded back to back. It never had dissatisfied customers or trade disputes. The company has not appealed its VAT assessments.

314.The director of DBP (Mr Fradley) later signed a disqualification order of 12 years with the Insolvency Service in which he admitted that, if he did not know, he acted recklessly or with gross negligence in permitting the company to trade in a way which put it at risk of MTIC fraud and left the company owing at least £35million to HMRC and potentially considerably more.

315.We find that DBP did not declare acquisition deals nevertheless the evidence is that they did at least occasionally act an acquirer for some purchases. However, based on the financial evidence referred to above *and* the release notes (paragraph 167), we find it more likely than not that DBP did *not* acquire the goods the subject of the subsequent purchase and sale by Earthshine in Deal 4.

316.The goods were imported, we find, by either DRT or Paris 2000. These companies did not have UK VAT registrations but should have done. The release notes, we find, show DRT shipped the goods on hold and then released them to Paris 2000: see our findings in paragraph 161 above. However, neither DRT nor Paris 2000 were in the chain of invoices and based on our findings this chain was orchestrated for the purposes of fraud *and* on the fact that the invoice chain by-passes the releases note/financial chain and starts with DBP (who did not have the goods), it

is considerably more likely than not that DRT and Paris 2000 were knowingly defrauding HMRC in that they were selling goods in the UK without VAT registration, without charging and without declaring or accounting for the VAT due.

317. Apart from our finding that the chain was orchestrated we find that DBP must have been and was knowingly a party to the fraud as it issued a VAT invoice knowing it did not have possession or title to the goods and wasn't even being paid for them.

318. As we have said above, all it is necessary for HMRC to prove is that there was a fraud: they do not have to prove the defaulter acquired the goods. In a less sophisticated but nevertheless organised MTIC fraud, no doubt the defaulter will be the acquirer. In this case, the chain of goods diverges from the chain of invoices and the acquirer was not the "defaulter" in the sense of being the person who issues an invoice and goes missing with the VAT. Nevertheless, DPB was still guilty of fraud despite not being the acquirer: it has issued a false invoice (because it did not sell the goods) and has failed to account for the VAT due under Schedule 11 paragraph 5 Value Added Tax Act 1994.

319. We are satisfied that there was tax loss as we are satisfied that the VAT charged on invoices issued by DBP would never have been properly accounted for to HMRC because the chains were orchestrated for the purpose of fraud and therefore beyond doubt the VAT would have been defaulted upon.

320. Earthshine's purchase and sale is connected with the fraud committed by DPB and with the fraud committed by the actual acquirer (DRT) and of course with the fraud of the person who orchestrated Deal chain 4 (which included Earthshine's purchase and sale). It is also connected to the fraud committed by Paris 2000 who we find for the reasons explained in paragraph 238 was a knowing party to the fraud.

Deals 5-7 - A-Z Mobiles

321. The main evidence in respect of A-Z was given by Officer Devine, who was the officer allocated to deal with A-Z's affairs from late 2007 (which was after the matters at issue in this appeal). Evidence was also given by Officers Downer and Humphries. We find the facts to be as follows.

322. A-Z was registered for VAT at the time its business was retail of mobile phones. The business moved to the wholesale of mobile phones in late 2005. A-Z made a number of applications to be put on monthly returns which were refused and it remained on quarterly.

323. Its turnover increased from a modest £57,000 in the year to 30 November 2004 to £2.34 million in the year to 30 November 2005 to nearly half a billion pounds (£451million) in the year to 30 November 2006. In fact it appears the company had a small but respectable turnover in the quarters up to 08/05 when its turnover jumped from £19,000 to £2.295million in the next quarter. It continued to increase almost exponentially to £315million in quarter of 05/06 and then diminished to nothing by 05/07.

324.The Director of A-Z was a Mr Ishaq Ahmed and we find on the evidence he was well informed by HMRC of the risks of MTIC fraud. A-Z was the recipient of a large number of veto letters dating late-2005 through to 2006, warning it not to trade with companies whose VAT numbers it had earlier sought to verify. On 3 March 2005 it was notified that one of its deals had been traced back to a defaulting trader. Despite the obvious inference that there were serious problems with the companies with whom it was trading, A-Z's trading continued to increase apace with no evidence of improved due diligence. On 21 August 2006 A-Z was notified that goods purchased by them in 05/06 had been traced back to a tax loss of over £700,000. Through October 2006 onwards it was notified that many other deals had been traced to defaulters and tax losses running into millions. It received further veto letters. It carried on trading notwithstanding.

325.Mr Ahmed has never provided any due diligence for its deals in the period ending 11/06 and provided it very belatedly for the periods to 05/06 and 08/06. He said he was not good at paperwork. Its due diligence comprised a supplier/customer questionnaire and declaration and A-Z did not insist that all customers and suppliers actually completed this. A-Z undertook no credit checks or any other third party checks on its suppliers (apart from VAT number validation): although it asked on its due diligence forms for trade references it never actually took up any of them.

326.A-Z only provided to HMRC inspection reports in relation to a relatively small proportion of its trades in 2006. The inspection reports which it has provided are very basic and did little other than state the goods existed. A-Z traded in very large quantities of mobiles phones knowing the MTIC risks of doing so. It did not request or keep any IMEI numbers of the phones in which it traded, despite written recommendation from HMRC to do so. Further, from IMEI records kept by a customer of A-Z we find some of the phones sold by A-Z were in repeated circulation.

327.Mr Ahmed, when speaking to officers from HMRC, did not seem to know in which EU country his customers were based.

328.Only a small proportion of the CMRs for its acquisitions and despatches have ever been produced by A-Z (its explanation being that the freight forwarders will not give them to it as A-Z has not paid its freight charges). We find that some of the goods dealt in by A-Z were consigned to freight forwarders who had no storage facilities, and some of the freight companies used who are known to have issued false CMRs. We find that it is more likely than not that goods did not exist for all of the transactions in which it purported to participate.

329.If it purchased goods from EU suppliers it invariably sold them to UK customers, and when it purchased from a UK supplier it normally sold them to a customer in another EU member state.

330.Its deals were all back to back and it never held stock. It never made a loss on any purchase. It was always able to sell on immediately albeit at a small profit. It had no formal trading conditions despite the quantities and value in which it traded. It did

not insure the goods although Mr Ahmed claimed that A-Z relied on the freight forwarders insurance policy. No copy of this was produced. It never had goods returned (apart from 4 cancelled deals below in respect of which there is no actual evidence goods were ever returned) and had no systems to deal with customer complaints. It did not appear to receive any.

331.There was some variation in its profit margin. In all cases it was low – varying from 0.05% to as much as 2.04%. Nevertheless, the figures show that its profit in buffer deals was normally considerably lower than in broker or acquisition deals.

332.Evidence from FCIB bank accounts show that originally A-Z was paid in full and then paid its supplier in full in all but a handful of cases: from about May 2006 payments became erratic and difficult to relate to specific trades. A-Z had no systems of credit control in place and no negotiated credit limits with suppliers and customers.

333.In periods 05/06 and 08/06 the chains in which A-Z dealt as broker show a great deal of repetition with the same defaulter, same buffers in the same position and the same EU customer.

334.We find other patterns in A-Z's trading. Five companies (A-Z, Starmill, Jag-Tec, ORIL and Red House) all purchased goods from a European supplier called Kom Team (among others). The goods were sold to one of a group of 8 companies (buffers) or to one of a group of 30 brokers. Where sold to buffers the goods would be sold on to other buffers in the group and ultimately to one of the 30 brokers. The brokers sold only to 5 EU customers, although in practice the vast majority of the sales were just to two, Evolution (French) and CEMSA (Spanish).

335.For example one chain which appeared repeatedly was:

Kom Team
Alleged Contra
Stardex
Grange Computers
Notebook Express or Nex Trading
Evolution or CEMSA

336.This chain appeared in respect of trades made by all 5 of the alleged Contras. We find Kom Team and Evolution did not have a real business establishment and did not produce documentary evidence of their intra-community transactions.

337.We find that comparing the price charged by Kom Team to one of the five alleged contras and assuming that Kom Team could have sold direct at that price to Evolution (also in France) or to CEMSA (over the border in Spain), purchasing the goods via chains of companies in the UK as they actually did in practice cost Evolution and CEMSA an extra £7.5million. We find the chains made absolutely no commercial sense whatsoever.

338.This evidence (which we also accept) shows that in May-June 2006 each purchase from a certain 9 of the brokers was always sold to a Latvian company called Vundera SIA (a company which has no business establishment in Latvia) and this company's only suppliers were Evolution and CEMSA.

339.A-Z was involved in a second pattern of trading involving some companies in the first pattern mentioned above but also different companies. These transactions chains similarly involved repeat patterns. There were 10 EU suppliers, 6 UK acquirers (including A-Z), 5 UK buffers (including A-Z), 23 brokers and 11 EU customers. Nine of the 10 EU suppliers are also EU customers, although the same EU supplier was never the same EU customer with respect to the same goods.

340.For all the deals which involved A-Z in May 2006 the EU customers paid £2.4million more than if they had bought the goods direct from the EU suppliers. We can find no rationale commercial explanation for why the EU customers bought from UK brokers when they could have bought from a Continental company at a much cheaper price.

341.It seems that April- July 2006 A-Z only entered into 15 other transactions (i.e. apart from its transactions within the 2 patterns described above). In these transactions it bought from Modular BV and sold to Worldwide Distribution NW, who sold to Zonna GmbH.

342.A-Zs customers in its broker chains were not retail businesses. They were virtually all newly registered businesses and where there is evidence, it seems none had storage facilities nor more than one or two employees (despite the high value of goods dealt in). Nearly all companies appeared to have no business activities in the country of their registration and their only "activity" was to be an acquirer of goods which were immediately sold on. Where there is evidence of their returns it appears the companies either did not declare the acquisitions on their domestic VAT return or entirely offset them with despatches. In respect of one major customer, we find circularity in that goods purchased in a chain involving A-Z were sold back to the companies from which they originated.

343. In VAT period 05/06 A-Z's VAT return showed it owed approximately £58,000 in VAT. However it also showed that it had outputs of £32,065,332 and inputs of £32,006,562 (leaving the net of £58,000). In VAT period 08/06 its VAT return showed it owed approximately £24,000 to HMRC. Its output tax was £11,119,595 and its input tax was £11,095,436 (the difference being approximately £24,000).

344.In VAT period 11/06 it claimed a VAT repayment of approximately £171,000. Its output tax was stated to be approximately £1.283m and its input tax was approximately £1.455 million. Its EC supplies were £8,158,385 and its EC acquisitions were £8,114,059. This period looks to be different but in January 2007 Mr Ahmed explained to HMRC officer that in November a deal from August 2006 had been cancelled leading to higher than expected input tax. Had it not been for this, the 11/06 return would have shown a liability of £64,000. No paperwork was ever produced evidencing this cancellation or a return of the stock.

345.In so far as HMRC has been able to trace back A-Z's broker chains they have, we find, all traced back to a defaulting, missing or hijacked trader. But the data for October and November 2006 was incomplete so most of A-Z's chains in this period cannot be traced.

346.In May 2007 Mr Ahmed informed HMRC that the company was owed some £115million and owed some £113million. There was no evidence that the company did anything to collect debts owing to it nor of action taken against A-Z to collect debts it owed. The company was liquidated in 2007 and its creditors listed by the liquidator are owed over £33million.

347.On 2 October 2009, Mr Ahmed entered into an undertaking under S1A of the Company Directors Disqualification Act 1986 that he would be disqualified from being a director of any company for 12 years. The schedule of unfit conduct to this undertaking was that Mr Ahmed had caused A-Z to engage in trading that put HMRC at risk of MTIC fraud, that, if he did not so know, then he was reckless or grossly negligent as to whether A-Z was involved in such a fraud. In particular, despite knowing the risks of MTIC fraud, he caused the company to enter into trades worth over £25million without sufficient due diligence and put HMRC at risk. He submitted unjustified VAT reclaims for the period 11/06 and 02/07.

348.We find from the cumulative weight of evidence that we have no doubt that A-Z acted as a contra trader throughout 2006 and that all of its trades were orchestrated for the purpose of MTIC fraud. In particular its "clean" chains (involving Earthshine amongst many others) were intended to offset its "dirty" chains which started with a VAT default. It is also clear that the director of A-Z was well aware of this as he made no attempt to run a genuine business despite being well aware of MTIC fraud.

349.It seems HMRC were suspicious of A-Z as early as May 2006 but did not take any action against it (except in respect of its failure to make intrastat returns). HMRC's explanation of its regrettable failure to take effective action was that A-Z was not seen as a priority as it was not making reclaims of input VAT but (on the contrary) filing VAT returns showing relatively small amounts of VAT owing.

Alleged defaulter - Nationwide

350.Two of A-Z's broker deals (ie alleged dirty chains) in November 2006 have been traced back to a defaulter (Nationwide Services Limited). The evidence on Nationwide was given by Tracey Beard and we find as follows.

351.Nationwide was VAT registered in late 2004 with its stated business of bookkeeping. For 5 of the 8 VAT quarters in the next 2 years it submitted VAT returns and has unpaid assessments in relation to the remaining 3 quarters (in particular 08/06 and 11/06 were never returned or paid). It seems sometime around October 2006 the existing director and shareholder Mr Field, appointed a new director, Mr Lahmadi, with a view to diversifying into mobile phone contracts.

352.Mr Field originally admitted the company had received post related to the inspection and release of goods to SPF Freight Limited and that Mr Lahmadi said he

had undertaken a large number of deals in wholesale mobile phones. He later disavowed all knowledge of the mobile phone part of the business run by Mr Lahmadi.

353.By March 2007 HMRC had raised three assessments on the company totalling over £7million, and according to Miss Beard's evidence these assessments related to sales by Nationwide to Churchill and Bluestar in October and November 2006. No copies of the invoices were produced to the Tribunal, nor indeed was any other primary evidence of supplies made by Nationwide.

354.However, we take into account that Nationwide has not contested the assessments. Further, there were numerous letters written by HMRC to persons thought to be connected to Nationwide. One written on 6 July 2007 got a reply purporting to be from Mr Lahmadi. Mr Lahmadi had no other contact with HMRC. In this letter Mr Lahmadi (or the writer) replies to HMRC's request for all invoices re wholesale sales by Nationwide in periods 11/06 and 02/07 saying that they cannot be provided due to a burglary at the premises. It seems to us more likely than not that the reply was sent by Mr Lahmadi or someone else connected with Nationwide as HMRC's letter was written to that company at one of its addresses and no one else would have an interest in replying. The letter says that the requested invoices cannot be produced: it admits that they existed.

355.We also take into account Miss Beard's hearsay account of Mr Field's account of how Mr Lahmadi joined the company and then behaved in relation to backdated invoices (to make a fraudulent insurance claim). We accept this account in so far as it shows Mr Lahmadi had no interest in Mr Field's bookkeeping business but carried on the new mobile phone/electronics side of the business with Nationwide's name and address. We recognise Mr Field may not have been wholly truthful with Miss Beard, but consider that that part at least of the story is consistent with what other evidence we have. Mr Field may well have understated his own role in the affair but that is not relevant. If Mr Lahmadi's electronics business had been genuine, Mr Lahmadi would have set up a new business on his own: his decision to adopt an existing VAT registered but unrelated business indicates (and we find) that he wanted VAT registration without having to apply for it in his own name.

