TC01605

Appeal number: LON/2008/2411

VALUE ADDED TAX – Input Tax – MTIC fraud – Contra-trading – Whether Appellant knew or ought to have known its trade in mobile phones was part of fraudulent trade – Whether if employee of Appellant company knew of fraudulent trade the company was liable – Whether Director turned a blind-eye to employee's activities – Appeal dismissed

FIRST-TIER TRIBUNAL

TAX

OPTION NTC LTD **Appellant**

- and -

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

TRIBUNAL: MISS J C GORT (Judge)
J ROBINSON (member)

Sitting in London on 1-9 June 2011 and 4-7 July 2011

Mr James Lewis QC and Miss S Naqshbandi of Counsel, instructed by Irwin Mitchell LLP, appeared on behalf of the Appellant.

Mr Mark Sutherland Williams and Mr Oliver Pownall of Counsel instructed by the Solicitor to the Commissioners for Her Majesty's Revenue and Customs appeared on behalf of the Respondents.

DECISION

1. This is an appeal against a decision of the Commissioners for Her Majesty's Revenue and Customs ("HMRC") contained in a letter dated 10 November 2008 to deny the Appellant ("Option")'s re-claim of input tax in the sum of £1,486,436.88 in respect of the periods 06/06 and 07/06.

2. The grounds for this decision were that the input tax incurred by Option was done so in transactions connected with the fraudulent evasion of VAT and Option either knew or should have known that this was the case.

3. The decision relates to ten separate deals involving the sale of mobile telephones ("phones") in June and July 2006, all ten of which trace back to tax losses within contra (or offset) trading schemes (a description of which follows at paragraph 12). The three contra trading companies involved were Devi (trading as PLC Communications Limited) ("Devi"), Owl Limited ("Owl"), and an associated company, Owl Import & Export Limited ("Owl I&E"). Option was the exporter on each occasion in the contra chain.

4. By its Notice of Appeal dated 13 November 2008, Option denied that it "knew or should have known that its transactions were part of such a scheme [to defraud the revenue] (if indeed they were) and therefore the decision to deny its claim for repayment of input tax was wrong".

The Issue

5. At the hearing it was admitted by Option that the following issues were not disputed:

(a) the identification of the deal chains; the length and the participants therein;
(b) the tax losses identified therein;
(c) that in each case the purpose of the said tax losses was fraudulent;
(d) that the Option transactions in question were connected to the tax losses.

6. It follows that the principal issue in the appeal is whether Option knew or ought to have known at the relevant time that the ten transactions in question were connected with fraud.

7. A secondary issue to be decided emerged in the course of the hearing: whether knowledge, blind eye or actual, can be attributed to an employee of a company and whether such knowledge can be ascribed to the company?

The background

8. Option NTC plc (formerly Option Telecom plc) was incorporated in August 2001 and was registered for VAT with effect from 10 January 2002. Its main business activity was described as being "telephone services, least cost routing and 0800 numbers". For sake of convenience we will refer to the Appellant as "Option" throughout this decision; the trading company between 2001 and 2006 at all times was Option Telecom plc. Some time in 2007 Option Plc became Option NTC plc, 'NTC' standing for 'non-trading company'.

9. In June 2003 Option moved its registered address from Borehamwood in Hertfordshire to Glenrothes in Fife, Scotland although it continued to occupy offices in Borehamwood. Option's lease was in the name of another company called Database Advertising ("Database") which for a time was owned by David Ford and Nicholas ("Nick") Fisher. By November 2004 Option had started trading in the wholesale of mobile telephones. When the company was formed the two directors were David Ford and Nick Fisher. Nick Fisher resigned as a director in on 29 September 2005 but remained an investor and retained close links with the company. At the relevant time (i.e June and July 2006) the directors of Option were David Ford and Michael Fisher ("Mike Fisher") (no relation of Nick Fisher), who was also registered as the company secretary.

Missing Trader Intra Community Fraud ("MTIC") and Contra- trading

10. When the VAT system is correctly operated, it is axiomatic that

- An amount of VAT charged by one VAT registered trader to another VAT registered trader should be accounted for as output tax, and then
- The amount of VAT previously charged as output tax, may subsequently be reclaimed by the purchaser as input tax (so as to ensure that the tax is neutral regardless of how many transactions are involved); and
- When a business's input tax claim exceeds its output tax it will be entitled to make a claim for a repayment of VAT.

A transaction chain in an MTIC fraud involves a "missing" or "defaulting" trader, who imports goods from another EU Member State; a number of intermediary or "buffer" traders, and a "broker" trader, who exports the goods. These are known as "tax loss chains" or "defaulter chains". In an effort to disguise or hide any tax loss, "contra trading" chains are often contrived to run in conjunction with tax loss chains as part of an overall scheme to defraud the revenue.

11. The basic scheme operates as follows:-

(i) Trader A, based in an EU Member State (e.g. France), sells taxable goods to Trader B, in another EU Member State (e.g. the UK). In effect, Trader B acquires those goods free of VAT.

(ii) Trader B, who is the defaulting trader in the UK (i.e. a trader who incurs liability to VAT but who goes missing without discharging that liability) or the trader using a hijacked VAT number (i.e. a trader using a VAT number belonging to someone else), sells the goods to a UK "buffer" (UK Buffer 1).

(iii) Trader B charges VAT on the supply to UK Buffer 1. Trader B is liable to account to HMRC for the output VAT it has charged to its customer (UK Buffer 1), but goes missing before discharging that liability to the tax authorities.

(iv) The goods can then be sold through a number of UK Buffer companies.

(v) The last UK Buffer company (UK Buffer 3) sells the goods to the UK Broker 1 (Trader C). As is normally the case with all buffer traders, UK Buffer 3 pays HMRC the output VAT charged after having deducted the input VAT paid.

(vi) UK Broker 1/Trader C exports the goods to another Member State or outside the EU Exports are zero-rated for VAT purposes, but UK Broker 1/Trader C is entitled to claim a refund of the input VAT paid on the purchase of the goods from HMRC. Should HMRC makes this repayment, the loss of VAT by Trader B is crystallised and goes on to fuel the next round of MTIC transactions.

12. HMRC first became aware of contra-trading in July 2005. 'Contra-trading' is the term employed where a trader who has acted as a broker (trader C in the above example) in a chain of transactions (known as a 'dirty' chain) which involves a missing trader and a fraudulent VAT loss, seeks to conceal his involvement in such a chain. He does so by acquiring goods which he sells to another trader, trader D (in this case Option), who exports the goods. Trader D claims back the input tax from trader C but does not have to account to HMRC for any output tax because the sale was by way of an export. This transaction is known as the 'clean' chain. This is done in the same tax period in which trader C has acted as broker in the dirty chain, and trader C's claim for input tax in that chain is off-set in whole or in part by the output tax due on the transaction(s) with trader D. The (apparently) legitimate transaction(s) with trader D are undertaken by trader C in order to disguise trader C's involvement in the fraudulent chain(s).

13. In the present case Option does not dispute that all of its transactions in the relevant periods were connected to dirty chains in a contra-trading scheme but claims that it was unwittingly involved by the fraudsters; not only did it not know of the connection with fraud at the relevant time but claims that it could not have known because the existence of contra-trading as that method of carrying out MTIC fraud was not known about at the time.

The legislation

14. Articles 167 and 168 of Council Directive 2006/112 EC of 28 November on the common system of VAT (the EC sixth directive) provide

> 167 – A right of deduction shall arise at the time the deductible tax becomes charged.
>
> 168 – In so far as the goods and services are used for the purposes of the taxed transactions of a taxable person, the taxable person shall be entitled, in the Member State in which he carries out these transactions, to deduct the following from the VAT which he is liable to pay.
>
> (a) the VAT due or paid in that Member State in respect of supplies to him of goods or services, carried out or to be carried out by another taxable person.

15. Sections 24 to 26 of the Value Added Tax Act 1994 ("the VAT Act"), which implemented Article 17(1) to (3) of the EC Sixth VAT Directive, deal with a taxpayer's entitlement to input tax credit. Those sections are in mandatory terms and provide that if a trader has incurred input tax which is properly allowable, he is entitled as of right to set it off against his output tax liability or to receive a repayment if the input tax credit due to him exceeds his liability.

16. Regulation 29 of the VAT Regulations provides:

> 29 - (1) Subject to paragraph (2) below, and save as the Commissioners may otherwise allow or direct either generally or specifically, a person claiming deduction of input tax under section 25 (2) of the Act shall do so on a return made by him for the prescribed accounting period in which the VAT became chargeable.
>
> (2) At the time of claiming deduction of input tax in accordance with paragraph (1) above, a person shall, if the claim is in respect of –
>
> (a) a supply from another taxable person, hold the document which is required to be provided under regulation 13 …

17. It follows that if a taxable person has incurred input tax that is properly allowable, he is entitled to set it against his output tax liability and, if the input tax credit due to him exceeds tax liability, receive a payment.

18. The Court of Justice of the European Communities ("the ECJ") has decided that there is an exception to Article 17, as implemented by sections 24-26 of the VAT Act. In *Axel Kittle v Belgian State and Belgian State v Recolta Recycling* SPRL (Joined Cases C-439/04 and C-440/04 [2006] ECR I-6161 ("Kittel") the ECJ held (emphasis added):

> *54. As the Court has already observed, preventing tax evasion, avoidance and abuse is an objective recognised and encouraged by the Sixth Directive (see Joined Cases C-487/01 and C-7/02 Gemeente Leusden and Holin Groep [2004] ECR I-5337, paragraph 76.* ***Community Law cannot be relied on for abusive or fraudulent ends*** *(see, inter alia, Case C-367/96 Kefalas and Others [1998] ECR I-2843, paragraph 20; 373/97 Diamantis [2000] ECR I-1705, paragraph 33; and Case C-32/03 Fini HJ [2005] ECR I-1599, paragraph 32).*
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> *55. Where the tax authorities find that the right to deduct has been exercised fraudulently, they are permitted to claim repayment of the deducted sums retroactively (see, inter alia, Case 268/83 Rompelman [1985] eCR 655, paragraph 24; Case C-110/94 INZO [1996] ECR I-857, paragraph 24; and Gabalfrisa, paragraph 46). It is a matter for the national court to refuse to allow the right to deduct where it is established, on the basis of* ***objective evidence****, that that right is being relied on for fraudulent ends (see Fini H, paragraph 34).*
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> *56. In the same way,* ***a taxable person who knew or should have known that, by his purchase, he was taking part in a transaction connected with the fraudulent evasion of VAT must,*** *for the purposes of the Sixth Directive,* ***be regarded as a participant in that fraud,*** *irrespective of whether or not he profited by the resale of the goods.*
>
> *57.* ***That is because in such a situation the taxable person aids the perpetrators of the fraud and becomes their accomplice.***
>
> *58. In addition, such an interpretation , by making it more difficult to carry out fraudulent transactions is apt to prevent them.*

19. At para 61 the ECJ summarised the position thus:

> *"… where it is ascertained, having regard to objective factors, that the supply is to be taxable person who* ***knew or should have known*** *that,*

by his purchase, he was participating in a transaction connected with the fraudulent evasion of VAT, it is for the national court to refuse that taxable person entitlement to the right to deduct".

20. Relevant to the Tribunal's considerations in this regard are what steps the Appellant took to protect itself. Paragraph 5 of the ECJ's judgment in *Kittel* provided as follows:

> *"… traders who take every precaution which could reasonably be required of them to ensure that their transactions are not connected with fraud, be it the fraudulent evasion of VAT or other fraud, must be able to rely on the legality of those transactions without the risk of losing their right to deduct the input VAT …"*

The Evidence

21. The Tribunal heard evidence from the following officers on behalf of HMRC who all submitted witness statements and were tendered for cross examination: Norman Morrison (the case officer); Richard Hodgson (the contra officer for Devi); and Helen Harris (the contra officer for Owl and for Owl I&E).

22. Witness statements were provided and were not challenged by Option, from the following officers of HMRC: Douglas Armstrong (Bluestar Communications); Neil Brownsword (Total Distribution Limited); Jane Carr (Alartec Limited); Paul Cole (Universal Appliances); Jennifer Davis (Beechson); David Farmer (Eagle Solutions); Paul Fisher (Causeway Initiatives); Jonathan Laing (Isales London Limited); Karen Mcdonald (Bushmaster Limited); John McPartlin (Udeil Solutions); John Read (Parfums UK Ltd and Rudey Limited); Gary Saul (SS Enterprises Limited); and Alistair Strachan (Carisma Industrial Supplies Limited and D.B.P. Trading Limited). Similarly, witness statements from officer Stephen McManus (HMRC Operational Accountant), Mr John Fletcher of KPMG, and Mr Roderick Stone (HMRC Policy Advisor on MTIC fraud) were admitted unchallenged. In total there were some thirty four ring binders of documents, statements and evidence.

23. David Ford, at all relevant times a director of Option, was the only witness to give evidence on its behalf. Beyond his witness statements and exhibits no other evidence or statements were produced on behalf of Option.

The facts

Option's personnel and trading history and practice

24. We find the following facts. David Ford is a qualified solicitor who was admitted in 1980. Three years later he became a partner in a firm of solicitors in London, Tarlo Lyons. He practised as a commercial lawyer. In 1990 he became the managing partner of the firm. In 1993 he left to work in a non-executive or semi-executive capacity in various types of business. He describes himself as being very

familiar with accounting methods and procedures and having been responsible for setting up and running the finance departments of several businesses. He had also been a non-executive in a number of businesses which imported various types of goods, and, to a lesser extent, exported them. At some stage he had acted as a consultant to his former firm giving advice both on accountancy matters and in relation to missing traders. In his evidence he described his understanding of MTIC fraud as being "that a trader would import phones from EU countries where he would not have to pay VAT on the import. He would then sell the telephones in the UK and consequently receive 17.5% VAT on the entire price of the phones without having to pay any VAT on the purchase price, so that would be a very large proportion, and then that trader would not account for the money, and would become a missing trader."