356.We find Nationwide did not return the VAT on the supplies HMRC alleged it made, but there very little primary evidence it made the alleged supplies. Fraud is most likely to be shown where invoices are issued charging VAT which has not subsequently been returned on a VAT return. We take into account what evidence we have, and although it is rather thin, we find that on balance it is more likely than not that Nationwide was a company which made (or purported to make) substantial wholesale sales of electronic equipment. Further we find that it issued VAT invoices in respect of such sales because there is evidence it did issue invoices, did not appeal the assessments, and as the most likely purpose of Mr Lahmadi's involvement with Nationwide was to obtain its VAT registration, we infer he used it. As the company made no returns of such liability, it was acting fraudulently at least in the period to 11/06 and 02/07.

357. However, there is little evidence about the alleged defaulter on the other 7 of A-Z's broker deals in its quarter to November 2006.

358. We find that it is clear that A-Z's pattern of trading was wholly fraudulent and that A-Z's purpose was to act as a contra-trader to hide the missing VAT taken by a defaulting trader. Its chains were clearly orchestrated for the purpose of MTIC fraud.

359. Whether the "clean" chains with which Earthshine is connected were used to off-set A-Z's broker deals with Nationwide as the defaulter, or another company which HMRC has not been able to trace, makes no difference to our finding that the clean chains were connected to fraudulent tax loss.

360. We have found that Earthshine's last 3 purchase and sales in this appeal were connected to A-Z Mobile's sales to New Order as set out above. Therefore, as explained by Lewison J in *Livewire* (see paragraph 67 above) Earthshine's transactions are connected to fraudulent tax loss because they are connected to the dishonest cover-up of the fraud by the contra-trader.

361. Further, we have also found that its last 3 purchases and sales in this appeal were connected to the fraud of either Nationwide or an unidentified defaulter as explained in the last but one paragraph. Therefore, as explained by Lewison J in *Livewire* (see paragraph 67 above) Earthshine's transactions are also connected to the fraudulent tax loss caused by the unidentified defaulter. Earthshine's purchases are also connected to its sales to Sunico, whose involvement we have found to be fraudulent: see paragraph 238.

362. That concludes the first part of this decision notice: we have found HMRC's allegation that all 7 of Earthshine's purchases were connected to fraudulent loss of tax proved.

Knowledge and means of knowledge

363.The remaining question for the Tribunal is Earthshine's knowledge or means of knowledge. Earthshine is a legal creation: its knowledge is the knowledge of any one of its directors or principal officers. When considering its state of knowledge we consider the knowledge of either or both of its directors, Mr Sharp and Mr Knatchbull.

364.Mr Green's case was that HMRC's conduct was very relevant to the question of Earthshine's knowledge and means of knowledge and we first consider this.

365.We go on to consider the reliability of the witnesses and to what extent the Tribunal should accept what they say.

366.We then go on to consider what Earthshine knew in general about MTIC fraud and then what it knew in particular about the deals at issue in this appeal.

HMRC's conduct

367.Mr Sharp and the other witnesses for Earthshine regard HMRC as being very seriously at fault and their allegations and our conclusions on them in summary are:

- It was for HMRC to given Earthshine effective warnings to prevent them making trades connected to fraud. It was for HMRC to carry out line checks in real time to identify a fraudster at the top of the chain. In Mr Sharp's stated view and Mr Green's submission, HMRC could have stopped MTIC fraud in its tracks by carrying out real time line checks.

  We deal with this in paragraphs 451-472.

- HMRC's action in withholding VAT (which was in effect Earthshine's working capital) has put Earthshine out of business.

  This is of course the subject of the appeal: whether HMRC was right to withhold the VAT. If we find they were, Earthshine has no complaint.

- HMRC had a deliberate policy of targeting exporters which was (they say) a disproportionate response to combat MTIC fraud. They should (say Earthshine) have targeted the defaulters.

  We cannot agree that this, even if true, is relevant to this Tribunal. If Earthshine is rightly denied its input tax under *Kittel*, it cannot claim to be nevertheless entitled merely because for policy reasons HMRC have chosen not to assess another company. Complaints about HMRC's policy must be made to the High Court by way of judicial review: this Tribunal has no jurisdiction.

  (We do not agree it is true either: it is HMRC's duty to verify input tax reclaims. It is also their duty to assess and pursue for payment persons who owe VAT to the State: but in exercising that duty they have to weigh the likelihood of the costs of pursuing defaulters against the likely return. With

chains orchestrated for the purposes of fraud, as HMRC allege these to be and as we have found them to be, the defaulters and buffers are almost certainly "men of straw": the money will have long since disappeared.)

- Earthshine allege HMRC took an unreasonable length of time to make the decision to withhold Earthshine's VAT and complain that Mr Kendrick did not even ask for copies of Earthshine's due diligence until well over a year after the transactions in issue and did not make a decision on Earthshine's refund until threatened with judicial review.

  Judicial review of HMRC's decision making process is outside the jurisdiction of this tribunal. In any event, HMRC's actions after the input tax was incurred tells this Tribunal nothing about whether or not at the time Earthshine knew or ought to have known its transactions were connected with fraud and is therefore irrelevant to this appeal.

- Earthshine says HMRC had a deliberate policy of disrupting the mobile phone trade and delaying repayments to traders such as Earthshine.

  We consider this in paragraph 419 but in brief Earthshine produced no evidence of this and it is not relevant to the question of whether Earthshine knew or ought to have known of the connection to fraud.

- They say total chaos at HMRC's Redhill office made it impossible for Earthshine to conduct effective due diligence.

  We deal with this allegation in paragraph 475-476.

- Mr Kendrick did not consider all the factors that ought to have been considered when reaching his decision and HMRC's understanding of the law both when the decision to deny the input tax was taken and at the opening of the original hearing in January 2010 was wrong.

  This is irrelevant. This Tribunal has original jurisdiction and we are not conducting a review of whether Mr Kendrick reached the right decision for the right reasons. We are simply deciding whether or not it was the right decision.

  Mr Green might well be correct to say that HMRC's case on the applicable law has evolved since the original decision to deny was taken but again it is irrelevant. The Tribunal has original jurisdiction and we apply the law as this Tribunal understands it be as explained by the Court of Appeal in *Mobilx*.

368. The question for the Tribunal is whether Earthshine's seven transactions in issue were connected to fraudulent tax loss (we have found they were) and then whether Earthshine knew or ought to have known this. HMRC's conduct is not immediately relevant to this question. Mr Green says it is relevant to:

- To assess the honesty of HMRC witnesses;

- To assess value of HMRC witness' opinions;

- To understand the situation Earthshine was in before drawing inferences on their behaviour and in particular their frustration with HMRC's conduct;

- Fair allocation of risk between Earthshine and HMRC as per *Teleos* [2005] EWCA Civ 200.

369. The Tribunal considers that HMRC's conduct is not directly relevant to the test as set out in *Kittel* and *Mobilx* and as summarised by us at paragraphs 39-41 above. We agree that it may have relevance, particularly to the question of means of knowledge, if HMRC's conduct in some relevant way misled the Appellant (and we deal with this point below in paragraph 489). We agree that HMRC's witnesses' evidence in its entirety must be considered when assessing its honesty. We deal with the extent to which Earthshine's frustration with HMRC is relevant to this appeal in paragraph 480 and conclude that it is not.

370. But in the main, HMRC's conduct is not relevant to the question of knowledge. As Mr Green was reminded on a number of occasions, this Tribunal does not have a judicial review function nor was this appeal a judicial review of HMRC's actions. Further, it is not open to Mr Green to allege that the decision in *Kittel*, which this Tribunal is applying, is in some way a breach of Earthshine's rights under the Sixth VAT Directive as set out in *Teleos*. As pointed out by the Court of Appeal in *Mobilx*, *Kittel* is a decision of the CJEU and must be taken as compliant with the Sixth VAT Directive.

Allegation of malfeasance by HMRC

371. Although it was not put to any HMRC witness, in closing Mr Green alleged that HMRC had an unlawful policy of permitting MTIC fraud to take place. The only evidence he cited of this was that (he said) HMRC chose to allow A-Z to continue trading for many months despite being suspicious of them. The only reason he put forward why HMRC would do this was because he said it was profitable to them. His argument was that if the fraud did not take place, HMRC would get to avoid losing the VAT run off with by the missing trader. But if the fraud did take place, HMRC could withhold the broker's input tax claim which (because of the series of intermediate deals at increasing prices) would be greater than the VAT stolen by the missing trader.

372. We would agree that if HMRC chose to act in this fashion it would be unlawful and might have an impact on HMRC's entitlement to withhold input tax (although no submissions on this were made to us). But Mr Green's allegation of malfeasance does not even get off the ground: it was not put to any of the HMRC officers. Nor is there any evidence of it.

373. There is evidence that A-Z traded and that at the time an HMRC officer was suspicious of the company's bona fides. But there is no evidence whatsoever in front of the Tribunal that A-Z was 'permitted' to trade by HMRC. Even if it could be said (and we do not see how) that A-Z was 'permitted' to trade by HMRC, there was no

evidence this was a result of a deliberate policy decision not to take action against them, and no evidence that such a decision would be financially advantageous to HMRC.

374. Indeed, such a suggestion appears strange to the Tribunal. We accept Mr Stone's evidence, as indeed it is a matter of public knowledge, that the UK Government has lost billions to MTIC fraud. HMRC are hardly likely to have chosen to permit the fraud to take place in the belief it was lucrative to the Government. It clearly wasn't.

375. Mr Green also suggested HMRC acted unlawfully by forcing (by unspecified means) banks to close the accounts of businesses involved in mobile phone wholesaling, including Earthshine's. We find no evidence of this: all Mr Sharp could say is that Earthshine's accounts were closed and the banks refused to tell Earthshine why.

376. Mr Stone's evidence, which we accept as it was credible, was that he believed banks decided to close the accounts of mobile phone traders (and not to tell the traders' why) because of information given to them about MTIC fraud by HMRC. In particular, banks were concerned that if they left the accounts open they would have to complete SARs (suspicious activity reports) for every transaction which took place on the accounts. This is because banks have legal obligations to report activities which might be connected with fraud and money laundering. Further, they are legally obligated not to "tip off" the account holders which would explain why the banks would not tell the traders what the reason was for closing their accounts.

377. The allegations of malfeasance appear to us entirely unfounded and we consider them no further.

Mr Stone's evidence

378. Mr Stone is a senior HMRC officer who was involved in the management and implementation of HMRC's policies for combating MTIC fraud. The reliability of his evidence was of particular importance to the Tribunal in February 2010 when taking the decision to admit late evidence lost and then re-discovered by Mr Stone.

379. Apart from this, his evidence, despite his long witness statement, was of limited relevance. He met and corresponded with Mr Sharp on a number of occasions and exactly what was said at their meeting on 5 July 2004 was in issue because the question was whether Mr Sharp's evidence was reliable and we make our findings on this in paragraphs 388-390 below.

380. Mr Stone also gave evidence on the fall-off of mobile phone trades to which we have referred to in paragraphs 189-192 above and which was the basis of a submission (which we dismissed) by the Appellant that their trades were not connected to fraud as fraud had much diminished by the time their deals took place.

381. The Appellant submits that Mr Stone's evidence was unreliable and that his witness statement was substantially partial, untrue, incomplete or misleading. This is

not the view of the Tribunal. We found him to be a reliable witness who gave consistent and rational evidence and we explain this below.

382.Mr Green put to him that it was misleading (although true) to state in his witness statement that "Sunico were named as participants in transactions tainted by MTIC fraud" in *Aircall Export Ltd* [2005] UKVAT V19185 because he did not also mention the Tribunal in *Aircall* had exonerated Sunico from *knowing* involvement. We do not consider it was misleading: the statement was true and in context the significance was the involvement in fraud rather than knowing involvement in fraud. In any event, Mr Stone also mentioned the findings of the tribunal in *Dragon Futures Ltd* [2005] UKVAT V19186 and that Tribunal did not exonerate Sunico so overall we do not consider the statement unfair.

383.Mr Stone is criticised as being less than fair for not mentioning to the police Mr Sharp's letter of 28 May 2004 in which he states he is employing Mr Young. But this seems reasonable: the use of the police databases by Mr Young was mentioned orally by Mr Sharp, not in the letter, and it was that oral statement that Mr Stone was reporting to the police.

384.Mr Green submitted in his closing that in answers to his cross examination, Mr Stone retracted much of what he said in his witness statement about typical features of MTIC fraud and agreed that Earthshine's pattern of trading was indicative of genuine commercial trading. The Tribunal does not agree. We find Mr Stone gave considered answers in cross examination consistent with his witness statement and consistent with the Tribunal's members' understanding of MTIC fraud.

385.Mr Stone was questioned at length on an alleged policy of targeting exporters. We found his answers reasonable, and described a rational policy of vetting input tax reclaims. He was questioned at length on line checks and we found his answers reasonable and described a rational policy of why after 2003 HMRC could not and did not line check every deal chain.

386.In cross examination, Mr Stone said he did not know that Denmark was carrying out effective line checks. Mr Green then points out that in a letter from Mr Sharp dated May 2004, Mr Sharp had said to Mr Stone he had heard line checks were a success in Denmark. We see no reason why Mr Stone would have remembered a comment in single line in a 4-page letter some 6 years later and his failure to recall it does not affect the credibility of his evidence. Nor do we consider his failure to respond to the comment in 2004 of any significance: HMRC had already taken the decision that line checks could not be done and were counter-productive and Mr Stone's evidence was that he was in regular contact with his counterparts in the Danish tax authority and knew what measures they were taking to combat fraud. Mr Sharp's comment was merely repeating what someone had said to him: it was not backed up in any way and in the circumstances we do not find it surprising Mr Stone neither acted on it at the time nor recalled it six years later.

387.We agree with Mr Green that Mr Stone (as he himself admits) considers that Earthshine was knowingly involved in fraud and was suspicious of them even before

HMRC denied them the input tax the subject of this appeal. We take this into account in assessing his evidence.

388.The Appellant's case is that Mr Stone was not truthful in saying that Mr Sharp had told Mr Stone at their meeting on 5 July 2004 that he employed a private investigator who looked at police and HM Customs & Excise databases. Mr Sharp's story is that he only mentioned government databases and meant publically available government databases. Mr Green points out that Mr Kendrick's note of that part of the meeting was actually compiled after the meeting finished. Mr Kendrick agreed it was completed after the meeting but within half an hour of its end.

389.Whose version of the story is right? After the meeting Mr Stone contacted the police and reported the conversation. The police investigated Mr Young who was found to be a serving police officer and he was later convicted of offences such as unlawful bugging, carried out as part of his off-duty private investigations. As a result of the police investigation the email chain the subject of our earlier decision came into the hands of Mr Stone. This email chain shows exchanges between Mr Sharp and Mr Young in which Mr Sharp was asking Mr Young to check police databases.

390.We conclude that Mr Stone and Mr Kendrick were telling the truth. If Mr Sharp's version was correct it would mean that Mr Stone rather remarkably correctly guessed and was prepared to report to the police both that Mr Young used police databases in his business as a private investigator and that Mr Sharp knew of his use of them. This is so unlikely that the only explanation can be that Mr Stone *knew* because Mr Sharp had told him of Mr Young's use of police databases.

391.It was put to Mr Stone that he lied when he said there was no HMRC policy document over the decision to conduct extended verification on all repayment claims from March 2006 onwards. It was put to him that this must be untruthful because it was a major policy shift and would have involved drafting in more officers. Our understanding was that Mr Stone said that the movement of personnel might have been put in writing but the decision to increase the extended verifications to all repayment claims was not, so far as he knew (and it was not his decision), put in writing. His explanation is that it was not a shift in policy so much as an extension of an existing policy.

392.We find it surprising that even mere extensions of existing policy are not formalised in writing but that does not mean that it is not true. We bear in mind that his answers to all other questions seemed reasonable and that we find he was telling the truth about what Mr Sharp said at the meeting on 5 July 2004 (see above). We conclude that Mr Stone was truthful on this matter too.

Mr Kendrick

393.Mr Kendrick is an officer of HMRC. He had responsibility for Earthshine's VAT relationship with HMRC and took the decision to deny Earthshine's VAT reclaim.

He gave the main witness statement for HMRC dealing with HMRC's extended verification of Earthshine's claim, the denial of the input tax and the evidence of the alleged deal chains.

394.The Appellant was very critical of his evidence: it said he lacked candour and did not give simple yes or no answers. We do not agree: we found Mr Kendrick to be a good and reliable witness.

395.The Appellant said that Mr Kendrick was biased and in particular would not acknowledge evidence that (in its opinion) tended to show that Earthshine did not know of the fraud. We find that it was Mr Kendrick's opinion that Earthshine did know of the fraud: indeed that was the basis of his decision to deny the input tax which decision is the subject of this appeal. Therefore evidence which might show Earthshine's unawareness of the fraud was regarded by Mr Kendrick as mere window dressing. This means he was 'biased' in the sense of having an opinion: it does not mean he was unreliable as a witness.

396.Of course, his opinion (other than in assessing his veracity as a witness) was of no interest to the Tribunal. The Tribunal makes its own assessment of the primary evidence and does not put any weight on the opinion of witnesses of fact.

397.It is also the case that Mr Kendrick was far from being a central witness in this case at least in so far as knowledge and means of knowledge is concerned. The question is what Earthshine knew and did in 2006. Mr Kendrick was not there (apart from attending a few meetings with Earthshine) and otherwise is only speaking to the documents produced in exhibits.

Mr Sharp

398.Mr Sharp is an experienced businessman. He had with others set up and floated a very successful company and been involved in numerous other business ventures.

399.We did not find Mr Sharp to be a satisfactory witness. He used cross-examination as a platform to put across his opinions (that it was all the fault of HMRC), he gave incomplete answers or avoided giving straight answers. As an example, it took several minutes of cross examination before he was finally prepared to admit that he knew HMRC would not carry out line checks despite it being obvious that in 2006 Earthshine traded without waiting for a line check from HMRC. He gave evasive and sometimes obtuse answers. As an example of this, when asked why Earthshine did not ask if its suppliers made third party payments, he said that Earthshine did not make them. He eventually agreed Earthshine did not ask about third party payments and that it might have been a good question to ask. He was asked why Earthshine did not do credit checks. His reply was that it was not sufficient due diligence to just do credit checks which we find was not an answer to the question. Sometimes Mr Sharp would not answer the question at all (eg whether he would have expected an inspection report to cover chargers).

400.We find Mr Sharp tended to develop his evidence. Originally his position was that HMRC could do line checks, next he said he thought they could do it in real time,

next he said he thought they could do it in a matter of minutes, and next that he thought they did it on every occasion. We do not think he believed this.

401.We did not find his evidence on chargers reliable either. When challenged to explain why some inspection reports recorded 2 pin chargers and others 3 pin chargers, his explanation was that he believed they were adaptable chargers able to be plugged into either 2 pin or 3 pin plugs. We accept Mr Fletcher's evidence that Nokia never produced such chargers and, more importantly, the deal documentation and inspection reports make no reference to such adaptability. We do not think Mr Sharp's evidence that he believed that he was trading in phones with adaptable 2/3 pin chargers was reliable.

The email chain

402.In his witness statement Mr Sharp says that he met Mr Young (aka Mr Black), a private investigator, in 2005. In evidence in chief he corrected this and says it was a mistake and he actually decided to employ a private investigator following his conversations with Mr Stone in mid-2004 in order to avoid being caught up unwittingly in MTIC fraud.

403.The email chain shows that he first met and used the services of Mr Young in late 2003.

404.Mr Green says Mr Sharp should not be criticised for getting the date wrong. Ordinarily we would agree: it is easy to make mistakes on dates. We do think, however, having decided that his witness statement was wrong, Mr Sharp should have been on notice to get it right and not give the Tribunal a second, incorrect date.

405.More importantly, we do not think Mr Sharp would have forgotten why he first contacted Mr Young. He told the Tribunal it was in response to Mr Stone's warnings in mid-2004 about fraud in the market. However, we find he had not forgotten his first contact was actually 6 months earlier and that (from the evidence of the email chain) the reason was that he wished Mr Young to conduct a background check on Mr Sharp's then business partner Mr Buxton and for Mr Young to use his "source" at HMRC to find out about HMRC's view of Earthshine and Earthshine's repayment claims.

406. The email chain shows quite a close relationship developed between the two men even to the extent of inviting Mr Young to Earthshine's charity events and discussing in some detail a possible joint business venture. The email chain shows that the main thrust of the initial work for Earthshine was to investigate Customs' attitude to Earthshine's VAT reclaims. Further, Mr Sharp was later arrested and questioned (but not charged) over Mr Young's activities. We do not think Mr Sharp would have forgotten much about his relationship with Mr Young, even if hazy on exact dates.

407.So we find Mr Sharp was untruthful in his oral evidence given in January 2010 about his relationship with Mr Young and the reason why he was employed by Earthshine. Mr Sharp misinformed the Tribunal about the origins of Earthshine's

associations with Mr Young and that his reasons for misleading the Tribunal were self-evidently from the email chain that Mr Young was originally employed to do illegal investigations.

408.Mr Sharp's evidence was also untruthful when he said that Mr Young revealed that he has used a false name (Mr Black) *before* Earthshine first instructed him. It was clear from Mr Sharp's and Mr Knatchbull's evidence that they first knew about the false name in 2005 whereas Mr Sharp had employed Mr Young's services from 2003.

409.Did Mr Sharp know at the time that Mr Young's activities on behalf of Earthshine were unlawful? It was Mr Sharp's evidence that he had not at the time appreciated that Mr Young's activities were unlawful. Mr Green pointed out that not only did Mr Sharp tell Mr Stone in June 2004 about Mr Young's use of government databases, he had also mentioned it in an earlier letter to Mr Stone which mentioned "criminal checks" and "databases of various UK government agencies". Mr Green's case is that Mr Sharp would not have done this if he had understood that Mr Young's activities were unlawful.

410.Mr Sharp said in evidence given at the hearing in June 2010 that he did not think Mr Young would be searching an electronic database and that he thought only "home office" records would be searched. We find this oral evidence was internally inconsistent and contradicted the email chain in which it was clear he asked Mr Young to search *police* databases.

411.Although the email exchange shows Mr Young offered to search "bank accounts, civil disputes, employee records, business interests, criminal history, associates, medical status, et cetera, just about anything" Mr Sharp said he had no interest in medical records and believed that the reference to bank accounts merely meant that Mr Young would ask someone to supply their own bank statements. We did not find this explanation credible (and note it was clear in respect of a company called Evolution that Mr Sharp was asking for information on bank accounts that was not being obtained direct from the company).

412.We also note that in an email of 14 May 2005 Mr Sharp asked for Mr Young to do two reports – the first written and the second oral "for additional colour". We also note that Mr Sharp was prepared to continue to employ Mr Young even after he admitted that he had used a false name at the start of their relationship.

413.Our conclusion is that Mr Sharp was aware at the time that some of the information obtained by Mr Young was obtained unlawfully because it was self-evidently so and because of the tone of the emails. We note that he did mention it to Mr Stone (see paragraphs 388-390 above), which we accept a person would be unlikely to do if they realised it was unlawful. Nevertheless, we think it the case that sometimes people get carried away and say more than they mean to say and overall taking all the evidence into account we consider it clear that Mr Sharp knew Mr Young's activities were in part unlawful. We note that the letter written to Mr Stone at the same time was more circumspect than the conversation with Mr Stone.

414. Mr Sharp went on to ask Mr Young to investigate HMRC's attitude to Earthshine and its refunds:

> "…As we discussed please start our business together by enquiring with your contacts at HMC&E how they feel about Earthshine and the business we are conducting. If you glean as much information as you can into what HMC&E feel about our supply chains that would be useful. If during the course of your conversation with your contact you unearth, which I doubt, something alarming – would you try to uncover more information?"

415. In the hearing, Mr Sharp claimed he thought Mr Young's contact at HMRC was an ex-employee of the department. However, his email refers to "contacts at HMC&E" and a further an email written on 4 May 2005 from Mr Sharp to Mr Black asked for information on a company called Evolution and said:

> "I was wondering whether you had heard anything from your friend in the know?!"

Our conclusion is that it was clear that at the time of the email exchange Mr Sharp thought Mr Young's contact was a current member of the HMRC and his evidence to the contrary at the hearing in June 2010 was not reliable.

416. An email written by Mr Sharp to Mr Black on 10 March 2004 said as followed:

> "The issues I wanted you to research were as follows:
>
> 1. VAT reclaims
>
> Earthshine reclaims VAT on goods that it buys in the UK and exports t our overseas customers…..
>
> My question is: HMC&E have reclaim thresholds at which point certain action takes place. For example reclaims made under £100K require no action other than repayment. When it gets to to 250K they sent the reclaim to level checking. When it goes over £1M it goes to head office and Mr Bigwig (who's he?) look it over. What are the thresholds and what is the action taken by HMC&E?
>
> 2. Joint & Several liability
>
> What is the HMC&E view of this judgment and what future actions are they taking?
>
> 3. Mobile phone trading – the future?
>
> What is the HMC&E view of the mobile phone industry – has it changed? And are there any new measure planned for the industry in the forthcoming budget (due in 10 days)"

417. Mr Sharp told the Tribunal he thought he was entitled to information about HMRC's thresholds for verifying VAT reclaims because HMRC treated Earthshine very badly because they stalled his repayments and didn't reply to his correspondence. We do not accept that he truthfully thought that this, even if true, entitled him to such confidential information: such a proposition is absurd, and in any

event he knew he was obtaining the information in an underhand fashion so he clearly knew he had no lawful entitlement to it.

418. He also claims he thought Mr Young's contact at HMRC was entitled to give him this information as the contact was acting as a whistleblower exposing HMRC's unlawful conduct. Yet Mr Young's contact did not go public and only on one occasion did Mr Sharp ask for information aimed at exposing unlawful conduct :

> "thanks for that update – it was brief but useful! What I was hoping for was whether he could find some sort of actual evidence that throws light onto the HMC&E policy of "unofficial disruption" of the mobile phone industry. There must be some sort of internal memo that has been sent around? Can your guy get me copies of this type of document? Of course this would be of (sic) record and I would have no idea how I came by it."

419.However, it seems the contact did not provide any such evidence and we the Tribunal have not been presented with any such evidence. All Mr Sharp could point to were delays by HMRC and lost post which were more likely explained by inefficiency and low staff levels. In so far as HMRC withheld input tax pending verification, they are entitled to do so. On one occasion Mr Young's contact reported that Earthshine's input tax repayment was delayed because of officers being childishly annoyed at being chased and on another occasion because Mr Stone was on holiday. However, this is not evidence of a *policy* of disruption and his contact on other occasions put the delays down to "a serious backlog and a postal problem" and HMRC's "inability to organise a piss up in a brewery".

420.In conclusion, we do not accept that Mr Sharp thought Mr Young's contact was acting lawfully as a whistleblower. The point of whistleblowing is going public and exposing unlawful conduct. We find that Mr Sharp knew at the time he was not lawfully entitled to the information about thresholds for repayment claims.

421.In summary, the email chain shows that Mr Sharp was an untruthful witness who was prepared to gather information to which he knew he was not entitled through means he knew were unlawful. The chain shows that some of the evidence he gave to the Tribunal in January 2010 was untruthful and we find in June 2010 he continued to be untruthful in many of the explanations he gave about the email exchange in order to explain away what could not be explained away. Quite, apart from the email chain, we were in any event dissatisfied with the reliability of his evidence as explained at various points in this decision notice and we conclude he was a wholly unreliable witness and we treat all his evidence with some scepticism.

Mr Agoh

422.Mr Agoh is a management accountant by training. He was company secretary of Earthshine. He was responsible for implementing the due diligence procedures and putting together the paperwork on deals. He checked suppliers' and customers' VAT registrations before a deal was completed. On occasions he carried out due diligence visits (eg to Sunico in March 2006). He has known Mr Sharp since 1991 and has worked with Mr Sharp as his boss in another company.

423.We found Mr Agoh to be a poor witness. He was often vague in his answers and frequently asked for simple questions to be repeated and often said he did not understand the question. He took illogical positions, for instance he insisted that it was possible for members of the public to find out the specification of a phone from an IMEI number but could not explain why he could not do this.

424.He agrees he knew about the risks of MTIC fraud and had read Notice 726. He says he could not remember if it was discussed with Mr Sharp, yet it is obvious that VAT verification (eg due diligence and inspections) were undertaken by Earthshine and the reason for this must have been discussed by Mr Sharp and Mr Agoh.

425.Mr Agoh completed a trade application form on behalf of Earthshine given to them by LMC (a supplier). One question on the form was whether Earthshine had ever purchased goods from a person who was a supplier in a chain which involved a defaulter. Mr Agoh gave the answer "no". This was not right as at the time Earthshine had already been notified of defaulters found in chains to which it was a party.

426.Mr Agoh insists his answer was true. He suggests that he had misunderstood the question as his English is not good. He suggested he thought the question meant whether Earthshine had *knowingly* traded in a fraudulent supply chain. We think he knew at the time the answer was not true: his English is clearly good and the question is quite clear.

427. He wrote a letter to Mr Kendrick in November 2006 saying that Earthshine had no outstanding loans. This was not true as Mr Knatchbull had loaned money to the company. Mr Agoh agrees he knew this but says he did not think it counted as Mr Knatchbull was a director: he denies his answers were not scrupulous. We do not agree.

428.In conclusion we did not find Mr Agoh to be a reliable witness.

429.Three officers of HMRC attended Earthshine's offices in August 2006 to execute a search warrant. Mr Sharp and Mr Agoh claim that officer Karen Mustapha complimented Earthshine on quality of Earthshine's due diligence and told them that Earthshine could sell its due diligence procedure it was so good.

430.We had the evidence of the three officers concerned. They deny making this compliment. They point out that they attended to collect documents and not to carry out an inspection. Although they must have looked at documents to identify the nature of them, they were not looking at the content of them. They say they formed no view on them.

431.The evidence of HMRC's three witnesses was consistent and logical. We found both Mr Sharp and Mr Agoh to be unreliable witnesses for the reasons given above. On this basis we prefer the evidence of HMRC's officers and find that no such compliments were made.

Mr Knatchbull

432. Mr Knatchbull was a director of, and holds a 50% shareholding in, Earthshine. He joined Earthshine in 2005. He has invested or loaned Earthshine some half a million pounds. Mr Knatchbull's evidence is that he was, with Mr Sharp, jointly responsible for all decisions made by the company.