25. Option was established with an initial investment of £25,000 from David Ford and £25,000 from Nick Fisher, a business man who had been known to David Ford since 1985. This money was put into the least cost routing side of Option; when, in 2005, it was decided to deal in mobile telephones, (see below) Nick Fisher then put in a further £500,000 and subsequently over time increased that investment, first to £900,000, and by June 2006 he had put in £1.25 million.

26. In 2004 Nick Fisher, who at the time was, inter alia, joint chief executive of a company which sold various gift products to Woolworths, had learned that Woolworths was one of the largest retailers of mobile phones in the UK. He had then contacted a Colin Thompson, who had formerly worked with him in the mobile phone business, it being HMRC's unchallenged evidence that both of them had previously been involved with companies with known MTIC connections. Colin Thomson was at the time trying to establish a vodka business in Romania, and Nick Fisher asked him to look into sourcing mobile phones in Romania and Eastern Europe which he did. In the event Colin Thompson was not able to provide Woolworths with a cheap but guaranteed level of supply. Nonetheless, Woolworths suggested to Colin Thompson that a company called Unique Distribution ("Unique") was repackaging imported phones and notifying them so as to make them compatible with UK power supplies and that Unique might be interested in buying cheap parcels of phones from time to time. Unique was contacted by Colin Thompson and confirmed the above. Nick Fisher then proposed to David Ford that Option should employ Colin Thompson and import mobile phones for sale to Unique. On 30 September 2004 David Ford met Colin Thompson and agreed to work with him on certain terms which we refer to below in paragraph 29. On 24 September, David Ford met some of the directors of Unique, together with Nick Fisher.

27. Colin Thompson had lost about £1million in his attempt to set up the vodka business in Romania. In an email to Nick Fisher sent on 1 September 2004 he referred to a meeting he had had with someone at Unique, he then ended the email with a P.S.:"I just wanted to confirm to you both that my commitment to this will be total. I have always loved the phone business, and my desire to get back what I lost is paramount to giving this 100%". Colin Thompson was at some stage employed by Option on a salary described by David Ford as "modest", with a maximum bonus of

£1,000 per month if Option exceeded a turnover of £20,000 in any month. Unfortunately, David Ford was unable to provide specific details of Colin Thompson's salary or employment. At some stage Colin Thompson returned to the UK to live in Cardiff and became employed by Option. Whether or not he had a contract of employment, and if so what its terms might have been, is not known to the Tribunal. He continued to live in Cardiff whilst working for Option.

28. At the outset it had been decided to make Option a public liability company to give it credibility. David Ford and Nick Fisher were the two directors at that time. Initially, a Tim Theobald was employed by the company but was soon replaced by Mike Fisher, (no relation to Nick Fisher) who was a chartered accountant who, although he worked in a part-time capacity for Option, was employed by Database (see para 9 above), not Option. Nick Fisher's cousin, Sarah Fisher, was appointed as managing director of Option, although she had no experience in the mobile phone industry, and only concerned herself with the least cost routing side of the business. Mike Fisher lived and worked in Scotland and was based in an office next door to a business operated by David Ford and Nick Fisher. He was appointed as the financial controller of various other businesses run by the two directors, as well as Option. He was recruited in part because he was known to be a committed evangelical Christian and as such was thought by David Ford to have 'a strong moral compass' and therefore likely to be completely trustworthy. Initially Mike Fisher had an accounts assistant working for him in Scotland, but he himself received no direct payment in respect of his work for Option where he was responsible for the monthly accounts. Up until May 2006 there was an arrangement with his then employer, Database, that they would charge Option for his time. In May 2006 there was a management buy-out of Database, and David Ford and Nick Fisher ceased to have any further interest in Database. Mike Fisher remained an employee of that company but had by then become a director of Option in place of Nick Fisher who had resigned under pressure from another company for whom he worked. Option continued to pay Database for Mike Fisher's work in both aspects of its business, and Mike Fisher was still not paid by Option, and his only financial interest in the success of Option arose from the small part of his salary that was recharged to Option by Database. Despite claiming to have complete trust in Mike Fisher, David Ford nonetheless in his first witness statement recorded: "I wanted Mike Fisher to act as a regulator and not to have any direct financial incentive for transactions to happen." It was never explained to the Tribunal precisely what Mike Fisher's salary was at the relevant time. Mike Fisher was described as being "not very commercially astute" by David Ford, and he also said that Mike Fisher was never treated as a director and never participated in any board level discussions. We were not told who, in that case, did participate in board level decisions after Nick Fisher had resigned, or indeed if there were any. There was only one other relevant employee of Option, an accounts clerk called Michelle Back who worked from the Borehamwood office at all relevant times.

29. At the time David Ford considered entering the mobile phone business, Option's least cost routing business had been progressing more slowly than he wished, although it was making small profits and was eventually sold separately in 2007 for £400,000. David Ford agreed to import mobile phones sourced by Colin

Thompson on the basis that all of the paperwork was to be dealt with by Mike Fisher and no deals were to be done without Mr Ford's personal approval. In his first witness statement David Ford said: "Although I had no concerns (at this stage) about any involvement with VAT fraud, I knew that Colin Thompson was a typical salesman and would not be concerned at all with dotting the 'i's or crossing the 't's. He was also not particularly commercially sophisticated and it was quite possible, in my view, for him to do a deal where we ended up losing money or doing deals for which we didn't have the cash flow available. All he was concerned about was selling something for more than he bought it for. He didn't consider any other expenses of a transaction, such as carriage or insurance or custom charges and that's why I wanted Mike Fisher to vet every deal and me to approve it."

30. In November and December 2004 Option did three deals with Unique. On 24 January 2005, David Ford and Colin Thompson met at Unique's offices to discuss further business. The issue of fraud was discussed and David Ford told Unique he thought that, as they were buying phones in the UK from small traders they were at risk of becoming involved in a missing trader chain. It was David Ford's view that if Option bought direct from the importer, and the importer had been trading and importing for a lengthy period ('lengthy' not defined), and the personnel in that company had not recently changed, then that company was not going to become a missing trader. He was not concerned with the credit rating of such a company.

31. David Ford had set an exposure limit of £100,000 on Option's deals with Unique, a limit which was more honoured in the breach than in the observance, as was clear from an email sent to him by Mike Fisher on 26 January 2005 which read in part as follows: "Currently they (Unique) owe £98,900 plus VAT of which £19,500 plus VAT should be paid by Monday with a further £30,500 plus VAT due three days later." In his evidence, with reference to the same period, Mr Ford said: "Even before there was any question of anything to do with MTIC, I would never let Mr Thompson close deals, and didn't". Yet the email above continues: "Colin has today agreed a further five deals with Unique for 1,200 phones totalling £123,400 plus VAT…" The trade with Unique ended in February 2005 when Unique rejected a parcel of phones from Option because they did not conform to Unique's specification in that they were not of European but of Far East specification. Mr Ford commented on this as follows: "I thought that this was an excuse as we had supplied them with phones of this specification in the past and they had not complained." This shows the attitude of all three men involved in those deals: Colin Thompson was prepared to source telephones which were not as the purchaser had specified, Mike Fisher did not overrule the purchase on that ground and David Ford was unconcerned that this had happened. David Ford had also not prevented further trade which exceeded his stipulated limit and which had been agreed by Colin Thompson, apparently without consulting Mike Fisher, or, if he had consulted him, then Mike Fisher had approved the trade. In the event, Unique went into administration and Option had to sell the rejected telephones elsewhere.

32. Following the failure of Unique, Colin Thompson approached Nick Fisher and proposed buying telephones in the United Kingdom and exporting them in a process

which he described as 'arbitrage'. Mr Ford referred to it as 'grey market' activity. There was no direct evidence of Option researching the wholesale market. The only evidence produced by David Ford at the outset was in relation to retail prices shown on a website called pricerunner.co.uk. Mike Fisher's files showed that he had visited the site on 24 May 2006 (i.e. just before the date of the contra-trading deals) and obtained European retail prices for that date. David Ford claimed that this evidence showed that it was reasonable to believe that there was a genuine opportunity to trade in the grey market at the time. He was prepared to let Option start dealing in that way on certain conditions. He stipulated that Option would only deal with suppliers and customers of whom he had first approved and no deal would take place unless he had previously approved it. He claimed that he was only prepared to approve as suppliers established companies who were the importers of the phones in question, or with middle men if Option could identify the original importer and could be confident that it was not going to be a missing trader. Again, this was not always borne out by the facts, as we set out below.

33. Prior to entering the mobile phone market the only research done by Option related to finding suppliers and customers. This was done by Colin Thompson who would visit the proposed suppliers, but not the customers other than on one occasion. There was no evidence of any research undertaken into the viability of importing telephones into the UK and then exporting them to Europe. David Ford had had a meeting with Ernst & Young to discuss triangulation, which would involve trading in the mobile phones without importing them to the United Kingdom, and at that meeting MTIC fraud was discussed. In November 2005 Option was still considering triangulation but David Ford later decided against it. He did not take up an offer from Ernst & Young to prepare for Option a manual to assist with due diligence in the MTIC sector. He described it as "know your client rubbish". Option did not provide any terms and conditions of sale. It was said by Mr Ford that he believed that accounts were obtained on every company with which Option traded, but these were not produced. From the autumn of 2005 onwards Option arranged to obtain Dunn & Bradstreet reports, but these were only obtained for foreign customers. David Ford's evidence was: "I didn't think for traders of this sort we were ever going to get good credit ratings and we weren't extending them credit, so…" Any checks that were done were only done when a customer was taken on, never subsequently. Option did insure its goods in transit.

34. From 1 November onwards Option received various letters from HMRC warning about MTIC fraud in the mobile phone sector and giving names of traders involved in the mobile phone business who had been deregistered. Option were in possession of Notice 726 which sets out HMRC's position in relation to joint and several liability. It was aware of the necessity of carrying out checks with Redhill to verify the reliability of its customers and suppliers' VAT registration numbers, and would supply Redhill with details of the intended transactions. From 8 March 2005 onwards HMRC officers, Morrison and Henderson regularly visited Option. Mike Fisher informed them on 12 April 2005 that he would obtain references and accounts in respect of Option's customers, and that Option was holding back from dealing with a potential supplier, Devi, as the referees had not replied and it had a low credit rating.

At this stage Option did not check the IMEI numbers of the phones in which it traded, although subsequently a complete record of all IMEI numbers was said to have been obtained from the suppliers and regularly supplied by Option to HMRC. It was not disputed that Option did this, but in the case of the trade with Owl I&E some doubt is cast on whether this occurred in Option's deals with that company, given the evidence of Officer Harris recorded at para 44 below. In a visit on 14 June 2005 it was confirmed that Option's only supplier was Devi, for whom they had by then obtained references and it was considered by David Ford that doubts over its credit rating did not apply as Devi was a customer, not a supplier. It is recorded that Mike Fisher believed that Devi obtained their goods direct from manufacturers such as Nokia in Germany. He produced Devi's consignment notes ("CMRs") to show the origin of the goods, but with the consignor's name blacked out. David Ford himself attended a meeting with HMRC on 14 July 2005 and stated inter alia that he was not aware that companies could or would go missing or default purely for VAT, a view he confirmed in his evidence. He claimed that it was Option's policy only to deal with long-established companies that had not had any recent changes of directors. It became clear during the course of the hearing that this was not a policy that was always adhered to. On one occasion at the end of July 2005 Redhill had not cleared Devi. Mike Fisher informed HMRC that Option would not deal with Devi until clearance was obtained, but in August Option was again purchasing from Devi and also from a company called Prizeflex, who had told Option that they only bought from authorised distributers. This information must have come from Colin Thompson who was the only employee of Option who had direct contact with the customers and suppliers.

35. In September 2005 HMRC asked Mike Fisher about duplicate IMEI numbers which had been found in phones bought from Prizeflex. One hundred and fifty five of those phones had already appeared in a deal carried out by Option and had been bought by Option from Devi two months earlier. Mike Fisher explained that someone in the freight forwarders, Hawks, must have inserted previously scanned records in error. The officer advised Mike Fisher that that explanation was unlikely and that the duplication of IMEI numbers was an indication that the goods had been carouselled. The goods in question had initially been bought from Devi by Option for £177.50 in June and from Prizeflex for £145 on the second occasion. We note that Option did no due diligence on any of the freight forwarders with which they dealt in the periods in question. Mike Fisher asked to be informed if HMRC obtained any evidence of goods being carouselled, but was informed by HMRC that they could not do this because of confidentiality, but would advise of any tax loss in Option's chains. In October 2005 HMRC informed Mike Fisher that deals in July had been traced to a defaulter. In July Option had only dealt with Devi and Prizeflex. It was said by Mike Fisher that Prizeflex had conceded that they were not the importer but had claimed to buy the goods from the importer who was said to be a company called London Mobiles. HMRC knew that London Mobiles were not importers and that one of Option's suppliers, Bulk GSM was also not an importer. Mike Fisher told HMRC that Option was awaiting a book of best practice from Ernst & Young, Mike Fisher apparently not being aware that David Ford was not prepared to pay for that document. A visit had been paid by David Ford and Colin Thompson to the freight forwarder in an unsuccessful attempt to get Hawk to certify that their suppliers were

the importers. At this stage Hawk would only give verbal confirmation, although in November 2005 they agreed to give written confirmation and did so subsequently. Option did not ever make third party payments.