433. We did not find him a convincing witness. He was challenged on how UK 3 pin chargers could have been used on the Continent. He insists that they were travel adapters suitable for 2 or 3 pin plugs despite the inspection reports making no mention of this. We do not accept this evidence.

434. His evidence on IMEI numbers was unconvincing. It was put to him that it was obvious (as indeed it is) that lists of IMEI numbers are not generally available to the public but he would not accept this. He exhibited an email exchange with a Mr Andy Calpin who had a contact at Nokia who could identify the specification of the phone from its IMEI number. It was obvious to the Tribunal that an employee of Nokia might well be able to match an IMEI number to a phone specification because the manufacturer of the phone ought to keep these lists. It was also obvious to the Tribunal that the information was confidential to Nokia and that Mr Knatchbull knew this. He said:

> "I did discuss IMEI numbers, but he [Andy Calpin] was always nervous because….Nokia try to be quite secretive about what they are doing, and so he didn't want to be seen to letting his friend down at Nokia by revealing information that would support our case."

435. Mr Knatchbull nevertheless went on to contradict himself when the inconsistency in his evidence was pointed out to him:

> "…I think Andy is actually being overprotective I think --- of his friend. I think actually Nokia information is readily available for anyone who wants to get hold of it."

436. His evidence on why Earthshine did not ask about third party payments in its due diligence was also confused and contradictory.

437. In conclusion, we find that Mr Knatchbull was not a convincing nor reliable witness.

General knowledge of MTIC fraud

438. At the time how much did Earthshine (via its principal officers) know of the prevalence of MTIC fraud in the market and what steps they should take to avoid being caught up in it?

439. Mr Sharp agrees that he was well aware of fraud in the industry but considered there was a substantial amount of legitimate trade as well and said he thought with careful due diligence Earthshine could avoid being caught up in fraud.

440. When Mr Sharp bought a stake in Earthshine in 2002 he says he was warned by a management accountant that mobile phones were a difficult business. He also agrees

that he knew prior to his involvement, Earthshine had been issued with false CMRs. He said this did not concern him as he learnt from the experience how to avoid it in future. He discussed MTIC fraud with HMRC visiting officers from 2002 onwards. We find Earthshine was well aware of substantial fraud in the market.

441.In 2003 Earthshine had two negative Redhill verifications on proposed trades. In the same year, Mr Sharp was informed by HMRC that one of their deals had been traced to a hijacked trader. A £250,000 input tax claim was withheld for over 3 months and Earthshine instructed solicitors. Later in 2003 there were further delays in repayments due to HMRC's enquiries and the funds were eventually released on a without prejudice basis.

442.There were very many letters between Earthshine and HMRC on the subject of MTIC fraud. Mr Sharp was told on 22 May 2004 3 out of 5 deals for the period 07/03 had been shown to be fraudulent. Mr Sharp summarised the meeting in a letter to Mr Stone:

> "The facts as stated by you are that HMRC have ascertained that during 2003 that there were "missing traders" in three of the eight trades that we conducted. These resulted in a loss to the Treasury of approximately £300,000.
>
> You are of the view the industry is such that 98% of the profit in the industry is generated via missing or defaulting traders HMC&E are unable to be exact due to difficulty in verifying trades with traders who hinder HMRC enquiries."

443.There was a dispute whether Mr Stone was as precise as to specify 98% but there was no dispute that Mr Stone had indicated to Mr Sharp a very substantial proportion of the industry was in his view fraudulent.

444.Indeed Earthshine stopped trading for approximately 6 months at this point because of its concerns (whether its concerns were of the risk of fraud or the risk of not being repaid is a matter we consider later). It was Mr Sharp's case that Earthshine only recommenced trading because they became convinced that stricter due diligence procedures would protect them from fraud.

445.Indeed it is obvious to the Tribunal how very well aware Earthshine was of the risks because much of the time of the business was devoted to risk procedures such as inspection and due diligence. Whether this was done genuinely to protect the business from fraud (as Earthshine says) or was merely window dressing (as HMRC say) we address later.

446.In summary, there were numerous visits from HMRC and long letters to and from HMRC about the subject. The directors of Earthshine knew due diligence procedures were to protect it from MTIC fraud. Earthshine was so concerned (it said) that it stopped trading for an interval because of it. It knew that some of its deals had traced to MTIC fraud. It said it desisted from carrying out some trades because it suspected MTIC fraud. Our conclusion is that Earthshine was extremely well aware of the risks of MTIC fraud in wholesale mobile phone trading.

447. We go on to consider what Earthshine knew or ought to have known about the connection to fraud of the particular deals at issue in this appeal. It was the Appellant's case that it went to great lengths to ensure it was not involved in MTIC fraud and in particular:

- It cooperated with HMRC and followed its advice on how to avoid fraud;
- Rejected profitable deals if it had concerns about them;
- Undertook extensive due diligence to test the legitimacy of their suppliers and customers.

HMRC's case was that all of this was mere window dressing to give the appearance that Earthshine did not wish to be involved in MTIC fraud, and where they actually rejected a deal, it was because had they not done so they feared HMRC would have good cause to reject the input tax claim rather than because they were concerned about a connection to fraud.

448. We consider these three matters together with other issues raised by HMRC. We consider Earthshine's relationship with HMRC and to what extent that demonstrated a genuine desire to avoid fraud and to what extent if any HMRC's conduct led Earthshine to believe that its transactions were not connected to fraud.

Relationship with HMRC

Desire to cooperate with HMRC

449. It was part of the Appellant's case that it cooperated with HMRC and wished to help HMRC do its job of rooting out MTIC fraud. Its case is that it would not have done this if it was knowingly involved in the fraud. Earthshine was a signatory to the Memorandum of Understanding 2000-2002 which was intended to be lead to cooperation between mobile phone dealers and HMRC to root out fraud.

450. Many letters (as we have mentioned) passed between Earthshine and HMRC on the subject of MTIC. We find in Earthshine's letters a politely confrontational approach to HMRC. Further, in September 2006 Earthshine refused to give certain information to HMRC unless HMRC first agreed it would not be used to incriminate Earthshine. Our conclusion is that although Earthshine signed the Memoramdum of Understanding in the early years, its offered helpfulness to HMRC was a veneer over a confrontational approach. That whatever Mr Sharp said in his letters to HMRC, Earthshine's actual approach to HMRC was less than fully cooperative is apparent from the Sharp/Young email exchange. Earthshine's concern was to obtain its VAT refunds.

Line checks

451. The Tribunal heard a great deal of evidence about "line checks". Our understanding of what the various witnesses meant by line checks was that this would be a check carried out by HMRC officers in a short space of time back down a chain of supply. In other words, if Trader E informed HMRC it was buying goods from

Trader D, HMRC could ring up Trader D and enquire from whom Trader D was buying the goods. Assuming HMRC were able to contact Trader D, Trader D would inform them from whom it was buying goods (ie Trader C), and so on back down the chain to the importer (Trader A).

452. Armed with the chain of supply, HMRC could then check that all the traders (ie Traders D, C, B, A) in the chain were validly VAT registered and had not to HMRC's knowledge previously defaulted on their VAT liabilities. If one of the traders in the chain was using a hijacked a VAT number, this check should reveal this as HMRC would ring the registered telephone number and speak to the real owner of the VAT number.

453. HMRC could then, without breaching taxpayer confidentiality by revealing the identity of any of the traders in the chain, convey the information to Trader E that there was no known defaulter or hijacker in the chain. It was possible in some cases that a line check could be carried out in real time: in other words HMRC could check the chain on the day the deal was to take place.

454. A line check was superficially similar to extended verification which also involved HMRC checking the entirety of a chain back to the importer. Extended verification, however, did not rely on word-of-mouth via phone calls but on laboriously collecting all the paperwork from the traders after the event and ascertaining in so far as possible the true documented supply line for a batch of goods. It could take a very long time. A line check was much more than the normal Redhill verication of the validity of the VAT registration of a proposed trading partner.

455. Line checks were said to be relevant to this appeal for the following reasons:

- It was the Appellant's view that HMRC was at fault for failing to carry out line checks in 2006;

- It was HMRC's view that the Appellant's requests for HMRC to carry out line checks in 2006 were "window dressing" because the Appellant knew HMRC would not carry them out.

456. Our findings on line checks are as follows:

457. HMRC did attempt to carry out line checks in the early years. In 2003 a practice had developed by HMRC in some cases of using information provided by traders to carry out a line check and then notifying the traders in real time whether HMRC had identified a defaulting or hijacked trader in the supply chain.

458. In 2003 Earthshine would wait for the "all clear" on a line check before proceeding and on at least one occasion in 2003 (their invoice 72) did not go ahead with a deal because HMRC said that they were unable to clear one of the traders.

459. There are obvious limitations to line checks. In particular, line checks could not identify that the importer was going to default. The nature of MTIC fraud is that the importer only defaults *after* it has issued its VAT invoices and collects the VAT.

Indeed, it is the nature of MTIC fraud that the VAT registered-importer is a mere tool of the orchestrator of the fraud. Each time the importer defaults and goes missing with the VAT, the orchestrator has another importer (and soon-to-be defaulter) lined up ready to continue the fraud with the same set of buffers and brokers (whether knowing or unknowing).

460. Another limitation is that traders in the know about the fraud might not cooperate with HMRC and would attempt to block HMRC from discovering the true identity of the defaulter or other traders in the chain in order to protect their supply chain and broker from being connected to fraud (for reasons explained in paragraphs 35-36 and 211).

461. Another obvious defect is that line checks would not reveal a connection to a "dirty" chain in a contra-trade, although it is not clear to what extent anyone appreciated this in 2004.

462. We find HMRC were also concerned that where an HMRC officer gave an "all clear" on a chain (because it did not contain a known defaulter) that this would make it difficult to challenge the VAT input tax reclaim if it later turned out that the importer had fraudulently defaulted.

463. HMRC was also concerned that by giving traders a negative line check report (because they identified a hi-jack or defaulter), so far from stopping the fraud, it merely gave the orchestrators of the fraud a heads-up that it was now time to substitute a new defaulter at the top of the chain, and the fraud would simply be carried out with a new company (and soon to be defaulter) substituted at the start of the chain.

464. Another factor was that it was very resource intensive to carry out real time line checks and in reality very few chains could be checked in real time due to limited man power.

465. We find HMRC publically announced in mid-2004 that it would no longer carry out line checks and had never in fact carried them out for the benefit of traders. This was well publicised in the trade press and Earthshine's directors agree that they were aware of the policy change.

466. Mr Stone wrote to Mr Sharp at Earthshine on 3 June 2004 in which, we find, it was made very clear that HMRC would no longer carry out line checks.

467. Earthshine (via Mr Sharp) complains that it was given mixed messages on line checks by HMRC. We find no evidence of this. The message from HMRC was, at least after 2004, clear: HMRC would not do line checks for the benefit of traders. Earthshine's witnesses were not entirely consistent over whether they understood HMRC would not carry out line checks. Mr Knatchbull accepted that they knew HMRC would not do line checks although he said he remained optimistic that they might one day do so. Mr Sharp and Mr Agoh were reluctant to accept in evidence at the hearing what was obvious to the Tribunal and we find was obvious to them in 2006 that HMRC would not do line checks. Earthshine's practice in 2006 was to

notify HMRC of the details of the trade Earthshine was about to enter into, but then to proceed with the deal without waiting for a line check (unlike their practice in 2003). Indeed, they did not ask for a line check until after they had inspected the goods so they gave HMRC no time to reply. We find in 2006 Earthshine knew HMRC would not do line checks.

468.It is therefore not possible for Earthshine to claim that they believed that HMRC would notify them if something was wrong with the chain. By 2006 they knew HMRC would not do this.

469.Mr Sharp said he believed that HMRC *ought* to have continued to do line checks. This is of no real relevance. It was explained to the Appellant that this Tribunal was not carrying out a review of HMRC's exercise of its statutory powers and indeed the Tribunal has no jurisdiction to so do. In any event, the explanation given by HMRC to the Tribunal (and set out above) as to why HMRC ceased in 2004 to do line checks appeared very reasonable and we consider Mr Sharp's view entirely misplaced.

470. Lastly, did Earthshine's persistence in providing HMRC Redhill with details of their proposed transactions and asking them to confirm that there were no defaulters or hijackers in the chain, while knowing HMRC would not do line checks and while knowing that Earthshine would go ahead with the deal without waiting for a reply, indicate that Earthshine was seeking to paint a false picture of innocence?

471.It seems at least as likely to us, however, that Earthshine did this as a defence should the deal prove to be connected with fraud so that they could then blame HMRC (as they did at the hearing) for failing to carry out line checks. This does not actually tell us whether or not they did know the deals were connected to fraud: it shows that, if they did not know, they were concerned that their deals might be connected to fraud and wished to protect their position in case it turned out that they were.

472.In conclusion, we found the evidence in respect of the line checks of very little assistance. Its greatest relevance was the concern it gave the Tribunal of the reliability of Mr Sharp's and Mr Agoh's evidence. We found Mr Sharp was deliberately obtuse in replying to questions from HMRC's counsel, refusing to accept the obvious when it did not suit him and to some extent internally inconsistent on the question of whether he knew HMRC would not do line checks. Mr Agoh's evidence was also inconsistent on whether he knew HMRC would not do line checks.

Frustration with HMRC

473.Mr Green's case is that Earthshine's behaviour at the time should be judged by what he considered to be Earthshine's directors' justified frustration with HMRC.

474.Mr Sharp was very critical of HMRC's conduct at the time in 2006 (as apparent from his letters) and at the hearing. He considered that HMRC failed to respond to or would deny receiving correspondence, phones at Redhill went unanswered for days, and that HMRC could but wouldn't carry out line checks. Mr Sharp was not the only one who said HMRC was inefficient: Mr Young's inside contact at HMRC said this

too and even Mr Stone did not give the Tribunal the impression he thought all Mr Sharp's criticisms about inefficiency unfounded.

475.We find HMRC's inefficiency, however bad, could have had little practical impact on Earthshine's ability to execute a deal. All Earthshine needed HMRC to do in advance of a deal was verify the VAT number (they knew they would not get a line check). Redhill might not do this quickly enough but, as Earthshine itself says, the information would be forthcoming from HMRC's national helpline.

476.And HMRC's inefficiency could have no relevance to Earthshine's knowledge or means of knowledge of fraud in its chains.

477.The rest of Earthshine's complaints boil down to complaints that HMRC did not always refund their VAT quickly and refused to do line checks. It should have been and we find it was apparent to Earthshine that HMRC were entitled to undertake checks particularly in a market known to be rife with fraud and especially in respect of a trader some of whose earlier deals had been found to be connected to fraud.

478.On the issue of line checks, our opinion (not that it is relevant to this appeal) is that HMRC had very good reasons for not carrying out line checks on behalf of traders. HMRC's failure to do line checks meant that Earthshine could not do deals in some confidence HMRC would not later challenge them as HMRC would not have confirmed an absence of a known fraudster in advance. Whether or not Earthshine was frustrated by its inability to gain advance clearance could not have given it any comfort that its deals were not connected to fraud.

479.The fact Earthshine continued to ask for line checks might indicate that it expected that it would get the all-clear and therefore did not know of the connection to fraud: we do not agree. We consider its continual requests for a clearance it knew it would not receive tells this Tribunal nothing about knowledge or means of knowledge other than they were (at the least) concerned they might be connected to fraud and wanted to be able to blame HMRC if their input tax was withheld.

480.Therefore we cannot see anything in Mr Green's suggestion that the Appellant's actions must be judged in the light of the frustration they felt at the time. There was nothing in their frustration or the cause of it that would have in any way diminished the knowledge or means of knowledge of the fraud that they had from the other factors which we consider in this decision notice.

Message from HMRC

481.We find that Notice 726 was issued by HMRC to traders to specifically warn them of the dangers of MTIC fraud and the risk that they might be caught up in it. Although it explains the risk of joint and several liability and not *Kittel* nevertheless it warns traders in clear terms of the dangers of trading in a chain in which MTIC fraud has occurred. It contains practical advice on how to avoid such chains although to a large extent the recommended checks are only checks on immediate suppliers and buyers:

> (paragraph 4.5) "We advise you to carry out steps to establish the legitimacy of your supplier to avoid being caught up in a supply chain where VAT would go unpaid. There are a number of checks that you could probably already undertake in line with good commercial practice, such as credit checks. We don't expect you to go beyond what is reasonable. You are not necessarily expected to know your supplier's supplier or the full range of selling prices throughout your supply chain, however, we would expect you to make a judgement on the integrity of your supplier chain…."

482.The Appellant drew the Tribunal's attention to an article in *Mobile News* concerning an interview with Mr Walker Head of Fiscal Policy at HMRC at the time of 28 July 2003. Mr Kendrick agreed that this was likely to be an accurate reflection of HMRC's policy at the time:

> "Mr Walker is keen to stress that…traders have no reason to worry about checking beyond their initial supplier and customer as long as they ask the right questions before doing a deal…We do not expect people to know their supplier's supplier. It is not about that. You need to consider three things. The first is your supplier and customers. Second you need to think about the commercial viability of the transaction you are entering into…you also need to consider whether or not you are actually going to get the goods you are buying."

483.The Appellant says that it was impossible for them to check beyond their immediate supplier and HMRC recognised this as Notice 726 (as quoted in penultimate paragraph above). In conclusion we agree with the Appellant that HMRC did not and could not have expected them to know who was their supplier's supplier and the terms on which they dealt. Nevertheless, we find the Appellant knew it needed to take an overall view of the information which it knew about its own transactions and how likely they were to be on a genuine market.

484.Mr Green points out that HMRC had informed Earthshine that HMRC would let them know if they discovered a hijacked trade in a trade of Earthshine's. Yet it was also clear that every VAT number verification was given with a warning that this was not authorisation to enter into a deal and that Earthshine knew that some of its trades had been connected to fraud. We find that Earthshine neither could nor did take the lack of notifications as authorisation to trade without concern.

485.We have already rejected (see paragraph 429-431) above that Mr Sharp and Mr Agoh were being truthful when they said HMRC complimented Earthshine on its due diligence.

486.Mr Green's case in part is that the Appellant followed (he said) HMRC's advice on how to avoid MTIC fraud and it should not now be criticised. It is one of Mr Sharp's complaints that HMRC did not give sufficient advice on how to improve due diligence. But it is the case that Mr Sharp did not in fact follow the advice he was given in Notice 726: he did not obtain credit checks. Nor did he take an overall view of his supply chain: we find (see paragraph 506) that Mr Sharp chose to ignore his knowledge that there was no rational explanation for the market in which he said he thought he was trading.

487.Mr Green said that Earthshine were entitled to understand risk of fraud from HMRC and it is the case that up until July 2006 HMRC kept repaying Earthshine. Moreover in a letter in April 2003 to Earthshine's accounts HMRC said "there is no suggestion of fraud on the part of your clients" and in a letter of July 2004 to Earthshine's solicitors HMRC said "at no time have Customs suggested that Earthshine were in any way involved in any fraud". However, Earthshine knew that some of its deals had been traced back to fraud. They knew some repayments were made on a "without prejudice" basis. The best that could be said of what they knew or ought to have known from this is that HMRC might make a repayment despite a proved connection to fraud.

488.It is clear Mr Stone gave Earthshine very frank warnings. Mr Sharp considered it wrong but says Mr Stone in 2004 told him he could not avoid fraud if he continued to trade and that Mr Stone thought Earthshine should stop trading.

Fire break

489. Earthshine did in fact stop trading for a few months in 2004 over concerns about MTIC fraud. Mr Sharp says he was persuaded by Veracis there was a genuine market in which to trade and that new improved levels of due diligence would mean that they were not at risk. Mr Knatchbull invested in the company and Earthshine recommenced trading at the start of 2005.

490.After the firebreak Earthshine received no veto letters and no further notifications that any of their trades had been traced back to fraud until the ones at issue in this appeal. It was Earthshine's case that its due diligence procedures improved after the firebreak. It was therefore its case that whatever had happened before the firebreak it genuinely now considered itself to be free of transactions tainted with fraud. Nevertheless, due to what had gone before, Earthshine were very well aware of extensive fraud in their market.

491.In conclusion, we do not find that HMRC did anything which actually did reassure Earthshine that their trades were not connected to MTIC fraud.

492.We consider below whether its due diligence in respect of the deals at issue, all post the fire-break, either did or should have given them this reassurance and reach our conclusion on this in paragraph 619.

Earthshine's knowledge in respect of its own position in the "market"

Going public

493.In the 1980's Mr Sharp had been one of 3 young men who set up a very successful company which had later floated. He said he wished to repeat the success. It was Mr Sharp's case that he was particularly careful to scrutinise Earthshine's deals as from the outset when he joined in 2002 he wished to float the company and he would not be able to do that if some of its deals were found to trace back to fraudsters.

494.He produced in evidence a presentation he intended to make to sponsors of Earthshine's proposed float. In his witness statement he said that the planning for

floatation on AIM took place in 2006 and early 2007 and that extensive due diligence into Earthshine had not identified anything of concern which would have prevented Earthshine's admission to AIM. This is not consistent with his more likely to be accurate evidence at the hearing when he said that the floatation did not go ahead was because the promoter advised it would fail due diligence because Earthshine had in the past had VAT withheld by HMRC.

495.In any event, it was the Appellant's case that they could not have known about fraud in their supply chains else they would not have been attempting to float the company. We do not agree with this. By itself it tells us nothing: either they did not know *or* they knew but did not think they would be caught out.

Irrational market

496. A grey market in phones did exist in 2006 although it is now apparent with hindsight that a large majority of trades in wholesale mobile phones in 2006 were for the purpose of fraud and that *all* of Earthshine's trades in this appeal were orchestrated for fraud: was this known or should it have been known to Mr Sharp and/or the other officers of Earthshine at the time?

497. Earthshine's case is that, although well aware of the risks, it nevertheless considered that fraud was the exception rather than the rule and that its due diligence procedures protected them. Mr Sharp says he believed (and still believes) that Earthshine traded on the secondary market. He said he researched the industry thoroughly before investing in Earthshine and in particular was convinced there was a large and genuine grey market, which was affected in some part by fraudsters.

498.His case is that Earthshine exploited (or at least thought it was exploiting) differences between prices for phones between the UK and Europe. We prefer Mr Fletcher's evidence that Nokia set identical prices in all regions. Mr Sharp was not aware of this. We think if he had researched the market as well as he said he had, he would have known this.

499.We also note that in oral evidence Mr Sharp's stance tended to shift. Having claimed Earthshine took advantage of price differentials UK and Europe, the next day his evidence shifted to saying Earthshine bought stock dumped by authorised distributors (although he had denied it bought dumped stock the day before). It was pointed out to him that this made no sense: if there was a market for the phones in Europe the authorised distributors would not have dumped stock. In any event Earthshine knew it was not buying from authorised distributors holding stock but from grey market traders who were dealing back to back.

500.Mr Sharp then said the explanation was that there was demand from wholesalers if not retailers. He said Earthshine and its suppliers were commodity trading so the retail market did not matter. We do not agree: wholesale markets must inevitably be driven by retail demand. He gave the Tribunal no rational explanation for why he thought phones could be so frequently sold wholesale at a profit.

501.In conclusion he gave us no rationale for the market he said he thought he traded in and we ask ourselves whether at the time he genuinely believed he was trading in a rational commercial market.

502.He was asked to explain why Earthshine bought stock with European specification from Dubai. His answer was that the Middle East uses 3 pin plugs which if true fails to explain why he thought he could sell them to Continental Europe. His answer was that the buyers in Europe would change the chargers or re-sell them in Dubai. We find this makes no sense. He also said that if Sunico wanted phones with 3-pin chargers then Earthshine would supply them without asking why Sunico wanted them. This seems more likely: Earthshine chose not to enquire. Bearing in mind Mr Sharp was well aware of the risk of fraud, we ask ourselves why he chose not to enquire.

503.It was also pointed out to him that (as Nokia has regional warranties) the warranty on phones from the Middle East would not be valid in Europe. His reply was that he would not know about the warranty and that warranties aren't important. (We note that his evidence was also that an earlier deal fell through due to the phones having an incorrect warranty and that that is why Earthshine always traded on product codes, so saying warranties were not important was inconsistent with his own evidence).

504.He also said that the price of a mobile phone might increase even where phones are over 6 months old. This makes little sense to the Tribunal and we prefer the evidence of Mr Fletcher that the price would gradually decrease over time.

505.It was pointed out to Mr Sharp that as all bar one company in the chains had a presence on IPT, Earthshine (or indeed its customers) could have cut out the middlemen and traded with the acquirer at the start of the chain and paid a much lower price. Mr Sharp's reply was to say that they had never heard of the companies which supplied their supplier and could not have traded with them having not conducted due diligence on them. We consider that this answer in no way explains why Earthshine made no attempt to get the phones at a cheaper price even if that meant carrying out due diligence on more companies listed in IPT.

506.Our overall conclusion of his evidence on the rationale of Earthshine's trading model, was that he did not know a great deal about the genuine markets for mobile phones and when tested, his explanations of what he said was the market in which Earthshine traded made little commercial sense. We think that he was aware of this because he tried (but failed) to give the tribunal a rational explanation and because at the time of the deals he chose not to act like a rational trader and seek to find a cheaper source of goods and chose not to investigate why there was an apparent large market for phones with 3-pin chargers in Europe. Bearing in mind his overall lack of credibility as a witness, his previous experience as a businessman, and that we did not think him unintelligent, our conclusion is that his evidence on this was unreliable and he was aware (but indifferent) in 2006 that the market in which he was trading was not driven by commercial rationality.

507.Mr Knatchbull similarly failed to give a rational explanation for the market in which he said he thought Earthshine was trading.

Knowledge of origin of goods

508. In evidence there was an email from Mr May, an employee of Earthshine, to Mr Sharp in respect of one of Earthshine's last three trades in which he says:

> "The stock will arrive from Europe tomorrow morning be inspected and shipped tomorrow evening"

509.The likely inference is that Mr May had been informed of this by Earthshine's supplier, New Order Trading. The significance is that Earthshine clearly knew that there was no logic to its deals. It did not stop to ask why stock would be shipped to the UK from Europe only to be shipped the next day by Earthshine back to Europe. It carried on with the deal regardless.

Knowledge of illogical products

510. The two inspection reports (Earthshine's and A1's) in Deal 3 describe the phones as having 3-pin chargers and that is what TTW requested in its purchase order (although Earthshine's own inspection report and invoice are silent on this). We find the phones the subject of Deal 3 did indeed have a 3 pin charger as it was clear that on the boxes they were described as "UK variant" and we accept Mr Fletcher's evidence this meant 3 pin chargers. This is in any event the only logical supposition. Mr Sharp failed to give us a satisfactory explanation of why he thought a Continental European company would wish to buy phones with 3-pin chargers.

Inconsistent product specification

511. In deal 1 Earthshine's inspection report describes the charger as 2-pin. A1's inspection report (despite the inspections happening simultaneously) describes the charger as 3-pin. Earthshine's customer requested a two pin adapter. Earthshine's own purchase order was silent. We find that A1's inspection report was right: firstly the evidence was that A1's team actually did inspect the goods so they ought to be right and in any event the photographic evidence is that the boxes were stamped "UK variant."

512.Mr Sharp's explanation is that "UK variant" meant a variant to the normal UK phone, in other words they had 2-pin rather than 3-pin chargers. We found this unconvincing: if he was right it would have been described as Continental and not UK variant and in any event from Deal 3 it is clear "UK Variant" meant 3-pin chargers. We think Mr Sharp, if he knew the market as well as he said he did, would have known the true meaning of "UK variant".

513.We find Earthshine did not care enough about the phone's specification to either notice or act upon the discrepancy between the two inspection reports, nor to act on the discrepancy between their customer's request for 2-pin chargers and the phones actually having 3-pin chargers, nor to request in its purchase order the same phones as specified by its purchaser.

514.We find that the only likely explanation for this is that Earthshine did not care because it knew its buyer would take the phones in any event.

515.There was a discrepancy in deal 2. In Deal 2 Earthshine's customer ordered phones with two pin travel chargers. Earthshine's purchase order was for three pin chargers. The A1 inspection report is that they were phones with 3 pin chargers. Again we find the Earthshine did not act to ensure its customer got what it specified and from this we find Earthshine knew that its customer would take the phones in any event and indeed the shipment was not rejected.

516.Earthshine's indifference to its customer's requirements is shown by a comparison of its customer's specifications in its purchase order and Earthshine's own purchase orders. They are different in several respects. Although we have said they are not inconsistent in the sense of incompatible, they are not identical either. For example, TTW in deal 1 wanted phones with (amongst other things) "European warranty", headset, English keypad, 2 pins adapter, and original nokia seal. None of these requirements were put in Earthshine's purchase order. There are other examples of this. Again we conclude from this that Earthshine did not act to ensure its customer got what it specified and from this we conclude Earthshine knew that its customer would take the phones in any event..

517.Another error pointed to by HMRC was that A1's inspection report on Deal 6 shows the goods at Hawk Precision whereas Earthshine's shows the goods were at Pauls' Freight. That Earthshine was right is shown by the CMR. We do not think anything can be read into this discrepancy: it could have been a simple if odd mistake by A1. No action was called for by Earthshine because (we presume) they knew where the goods were.

Traded on basis of handset codes

518. We heard a great deal of evidence about handset codes. Mr Fletcher was unable to determine exactly what specification would be indicated by a handset code although on balance we think it likely it would contain some information probably related to the languages on the phone. We accept Mr Fletcher's evidence that product codes would not have covered all aspects of the product's specification because he pointed out that the same code was used for some phones intended for the UK and some intended for Germany: yet they must have had different chargers.

519.The Appellant did produce an unofficial website that purported to have some Nokia handset codes but they accepted that they did not know of this at the time of the deals and we had no evidence it was either accurate or comprehensive.

520.At the January 2010 hearing Mr Green indicated he would make an application to adduce in evidence a witness statement by his instructing solicitor (Mr Croft) about product codes that Mr Croft had recently discovered from Carphone Warehouse. HMRC indicated that they would not object to the admission of this evidence, despite it being very late, as long as it was given to Mr Fletcher in advance of his being asked to respond to it. The following day Mr Green asked to admit a further witness statement by Mr Croft with an exhibit about product codes. HMRC expressed

reservations about this being admitted as Mr Fletcher had not had a chance to review it. The Tribunal had no formal application to admit it at that point as the Appellant was trying to resolve a question about the exhibit's confidentiality. Later that same morning Mr Green then indicated he would not pursue this second application because, he said, HMRC had indicated that they wanted an adjournment to give Mr Fletcher time to deal with it and he wished to avoid an adjournment. A few moments later he said he had instructions to withdraw the application to admit Mr Croft's first witness statement. No reason was given.