36. A large company called Sunico, located in Denmark, was a customer of Option at this time (2005) and had been visited by Colin Thompson. It was an established company, but one with a poor credit rating. (This was an exception to Option's normal rule that overseas customers were not visited.) Sunico, who became a supplier to Devi in the later fraudulent chains must have been cleared by Colin Thompson and David Ford, although no relevant documents were produced by Option. On 28 September 2005 Option had pulled out of a deal with Prizeflex because the IMEIs showed the phones in question to be the same as those sent to Sunico by Option on 26 September, but offered at a lower price. Prizeflex claimed to have obtained the goods from Germany. Following Option's September meeting with HMRC David Ford had sent an email to Mr Morrison saying: "We are going to restrict ourselves to buying from major companies or importers, and that, if the CMRs were genuine, Option would be happy continuing trading with Prizeflex." In October he sent another email stating that since the last email, he had decided that Option would stop dealing with Prizeflex until 'we' (i.e. Option) had cleared them. HMRC informed David Ford that the goods Option traded in during July 2005 originated from companies which were in default with their VAT payments, although they were not missing; this was confirmed at the monthly meeting with HMRC in November, as was the possibility of a September deal leading to a defaulter. The only people Option had purchased from in July 2005 were Devi and Prizeflex. Subsequently, Option had sold goods to Dubai but had not been paid for them, which gives the lie to David Ford's evidence that goods were always sold "ship on hold" and not released until paid for. At the October meeting, on being told that Sunico, Option's customer, would not buy goods previously stamped in the United Kingdom, HMRC advised Mike Fisher to consider the suitability of Sunico as a customer. This warning was ignored by Option, who continued trading with Sunico, because, in David Ford's opinion, Sunico was a substantial business and not a missing trader. The warning was not given because of Sunico's poor credit rating, but because it had been involved in the deals with Priceflex as well as because of its attitude to Customs stamps.

37. At a meeting with HMRC in January 2006 Option was informed that some of the IMEIs provided were turning up again in potential MTIC chains. The officers' note records: "Mike Fisher thinks that all his customers are above board. He thinks some may come in legitimately or be brought in by someone further down the chain from the actual customer. Ian Henderson pointed out that some of the phones dispatched that have come back are 'two pin' and therefore not suitable for the UK market." All Option's trade in the relevant period was in telephones with two pins. Sunico failed to pay Option for goods purchased in April 2006. A visit report from HMRC dated 2 May 2006 records: "Also bought and despatched 3,993 Samsung D500s to Sunico but have not received payment. Now trying to find a new customer or persuade Sunico to complete the deal. They have stalled due to price reduction from manufacturer. Option out £700k. Have now found a new buyer for these phones also in Denmark. Company is Trading Point ApS ("Trading Point"). Trading

Point was a new company owned by a director of Devi. At this meeting with HMRC it was learned that Colin Thompson had described Mike Fisher as 'the Sales Prevention Officer'.

38. On 24 May 2006 Mike Fisher informed HMRC by email that Option had purchased inter alia 1,000 Nokia mobile phones from Devi and sold them to Trading Point (a company which was first registered on 3 March 2006). Of these, the IMEIs showed that 254 had been seen before by Option, having previously been purchased from Devi on 19 April and sold to Sunico. Devi were adamant that telephones had been purchased from an authorised distributor and Hawk, the freight forwarders, thought they had sent to Option the IMEIs from the wrong pallet. Hawk then sent a further batch of IMEIs which proved also to relate to an April shipment to Sunico. Option did not complete the purchase of those Nokias.

The fraudulent deals (See Annex 1)

39. The first contra deal (Deal 1) was carried out on 7 June 2006 and involved the purchase by Option from Devi of 1,700 Samsung D600 telephones. Devi had purchased the telephones from Sunico (Option's usual customer) in Denmark. Option sold them to Trading Point. In the 'dirty' chain Devi had purchased the phones from a buffer trader, Grade One, who in turn had purchased them from SA Trading (a buffer), who had bought from 4A Developments (also a buffer), who had purchased them from DBP Trading, the importer who was a defaulting trader, who had purchased them from Sunico. Although the quantities and makes of the telephones varied, the remaining contra deals with Devi which took place on 9 June (Deals 2 and 3), 19 June (Deal 6) and 3 July (Deal 7) all followed the same pattern of there being three buffer traders in between Devi and the missing trader who had purchased the phones from Sunico, other than in Deal 7 in which the missing trader had purchased from NT Plus, not Sunico, and also in the contra (or clean) chain in Deal 7 Devi had purchased the phones from NT Plus, and Sunico was not the EU supplier.

40. In those deals where Owl was Option's supplier Option's customer was Evolution Sarl ("Evolution") on 3 occasions and Navigo IT ("Navigo") an Italian company, on one occasion. Where its supplier was Owl I&E its customer was Evolution on one occasion and Navigo on 2 occasions. In Deal 4 which, according to Option's invoice took place on 9 June, but according to documents produced by HMRC the relevant phones were actually exported by Option on 7 June, Option purchased 2,000 Nokia 8800 phones from Owl and sold them to Evolution. Owl had acquired the phones from Dantec Enterprises. In the 'dirty' chain in Deal 4 Udeil Solutions, the importer, was the defaulting trader, the goods having passed to Owl from Udeil via three buffer companies. Udeil Solutions was also the defaulting trader in Deal 5 (14 June) in which Option had purchased 2,000 Nokia phones from Owl and 1,000 from Owl I&E. These two companies had both been supplied by Dantec Enterprise. Option sold all 3,000 phones to Evolution.

41. In Deal 8 according to its invoice Option purchased 2,600 Nokia 8800 phones from Owl on 10 July. They were exported on 10 July to Evolution who in turn sold

them to Dantec, the company from whom Owl had purchased them, and Dantec subsequently resold them to Owl. In the dirty chain there were two buffer companies between Owl and the importer/defaulter, Parfums (UK) Ltd. In Deal 9 (11 July) Option purchased 891 Nokia 8800s from Owl and 2,600 from Owl I&E. These companies had both purchased the goods from Dantec. Option on this occasion sold all the goods to Navigo. There were three buffer traders in both the dirty chains involved in this deal, in Owl's chain the defaulter was again Parfums (UK) Ltd. The defaulter in Owl I&E chain was Carisma Ltd. In Deal 10 (21 July) Option purchased 1,000 Nokia N9300 and 4,400 Nokia 8800 phones from Owl I&E and sold them to Navigo. Owl I&E had purchased them from Dantec. In the 'dirty' chain there were three buffer traders between Owl I&E and the defaulting importer, Carisma Ltd. Owl was selling directly to Evolution, and both Owl and Owl I&E were selling directly to Navigo during this period.

42. In relation to the above contra deals there is evidence which shows the following matters. In Deal 1 Options' invoice to Trading Point is dated 7 June 2006, however the goods left London Heathrow on 5 June 2006, and Redhill clearance was not obtained until 6 June. HMRC's evidence shows that the goods involved in Deal 2 had been imported and exported from the UK by other traders in May 2006, the EU acquirer on that occasion being Sunico, who also supplied Devi. In the contra deal Devi's invoice to Option is dated 2 June, whilst Option's invoice to its customer Trading Point is dated 9 June, the goods having been despatched by Option on 2 June and then remaining on hold for 6 days. There is evidence from HMRC that Devi was dealing directly with Trading Point at the same time, In Deal 3 there was a 2-hour time difference between Devi issuing its invoice to Option and Option subsequently issuing its invoice to Trading Point. The goods had begun their journey in Denmark at Kuhne & Nagel and were returned there to the same depot on 8 June. In Deal 4 Option's supplier's invoice predates its customer's purchase order by a day, but Option's sale was on a sale or return basis. There is no evidence of a check by Option that Owl had title to the goods. In both purchases in Deal 5 there was a 3 day gap between the supplier's invoice and the customer's purchase order. This was a split purchase from Owl and Owl I&E but there is no evidence of Option querying the reason for the split sale. In Deal 6, where Option exported goods to Trading Point on 7 June, the goods remained on hold for 12 days, despite this deal (as with the other Devi deals) being said to have been arranged to aid Devi's cash flow situation, and having been described by David Ford as a 'back-to-back' transaction. As in Deal 3, the goods were returned to the same address they had left the previous day, as also had happened in deals 4, 5 and 8. In Deal 7 Devi had invoiced Option for goods before the goods had been released to it by NT Plus, its supplier. In Deal 8 the goods were delivered by Option to the freight forwarders in France on 11 July but remained on hold until 19 July. In Deal 9 (as set out at para 46 below) there were two breaches by Option of specific terms of its contract with its customer. In Deal 10 Option's supplier's invoice predated Option's purchase order. In this deal the goods, although sold to an Italian company, were exported by Option to the same location in France as that used by Evolution. In 3 of the 10 deals in which Owl acted as a broker its EU customer was Navigo, and in 6 deals its customer was Evolution. As shown above, both those companies were also customers of Option. Mike Fisher (a director of

Option at the relevant time) informed HMRC that in its deals Option dealt with its supplier first. In 3 of the deals in which Owl I&E acted as a broker its customer was Evolution and in 2 of the deals it was Dantec. Option sold to the same two customers in its purchases from the Owl companies.

43. It was uncontested evidence from Mr Fletcher on behalf of HMRC that arbitrage dealers take advantage of price differentials in the gross price between countries, that Nokia sets homogenous pricing across all markets (the price being set in Euros) and that during 2006 it was unlikely that there was sufficient opportunity for arbitrage in Nokia handsets because of limited exchange rate variations. There is no evidence that Option ever took account of the exchange rates.

Options actions surrounding the fraudulent deal chains

44. The background to the first of the contra deals with Devi was that in May 2006 when Mike Fisher had raised the possibility of selling phones acquired from Devi to Trading Point with David Ford, David Ford initially rejected the proposal. Colin Thompson complained to Nick Fisher about this rejection. Nick Fisher then asked David Ford to justify his feelings that the arrangement was fraudulent. Subsequently, David Ford accepted Mike Fisher's explanation that it aided Devi's cashflow on the basis of a spreadsheet prepared by Mike Fisher of how it could be beneficial to Devi to sell the phones to Option rather than directly to Trading Point. Devi had explained to Colin Thompson, not to Mike Fisher, the benefit to Devi of giving up part of their profits by this move, and Colin Thompson had explained it to Mike Fisher. The spreadsheet provided to David Ford was based on assumptions made by Mike Fisher, no document from Devi was ever produced to Option to show their cash flow position, and David Ford did not question Colin Thompson about it or require Mike Fisher to enquire of Devi if his understanding of the position was correct. Whilst it might have been perfectly reasonable for Devi to need to sell the phones within the United Kingdom to improve their cash flow by having immediate access to the relevant VAT, and evidence from HMRC officer Stephen McManus confirms that this might have been so from Option's point of view, other evidence obtained by HMRC shows that Devi was in fact lending money to Trading Point and did not at this time have problems with cash flow. No reasonable explanation has been provided to this Tribunal as to why Option was required to sell the phones to Trading Point, rather than to find a purchaser in the open market, and how this could benefit Devi. Devi's only explanation (again presumably to Colin Thompson) had been that it wanted to keep control over the phones in question, an explanation which Option appears to have accepted without any further enquiry being made. At the June meeting with HMRC Mike Fisher's explanation when asked why the deals made commercial sense was that it was to do with tax points and VAT and that there was a profit for Devi. As with all its deals, Option does not appear to have queried why the goods had entered the UK in the first place.

45. On 14 June 2006 Mike Fisher had sent an email to HMRC informing them of the recent purchase of 2,000 Nokias from Owl, a new company to Option (although see para 57 below), which Option sold on to another new company, Evolution. Owl

had provided the IMEIs, in accordance with Option's practice to ask the sellers to provide the IMEIs and not itself to do an independent check, and this revealed that none of the phones had been seen before. On 13 June Option purchased a further 3,000 Nokia phones from Owl and this time the IMEIs revealed that there were many duplicated items from the previous purchase from Owl. The freight forwarder in question, Interken, and Owl both informed Option that they believed the previous IMEI numbers were not specifically for the phones Option bought, the wrong IMEIs having been sent. Option did not proceed with that order, and Mike Fisher said Option "will not purchase any further phones from that batch". Evidence from officer Harris of HMRC in her witness statement [138] showed:

> "Owl Import & Export failed to record or obtain IMEI numbers for stock in which they dealt (something that would have been prudent for any business with a genuine intent to protect themselves and the Revenue from involvement in fraud and ensure that stock had not been previously traded by themselves or others)."

It was only at this point (mid-June 2006) that Option decided to ask the relevant freight forwarder to undertake a 10% scan of any phones that Option was purchasing, Option previously having relied on the IMEIs produced by its supplier, this change in procedure possibly having arisen because of Owl's failure to provide the IMEIs. In July HMRC were informed that Option had bought phones from both Owl and its sister company Owl I&E. The phones had been exported to Evolution in France. Option had carried out Redhill checks and also claimed to have Dunn & Bradstreet reports. A Dunn & Bradstreet report dated 6 June 2006 on Evolution provided by HMRC stated that there was 'insufficient information to offer a credit opinion' and the Risk Indicator showed 'a significant level of risk'. The company, which used an accommodation address, had a nominal capital of €7,500 and banked with the First Curacao International Bank. No reports were produced by Option in relation to Devi or Owl or Owl I&E. HMRC themselves produced an Experian check dated July 2006 on Owl which showed it to be "above average risk" and that it was "worsening". An Experian report on Owl I&E obtained by HMRC showed that in September 2006 it was a maximum risk company. HMRC noted that payments to Owl were made to the Bank of Baroda in London. An email from Mike Fisher to Michelle Back dated 12 June 2006 reads: "Option crap that landed on my fax over the weekend for your information. I notice that Owl quoted Curacao bank account on their invoice. Did we pay to that account or a UK one (please tell me it was a UK one….)". Michelle Back replied that the payment was to the Bank of Baroda which was a UK account: "so HMRC will be able to check it and we can't be accused of taking money offshore. Phew!" Mike Fisher had informed HMRC that to avoid fraud Option would not deal with foreign banks, in particular not with the First Curacao International Bank ("FCIB"). At a subsequent meeting in August 2006 Mike Fisher indicated that the reason for not dealing with the FCIB was because its (Option's) customers were experiencing long delays and checks on money transfers, yet in late July Mike Fisher and David Ford discussed opening an account at the FCIB because its customers banked with it and it would save delays. All the companies who supplied Option used FCIB as their main trading account, as did Evolution and Navigo.