521.As already mentioned, Mr Fletcher was shown some product codes by Nokia under a non-disclosure agreement. We were informed Mr Croft similarly had issues over confidentiality of the evidence he had intended to give. Earthshine's evidence was that they did not know of the meaning of the product codes at the time of the trades and had not been able to discover them until Mr Croft's enquiries. It was clear to the Tribunal that product codes were commercially sensitive information and Nokia did not make them freely available and so we find.

522.Mr Green complained in his closing submissions that he was unable maintain his application to adduce Mr Croft's evidence and said that the reason was because he had been put under pressure of time. We do not know why he withdrew his application to admit Mr Croft's first witness statement and we did not enquire as such is privileged information and no doubt a decision taken by the Appellant's legal advisers with its best interests in mind. We note the decision was made at a time when Mr Green was vigorously opposing HMRC's application to admit late evidence (the email chain). In any event, Mr Green did not at the time say that he was withdrawing the application to admit the evidence because there was not time to hear it: the Tribunal would have been most surprised had that been the reason as, apart from other considerations, it was evident from the start of the hearing that there would be an adjournment in any event for some weeks or months in order to allow closing to take place after the Court of Appeal's decision in *Mobilx*.

523.In any event, the actual meaning of the product codes seems irrelevant to the Tribunal. We explain why below.

524.It was Earthshine's case that they did not include detailed product specifications in their deal documentation because they traded on the basis of handset codes from which the phones' specifications could be determined by their customers. The Appellant's submission is that even though Earthshine did not know what the handset codes meant, they knew that they purchaser might know and considered that it was a rational commercial basis on which to trade.

525.The reason why Mr Sharp maintained Earthshine's customer might know the meaning of product codes (although Earthshine itself did not) was that before the deals at issue in this appeal in another transaction a German customer had complained that the phones delivered by Earthshine had the wrong warranty and that Earthshine should have known this from the product codes. Mr Sharp said that he had had to agree a £20,000 reduction in price to keep this customer happy and in future always traded on basis of handset codes.

526.Trading on the basis of handset codes meant, as far as Earthshine was concerned, that they would negotiate a purchase of phones and a sale of phones without any reference to handset codes. Their customer would deliver a purchase order to Earthshine without any reference to handset codes. Earthshine would deliver a purchase order to its supplier without any reference to handset codes. Once the deals were agreed, Earthshine would instruct A1 to inspect the goods. Earthshine would attend. As part of the inspection the handset codes would be discovered. Earthshine would then issue a pro forma invoice to its customer which would specify the handset codes.

527.Mr Sharp's explanation was that the pro forma was faxed to their customer at the time of completion and at that point the customer could call off the deal if it was not happy with the handset codes. He did not satisfactorily explain why, if handset codes were so important, they were not specified in the purchase orders issued by or to Earthshine.

528.We do not consider this to be trading on the basis of handset codes. If the customer wanted specific handset codes, it would have said so on its purchase order and in its negotiations. It did not. Nor did Earthshine make any attempt to buy phones with the handset code its customer required and indeed gave evidence it would not expect its suppliers to even know the product codes. It just bought stock with the rather general specifications we have set out above when looking at the deals. Earthshine agreed to buy the phones without knowing the handset codes (indeed Mr Sharp's evidence was that he did not expect Earthshine's supplier to know the handset codes as he did not expect them to inspect the goods).

529.Mr Knatchbull's evidence was different to Mr Sharp's. He described the product codes as a red herring and stated they were important to Earthshine's customer rather than to Earthshine.

530.But we find the handset codes were meaningless to the customer. It is quite apparent from Earthshine's pro forma invoices that a single batch of phones might be divisible into two or three sets of phones with quite different handset codes (see as an example deal 2 where the 1,000 phones divide up into 700 with code 005709 and 300 with code 0049041). Further, we know that the meaning of product codes were not generally available and further that the deals were orchestrated and that Sunico was a knowing participant (see paragraph 238). We do not find that Sunico had any interest in the product codes.

531.We find that Earthshine bought phones without any real interest in their specification nor any interest in whether their specification matched their buyer's requirement. They did not trade on the basis of product codes and their customer had no interest in the product codes.

Traded on meaningless specification

532.As already mentioned Earthshine specified phones that were "central" or "standard" European specification. We find it used the terms interchangeably in the same deal. From its customer's purchase order it is apparent it is also interchangeable

with simply "European specification". We accept Mr Fletcher's evidence that this specification is meaningless as it is not used by Nokia. Mr Sharp disputed this and said it was used by everybody and everybody knew what it meant. We find on the contrary that the three terms were used interchangeably on a few of the invoices and purchases in each chain at issue in this appeal all of which we have found were orchestrated for the purpose of fraud. As we find none of the knowing participants in the fraud would have had the slightest interest in the specification of the phone, there is no reason to suppose because of its use in this context that it had any meaning. We prefer Mr Fletcher's evidence.

Inspection of the goods

533.Mr Sharp's evidence was originally that the goods were simultaneously inspected by both Earthshine and A1. A1 would field 4 or 5 persons to do an inspection: Earthshine sent along one.

534. Mr Sharp's evidence was inconsistent on whether Earthshine merely supervised A1 or did its own inspection. Mr Knatchbull's evidence was far more consistent and credible on this: Earthshine merely supervised A1. The Earthshine representative stood by and watched as he would have got in the way if he had intervened. Mr Knatchbull had seen an inspection take place: Mr Sharp had not.

535.Earthshine's evidence is that they paid A1 to inspect the goods and would reject them if there was a phone with an IMEI number which duplicated one Earthshine had traded in earlier or if the goods were not in pristine condition. It would reject stock if had a HMRC mark on the box. It would reject the phones if any of the individual boxes had been opened before.

536.If the individual boxes were untouched, A1 (on Earthshine's instruction) would undo the seal and inspect the contents of every single retail box. Earthshine would photograph the stock while it was inspected. Once inspected the phones would be sealed into a bundle with proprietary tape.

537.HMRC challenged whether the inspections were as thorough as claimed. From A1's inspection reports which said how long they spent on site, 4 to 5 people inspected phones at a rate of between 5 phones to 16 phones per minute (and that was without allowing for time spent waiting the phones to be delivered to the conveyor belt for inspection). Mr Agoh denied that the inspection was merely ascertaining the existence of the phone rather than checking carefully the specification of the phone, the language of the manual and the contents of the box, although his evidence was inconsistent on this as he also indicated also that the box was just opened, phone looked at and then box closed. Mr Knatchbull was more robust in saying the inspection was to ascertain that it's a phone and not a stone (to use his expression). Nevertheless the inspection reports were quite detailed.

538.We find based on the evidence overall that while a few phones might have been inspected in detail, for the vast majority of the phones the inspection was no more than opening the retail boxes, ascertaining the existence of the phones in their retail boxes and noting down product codes.

539. What does this tell us? It tells us that Earthshine were very careful to ensure that they traded in real phones and that they would not trade in phones in boxes that were knocked about or marked with HMRC stamps. This may mean they were genuinely concerned to avoid phones which had been carouselled or simply that they wished to avoid a situation where HMRC would have good reason to refuse their input tax claim (such as if the phones had not existed or if the phones were in battered boxes that had clearly been moved about a lot indicating that they may have been carouselled).

540. Mr Sharp agreed to the obvious proposition that the purpose of the seal on the retail boxes is to authenticate goods. Mr Agoh denied another obvious proposition that breaking or undoing the seal, as A1 did on Earthshine's instructions during inspection, devalues the phones. We note that in any event TTW's purchase order on deal 1 and 3 asked for "original nokia seal" and Earthshine rejected phones with broken seals.

541. It is obvious to the Tribunal that a broken or undone seal means that the purchaser of the box cannot be sure the contents are authentic (because the contents could have been switched for a counterfeit phone or otherwise tampered with) and that TTW, in requesting "original nokia seal" meant they wanted (or wished to appear as wanting) the seal to be in place.

542. Yet Earthshine, although they would reject phones if the seal had been broken or undone, nevertheless was prepared to undo the seal itself as part of the inspection. It bolsters the conclusion that Earthshine was not concerned with what its customers' specified on their purchase orders and that must be because they knew TTW and Sunico would take the phones despite the undone seal. We find Earthshine's inspection of the goods was more concerned with being able to prove the phones existed than they were in delivering pristine goods to their customers. This must be because they knew their customer was not concerned about the condition of the goods. We reject Earthshine's claim that it undertook inspection to protect against the risk of MTIC fraud.

IMEI numbers

543. Earthshine conducted 100% scans of IMEI numbers and would refuse to proceed with a deal if they found a duplication of numbers. It was Mr Sharp's case that not only did the product codes contain information on the phone's specification but the IMEI numbers also did and Earthshine made the lists available to its customers. He agreed that he did not know the specification of a phone from its IMEI number.

544. We accept Mr Fletcher's evidence on IMEI numbers: they are identifying numbers unique to each phone which contain no publically available information about the phone other than its make and model number. The only way of identifying the specification of the phone from the IMEI number was to check it against a database held by the manufacturer and that database was not publically available. Although the Appellant strongly disputed this evidence, Mr Knatchbull's evidence from his friend Mr Calpin actually confirmed this (see above at paragraphs 434-435). Indeed, Mr Knatchbull's third hand hearsay evidence from Mr Calpin's friend who

worked at Nokia was that it was a laborious task to check IMEI numbers and would take 3 days to check the numbers on 3,000 phones.

545.Mr Agoh gave evidence that he had discovered an internet site (numberingplans.com) which would give the user the specification of the phone if the IMEI number was inserted. We find that there was no evidence that this site was authorised by Nokia, that it was comprehensive or that it was accurate. We consider it highly unlikely that Nokia would publish the IMEI numbers of all its phones together with the phone's specification as it would defeat the object of having unique numbers to prevent fraudulent imitations. We preferred Mr Fletcher's evidence on this as more likely to be correct.

546.In any event Earthshine did not suggest that they were aware of this database in 2006. We find that Earthshine did not trade on the basis of the IMEI numbers any more than it did on product codes.

547.It was also put to Mr Sharp that it was odd that A1 would not check IMEI numbers against any deals except Earthshine's previous deals. It was put to him it should have put him on notice something was wrong with A1 because they did not maintain a database of all IMEI numbers they collected on behalf of all customers. Mr Sharp said he thought they would not do this as the information was confidential to each customer and to do so would be helping a competitor. We agree with Mr Collins that Mr Sharp knew that this was not a sensible or true answer. It is obvious that if A1 and its customers had truly wished to avoid fraudulent deals they would have pooled IMEI numbers to avoid risk of buying goods which had been carouselled.

Rejected deals

548.We find that Earthshine would reject a deal if a single IMEI number reappeared from an earlier deal. Nevertheless, Earthshine would continue to trade with the same supplier. Mr Sharp said he did not think that that the reappearance of an IMEI number indicated a problem with the supplier.

549.It was Earthshine's evidence that they would walk away from a deal if the stock was not pristine, and indeed their customers' specification was normally for "new" stock. At odds with this was Mr Sharp's oral evidence that its buyers would be very pleased – rather than expecting – to be getting new stock.

550.Earthshine rejected some 700 phones which were offered in Deal 4. Its officers suggested this was because the phones were not pristine but we do not find that this was true as the inspection report says the phones are new and in excellent condition. We do not know why this deal was rejected and are unable to draw a conclusion from this.

Matters of no concern

551.In a report of a visit on 12 September 2006 to Sunico an employee of Earthshine's records that:

> "Sunil [ie a person from Sunico] stated he had some UK suppliers who weren't in a position to export and would we be interested in him putting us together. I said this would be fine. The reality of the situation is that Sunil would dictate the buy and sell price and therefore the margin we would take. Having spoken to [Mr Sharp] we're not going to follow this route as (1) it may look questionable to HMRC that a customer has suggested and has ownership of the entire transaction and (2) having our margin dictated to us does not sit well."

552. Despite this rather open offer to participate in an orchestrated transaction, and although Mr Sharp at least in Mr May's report refused to participate, nevertheless he chose to continue to trade with the author of the offer. Indeed Sunico was the buyer in all Earthshine's remaining trades.

553. Mr Sharp's case is that this shows Earthshine did not know the offer was inappropriate or it would not have been written down. We do not agree: on the face of it Mr Sharp was clearly aware that it was an inappropriate offer for the reasons given by Mr May for his refusing it.

554.Mr Collins' point is that it shows Mr Sharp knew (or had means of knowledge) as he was prepared to trade with Sunico despite good evidence they were involved in contrived chains. Mr Sharp's reply was that he would not detonate a relationship just for one inappropriate conversation.

555.We think if, as he claimed, that he wished to avoid fraud the only possible reaction to such a blatent offer to participate in contrived chains was to refuse to deal with the company making the offer. It is clear to the Tribunal that Mr Sharp was prepared to trade despite this.

556.A similar suggestion was made on the due diligence report for Unique Distributions Ltd (not a trader for the deals at issue in this appeal). The due diligence report noted

> "Russell stated they would be able to find suppliers for us and assist putting deals together".

557.Mr Young who did carried out the due diligence thought this surprising and put a question mark and exclamation mark next to it. Mr Sharp said he saw nothing was wrong with the suggestion as he thought it was usual networking and meant nothing more than their supplier would suggest another supplier if they could not supply Earthshine's needs.

558. We do not think Mr Sharp really thought that that was all that was meant and find he was unconcerned by a suggestion that Earthshine should be involved in contrived deals.

559.Having customers in a different country to the delivery address was identified in the memorandum of understanding as a possible indicator of fraud. In one of the deals Earthshine's customer was in country but the delivery address was in a different country. Mr Sharp said that it was of no concern to him.

560.Mr Sharp was prepared to trade with Hawk (a freight forwarder) despite knowing that it might have been involved with fraud. It was in the press that Hawk's involvement was suspected but Mr Sharp denied he knew this. The email exchange shows, however, that Mr Sharp asked Mr Young/Black to "look into" Hawk Logistics because, said Mr Sharp in the email chain, "I know for a fact that HMC&E are investigating them….I'd love to know that way I can avoid potential trouble."

561.Mr Black's reply on Hawk and its related company was:

> "….I have been reliable (sic) informed that both Puri and his companies are extremely well known to the customs.
>
> Our advise (sic) is to keep well away from them. They are not trustworthy and are being seriously looked into. Any dealings that you have may have serious consequences"

562.Later when it was shown his evidence was wrong, he said he had forgotten. We do not accept this: we do not think it would have been easily forgotten and we note that his evidence in general was unreliable. His last witness statement (made after the email exchange was adduced) admits he knew this and in any event the email exchange with Mr Young clearly shows that he had heard rumours and wanted Mr Young to investigate.

563.Mr Young's reply was advice not to trade with Hawk. Mr Sharp ignored this and continued to trade with them. He said to the Tribunal that Hawk's honesty was irrelevant and his concern was only with the security of his stock. We do not think this is an attitude which would have been adopted by anyone truly seeking to avoid fraud.

Price negotiation

564.Mr Sharp's evidence is that the prices were freely negotiated and Earthshine had to work to find a buyer and seller at the right prices:

> "its bit like pelmanism and you've got one phone in one ear and you've got the buyer here and the supplier here and you're trying to agree a price."

565.In his witness statement he says they made many calls a day to potential suppliers and customers and also utilised the International Phone Traders website for leads. A detailed trading diary was kept.

566.We find he later retreated from this evidence. It was put to him that the IPT website would have made it very easy to find stock for sale and purchase. He then suggested that what enabled Earthshine to put the deals together was having the working capital to conduct the export. He also said that Earthshine chose to deal with a small group of trusted customers and suppliers. This contradicted his earlier evidence on pelmanism but appears to be right: Earthshine had only 3 suppliers and 2 customers. This did not offer much scope for a game of pelmanism.

567.We also bear in mind that, although Mr Sharp remained prepared to deal with Sunico despite the open offer made to Mr May (referred to in paragraph 551 above) to

orchestrate the deals, Mr Sharp did tell Mr May he would not go ahead with those particular deals. Does this mean that Mr Sharp did not go ahead with deals he knew were orchestrated, or that merely this is what he said to his employee?

568. We know that the chains were orchestrated: see our finding in paragraphs 237-238. The buyers and sellers were determined by the orchestrator of the fraud. The orchestrator intended the entire chain to come into existence and therefore it follows that it did arrange the sale to Earthshine and the sale by Earthshine. Mr Sharp's evidence was that the deals were negotiated: we have already commented that his account was internally inconsistent. Because of the fact the chains were orchestrated, and because of his unconvincing account of negotiation, we reject as unreliable his evidence that the deals were negotiated. Mr Sharp's refusal to accept a blatent offer of orchestration made via an employee does not cause us to revise this view: had he truly wished to avoid orchestrated deals he would have ceased to trade with Sunico who made the offer.

Terms of Trading

569.Earthshine traded on terms and conditions drafted for them by lawyers. The terms were very much in Earthshine's favour such as a warranty from its supplier that its supply line was bona fide. Clause 6.2.2 provided:

> "In the event that HMRC discover any fault or breach or non-compliance in the seller chain of supply, with the result that the buyer become liable to an assessment it would not normally have or the buyer suffers a delay in receiving a payment of VAT, the seller will repay to the buyer the amount equal to the withheld VAT and allow access to the books and records."

570.This clause has not been enforced by Earthshine against any of its suppliers in respect of the 4 deals to which it applied and to which Mr Sharp accepts that it is applicable. Earthshine has had its VAT withheld since the end of 2006 and is therefore clearly suffering a "delay" in receiving its repayment. In the meantime Earthshine has gone out of business and into liquidation. Yet Mr Sharp's evidence is that the company never even asked its suppliers to honour their obligations under this clause let alone contemplated legal proceedings against them.

571.Mr Knatchbull suggested that they did not enforce the clause because they had had a bad experience with litigation before. Earthshine was owed £30,000, sued the debtor and put it into liquidation. Earthshine is still waiting to receive any part of the money owed at the end of that company's liquidation.

572.Mr Sharp's view was that they would not enforce the clause because it was really HMRC who owed the money and they would pursue the supplier only if their current litigation against HMRC failed.

573.We do not accept his denial that this clause was mere window dressing. We think if Earthshine had genuinely intended to use the clause, they would have enforced it when their VAT was withheld. We do not think they are shy of litigation and we think Mr Sharp would have pursued any course he considered open to him to avoid

Earthshine's liquidation. That he did not even consider enforcing this clause means, we find, he knew that it was not really part of the terms on which Earthshine was doing business.

No risk

574. Mr Sharp's evidence was (which we accept as consistent with the paperwork) was that Earthshine would only pay its supplier once its customer had paid Earthshine. Its customer would only pay on receipt and inspection of the goods in the European warehouse. Indeed Mr Sharp describes Earthshine as taking a positive decision not to hold stock as too risky.

Mark up

575.Earthshine made a fairly consistent profit: £16 per unit in deal 5, £9 per unit in deal 6B and 7; £10 per unit in deal 2 and 6A; £10.50 per unit in deal 1 & 3; £11 per until in deal 4. As a fraction of the VAT defaulted upon (or in the case of the contra trade with A-Z the VAT offset by A-Z), Earthshine's profit was in most cases approximately one-third. It was slightly lower in deals 5 & 6 where it was between one fifth and one quarter.

Knowledge of long chains

576.Mr Sharp was clearly aware that although Earthshine, as exporter would make a large profit, any UK to UK seller in the chain would not. In cross-examination he said he would not expect a trader selling UK to UK to undertake the due diligence undertaken by Earthshine and indicated he would not expect them to carry out inspections due to low margins (and that this was why they would not know the product codes). When put to him that this made no sense as UK to UK traders would have a similar risk of being caught up in fraudulent transactions he said he could not comment on their trading methods (although he just had).

577.Mr Sharp's evidence was that the profits made by Earthshine were because it was exporting which meant it had high costs and in particular costs of freight, inspection, due diligence and cost of money (the VAT reclaim outstanding with HMRC until repayment). He had a clear expectation expressed in cross examination that the profits were made on export deals and not UK to UK trades and that companies might do UK to UK trades when they had run out of funds to do export trades.

578.We find Mr Sharp was aware that some at least of his chains were long as he agreed that Earthshine preferred short supply chains so that they could release goods more quickly to its customer. He disagreed that long supply chains indicated fraud. But he was clearly aware that some of Earthshine's chains were long since he indicates that that he had anxious customers who kept ringing to have goods released but they could not be released as calls to release goods had to go all up supply chain once payment made.

579.It was put to him that the UK to UK trades made no sense in the market as described by Mr Sharp but he denied this. Mr Sharp on his own testimony told us that he knew that very little profit could be made on UK to UK trades. He knew "brokers" might do UK to UK trades when they ran out of money to fund the VAT. We draw

the obvious inference that he knew that the reason he was earning high profits was his availability of ready capital. And he effectively says as much in cross examination when it was put to him that it was extraordinary that Earthshine was getting so much of the profit.

Earthshine's due diligence

Independent due diligence

580. Earthshine paid an independent company, Veracis, to carry out a check on its due diligence procedures. We were told Veracis employed ex-HMRC employees and their report to Earthshine in June 2004 was that its due diligence was some of the best in the industry and went beyond what could reasonably be expected.

581. This is, of course, irrelevant to the question of knowledge: if Mr Sharp knew that his trades were connected to fraud a report saying Earthshine had excellent due diligence could not have reassured him. It may be relevant to whether Earthshine ought to have known of the connection to fraud.

582. We note, however, that at the same time as Veracis was making this report to Earthshine, Mr Stone was notifying Earthshine that some of their trades had been traced back to fraud. The Veracis report could not have reassured Mr Sharp that its due diligence was effective.

583. Veracis also recommended Earthshine should undertake more detailed checks on directors of supplying companies as well as appointing an independent person to do so. Mr Sharp agreed that for the most part he did not take up these recommendations. He also agreed he considered Veracis to be wrong on what they said about what a line check would not reveal. Our conclusion is that Mr Sharp did not rely on Veracis' opinion, irrespective of the question of whether it was reasonable to do so.

Credit checks

584. It was accepted by the Appellant that they did not (usually) carry out credit checks on their trading partners. It was its view that it did not give nor receive credit and that credit checks were therefore unnecessary.

585. Mr Green's submission was that Notice 726 said traders were "free to ask the most appropriate questions required to protect you in the particular circumstances of your individual transactions" so it was not now open to HMRC now to criticise their lack of credit checks. We do not agree. HMRC advised traders to take a view on their supply chain. This would include taking a view whether they were dealing with reputable businesses of financial standing that were likely to be legitimately trading in the value of goods in the deals at issue in this appeal.

586. Apart from that we think it was obvious to Earthshine that they should ensure themselves of their trading partners' financial standing as it would be commercially important to deal with companies that could comply with their obligations as well as a way of checking that the companies were not set up solely for the purpose of fraud.

587.In any event to some extent Earthshine did grant credit. It contracted to buy the goods although the terms were that it did not pay until it was paid. Nevertheless, it had to incur certain costs such as inspecting, insuring and shipping the goods. For example, Earthshine's freight bill in deal 4 was £2,438.12. Its profit was £16,489 (£11 x 1,499). The only possible assumption is that not only would Earthshine's freight of the goods to the Continent be wasted if its customer did not pay, but it would have to re-import them and cancel the deal. It was therefore risking a significant amount of money per se and in relation to its expected profit on the deal.

588.Mr Sharp agreed that Earthshine ran the risk the trade would not complete. We find it would have been commercially sensible to have ensured in advance Earthshine's customer was likely to be able to pay.

589.Apart from wishing to avoid MTIC fraud, as they said they did, their suppliers' financial standing should have been of concern because they required them to sign up to some quite onerous terms and conditions. This would be pointless if their suppliers could not meet their obligations.

590.We also note that Earthshine's witnesses did not actually suggest that the trading partners' financial standing was irrelevant as on the contrary they said that they got a lot of "comfort" from visiting them and taking photos of their substantial offices. We don't regard this as a reliable method of ascertaining a company's financial status.

591.We note that credit checks were recommended by HMRC in Notice 726 and that (even if the Appellant did not extend credit) they would have been a method to assess the legitimacy of trading partners. It would tell them if the proposed trading partner was a long-established business with a solid asset base. Being such a company was not guarantee it was not involved in fraud but we consider it obvious that a new company turning over hundreds of thousands or even millions of pounds without any asset base or credit rating was a clear risk of fraud.

592. Earthshine had traded with all of its trading partners in these seven deals before its "firebreak" in 2005 with the exception of New Order Trading and Tele Trading. It was Mr Green's submission that it was reasonable to take into account that Earthshine had traded with them before without a problem and this was an explanation of why their checks in 2006 were less thorough.

593.However, we find that the due diligence on New Order and Tele Trading was very similar to that on their other trading partners: there were no credit or other independent financial checks undertaken. So we find the explanation of the lack of credit checks is not in fact connected with the longer trading relationship.

594.We find that Earthshine's failure to take effective and detailed independent checks of their trading partners' financial standing meant that they were not interested in it. We consider that a business which believed itself to be trading on the open market (particularly one known to be vulnerable to fraud) would have been very interested in this. Because Earthshine chose not to take up credit checks or make any

other independent check into financial standing of their trading partners, we do not think Earthshine believed they were trading on an open market.

Due diligence

595.It is the Appellant's case that Earthshine took every step to ensure that it was not caught up in fraud. Mr Sharp describes Earthshine has having exacting standards and that on occasions they did refuse to trade with would-be suppliers that did not meet that standard.

596.On the contrary, HMRC allege that Earthshine's due diligence amounted to window-dressing to hide that they knew that their transactions were connected to fraud.

597.Our findings on Earthshine's due diligence are as follows:

598.<u>timing:</u>

599.Earthshine held due diligence reports on all trading partners in the deals at issue in this appeal but historically Earthshine did not always hold due diligence before entering into a trade (eg in its first trade with Cybercomms – which was not a party to any deal in this appeal). In particular, Sunico was a long-standing customer of the company's (this is not denied and is indeed stated to be the case in the due diligence report dated 31 March 2006) yet Earthshine produced no due diligence report earlier than this date. Other due diligence reports produced for other companies not in the chains in this appeal on their face refer to the fact that the Earthshine had already traded with the company.

600.We consider that if Earthshine had earlier due diligence reports it would have produced them to the HMRC and then to the Tribunal, especially as this point was pleaded. We consider whether it lost them, but note that at the hearing Earthshine's officers emphasised that Earthshine kept everything (eg even invoices from deals that did not proceed). We note that Earthshine's witnesses said that earlier reports existed but that we consider their evidence unreliable. In conclusion, we find that means that only the reports which were produced existed and that therefore Earthshine had been prepared to trade with companies on which it held no due diligence.

601.<u>third party payments</u>

602.Earthshine did not ask whether its suppliers made third party payments. Mr Green points out that even if it had asked these questions it was unlikely to have learnt anything: buffers (other than first line buffers) rarely made third party payments and they may not have given a truthful answer in any event. We agree that Earthshine's failure to ask this question is of no significance to the question of whether they had *means of knowledge*.

603.Mr Collins submits it is relevant to the question of *knowledge*: he suggests that their due diligence was less thorough than it should have been which indicated (he suggested) that it was just window dressing. We agree.

604.reliable reports

605.Earthshine employed Mr Young to carry out many of its due diligence reports. HMRC's case was had Earthshine truly wanted reliable reports on the bona fides of its trading partners it would not have employed someone who had lied to Mr Sharp about something as fundamental as his identity. We agree that this also indicates that Earthshine was more concerned with the appearance than substance of its due diligence.

606.individual due diligence reports

607.*New Order Trading*. Earthshine commissioned JDS Consultants to provide the due diligence report. Earthshine relied on this report in deciding to trade with this company despite statements in the report that (a) the goods were not sourced from the grey market (b) the goods were sourced from suppliers who imported and (c) that they would only source "brand new stock, not traded" to their customers; and a statement that the company was in a "unique" position in the market.

608.Mr Sharp agreed in cross examination that it was not a useful opinion. We find it was contradictory on the face of it (referring to both untraded stock and the fact they had suppliers) and clearly informed Mr Sharp that the goods were being imported. It made nebulous and meaningless statements about being in a unique position and not trading on the grey market but without giving any kind of credible explanation.

609.We consider this report should have put Mr Sharp on notice that something was rather odd and that knowing how rife the market was with fraud he should not have continued to trade with this company: we also consider the fact that he chose to ignore the oddities in this report meant that he had no real interest in it and it was done for the purpose of window dressing.

610. *New Way Associates.* Earthshine chose to trade with this company without undertaking companies house or credit checks.

611.*TTW:* Mr Sharp accepted documents written in Dutch on the basis that they looked official even though he had no translation of them. We have already commented that Earthshine chose to trade with TTW despite having no financial data about the company.

612.*LMC:* HMRC criticised the due diligence on LMC because LMC stated they had a foreign bank account which was said to be an indicator of fraud in the Memorandum of Understanding. Mr Sharp's explanation is that by 2006 he had ceased to consider it an indicator of fraud because by then so many businesses (including Earthshine) had found it difficult or impossible to keep open a UK bank account. We do not draw inferences of knowledge or means of knowledge from this per se but note in respect of Cybercomms he said in his witness statement that he had considered it relevant they banked with FCIB.

613.We also note that he ignored the rather silly and incorrect statement in the due diligence on LMC that the chains will be very small and "totally checkable". Mr

Sharp said he thought that this meant HMRC would check the chains but we do not think he really believed this: he was simply not concerned.

614.*Shavondra*: although not a party to any of the deals at issue in this appeal we note that Eartshine carried out due diligence on this company in May 2006 and the following day traded with it in a transaction worth half a million pounds. Earthshine did this even though the company traded from a private house, and the director was a UK national although the company was based in Cyprus. Earthshine had no worthwhile independent information on the company: the only documents collected were a VAT registration certification, company registration document and an untranslated document. The company had only been registered for VAT for 4 months.

615.Mr Agoh carried out the due diligence and said he was doing the sort of due diligence expected by the company. The only attempt at independent verification was a call by Mr Agoh to the company's accountant whose only comment was that the company was good at providing requested information.