46. An email from Mike Fisher to HMRC dated 10 July 2006 refers to a further agreement to a purchase by Option of 3,000 Nokia phones from Owl of which the IMEIs showed that 373 were duplicates (25 duplicated within the batch and 348 had been seen by Option before). Option rejected this batch. Mike Fisher was again prepared to accept that the previous explanation given by Owl and the freight forwarders applied, and said Option was prepared to accept the batch if they received new IMEIs which they had not seen previously. Option continued to trade with Owl. In July Option were informed that HMRC were carrying out an extended verification of its trade in June.

47. On 11 July 2006 Navigo had issued a purchase order for 3,491 Nokia 8800 telephones, a curious number to be purchased. The terms and conditions of the contract, which are contained in the same document, specify that the telephones should be: made in Germany, brand new, SIM-free, Euro spec and any with customs stamps will be automatically rejected. It also provided that they must be inspected no later than Thursday 13 [July] 2006 at Prologic, a freight forwarder in France. The seller is named as Colin Thompson, and his signature is required (but was not present) at the foot of the document. Despite the above terms and conditions, the relevant delivery note shows that the phones did not reach Prologic until 14 July 2006 and were not released to Navigo until 18 July. Additionally, despite the requirement for phones of German manufacture, the inspection report shows that the phones in question were manufactured in Singapore, nonetheless the phones were not rejected by Navigo.

48. David Ford informed the Tribunal that he had not seen the above document prior to the appeal, which raises the question of just what enquiries he did make once he learned in late July that HMRC were withholding the VAT for June, and then later on that they were also withholding it for July because of the extended verification which they were undertaking. David Ford informed the Tribunal that he had not at any time spoken to Mike Fisher or Colin Thompson about the fraud uncovered by HMRC and he did not speak to any of the defaulting companies, despite Mike Fisher having been told on 3 August by HMRC that the fraud was mutating and needed further checks, and deals with no apparent default could be involved. At this meeting Mike Fisher told HMRC that Option would not pay to foreign bank accounts but would to money exchange bureaux in cases where the company had no UK account. David Ford himself informed the Tribunal that Mike Fisher was wrong as to that, but since he never checked any of the documents himself we do not see how he is able to make that statement. David Ford repeatedly stated that he never had any involvement in the day to day workings of Option, and never saw any of the trading documents.

49. At a meeting on 3 August 2006 HMRC had been informed that Navigo was a new customer of Option. Option had obtained a Dunn & Bradstreet report dated 5 July 2006 on Navigo which gave a maximum credit of €1,187,851 and a failure score of 97 out of 100, which indicates a very low risk company. However, HMRC were informed by Mike Fisher that Navigo's terms and conditions stated that any phones with UK customs stamps would be automatically rejected, a condition which HMRC

had previously informed Option, when told in November 2005 about a similar condition imposed by Option's customer Sunico, they did not consider would be imposed by a legitimate company. Similarly, Navigo (an Italian company) required the goods to be delivered to a freight forwarder in France, to the same freight forwarder as that in fact used by Evolution in the former Owl deals. Both these conditions were considered by HMRC to be indicators of carousel traders. When asked by HMRC how Option knew the phones were those that were acquired by their supplier, and were not sourced in the UK, Mike Fisher said they had IMEIs and a declaration from the freight forwarder that the phones were imported. He conceded that that meant nothing if the freight forwarders were involved in fraudulent trading. There was no evidence of any due diligence checks being made by Option on Interken, the freight forwarder they used in June, or on Securefreight, Owl's freight forwarder or on Hawk, Option's main freight forwarder, although Hawk was visited in 2005 to discuss disclosure of information about importers.

50. At a meeting with HMRC on 6 September 2006 Mike Fisher was informed that checks made on the June and July trades indicated that a considerable number of the phones sold by Option had previously been in the UK. He was given a leaflet explaining contra-trading. David Ford gave evidence that he only became aware of contra-trading some time in September after this meeting when he decided to stop all trade in mobile phones. Option then became 'Option NTC plc'. Despite this decision, on 23 March 2007 Mike Fisher signed as a director of Option an 'Account application, supplier and customer', being an application for Option NTC plc to do business with PLC Communications i.e. Devi. Colin Thompson's name is given as the responsible trader (despite his having left Option in December 2006) and Mike Fisher was asked to backdate it to 2006, but this he did not do. Also with this document is a credit report dated 30 March 2007, which names both Mike Fisher and David Ford as directors. As we did not hear from Mike Fisher, and as David Ford was unfamiliar with the documents generated by Option, we had no proper explanation as to why there was continued contact between Option and Devi at this stage so many months after the fraud had been exposed, nor why Devi had not at any stage been asked about the fraudulent deals by Option.

David Ford's evidence

51. David Ford gave extensive evidence, however that evidence was in large part based on his understanding of what had happened which he had learned from what he had been told rather than from any direct knowledge, David Ford in his own words being a delegator and having no direct involvement in the details of Option's business. The system David Ford set up was that Colin Thompson would source the suppliers and the customers. Mike Fisher would make checks on them and pass on to David Ford the information he obtained for David Ford to sanction dealing with them. There is evidence in the form of emails sent by Mike Fisher to David Ford of companies Colin Thompson had come across but which were rejected by David Ford. It is not quite clear on what basis individual deals were supposed to be checked by Mike Fisher, but his role appears to have been chiefly to ensure Option did not commit itself to spending over a certain limit and was not left without a customer for

the goods. This was said to be achieved by back to back trading and by selling the goods ship on hold. Nonetheless there were several instances where Option was left with goods it had paid for, and also of customers delaying in making payment. There was also a clear instance (see para 31 above) where Colin Thompson had overcommitted Option. Mike Fisher himself did not handle the paperwork, that was done by Michelle Back in Borehamwood. A system of checking the IMEI numbers of the phones was introduced, but it was not until June 2006 that Option itself had 10% of them checked rather than relying on the numbers provided by the suppliers. David Ford also had introduced the system whereby the freight forwarder would indicate to Option whether the goods had been imported by the supplier, it being his stated intention that Option would only buy from the importers themselves or from authorised distributors.

52. David Ford never met any of Option's suppliers or customers, and only attended one meeting with HMRC. He gave his reason for not authorising due diligence checks to be carried out on Hawk, the main freight forwarder used by Option, as being that he did not think it was necessary. Similarly, whilst Mike Fisher did not recommend dealing with low credit rated companies, David Ford said that he: "… was not particularly concerned about a supplier's credit rating as we weren't going to be extending any credit to them." He appears not to have considered that this might be relevant to the supplier's ability to pay for the goods it was selling on to Option, and Option itself might have ended up with an obligation to sell goods to which it had no title. His main concern, as cited above, was that Option should not buy from missing traders, nor sell to missing traders. He does not appear to have understood the implications of the joint and several liability provisions in Notice 726, nor that Option would be at risk if its supplier did not account for its liability to VAT, nor that a company such as Devi, with substantial cash flow problems, and with a low credit rating, was the very type of company liable to be involved in MTIC fraud. In his witness statement he recorded: "My only concern in our due diligence process was that we shouldn't deal with people where we might lose money or deal with a missing trader. Nothing in these reports (referring to the reports on Owl, Owl I&E and Evolution) would have concerned me from that point of view. It is true that when you establish a check list for people to tick off, they start to switch off as long as the boxes get ticked. My concern in agreeing to deal with any new supplier or customer was very clear." We agree with officer Morrison in his opinion that David Ford had missed the point of due diligence checks, which was not to ensure that a business did not lose money, nor even just to avoid dealing directly with a missing trader, but to ensure that the business did not get involved in any transactions connected with fraud. HMRC's purpose in suggesting the various checks was in order to identify potentially fraudulent deals, and the fact that a business may have no assets or employees would be a possible indicator of involvement in fraud. David Ford was aware that pressure had been put on banks not to provide banking for people in the mobile phone industry and the banks were operating some form of due diligence check on customers. Because of this he thought that it was sensible to deal only with people who held a UK bank account. Nevertheless, he did discuss with Mike Fisher the possibility of opening an account with the FCIB and Mike Fisher had obtained an application form from FCIB in July 2006 in order to receive payments from foreign companies, after

Navigo had issued a payment which had taken several days to clear. David Ford was aware that Option were making payments to Devi into a foreign exchange account at HSBC through the TTT Money Corp and those payments were then sent off to the FCIB. He believed that Devi had a UK bank account, but there had been no check on this and he had accepted the reason given for Option using a money exchange service to pay Devi being that it was to facilitate Devi using money to buy more goods abroad and it thereby costing them less in foreign exchange charges.

53. David Ford was unaware that a consignment of goods to Navigo in one of the fraudulent deals was sent to the same freight forwarder as was used by Evolution. The goods had been shipped to Navigo at that freight forwarder 11 days after a shipment to Evolution to the same freight forwarder. That matter was not noticed by anyone at Option and David Ford uttered his belief that it would have been mentioned to him if it had been noticed. Despite this apparent belief, David Ford, when he learned of it, had not asked either Colin Thompson or Mike Fisher whether they had in fact known about it. He relied on the fact that nobody had ever suggested to Option that they should make checks on freight forwarders, a matter which we would have expected a competent businessman to have done in any event. David Ford appeared to consider that there was an obligation on HMRC to tell Option how to conduct their business in every particular.

54. Option had no written terms and conditions, but David Ford 'believed' that Option had written terms and conditions, and he 'assumed' that Mike Fisher had started using a model which he, David Ford, had produced for another company. Again, this was not a matter he saw fit to check with Mike Fisher prior to this appeal hearing, just as he did not check with Colin Thompson what his understanding of the circumstances of Option's involvement on the fraudulent deals was, nor how he had made contact with the various customers and suppliers who were involved in the fraudulent deals. Whilst David Ford believed Colin Thompson was financially honest, he acknowledged that he was somebody who would exaggerate. He described Colin Thompson as not very commercially sophisticated and Mike Fisher as not commercially astute, and yet David Ford himself. in not recognising the importance of Option supplying goods which did not accord with the requirements of the customer, as happened in the case of the final sale to Unique and also in the case of the final sale to Navigo, had not implemented a system which ensured that Option complied with the customer's terms and conditions. He had been informed by Mike Fisher of Devi's low credit rating but it was he who instructed Mike Fisher to trade with Devi. In his witness statement David Ford said that Mike Fisher did not personally deal with the day to day details of the mobile phone transactions. In his evidence, he resiled from this position to the extent that he said that Mike Fisher would delegate the paperwork in the deal to Michelle Back, his accounts assistant in Borehamwood. It became apparent that Mike Fisher was only concerned with the company's cash position, and whether the company could afford to do the deal, rather than with matters such as whether the phones complied with the purchaser's terms and conditions, such matters being left to Colin Thompson.

55. David Ford believed that Devi were buying the phones from authorised distributors in Germany, although Mike Fisher had informed HMRC that he believed they were buying their goods direct from manufacturers such as Nokia. Again, this is something apparently not discussed with Mike Fisher or Colin Thompson as to the source of this misinformation. In his evidence David Ford said that he took most of the statements that the suppliers had purchased phones direct from manufacturers "with a pinch of salt". In Devi's case he had accepted it because, he said, whenever Devi informed Option they had phones to sell the phones materialised. Mr Ford was aware that Devi were buying from NT Plus, an authorised distributor, but he accepted that in most cases they were not purchasing from authorised distributors. As far as the Ernst & Young manual was concerned he felt, on the basis of a discussion with a former employee of Ernst & Young's that it was 'rubbish' and that it would not be read and would not improve what Option was doing. He provided no evidence as to who had assured Option that Prizeflex were not buying goods at the end of a chain, and he made no subsequent enquiries as to the basis of that assurance which he had accepted. He was not concerned whether or not there were any warranties attached to the phones in which Option was trading, in his evidence he said: "All I really would have been concerned about was that they made sure that they (Option) were selling the same specification that they were buying." He made no reference to being concerned that Option were selling the same specification as its customer wished to purchase. Just as he had accepted the assurance from Prizeflex (to whomsoever it was given), similarly, he was prepared to accept the assurance from the freight forwarder, Hawk, about the duplicated IMEI numbers. With regard to the IMEI numbers showing that the phones had been traded on previous occasions, there had been 6 instances of this. As with the freight forwarder's explanation, Mr Ford was also prepared to accept the explanation from Devi – not given to him personally – that the duplication was nothing to do with them. David Ford thought Devi must be telling the truth because "They knew we were going to disclose all this to Customs". He believed that everybody that Option dealt with knew that HMRC were told of anything that Option came across; the basis for this belief is not clear. David Ford said that he was "sure" that when Mike Fisher spoke to Devi, Devi knew that he would be telling HMRC. In relation to the fifth occasion when the IMEI numbers revealed that some of the phones had being seen before, on 13 June 2006 concerning Owl I&E, again David Ford accepted the explanation that the same IMEI numbers had been reused. HMRC were notified of this by Mike Fisher and the reason given by David Ford for Option continuing trading with Owl I&E was that, having told HMRC about it, if Option did not hear anything negative, i.e. that the phones had positively been involved in any fraud, then Option was prepared to continue dealing with that company. He said he felt that, "By telling Customs, I was discharging a very large part of my responsibility, particularly when I was telling them things that otherwise they would not have known. I felt that this would enable them to come back to me." David Ford believed that on the sixth occasion of previously seen IMEI numbers, on 7 July 2006 which involved Owl, that this was the same as the previous occasion involving Owl I&E. He had not understood that it involved a separate but related company.

56. With regard to the deals concerning Devi and Trading Point, David Ford's evidence was: "My understanding was they did not want to lose these goods, they wanted to trade in these goods. What they were doing is wherever they were getting these goods from, they could have shipped them direct to Trading Point, and what they wanted to do instead was to ship them to the UK so that we would then bear the net cost of shipping and they would get additional cash flow that they could use." In answer to the question what would have happened if Option had sold the phones to a trader other than Trading Point, David Ford said that Option would have been sued, he then clarified this by saying Option would have been sued by Trading Point and that Devi would not have dealt with them again. The issue had never been raised with Devi. Whilst Option sold goods on a sale or return basis, no checks were made as to what would be the case had Option's supplier not paid its supplier, in which case David Ford did not know who would have ownership. He was unable to explain specifically how it was that in relation to Deal 4 Owl invoiced Option for the goods on the 7 June whereas Option did not issue a purchase order until 8 June. Something else that was not within Mr Ford's knowledge was that in relation to the same deal, the goods left AFI Logistique in France on the 7 June, and were re-transported back to AFI Logistique on the 8 June by Option. Similarly, in relation to Deal 5, Option sent the phones back to AFI Logistique on 13 June, the goods having arrived at AFI Logistique on 8 June. Despite the credit rating of Owl I&E being zero, David Ford did not think there was a risk that the company might go missing, and did not consider that it might go into liquidation and therefore default on its VAT. There appears to be no evidential or reasonable basis for this belief. David Ford had no direct knowledge of how the documents were dealt with within Option, but from the documents in the bundle he claimed that he could tell that Option always entered a pro-forma first and a final invoice later. The final invoice was dated the date the goods were released. However, the evidence shows that when Mike Fisher was dealing with the documents he had dated the invoice the same date as the date of the pro-forma. David Ford did not accept the inference that the reason that the invoice pre-dated the purchase order on some occasions was that Option was simply putting together a paper trail. Mr Morrison of HMRC stated that Option did not date its final invoices until the goods were delivered and payment received, which does not always appear to have been the case, which has led to a confusion which could have been cleared up by evidence from Mike Fisher.

57. David Ford had provided an email from Mike Fisher sent on 27 September 2005 in which he said inter alia that Owl wanted to use the FCIB; had net assets of £2,500; he wanted more information on them before going ahead and Colin would need to find people who had dealt with them, and 'possibly' get trade references. On 16 June 2006 Mike Fisher had sent David Ford an email about a company called Beechsons, which he put forward as a potential supplier provided that they did not have an FCIB bank account. Mike Fisher did not refer to the fact that one of Beechsons' directors, a Micky Nayyar, was also involved with Owl and Owl I&E, or that it had previously been based at the same address in Coventry as Owl I&E. HMRC evidence also showed that Owl supplied Beechsons who sold to Evolution, Option's customer in Deals 4, 5 and 8. David Ford had accepted Mike Fisher's assessment of Beechsons, but in evidence he agreed that he would have expected

Mike Fisher to tell him of the above facts had he known them. Colin Thompson was said to have dealt with, and visited all Option's UK customers, and therefore he must have been aware of the connection from his personal knowledge. Mike Fisher, had he properly investigated Beechsons would have discovered those facts, therefore either Mike Fisher did not do a thorough investigation or he choose to withhold those facts from David Ford. David Ford's approach had been to lay down a system that he believed was sufficient and to employ people that he thought would be able to do the jobs he required of them.

Notice 726

58. Notice 726 which was provided to Option at an early stage provides inter alia as that follows:

> *2.*5 How will you establish reasonable grounds to suspect?
>
> You will be presumed to have reasonable grounds for suspecting that the VAT on the supplier would go unpaid if you have purchased the specified goods for less than
>
> - The lowest open market value of the goods; or
> - The price payable for them by any previous supplier.
>
> 3.1 How am I to ascertain the lowest open market value of the goods?
>
> Though a range of prices can occur for goods, we are only concerned with prices below the lowest open market price. A business trading within the market should have a reasonable idea what range of prices are on offer on any given day…
>
> 4.5 What are 'reasonable steps'?
>
> We advise you to carry out checks 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 probably already undertake in line with good commercial practice such as credit checks. We do not 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 supply chains.
>
> Facts that you may wish to consider include:
>
> - The type and level of checks you carried out to establish the integrity of the supply chain and the action you took as a consequence of those checks;
> - The nature of the supplier;

- Aspects of payment arrangements and conditions;
- Details of the movement of goods involved.

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

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

1. Undertaking reasonable commercial checks to consider the legitimacy of customers or suppliers. For example:
   - What is the supplier's history in the trade?
   - Are normal commercial arrangements in place for the financing of the goods;
   - Are the goods adequately insured;
   - What recourse is there if the goods are not as described?

2. Undertaking reasonable checks to ensure the commercial viability of the transactions. For example:
   - Is there a market for this type of goods – such as superseded or outdated mobile phone models?
   - Is it commercially viable for the price of the goods to increase within the short duration of the supply chain?
   - Have normal commercial practices been adopted in negotiating prices?

…

3. Undertaking reasonable checks to ensure the goods will be as described by your supplier. For example:
   - Do the goods exist?
   - Have they been previously supplied to you?
   - Are they in good condition and not damaged?

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

Various other matters were recommended in Notice 726 in particular it was recommended that credit checks should be obtained, and the prospective supplier's bank details should be obtained to check whether a) the payments would be made to a third party and b) that in the case of import, the supplier and the bank shared the same country of residence.

59. David Ford was taken in detail through the above sections of Notice 726 and stated that Option had complied with all of those requirements and, in addition, Option had required confirmation from freight forwarders in the form of a Letter of Import that the seller was the consignee when the goods were imported into the United Kingdom, a document not mentioned in Notice 726. A check list produced by Option which shows this to have been received, however, also shows a heading

'PriceRunner check performed', PriceRunner being the website which gives the retail prices, not the wholesale prices of the goods. The 'Letter of Import' was instigated by Option only after they had been informed by HMRC that the CMRs they had been relying on were useless. It was David Ford's evidence that he later discovered a wholesale website that he believed Option was using, however the date of the check list referred to above is 16 June 2006 and on that date Option were still using PriceRunner to check the prices. Insofar as Option were trading in two pin plugs, Mr Ford did not consider this to be a problem, indeed he considered it to be a benefit because the phones were being sold to Europe. He does not appear to have asked himself why phones with two pin plugs were imported into the United Kingdom in the first place. There is no evidence that Option were making any effort to find out if the goods were being purchased at less than the lowest open market value, David Ford's attitude being that this was irrelevant if Option were able to find a customer and make a profit on the deals. There is no evidence of Option attempting to find the range of prices available on any given day. We have set out above David Ford's attitude to credit checks. There is no evidence that Option were aware of the movement of the goods involved, beyond attempting to ensure that its supplier was the importer. Devi 's banking arrangements appear not to have concerned David Ford, nor did the fact that Devi was connected with the Prizeflex deals, which should have given cause for concern (see paragraphs 34 and 35 above).

The Respondents' case

60. The Respondents accepted that the burden of proof was upon them throughout. They based their case on paragraph 56 of *Kittel* (*supra*) and paragraphs 59 and 61 of *Mobilx* where Moses LJ when considering the issue of knowledge concluded:

> "59. The test in *Kittel* is simple and should not be over-refined. It embraces not only those who know of the connection but those who should have known. Thus it includes those who should have known from the circumstances which surround their transactions that they were connected to a fraudulent evasion. If a trader should have known that the only reasonable explanation for the transaction in which he was involved was that it was connected with fraud and if it turns out that the transaction was connected with the fraudulent evasion of VAT then he should have known of that fact. He may properly be regarded as a participant for the reasons explained in *Kittel*.
>
> 61. … 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."

61. We were also referred to the case of *Red 12 Trading Ltd* where Christopher Clarke J said:

> "109. … in determining what it was that the taxpayer knew or ought to have known the Tribunal is entitled to look at the totality of the deals effected by the taxpayer (and their characteristics), and at what

the taxpayer did or omitted to do, and what it could have done, together with the surrounding circumstances in respect of all of them."

62. HMRC's primary case was that Option itself had actual knowledge of the fraud. They relied on the following factors:-

(a) The overlap of the other companies that featured in the chains

It was beyond coincidence that:

(i) Sunico, Option's sole customer in May 2006, and a regular customer prior to that, should have been Devi's supplier in Deals 1, 2, 3 and 6.

(ii) Option's sourced Evolution as a new customer in July 2006 and Owl, the contra-trader was also selling to Evolution in the same period. The inference may be drawn that they were introduced, or the trading was orchestrated, in circumstances which could only be connected to contrived dealing.

(iii) Option should happen to source a new customer called Navigo in July 2006 in circumstances where the contra-traders Owl and Owl I&E were also selling to Navigo in the same period. It posed the question why Owl and Owl I&E did not maximise their profits by selling to those companies rather than to Option.

(iv) Of the hundreds of potential customers and suppliers in the UK and Europe at this time Option just happened upon Navigo and Evolution, and Devi upon Sunico. The inference to be drawn is that Option and the contra-traders were working in tandem.

(b) Option knowingly entered into contrived Devi transactions

Option knowingly allowed itself to be used in a series of artificially constructed transactions with Devi and its related company Trading Point. The fact that the directors of Option were prepared to enter into such a scheme with Devi suggested a very close working relationship. The Tribunal should consider why a small company such as Option was approached with an offer to buy and sell substantial quantities of phones in this way? It was suggested that the 'cashflow' arrangement was an obvious front for fraud and Option did not press Devi about the proposal because it knew that the purpose beyond the scheme was fraudulent and it chose to turn a blind eye. Option would still have been injecting funds into Devi by simply purchasing from it the same goods on each occasion, this did not require Option to have to sell to Trading Point or become involved in the artificiality of Devi's proposal.

(c) The delivery point

The evidence shows that in these deals the customer and the delivery point were pre-arranged. This is the only obvious explanation for the fact that the goods were repeatedly returned to the same address from whence they came via the freight forwarders. (See Deals 1, 2, 3, 4, 5, 6, 8 and 10.) It was submitted that Option had no independent control over the goods and must have been directed as to where they were to go and on which dates. It could not have been left to chance that Option might sell to another customer and all the indications were that the deals were orchestrated.

(d) Subsequent actions

It was apparent from the application form relating to trading which was filled in by Mike Fisher for Devi that Option was prepared to continue dealing with Devi even though it had been informed about contra-trading at that stage.

(e) Other factors suggesting actual knowledge

(i) Each deal bore compelling similarities between one transaction and another. Option did not question why the suppliers would be bringing two-pin plug phones into the United Kingdom for immediate export.

(ii) There was no proper research by Option in terms of wholesale/manufacturers' pricing.

(iii) All three suppliers in the fraudulent deals had low credit ratings.

(iv) The deals were too good to be true, with access to immediate supply and to immediate customers, with no effort and no value added by Option, together with no risk and no left over stock.

(v) There were no detailed written contracts, no proper terms and conditions, no record of negotiations. This suggested collusive trading and the absence of protection underlined that such things were unnecessary as Option knew the deals would go through as planned.

(vi) It was unchallenged that both Nick Fisher and Colin Thompson had previously been involved in the MTIC sector.

In all the circumstances it was more likely than not that Option knew what was going on and knew that the transactions were connected to fraud but chose to continue with the deals. Option was fully aware of the risks of trading in that sector.

63. Mr Sutherland Williams also invited the Tribunal to take into consideration Option's approach to the appeal as part of the overall picture. In particular we were

referred to the lack of direct evidence from any of the three people most directly concerned in the financing of and the making of the deals: Nick Fisher, Mike Fisher and Colin Thompson. As a qualified solicitor with extensive business experience David Ford must have appreciated that without evidence from Mike Fisher and Colin Thompson the Tribunal's fact-finding role would be limited. Equally David Ford failed to make reasonable enquiries of any of the three, and of the traders who had been involved in the contra-chains. In particular no enquiries were made when HMRC initially refused Option's repayment claims for June and July 2006 before the allegation of fraud was made, which left Option financially exposed. It was suggested that the reason for the lack of pursuit of the enquiries was because Option knew all along of the connection with fraud.

64. It was submitted that it was consistent with Option being aware of the fraud that Sarah Fisher, Option's chief executive, was said not to be privy to any of the details of the phone side of the business, given that she was Option's chief executive. She was there to deal only with the least cost routing side of the business; she was not consulted about the viability of the Devi deals despite being said to know many people in the industry, and both side of Option's business use the same premises and the same VAT number.

Factors HMRC submit indicate that Option should have known its deals were connected with fraud

(a) Warnings and awareness of fraud

It was not disputed that all those involved had an awareness of MTIC fraud at the time.

(b) Two-pin plugs

(i) All the phones were imported with two-pin plugs, although Option were told by HMRC that these were unsuitable for the UK market.

(ii) Option should have asked why the phones were imported only to be exported again and why it was possible to make a profit given the transport costs involved.

(iii) Option never ascertained whether a company would be prepared to pay the cost of opening up each phone to modify and supply an adaptor. A sale in the UK market was never contemplated, it was irrelevant what had been done earlier by Unique in respect of the sale of phones to Woolworths.

(c) 'Veto' letters

Option had received letters from HMRC inviting it to stop dealing with a particular trader because of MTIC risk, but David Ford denied having seen such letters. HMRC queried why this was the case.

(d) Press articles and Law Reports

Option was aware of Press articles, and at a meeting with HMRC Michael Fisher had referred to obtaining law reports.

(e) Caution as a result of previous dealings

It would be expected Option would take extra precautions given its difficulties with Prizeflex and others.

(f) FCIB

Option knew that its customers banked with the FCIB, it was apparently unconcerned and itself considered opening an FCIB account.

(g) Ernst & Young

David Ford's view of the Ernst & Young manual as potentially being 'know your client rubbish' gives an insight into how he regarded due diligence and the precautions companies were being asked to take.

Given all the above factors Option should have considered whether it was reasonable to continue trading.

Other factors which HMRC submit indicate Option ought to have known

65. Option failed to take reasonable precautions or sufficiently react to identifiable warning signs such as:

(i) Some of the deals took place within the space of one day with suppliers' and customers' requirements exactly matching, this was unlikely in normal commercial conditions.