616.We find these checks to be wholly inadequate for a business which stated that it intended to avoid being involved in fraudulent chains. The due diligence could only have reassured them that the company was VAT registered and a corporate entity: to the extent they learnt anything else it was that it must have been surprising that the so new a company and one currently without premises could carry out such large trades. Yet this was of no concern to Earthshine as it traded with this company the next day in a high value deal. We find the due diligence must only have been done for the purpose of window dressing as Earthshine ignored all negative indicators.

617.*Letting solutions.* This company was not a trading partner of Earthshine's in the deals in question. Mr May for Earthshine carried out a due diligence report in August 2006. It is apparent that with this company, as with others, Earthshine had no interest in the financial status of the company. It states in terms that "Proof of financial liquidity and capability to trade was not sought but a companies house check shows Letting Solutions returns are overdue". No credit check was sought. Mr Sharp maintained in cross examination that he got a lot of comfort from the fact that the company is 3 years old, trading from the address on their returns, a BT phone bill, their headed paper, the director's passport and bank details. He said he considered it to be comprehensive due diligence. We find it was nothing of the sort: it gave them virtually no information on the financial status of the company.

618. <u>Freight forwarders:</u> Earthshine did not do much if any due diligence on freight forwarders. Their explanation for not doing due diligence was that they may have done a report at the outset (we do not accept this as Earthshine prided itself on not losing documents), their insurer did due diligence and their insurance agent had recommended them, and everyone in the industry used them. On Interken, Earthshine did hold a credit report because they had paid a deposit and did not wish to lose it. We have already commented about Hawk. No credit checks were carried out on Paul's Freight.

619.We therefore reject the Appellant's case that Earthshine undertook due diligence to test the legitimacy of its suppliers and customers. Prior to mid-2006 we find Earthshine was prepared to trade with persons with whom it may have traded for some time but on whom it held no due diligence. It chose not to query questionable statements made in due diligence reports. Its due diligence failed to look at the financial standing of its trading partners. Earthshine traded with a company despite a due diligence report which should have made it suspicious. We find that this is because Earthshine's Directors, who were both experienced businessmen and not unintelligent, chose to ignore the obvious. Our conclusion is that Earthshine did not undertake its due diligence because it had any genuine desire to avoid being caught up in fraudulent chains. The only reason, therefore, for its due diligence was a desire to make it appear as if they were not involved in fraudulent chains. It was window dressing.

Findings

Conclusions on actual knowledge

620.We consider and so find that that actual knowledge by one of its two directors is actual knowledge by the company.

621.Earthshine by its officers were well aware of the risk of MTIC fraud in the market in which they say they traded; yet they continued to trade despite (we find):

- knowing there was no rational commercial explanation for the market in which they were trading, and choosing not to investigate oddities such as why Continental companies wanted phones with 3 pin plugs nor taking any steps to increase their profits by cutting out the middlemen even though they knew the chain was long;

- knowing they were able to make substantial profits for doing virtually nothing but issuing invoices, inspecting goods and having ready capital. Earthshine's officers were not able to explain to this Tribunal a commercial rationale for how a market might have arisen which allowed them to do this without taking commercial risk;

- knowing at least in one deal that the goods were being imported from Continental Europe and then immediately re-exported;

- being of the opinion that their suppliers were dealing back to back and making too little profit to undertake inspections of the goods;

- knowing their customers had no real interest in the specification of the products they were purchasing. They offered no rational explanation of how this could happen in a genuine market.

622. We have found the trades were part of an orchestrated fraud and that Earthshine's profit was a significant percentage of the money that was the object of the fraud (between 20% and 33% but mostly around 33%) and this indicates to us that

the orchestrators were prepared to share the proceeds to a significant extent with Earthshine and begs the question of why they would do this if Earthshine was not a knowing participant.

623.We also found that Mr Sharp's evidence on how the deals were negotiated was unreliable. We also note that it was our finding that the deals were in fact orchestrated so we find that Earthshine's deals were to the large part dictated to it and not negotiated. This finding is bolstered by other evidence which shows Earthshine had no genuine interest in meeting its customers' specifications and did not investigate discrepancies in inspection reports over whether the phones had 2 or 3 pin chargers: we find this shows it knew its customers would take the phones in any event.

624.Earthshine's due diligence included no effective third party check on the company's financial position and indeed Mr Sharp said he did not consider credit checks relevant. We find he had no real interest in Earthshine's trading partner's financial position and that this must be because he knew that the deals would take place in any event and that Earthshine would be at no risk (other than risk of non-repayment by HMRC). Any negative indicators, such as inappropriate suggestions to orchestrate deals, were ignored and Earthshine continued to deal despite negative indicators.

625.Further we find that this means Earthshine did deliberately "window dress" its transactions: its use of product codes, when Mr Sharp must have known its customer had no interest in them (because its customer did not specify them and in any event Earthshine knew it would take the phones in any event) must have been to dress up the invoice to make it appear more like a real commercial transaction than it was. It undertook due diligence without any real interest in the commercial viability of the subject of it because it had no interest in its customers' or suppliers' financial standing. The purpose of the due diligence could therefore only have been to appear to comply with Notice 726 rather than any genuine desire to actually avoid fraud. We note in connection with this that Earthshine chose not to enforce its terms of trade against its suppliers which had promised to indemnify it in the event its VAT repayment was not paid promptly: its failure to give a convincing explanation for this to the Tribunal means that we find it knew that it was not trading on these terms and conditions.

626.Its inspections were fairly thorough. We found there was a genuine desire to know the phones existed and were not in battered boxes, but as we also found the directors knew that their customers were not genuinely concerned with the condition or specification of the phones we find this concern was not to fulfil contractual terms or protect against fraud but to protect Earthshine's input tax claim.

627.It is irrelevant if HMRC's conduct led Earthshine to believe that despite a proved connection to fraud they might nevertheless still receive repayment: the question is whether they knew or ought to have know of the fraud, not whether they thought they would be refunded the input tax. We have found nothing in HMRC's conduct which

could or did lead Earthshine to believe that its transactions were not connected to fraud.

628.As we have concluded Mr Sharp did know that Earthshine's transactions were connected to fraud, we do not think the firebreak of 2004 has any relevance: as it is clear to the Tribunal that he was prepared to trade despite knowing the connection to fraud we find the decision to cease trading was taken out of concern that HMRC would cease to make repayments and not out of a genuine concern to avoid fraudulent transactions. Further, that no veto letters or withholding of tax or notifications of connection to fraud occurred after that date until the transactions at issue in this appeal, could not have reassured Earthshine that its transactions were not connected to fraud as it knew (via Mr Sharp) that they were so connected.

629.We reject the Appellant's case as set out in paragraph 449. The Appellant did not follow HMRC's advice on how to avoid fraud: in particular it did not "make a judgment on the integrity of [its] supplier chain" as required by Notice 726. If it had followed this advice it would not have carried out the deals that it did for the reasons explained above.

630.We find that Earthshine (via Mr Sharp) did know that its transactions were connected to and facilitated fraud: where Earthshine rejected deals we find this must have been because they were concerned that otherwise HMRC would be able to refuse their input tax claim. This is because if the reason they rejected the deals was a genuine concern about connection to fraud, then such a genuine concern would have been evidenced elsewhere in actions taken by Earthshine: they would have taken a proper view on the integrity of its supply chain, such as taking a real interest in the financial standing of the companies with which it traded, such as being extremely suspicious of the fact that the "market" on which they traded was patently not commercially rational, not trading when it knew its customers would take the goods without any real interest in their specification etc, and as explained above.

631.In conclusion we have no doubt that Mr Sharp, and therefore Earthshine, knew that its transactions the subject of this appeal were all connected to (and indeed facilitated) a fraud on HMRC.

632.We note that certain matters were known to Mr Sharp, as the one responsible for day to day management and negotiation of the deals that were not necessarily known to Mr Knatchbull. It was also the consistent evidence of Mr Sharp and Mr Knatchbull that Mr Knatchbull did not know of the true purpose of Mr Young's employment by Earthshine prior to the firebreak and was unaware of matters evidenced by the email chain between Mr Sharp and Mr Young. Nevertheless it was clear he was aware of all the other matters to which we have referred. He was actively involved with the company's business even if not its driving force: he had attended an inspection and initiated the relationship with TTW. He knew Earthshine was making a large profit for doing very little. He knew that due diligence did not given Earthshine any sensible view of the financial standing of its trading partners and he knew Earthshine was not interested in the financial standing of its trading partners. He was party to the

decision not to pursue its suppliers under the indemnity referred to above. He could not give a rational explanation for the market in which Earthshine traded.

633. With respect to Mr Knatchbull we conclude that if he did not actually know of the connection to fraud, he was choosing to turn a blind eye to it. For this reason too, we conclude that Earthshine had actual knowledge that its transactions the subject of this appeal were all connected to (and indeed facilitated) a fraud on HMRC.

634. That disposes of this appeal. HMRC were right to deny the claimed input tax.

Means of knowledge

635. Whether Earthshine had the means of knowledge that its transactions were connected to fraud is irrelevant as we have already concluded the appeal in HMRC's favour. Were we called on to decide this, we would conclude for many of the reasons given above that Earthshine ought to have drawn the conclusion from what it did know about the transactions. In particular the lack of commerciality in the "market", the suppliers' lack of interest in specification of the goods, Earthshine's substantial profit for doing very little and taking no commercial risk, the re-export of recently imported goods, and the easy profits should have led the officers of Earthshine to conclude that the only explanation for its trades were that they facilitated MTIC fraud. They had all the primary facts from which it ought to have drawn the conclusion that the transactions were connected to fraud because there was no other rational explanation for all these factors.

636. HMRC's conduct is, as we have said above, relevant to the question of means of knowledge. Yet we find that nothing that HMRC did could reasonably have reassured Earthshine that its transactions were not connected to fraud: on the contrary Mr Stone gave explicit warnings that Earthshine could not avoid fraud if they continued to trade. At best HMRC's continued repayment of Earthshine's refund claims up to July 2006 could only have reassured them that they would be repaid despite a connection to fraud: this is not the same thing.

637. Mr Green says that there was nothing more Earthshine could have done to protect itself from fraud: for the reasons given above we disagree. For instance, it could have refused to undertake deals where it knew its suppliers and customers were not interested in the specification of the goods and there was no commercially rational explanation for the opportunity it was being offered to make a profit. In any event the Tribunal finds that Earthshine had means of knowledge because it had all the information it needed without further investigation to reach the conclusion that the only possible explanation for the opportunity it was offered was that it was connected to (and indeed facilitated) fraud.

638. We find there was means of knowledge because, on the facts as known to Earthshine's directors at the time in 2006, as in the words of Moses J "there was no reasonable possibility other than" the transactions were connected to fraud. Therefore, for this reason too, Earthshine's appeal must be dismissed.

Late submission

639.Just before release of this decision, on 14 October, the Appellant's solicitors, Maitland Walker, made a further submission to this Tribunal. Ordinarily, submissions made after the conclusion of the hearing and which have not been expressly permitted by Directions of the panel at the hearing, would not be considered. An exception is where the matter raised is of such importance that there is a risk if it were not considered an injustice would follow. Maitland Walker consider their submission is in this category as they say it is fundamental to the credibility of a witness (Mr Stone) on whose evidence we might rely.

640.As the witness was Mr Stone and we have to some extent relied on his evidence, we therefore considered whether there was any substance to Maitland Walker's submission such that submissions in reply should be invited from HMRC or the hearing reconvened.

641.In brief, Maitland Walker's submission is that Mr Stone's evidence, as summarised by the Judge in paragraph 31 of the case of *Express Computers UK Limited and another* [2011] UKFTT 572 (TC) contradicts the evidence he gave in the hearing in this appeal and casts doubts on his credibility.

642.His evidence summarised in paragraph 31 of that decision concerned "Redhill checks" which are clearly explained by the Judge in that case to be verifications by HMRC of the VAT number of the taxpayer's proposed immediate trading partner. Mr Stone's evidence in that case was that HMRC recommended and expected that a trader carry out such a check before each transaction even where the transaction was with an existing trading partner.

643.Unlike the decision in *Express Computers,* VAT number verifications were not in issue in this appeal because (as mentioned at paragraphs 422 and 475) Earthshine always got a VAT number verification before proceeding with a deal if not from Redhill (whom they said were too slow) then from the National VAT helpline.

644.Mr Stone's evidence in the case before us was that HMRC at Redhill (or indeed any other HMRC office) would not carry out *line checks.* We have described in detail what a line check was at paragraphs 451-472 of this decision. Line checks are *not* Redhill VAT number verifications as described by Judge Kempster at paragraph 31 of his decision. They are two very different things as a VAT number verification was a check of the validity of VAT registration of an immediate supplier and a line check was a check of the VAT status of the entire chain of supply (the supplier's supplier's supplier etc). HMRC strongly recommended the former and refused to carry out the latter. We can see no inconsistency in Mr Stone's evidence as it was about two different processes, albeit superficially related as they both concerned VAT number verification.

645.In conclusion, the Tribunal sees no inconsistency in the summary of Mr Stone's evidence given in *Express Computers* and his evidence in this case and nothing to affect our conclusion that he was a credible witness.

646.We are also satisfied that the officers of Earthshine themselves, if not their solicitors, were quite clear on the difference between the two processes. Their complaint was that they were not given line checks at all in 2006: but it was clear in 2006 Earthshine received VAT number verifications of its immediate suppliers and their only complaint in this respect was that Redhill turned requests round too slowly.

647.Our conclusion is that there is nothing in the submission that suggests that failure to consider it would lead to miscarriage of justice. We therefore refuse to accept it.

648.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.

Barbara Mosedale

TRIBUNAL JUDGE
RELEASE DATE: 20 October 2011

Alartec	Alartec Limited
A-Z Mobiles	A-Z Mobile Accessories Ltd
Black Country	Black Country Trading Limited
Blue Star	Blue Star Communications
Cirex	Cirex Corporation Limited
Cobra	Cobra Communications Ltd
Data Solutions	Data Solutions Northern Limited
DBP	DBP Trading Ltd
DRT	DRT Vertriebs GmbH
DTM	DTM Provisions Ltd
Interken	Interken Freighters (UK) Limited
Global Mobile	Global Mobile Leasing GmbH
Highbeam	Highbeam (UK) Ltd
Jag-Tec	Jag-Tec Limited
K N Exports	K N Exports Ltd
Letting Solutions	Letting Solutions (UK) Ltd
LMC	London Mobile Communications Ltd
Mana	Mana Enterprises Ltd
M. S. Enterprise	M.S. Enterprise Ltd
New Order	New Order Trading Ltd
New Way	New Way Associates Ltd
OHM	OHM Traders GmbH
On Line	On Line Celular Y Multimedia
ORIL	Opportunities Recruitment International

	Limited
Outer	Outer National Limited
Owl	Owl Limited
Parfum	Parfum (UK) Limited
Paris 2000	Paris 2000 SPRL
Pauls Freight	Pauls Freight Services Ltd
Phone City	Phone City Limited
Red House	Red House International Limited
Santok	Santok Enterprises Limited
Silus	Silus BV
Snowrix	Snow Rix LDA
Starmill	Starmill International Limited
Sunico	
Trans Global	Trans Global Traders Ltd
TTW	Tele Trading Worldwide BV
Vescon	Vescon Construction Ltd