(ii) The deal chains involved traders who were themselves wholesalers. In the case of Devi, Option did not properly query its own role.

(iii) Option did not question why its suppliers and customers did not deal directly with each other. Option added no value and increased the price to the customer.

(iv) No evidence of enquiries into guarantees or specification documentation for any of the goods.

(v) No proper checks were made nor questions asked in respect of the arrangement with Devi. The proposal was un-businesslike and unique. David Ford made no proper enquiries of Mike Fisher or Colin Thompson.

(vi) Lack of due diligence generally.

(vii) The credit ratings were ignored as were the Dunn & Bradstreet reports were obtained.

(viii) On six occasions Option had either become or had been made aware that the phones in which it intended to or had traded were duplicates. David Ford ignored HMRC's warnings and preferred the freight forwarders' view that there had been a mistake.

(ix) Mike Fisher delegated due diligence checks to Michelle Back to carry out what was only a tick box exercise.

66. The ultimate motive of Option was profit and Option was prepared to turn a blind eye to the fraud that was going on. It was unlikely in a sophisticated plan where there are both contra-trading and dirty chains, that those involved would have left part of the deal chains to chance, or alternatively risk that the goods may not end up back with the right party, but instead sold on to other traders with the result that the contrived nature of the deals would fall apart. No legitimate trading company would want to share that element of profit in the way Option suggests Devi did. All the deals were too good to be true.

The Respondents' submissions on the company's knowledge

67. The director's knowledge and the knowledge of those acting on Option's behalf, should be attributed to Option in the context of this appeal. It was further submitted that the directors and those acting on Option's behalf, should have known of the connection to fraud in all the circumstances.

68. Mr Sutherland Williams referred us to the case of *Meridian Global Funds Management Asia v Securities Commission* in which two employees of the company, acting within the scope of their authority but unknown to the directors, used company funds to acquire some shares. The question was whether the company knew, or ought to have known that it had acquired both shares. The Privy Council held that it did, and whether by virtue of their actual or ostensible authority as agents acting within their authority or as employees acting in the course of their employment, their acts and omissions and their knowledge could be attributed to the company, and this could give rise to liability as joint tortfeasors where the directors have assumed responsibility on their own behalf and not just on behalf of the company.

69. Attribution was relevant to *Kittel* because knowledge is central to the test in that case. The Tribunal should attribute the knowledge of the person(s) who arranges and overseas the transactions to the company engaged in the transaction. If such knowledge were not attributed to the company, the directors could simply close their eyes to the fraud by leaving the transactions to their employees. We were referred to the case of *Mobilx* at first instance where Judge Bishopp, having considered the case of *Meridian Global* above, said: "It seems to us that the same principle must apply in a case of this kind, and for the same reasons. It cannot be open to the directors of a trading company to avoid the consequences of the Court of Justice's judgment in

Kittel by delegating the day-to-day operation of the company to a non-director employee and closing their eyes to the employee's activities."

70. There is an exception to the attribution rule referred to as the *Hampshire Land* principle. In the case of *Stone and Rolls v Moore Stephens* Lord Phillips at paragraph 44 said: "The cases demonstrate some confusion as to the precise nature and scope of the *Hampshire Land* principle and doubt has even been expressed as to whether it exists." Lord Brown at paragraph 198 said; "The *Hampshire Land* exception recognises that in reality agents will not disclose to their principals the fact that they are committing fraud, least of all when they are defrauding the principles themselves, and that it would be contrary to common sense and justice for the law to presume otherwise."

71. In the case of *McNicholas Construction Co Ltd* Dyson J held that McNicholas ("MC") was not the victim of fraud saying:

> "55. In my judgment the Tribunal correctly concluded that there should be no attribution in the present case, since MC could not sensibly be regarded as a victim of the fraud. They were right to hold that the fraud was 'neutral' from MC's point of view. The circumstances in which the exception to the general rule that attribution will apply are where the person whose acts it is sought to impute to the company knows or believes that his acts are detrimental to the interests of the company in a material respect. … It follows that, in judging whether a company is to be regarded as the victim of the act of a person, one should consider the effect of the acts themselves, and not what the position would be if those acts eventually prove to be ineffective …
>
> 56. The *Hampshire Land* principle or exception is founded in common sense and justice. It is obvious good sense and justice that the act of an employee should not be attributed to the employer company if, in truth, the act is directed at, and harmful to, the interests of the company. In the present case, the fraud was not aimed at MC. It was not intended by the participants in the fraud that the interest of MC should be harmed by their conduct. In judging whether the fraud was in fact harmful to the interests of MC, one should not be too ready to find such harm …"

72. Mr Sutherland Williams submitted that whether to attribute an employee's knowledge to a company was a two limb test:

> (i) Was the company a victim of the fraud (was the fraud 'on or against' Option?)
> (ii) In determining the above, were the acts harmful to the interests of the company?

73. In the present appeal the relevant factors were:

(a) Option had actual knowledge of the connection with fraud through those individuals who orchestrated and oversaw the deals: David Ford, Mike Fisher, Nick Fisher and Colin Thompson.

(b) If any of those did not have actual knowledge, then they were overly naïve and should have known.

(c) There was no dispute that the directors' knowledge should be attributed to Option, the dispute was as to whether or not they knew.

(d) The culpability and knowledge of those individuals should be determined by reference to their knowledge at the relevant time.

(e) Colin Thompson was engaged by Option to source and conduct the disputed transactions on its behalf. He provided the relevant information in respect of each transaction without which there would have been no transaction. The evidence demonstrates that the real responsibility for the arrangement of the deals lay with Colin Thompson.

(f) Following the case of *Meridian Global* the relevant substantive rule in the instant case is the *Kittel* principle in relation to the application of the VAT legislation in paragraphs 56 and 57 (supra para 17).

(g) Applying the *Kittel* principle, Colin Thompson's role placed him at the centre of the purchases and within the group of individuals whose knowledge should be attributed to the company. When considering the policy and purpose behind the VAT legislation and the *Kittel* principle, the company should not be insulated from its effect by delegating the bulk of the responsibility for the deal to another. Ascribing to one individual the role of agreeing to a transaction, whilst those around are complicit in the fraud, should not permit a company to walk away from the consequences of the *Kittel* test.

74. The correct approach in determining whether the acts were directed at, and harmful to, the interests of the company was to look at what the fraudulent individuals intended should happen. In this case the only victim of the fraud was the state. If, as intended, the fraudulent acts had proved effective, Option would have profited considerably from the transactions. Because Option has had its VAT withheld and is having to appeal, this does not make it a victim. The potential risk to Option of a denial of input tax deduction is irrelevant in deciding whether Option was a victim of the fraud and whether Colin Thompson's knowledge (or that of the others involved) should be attributed to it for the purposes of the *Kittel* principle. The purpose or aim of the fraud necessarily involved the company making a profit and suffering no detriment. Colin Thompson and Nick Fisher's interests were allied to those of Option.

75. The substantive rule giving rise to the issue was within the context of the VAT legislation and the combating of fraud, and to that extent company law principles which are not set within the context of fraud are unlikely to assist. The policy behind

the *Kittel* principle is to combat fraud and its effect on the VAT system. Such policy would be severely undermined if Option's contention was correct, in circumstances where the company stood to gain very significant profits from transactions conducted on its behalf, those transactions and profits simply not being available but for their connection to fraud.

76. Option's proposition that it would be unreasonable to hold anyone responsible for guarding against a fraud that they did not know could exist, made in the context of Option's lack of knowledge of the existence of contra trading, was not relevant. The issue in *Kittel* is knowledge of fraud, not contra trading. We were referred to the case of *Megtian v Commissioners of HM Revenue and Customs* where at paragraph 37 Briggs J said:

> "… there are likely to be many cases in which a participant in a sophisticated fraud is seen 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 enquiries. 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."

The Appellant's case

77. There was no dispute that *Kittel* and *Mobilx* set out the relevant tests with regard to knowledge/means of knowledge. Mr Lewis placed specific emphasis on the following:

> (i) The Tribunal must look at the objective factors (*Kittel*) [59]);
> (ii) actual knowledge that by its purchases Option was participating in a transaction connected with fraudulent evasion of VAT must be demonstrated, suspicion is not enough (*Mobilx* [56]);
> (iii) it must be shown by the Respondents that the only reasonable explanation for the transaction in which Option was involved was that it was connected with fraud (*Mobilx* [59]). With regard to this, Mr

Lewis submitted that if there was another reasonable explanation, such as improving cashflow or making legitimate profits, then HMRC have not discharged this burden;

(iv) HMRC must identify not only what should have been done, but also that, had it been done, the only reasonable explanation was that the transaction was connected with fraud.

78. With regard to whether or not the knowledge of Colin Thompson as well as that of the two directors of Option at the relevant time, Mike Fisher and David Ford, was relevant to the issue, Mr Lewis referred us to the case of *Livewire*, where Levison J at [123] said:

> "… the question therefore for the Tribunal was not what a director of Olympia knew or ought to have known, but what the company itself knew or ought to have known. The knowledge of a director of the company may, to be sure, be attributed to a company, but there may be other knowledge (for example that of a senior employee) which, on the facts ought also to be attributed to the company: *Meridian Global*."

In *Meridian Global* Lord Hoffman said that whether or not the act of an individual can be attributed to a company (and therefore be treated as the company's act) depends on "rules" of attribution; the primary rules derived from the company's articles of association, and secondary rules derived from principles of agency. At page 511 Lord Hoffman said:

> "But their Lordships would wish to guard themselves against being understood to mean that whenever a servant of a company has authority to do an act on its behalf, knowledge of that act will for all purposes be attributed to the company. It is a question of construction in each case as to whether the particular rule requires that the knowledge that an act has been done, or the state of mind with which it was done, should be attributed to the company."

79. Mr Lewis submitted that the level of attribution the rule in *Kittel* requires is guided by the fact of legal certainty with reference to the transaction in question. The rule of attribution will only apply to an employee of the company who is a directing mind of the company or a senior employee of the company who makes the decision to enter into the transaction which results in the payment of input tax. We were referred to the dicta of Moses LJ in *Mobilx* where he said:

> "[28] … since the right to deduct is fundamental to the system of VAT because it ensures that the charge is limited to the value added at each stage of the supply and because it ensures fiscal neutrality, it may not, in principle, be limited; any derogation from the principle of the right to deduct tax must be interpreted strictly … moreover the right must be exercisable immediately in respect of all taxes charged on input transactions. Since the right arises immediately the taxable

> person pays tax (input tax) to his supplier, the principle of legal certainty demands that he knows when he enters into the transaction that it is within the scope of the tax and that his liability will be limited to the amount by which any output tax he may be liable to pay, on making a supply, exceeds the input tax he has paid. The objective criteria determine both the scope of the tax and the circumstances in which the right to deduct arises."

80. In *Regina v Boal* the assistant manager of Foyle's bookshop was held not to be a manager of the bookshop despite being in control of the day-to-day running of the shop. Simon Brown J (as he then was) said at page 597:

> "It follows from this that the Appellant was only properly to be regarded as imperilled by section 23 if, as the assistant general manager of the shop, he had "the management of the whole affairs of the company", was "entrusted with power to transact the whole of the affairs of the company," and was "managing in a governing role the affairs of the company itself." The intended scope of section 23 is, we accept, to fix with criminal liability only those who are in a position of real authority, the decision-makers within the company who have both the power and responsibility to decide corporate policy and strategy. It is to catch those responsible for putting proper procedures in place; it is not meant to strike at underlings."

Mr Lewis submitted that it followed in the instant case that the Tribunal could only dismiss the appeal if it was satisfied that either or both Mike Fisher and David Ford knew or should have known the transactions were connected with fraud. Colin Thompson was a salesman who had no decision-making power in relation to who Option contracted with or whether Option carried out a transaction. Nick Fisher was not a de jure, de facto, nor shadow director and was not an employee of Option.

(a) The Appellant's submissions on the different evidential relevance on Issue 1 (whether Option knew of the connection with fraud), and Issue 2 (whether Option should have known of the connection)

81. Each piece of evidence must be considered against either Issue 1 or Issue 2 as each evidence may have a different relevance to the issue under examination. When considering Issue 1, the fact that Option did not check out the freight forwarders could be relevant and be consistent with knowledge of the fraud, it was not relevant to Issue 2 because nothing would have been found out imputing knowledge if the freight forwarders had in fact been checked out. Similarly, with regard to the timing of the replies from Redhill, if there was a trade before the Redhill check came through, the fact that the Redhill check in fact came through a day late is irrelevant to constructive knowledge.

(b) Consideration of deals issued separately

82. There is a natural distinction between the deals done with Devi, which were constructed deals, and the deals done with Owl and Owl I & E, which were ordinary spot trading deals.

(c) Hindsight and post acquired knowledge

83. The Tribunal should not judge the circumstances with hindsight or take into account factors not known or reasonably capable of being known by Option at the time of the transactions. The state of knowledge and what should have been known must only be judged as at June and July 2006. Of crucial importance in the case was knowledge of contra-trading MTIC fraud and how it operated.

(d) Suggested correct approach

84. The correct approach was first to decide Issue 1 by identifying the relevant evidence available as at June and July 2006 and making a decision on knowledge. If that issue is determined in favour of Option, then the Tribunal should turn to Issue 2 by identifying the relevant evidence on Issue 2 available as at June and July 2006, namely what Option should reasonably have done, and then evaluating what Option would have known if that had been done. It was submitted that HMRC had elided at both knowledge and means of knowledge.

The Appellant's submissions re the evidential background

(a) Basic or simple MTIC fraud

85. Mr Lewis drew a distinction between the importer, who holds a significant amount of VAT from the imported goods he sells in the United Kingdom, being 17.5% of the whole sale value, and a buffer trader going missing where the amount of VAT he would be holding would be very small, being 17½% of his profit. Every basic MTIC carousel fraud must include a missing trader in the dirty chain. Until after August 2006 nothing was known by Option of connecting an ordinary 'clean' chain to a dirty chain by way of contra-trading. There was never any communication from HMRC about it until August or September 2006 and it is not mentioned in Notice 726.

(b) Contra-trading

86. Mr Lewis submitted that it was not possible for an ordinary business to know if the company it was dealing with is an importer/exporter unless it tells you. However, HMRC will always know this from the VAT returns, which are not available to other businesses. It followed that:

(i) As Devi and Owl were fraudsters and using contra-trading as part of their fraud, it was inherently unlikely they would tell Option they were contra-trading even if Option asked;

(ii) Option had no means of knowing Devi or Owl were contra-trading;

(iii) HMRC knew and had the means of knowledge that Devi and Owl were contra-trading but did not see it as a badge of fraud or an MTIC problem;

(iv) Even if Option did know Devi and Owl were contra-trading, which they did not, it would have been an irrelevant piece of information at the time as no one considered contra-trading to be an indicator of MTIC fraud;

The emergence of contra-trading was unknown as at June and July 2006.

The Appellant's evidential analysis on Issue 1

87. It was suggested that there are five main areas of circumstances that indicate knowing participation in a fraud:

(i) Was there a commercial purpose for doing the deals in question? If there was a commercial purpose it militated against involvement in fraud and if there was no commercial purpose it leaned towards involvement in fraud.

(ii) What was the level of due diligence carried out in relation to the deals? A low level of due diligence might be an indicator of fraud or an indicator of carelessness. If the due diligence was a box-ticking exercise to give a façade of due diligence then that pointed to involvement in fraud, but conversely a targeted and relevant due diligence was a strong indicator against the participation in fraud.

(iii) What was the level of communication with HMRC? A fraudster in the mobile phone industry will want minimum contact with HMRC. A genuine trader seeking to avoid involvement in MTIC fraud, will make full disclosure to HMRC, seek their advice and inform HMRC of anything suspicious.

(iv) What was the relationship between Option and the other fraudulent traders? A close relationship with meetings would give the opportunity to involve one another in a fraud. Cross-ownership and common directors does the same. A more distant relationship militates against involvement in fraud. Strangers do not usually co-conspire and are not trusted by existing fraudsters to be brought into a fraud.

(v) How was the deal carried out? Part payments, banking arrangements offshore in mutual banks, inadequate invoicing, and

unusual timing of invoicing and deals may support involvement in a fraud or at least require a reasonable explanation.

(i) (a) Commercial purpose

88. Option relied on the evidence of Mr Stone at [21] of his witness statement where he said that the key characteristic of MTIC fraud was:

> "However, the transactions will almost inevitably display different characteristics from both of the transactions which occur in the course of genuine 'arm's length' trading. By an 'arm's length' transaction, I mean one in which the buyer and seller act independently of each other and in their own commercial interests, with each business under separate management, ownership and control."

It was submitted that the evidence showed that Option was acting independently of both Devi and Owl, and in each case there was a commercial justification for the trade. There was no evidence of either David Ford or Mike Fisher meeting the management of either Devi or Owl, so excluding any possibility of collusion between them.

(i) (b) Devi

89. It was known that the deals with Devi were constructed; a constructed deal is perfectly lawful as long as it has a commercial purpose. As long as Mr Ford could not see any commercial purpose, he decided not to do those deals with Devi. Having been persuaded that there was a commercial purpose on the basis of the spreadsheet produced by Mike Fisher, David Ford agreed the deals could proceed. The evidence of Mr McManus of HMRC was relied on where at [41] of his witness statement he said:

> "In my opinion, I have obtained key information that reconciles with Mr Fisher's explanations of the commercial basis of Option's involvement in the deals. I have not identified any information that would lead me to question Mr Fisher's explanations in this regard."

Mr McManus had continued by saying that he could not see any commercial purpose from Devi's point of view because Devi could make more money from obtaining finance by a different method than cashflow from contra-trading. This did not deal with the reality that no mobile phone business could obtain finance from banks or elsewhere. Mr Ford genuinely believed on reasonable grounds that this was so. It was queried why, if Option were actually involved in the fraud, would David Ford raise initial concerns about the deals at all?

(i) (c) Owl

90. There was no evidence from HMRC that the deals were done at an uncommercial price or that the sales were sold at an unrealistic market value. It should therefore be accepted that deals with Owl were at a commercial price.

(ii) Due diligence

91. Due diligence must be tested against the specific transaction and business model involved.

(ii) (a) Option's business model

92. The business model for Option was designed to prevent Option becoming involved in basic MTIC fraud and that model involved Option only buying phones from an established importer and then exporting those phones directly and in that way there could be no 'missing trader' in the chain, as the missing trader was always the importer.

(ii) (b) Verification of the business model

93. Option had designed a business model to prevent MTIC fraud which was checked by Ernst & Young. It was submitted that the business model designed to prevent MTIC was checked with HMRC, this was specifically at the meeting of 14 July 2005 where David Ford was present. In cross-examination Mr Morrison had accepted that on the basis of the following:

> "Q. So I just want to make this clear. So if the plan which was put to you by Option was to only buy phones from the importer who is established – he has not hi-jacked a VAT number or not a defaulter – and then export the phones, it does not seem possible to become involved in a simple MTIC fraud or MTIC export fraud as Mr Stone calls them?
>
> A. That's correct."

Option also has relied on the following from an e-mail sent to Mr Morrison on 27 September 2005 by David Ford in which he said:

> "… clearly if we buy direct from the importer and the importer is not a missing trader then there can't be a missing trader in the chain."

If that situation is accepted as correct, and there is absolutely nothing to contradict it in the evidence, it follows that the business dealings of Option with Devi & Owl must be tested against a backed drop of belief that Option could not be involved in MTIC fraud.

(i) (c) Option's Decision-making process

94. It was a large part of Option's case that its decision-making process was such that only David Ford could make the decision to trade. It was David Ford's evidence that Colin Thompson was not allowed to conclude any transactions without prior approval, and that approval was to come from Mike Fisher. In addition Mike Fisher would always go to David Ford before taking on new suppliers or customers. Caution was David Ford's watchword.

95. Of the personnel in Option, Nick Fisher did not have any involvement in the business and was not a director at the relevant time. Mike Fisher had no financial interest in the success or otherwise of Option other than a small part of his salary that was recharged. Michelle Back was an accounts clerk who had no decision- making power. Colin Thompson was a salesman on a modest salary with an equally modest bonus who had no independent decision-making power and, on the available evidence, it could not be said that he was a directing mind and will of Option. Mr Lewis made no submissions in relation to the role of Sarah Fisher.

(ii) (d) IMEI checks

96. The most important due diligence was that of the 100% IMEI checks. This was done by Option of its own volition and before there was a provision in the Finance Act allowing HMRC to request IMEI information which was brought in after July 2006. It was accepted by Mr Morrison that no other traders in MTIC goods that he dealt with also did this.

(iii) *(a) Option relied on the evidence of Officer Harris (*see para 45 above) *re IMEIs*

97. It was submitted that it was inconceivable that anyone involved in a fraud would be doing 100% IMEI check and would report on every deal, and indeed on deals that did not take place, and submit the findings to HMRC. The 100% IMEI checks were a bespoke piece of software for Option. No fraudster would volunteer such information to HMRC in the knowledge that it was informing HMRC of a possible fraud and that it would or could be put on to NEMESIS, HMRC's computer programme.

(iii) *(b)*

98. Option specifically relied on the fact that on 24 May 2006 Option passed on to HMRC information of duplicate IMEI numbers which concerned Devi. HMRC would not have had this information if it had not been provided by Option and it was submitted that this was utterly inconsistent with HMRC's allegation that Option and Devi were co-conspirators in a fraud on HMRC. It was submitted that the only possible and logical explanation was complete innocence on the part of Option in doing this action. Similarly there was an e-mail dated 14 June 2006 which informed HMRC that Option cancelled an order with Owl because of previously seen IMEI numbers.

(iv) (a) What was Option's relationship with the fraudulent traders?

99. Option's case was that it was involved as an unwitting party by the fraudsters to pass on the risk of having their repayment claims verified or denied. There were no part payments, no banking arrangements offshore in mutual banks, no inadequate invoicing. The transactions were genuine arms length transaction. With regard to the use of the FCIB, there was no persuasive evidence that Option knew that FCIB was 'dodgy'. There was no public information on this until October 2006. Had Option been a knowing party to the fraud, it might have been expected that Option would also bank with FCIB.

(iv) (b) Company checks

100. Option had carried out checks on Devi, Owl, Owl I & E, Navigo and Evolution. Option relied on the e-mail sent on 27 September 2005 from Mike Fisher to David Ford in respect of Owl, see para 57 above). It was submitted that this demonstrated that proper company checks were carried out and carefully considered before Option did business with Owl and it was impossible to equate this e-mail with fraudulent participation by Option with Owl. Mr Lewis submitted: "If they were in it together this e-mail would never have been sent." Option relied on the positive report from Dunn & Bradstreet checks carried out on Navigo which gave it a high credit rating and turnover of €112,773,895 and showed it to be an established, profitable, well thought of company with which to trade. Option had rejected many companies when deciding whether or not to do business with them and examples had been cited.

(iv) (c) Credit checks

101. A company having a poor credit rating had no bearing on Option's business model. It was accepted that it made no commercial sense to extend credit to a company that had a poor credit rating, but where no credit was being extended, it did not affect the commercial sense or rationale of the transaction. In Option's case there was no commercial reason to check the credit rating of a supplier because Option was not giving credit to its suppliers. Option relied on evidence that a known distributor, NT Plus, supplied Devi and did so by shipping goods on hold to them. It did this despite Devi's low credit rating.

102. HMRC had never suggested that obtaining credit ratings was an essential part of due diligence and in Notice 726 at paragraph 8.1 credit checks was not amongst the suggested checks to be made. At paragraph 8.2 there was a reference of credit checking, but it was in the context of "obtain credit checks or other background checks from an independent third party" and therefore background checks were viewed as an acceptable alternative to credit checks. In a later version of Notice 726 (March 2008) at paragraph 6.1 a low credit rating was an indicator only when combined with a supplier being newly established, it was not suggested that a low credit rating of itself could indicate anything untoward.

(iv) (d) Verification from the Freight Forwarder that the supplier is the importer

103. Option obtained a confirmation from the freight forwarder that each supply was made directly from the importer.

(iv) (e) CMR checks

104. These were originally carried out but were replaced with the certificate of verification as above.

(iv) (f) PriceRunner

105. Option conducted a PriceRunner check on the retail prices of phones at home and abroad to ensure the prices for the phones that Option were buying and selling were realistic. David Ford had found reference to another website that Mike Fisher and Michelle Back were looking at in relation to wholesale prices. It was submitted that this was evidence that Option were considering the wholesale prices notwithstanding David Ford had not set this up originally and was unaware of a site to check from. This was said to be evidence that the decision-makers in Option were themselves keenly trying to avoid being involved unwittingly in any scheme to defraud HMRC.

(iv) (g) Redhill checks

106. Option carried out complete and full Redhill checks. Mr Lewis referred to the following exchange in cross-examination of Mr Morrison:

> "Q. And in relation to Prizeflex, although that had occurred a month or two earlier, would it be fair to say that you tipped the wink to Mr Fisher, so I can use that expression, not to trade with Prizeflex?
>
> A. I think that reading between the lines, yes, probably."

This was relied on by Option as creating a legitimate expectation about the nature of Option's relationship with HMRC. As Option was providing HMRC with intelligence, Option were entitled to expect they would use it and then inform them of anything of interest.

(iv) (h) Notice 727 (2003) Compliance

107. Mr Lewis submitted that Option never purchased the phones for less than the lowest open market value of the goods or the price payable for them by any previous supplier and HMRC had put forward no evidence to suggest the contrary. It was submitted that Option complied with all the requirement of the Notice.

(v) *HMRC's evidence of features that demonstrate they were not arms length transactions*

(a) Back to back transactions

108. This ignores the fact that all spot trades by their nature take place back to back, and all arbitrage trades, by definition take place back to back. Option's trades did not take place in a single day, contrary to HMRC's assertions. Option would only place a purchase order with its supplier after it had received a purchase order from its customer. Completion did not take place on the same day, the goods would be released to Option, the sale by Option did not take place until it was paid. There was evidence that on a number of occasions Option were left holding the goods. No adverse inference can be drawn from the fact that Option were carrying out these types of transactions.

(v) (b) From its previous trading Option were well aware of the legitimacy of trading in two-pin plugs in the United Kingdom. As Option's business model was to export the imported phones, it would be an advantage to only have two pin plugs. The only model phones with UK plug adaptors would be those that originated in the UK authorised distribution chain, goods imported in the UK outside of the authorised chain would never have UK plugs. No adverse inference can be drawn from the fact that Option were buying two-pin plug phones.

(v) (c) Import phones into the UK which then get exported

109. Option relied on the evidence that Devi had an account with NT Plus for its understanding that Devi had a relationship with authorised distributors.

(v) (d) Timeline Issues

110. As the orders were pre-arranged, Devi did its paperwork ready for the transaction and after it was arranged, but before it was contracted. The fact that Owl's invoices predated the transaction did not indicate anything untoward, all Option would have been concerned about was to receive the purchase order from the customer before it issued an order to Owl. With regard to the breach of terms in relation to the purchase orders from Navigo, it was submitted that this could not be an indicator of fraud as, if they were all in it together, why would such terms be put on the order form?

The Appellant's evidential analysis on Issue 2

111. HMRC accepted that Option did not know of the existence of contra-trading at the time of its transactions with Devi and Owl, and that Option were not told by them of contra-trading at that time. None of the checks required by Notice 726 would have led to Option being aware that it was involved in a contra-trading fraud as contended by HMRC. Credit checks and receipt of poor credit ratings would not have led Option to the only reasonable conclusion that Devi and Owl were involved in a scheme to defraud HMRC. Similarly there was no evidence that any book of best

practice from Ernst & Young would have led Option to the only reasonable conclusion that Devi and Owl were involved in a scheme to defraud HMRC.

112. There is no evidence that basic checks as suggested by HMRC would have shown that Evolution was not a genuine business. On the contrary the Dunn & Bradstreet check showed it was a genuine company, properly incorporated and trading. HMRC's evidence acquired by the French authorities could not have been obtained by Option. Similarly, despite the fact that Navigo insisted in its terms and conditions that any phones with Customs stamps would be automatically rejected, credit and company checks on Navigo show it to be a long-established and successful business with a very good credit rating. Similarly nothing which could be identified as a result of checks on freight forwarders would have led Option to the only reasonable conclusion that Devi and Owl were involved in a scheme to defraud HMRC. It was not accepted on behalf of Option that Mr Morrison's comment that Mike Fisher had confirmed that Option had no written contracts or confidentiality agreements with either suppliers or customers was correct. It was submitted that even if it were, there was no evidence that had it been otherwise that the only reasonable conclusion for Option is that they were involved in a scheme to defraud HMRC.

113. With regard to the re-appearance of the phones, following the IMEI checks, it was submitted that at no time did Option consider any kind of VAT fraud other than simple MTIC fraud and so a re-appearance of phones, if not connected to simple MTIC fraud, did not seem to Option to be necessarily indicative of anything untoward.

114. In conclusion Mr Lewis submitted that HMRC was driven to put its case on the basis of actual knowledge and that Option was a willing participant in the fraud perpetrated. It had not put a consistent and clear case on knowledge and had not decided who in Option was a participant, the reason HMRC found itself in this difficult position was that the evidence did not support a conclusion that Option probably was a known participant in the fraud.

Reasons for decision

115. Our approach to this appeal is governed by the passages in *Kittel* and *Red 12* referred to us by Mr Sutherland (see paragraph 60 above) and the case of *Mobilx*, referred to us by Mr Lewis at paragraph 79 above. We adopt in particular the approach of Christopher Clarke J in *Red 12* which was endorsed by Moses LJ in *Mobilx*, of looking at the totality of the deals, their characteristics, what the taxpayer did or omitted to do, and what it could have done, together with the surrounding circumstances in respect of all of them. We bear in mind that the burden of proof is throughout this appeal upon HMRC.

116. There is no dispute that both of the supplies to, and the customers of, Option during the relevant period, June and July 2006, were engaged in contra-trading. Option itself was the exporter (broker) in the 'clean' chains. Option claims it was not party to any such fraud, that at the time it had no knowledge that such a fraud could exist and that it was unknowingly used by the fraudsters to carry out their fraudulent

purpose. We have been very much handicapped in arriving at the precise circumstances in which Option did agree to carry out the deals in question by having heard no evidence from the two people who were most directly involved in arranging the deals in question, Mike Fisher and, more particularly, Colin Thompson.

117. We do not accept Mr Lewis' submission that, because contra-trading was not known about by David Ford, nor mentioned to Option by HMRC, that Option could not have guarded against it. This begs the question of whether or not Option was itself a party to the setting up of the contra-trading deals. Also it is not necessary for HMRC to show that Option knew the exact mechanics of the fraud to which it was a party, but it has to show that Option knew or ought to have known that it was party to a fraud (see *Megtian* cited at para 76 above). As we are without an explanation as to how Option sourced Evolution and Navigo, or arranged on each of the five occasions to sell to those fraudulent traders, we must look at all the evidence which is available to us. In respect of Owl and Owl I &E deals, the only explanation offered by David Ford, and we bear in mind that he had no direct involvement with the deals in question, is that Option was manipulated by the fraudsters. Quite how Option was manipulated into the deals in question was not explained by him. David Ford relied on various constraints under which Option was supposed to operate, but, as we have set out above, it did not always do so, and, in particular appears not to have done so in its dealings with Evolution and with Trading Point. It was accepted by David Ford that it was not by chance that Colin Thompson came across Evolution and Navigo.

118. The Dunn & Bradstreet report on Evolution (see paragraph [45] above) was not such as to encourage a prudent businessman anxious not to be caught up in fraud, anymore than are the Experian checks provided by HMRC but not apparently obtained by Option (paragraph [45]). There is also the fact that Option continued to trade with Owl despite having come across duplicate IMEIs in an earlier aborted trade with that company (see paragraph [46]), when it might be expected that all trades with Owl, and indeed with its sister company Owl I&E might have been stopped forthwith. With regards to Navigo, whilst Option had obtained a Dunn & Bradstreet report which indicated that it was a very low risk company, its terms and conditions stated that any phones with UK Customs stamps would automatically be rejected, a condition which Mr Morrison had told Option in November 2005 (in relation to Sunico) would not be imposed by a company that was trading legitimately. Option were required by Navigo to deliver the phones to the same freight forwarder in France that Evolution had used in the earlier deals with Owl, another factor which is an indicator of contrivance on the part of all the companies involved in the deals with Evolution and Navigo. Option had not carried out any due diligence in respect of any of the freight forwarders involved in the fraudulent deals. We adopt Mr Sutherland Williams' submissions set out at para 62 (a) above in relation to the inferences to be drawn from the connection between Option and its suppliers and customers. Similarly as referred to by Mr Sutherland Williams above at para 62(c) the delivery point in almost all the deals was back to the point of origin, a fact which would have been known to those at Option responsible for dealing with the freight forwarders.

119. With regard to the deals with Devi, we take account of the fact that Devi was prepared in the first place to approach Option, specifically Colin Thompson, and

suggest a completely artificial trade. We have seen no contemporary documents whatsoever about the nature of the trade, and are asked to rely on David Ford's account of an account given to him by Mike Fisher based on Mike Fisher's speculative reasoning derived from an account given to Colin Thompson by Devi. There is evidence from HMRC that Devi did not have cashflow problems at the time and Option had not seen any evidence that it had. Had Option called for such evidence, none could have been provided. The most significant fact in our minds is that no reason beyond Devi's purported wish to retain control of the phones in question was advanced for Option being required to sell the phones to Trading Point. Any competent businessman (and Mr Ford had put himself forward as a competent businessman) would have queried the necessity for this to be part of the arrangement. Option did not question why the phones went back to the same freight forwarder from which they had originated, or why, given that the point of the trade was said to be to aid Devi's cashflow, Trading Point delayed in paying Option, as Option's trading method was said to be that it did not pay the supplier or release the goods to the customer until the customer had paid it, therefore Option should have immediately queried the basis for the trade.

120. Even after being told that HMRC were withholding the VAT repayment for Option's June trading, David Ford did not make any enquiries of either Colin Thompson or Mike Fisher as to the circumstances of this, or invite them to make enquiries of the customers or suppliers, and similarly with regard to the July period. It is to be expected that a competent businessman would instigate such enquiries and would require a reasonable explanation. By not even investigating the facts, regardless of what might have been found in the course of such an investigation, David Ford gives rise to the suspicion that, contrary to his evidence, he did not have complete confidence in Colin Thompson or Mike Fisher, and preferred not to learn anything about the June and July deals. Taking the above facts into account, together with those set out in paragraphs 39 to 50 above, we find that HMRC have shown on the balance of probabilities that Option was, through Colin Thompson, a knowing participant in the fraudulent deals, there being no other reasonable explanation for the June and July trades with Devi, or with Owl and Owl I&E. That Option was making a profit on all those deals, despite adding nothing to them and their having been imported into the UK only to be immediately exported again, should have caused Mr Ford to question fully the rationale for the deals and make enquiries of Colin Thompson.

121. Mr Lewis relied on the following principle aspects of Option's business model which he submitted point to Option's not being involved in the frauds. These aspects are that the model involved Option only buying from an established importer, thus avoiding buying from a missing trader; only David Ford could make the decision to trade, Colin Thompson not being allowed to conclude any transactions without prior approval from Mike Fisher who had to consult David Ford before taking on new suppliers or customers; the IMEI checks carried out by Option were referred to HMRC on all occasions, and in particular when duplicates were found, and lastly the fact that Option would not make payments to the FCIB. We have commented above in the course of setting out the evidence on all of these, and, in the case of Colin Thompson not being allowed to conclude any transactions, the evidence in respect of

Unique and Navigo shows that this was not the case. Of the above Option relied most heavily on the fact that it had informed HMRC in May 2006 of an instance where Devi had been concerned in deals with repeat IMEI numbers, and similarly with Owl. Whilst this would seem to indicate lack of involvement by Option, we ask ourselves why, following these incidences Option nonetheless continued to trade with both Devi and Owl? David Ford repeated on several occasions in the course of his evidence that he expected HMRC to inform Option if any of its trading partners were involved in carousel trading, despite being told by Mr Morrison that HMRC could not give that information, and it is more than probable that, not having been told specifically by Mr Morrison not to deal with Devi or Owl, Option considered it safe to carry on, as it did. We find that David Ford determinedly preferred his own views as to the best method of trading to those suggested by HMRC, for example ignoring low credit ratings of all three of the suppliers involved, being prepared to trade with Navigo despite its attitude to Customs stamps, and accepting the word of the freight forwarder in respect of duplicated IMEIs. Even if David Ford did not know of these details, Option through Mike Fisher did. It is also relevant that Option did not have any terms and conditions of trade, and that David Ford himself was unconcerned when Option sold the wrong specification of phones to Unique in its earlier dealings and Colin Thomson had ignored the specifications in respect of the phones sold to Navigo in the fraudulent deals.

122. We have stated above that the evidence looked at as a whole satisfied us that Colin Thompson was a knowing party to the fraud, there being no other reasonable explanation given to us for his having arranged for Option to carry out the trades in question. In that Colin Ford was said not to be empowered to commit Option to the deals in question which, given the evidence about his dealings with Unique and Navigo, we do not accept was the case, then it may be asked why David Ford sanctioned any of the deals in question? With regard to Devi, David Ford did not query the need to sell to Trading Point nor seek an explanation direct from Devi; with regard to Owl and Owl I&E there was a complete lack of evidence provided by Option to show that they were reliable companies and the credit reports provided by HMRC are such that no responsible businessman would consider trading with them in an industry which is rife with fraud, as it was known by Option to be. With regard to Evolution, the situation is similar. Whilst Navigo had a satisfactory Dunn & Bradstreet report, its terms and methods of trade were not. Option employed Colin Thompson at a low salary and with the possibility of increasing his earnings by only £12,000 per annum by way of bonus. Given that Colin Thompson had stated to the knowledge of David Ford that he wished to recover the £1m he had lost in his vodka business in Romania, David Ford might have wondered how this would be possible, and been alert to the temptation Colin Thompson faced. David Ford himself had a naïve view of MTIC fraud and appears not to have considered that Option would be liable for the VAT involved should its supplier fail to pass on to HMRC the VAT involved in its purchases, let alone the possibility that its suppliers and customers might need to make money by fraudulent means given their poor cashflow positions.

123. Contrary to a submission made by Mr Lewis, Option had in some respects the classic profile of an MTIC trader in that it added no value to the product; it traded back to back, with little or no risk of loss; it had a dramatically increased turnover; it

was never (other than on one occasion) left holding stock; it took little account of the specifications of the phones in which it was trading; it disregarded the credit ratings of the companies with which it traded and it ignored the improbability of the phones, all of which were two-pin plug, being imported to the UK as part of a genuine trade. In the above circumstances and taking account of all the circumstances surrounding the deals set out above, we conclude that Option through Colin Thompson knew of the connection with fraud and that David Ford also knew or should have known in that he turned a blind eye to what he would have known had he made proper enquiries of the circumstances of the Devi deals, namely that there was no good reason for Option having to sell the phones on to Trading Point; and also to the likelihood of Owl and Owl I&E being involved in fraud given their previous involvement in duplicated IMEIs, and their low credit ratings. He had made no enquiries of Colin Thompson as to how he had found those companies, or Evolution and Navigo. He had turned a blind eye to the likelihood of Colin Thompson wanting to improve his financial position and the temptations there would have been in this particular industry to someone needing to recover a substantial sum of money. He failed to consider the implications of the fact that Colin Thompson had gone beyond the limits of what was said by David Ford to be his ability to trade which is clear from his dealings with first of all Unique, of which David Ford was aware and subsequently with Navigo. The clearest evidence of David Ford turning a blind eye comes from his behaviour in July after being informed that HMRC were carrying out an extended verification and were withholding Option's June input tax. Any reasonable and honest businessman would immediately have made enquiries of those directly involved, i.e. Colin Thompson and Mike Fisher, of the exact circumstances of these June deals. Whilst we bear in mind that the relevant time in respect of David Ford's knowledge is at the time of the deals in question, that he did at no point, then or subsequently, make such enquiries is the most conclusive evidence of a man not wanting to know what the answer would be, and points to the probability that he did know what the answer would be, namely that the deals were contrived with the assistance of Colin Thompson. Had he made reasonable enquiries and found the lack of evidence for Devi's need to trade with Trading Point, he would have been in a position to stop the remainder of the July deals.

124, If we are wrong that Option, through David Ford, knew or should have known of the connection with fraud, then we turn to consider whether our finding that Colin Thompson knew of the connection is sufficient to fix Option with that knowledge, given that he was not a director of Option. For Option not to be fixed with Colin Thompson's knowledge of the fraud and, thereby liable for the consequences, we have to be satisfied that Colin Thompson had decision-making power. Given that the evidence shows that Colin Thompson did commit Option to the deals with Unique, and also on the balance of probabilities that he was also responsible for the trade with Navigo, the latter of which was part of the contra-trading fraud, and on the basis of Mr Sutherland Williams' submissions set out at paragraphs 72-76 above, with which we concur, we find that Colin Thompson's knowledge should be ascribed to Option for all the above reasons this appeal is dismissed.

125. 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.

MISS J C GORT
TRIBUNAL JUDGE

RELEASE DATE: 28 November 2011