TC02728

Appeal number: LON/2008/0156

VALUE ADDED TAX – MTIC fraud – whether trader entitled to recover input tax –transactions formed part of transaction chain which was connected with VAT fraud – whether trader knew or should have known its transactions were connected with VAT fraud – trader knew of connection – alternatively, trader should have known of connection – appeal dismissed

FIRST-TIER TRIBUNAL
TAX CHAMBER

JMC ELECTRONICS LIMITED **Appellant**

- and -

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

TRIBUNAL: JUDGE EDWARD SADLER
MARK BUFFERY FCA AIIT

Sitting in public in London on 12, 15 - 19 October and 27 November 2012

Liban Ahmed of Controlled Tax Management Limited, for the Appellant

Amy Mannion of counsel, and Natasha Barnes of counsel, instructed by the General Counsel and Solicitor to HM Revenue and Customs, for the Respondents

DECISION

Introduction

1. This is an appeal by the company JMC Electronics Limited ("the Appellant") against a decision of The Commissioners for Her Majesty's Revenue and Customs ("the Commissioners") to deny the Appellant its claim to deduct input value added tax in the sum of £402,440.08. The Commissioners notified the Appellant of their decision by their letter to the Appellant dated 7 January 2008. The Appellant appealed to this tribunal against that decision in its Notice of Appeal dated 8 January 2008.

2. The claim made by the Appellant relates to its entitlement to deduct input tax for two of its monthly VAT accounting periods, 07/06 and 08/06. The Appellant carried on at that time the business of wholesale trading in the electronic components known as central (or computer) processor units ("CPUs"). In the course of July 2006 the Appellant entered into six transactions and in the course of August 2006 it entered into two transactions. Those eight transactions are the concern of this appeal (we refer to them together as "the Disputed Transactions", and to each individually as "a Disputed Transaction"). In each case the Appellant purchased Intel SL7Z9 CPUs from another UK trader (on which input tax was payable) and later the same day sold on those CPUs by way of export to a trader outside the EU in a zero-rated transaction for VAT purposes. The Appellant seeks a deduction of the input tax of £303,463.13 paid on the respective purchases of the CPUs in the July 2006 Disputed Transactions and of £98,976.95 paid on the respective purchases of the CPUs in the August 2006 Disputed Transactions. If the Appellant is entitled to such a deduction the Commissioners are required to give effect to it by making a repayment of VAT to the Appellant.

3. The Commissioners have refused to accept that the Appellant is entitled to the input tax deductions it seeks and in consequence have refused to make any repayment of VAT. The Commissioners contend that each of the Appellant's purchases and sales comprising the Disputed Transactions can be traced directly back through a chain of UK traders to traders who fraudulently have defaulted in payment of VAT in relation to the CPUs traded, and that accordingly each of the Disputed Transactions was connected with the fraudulent evasion of VAT. They claim that the fraud is of the type now widely known as Missing Trader Intra-Community ("MTIC") fraud. They claim that, in respect of each of the Disputed Transactions, the deal chain (including the Disputed Transactions in that deal chain) was contrived and fraudulent, and that the Appellant knew that the Disputed Transactions were connected with the fraud, or alternatively, that the Appellant should have known (because it had the means of so knowing) that the Disputed Transactions were connected with the fraud. They claim, on the authority of European and domestic case law, that this results in the Appellant having no entitlement to a credit for the input tax paid by the Appellant in relation to the Disputed Transactions and hence the Commissioners are not required to repay any part of the VAT claimed.

4. The Appellant concedes, now that it has seen the body of evidence assembled by the Commissioners after their lengthy and extensive investigation carried out since August 2006, that there was a loss of value added tax in the deal chains of which the Disputed Transactions form part, and that that tax loss resulted from fraud perpetrated by traders in relation to the trading of the CPUs which the Appellant subsequently traded. The Appellant therefore concedes that the Disputed Transactions are connected with the fraudulent loss of VAT identified by the Commissioners.

5. However, the Appellant argues that, for its part, the Disputed Transactions were commercial and at arm's length in the course of an established and commercial business. The Appellant also argues that the Commissioners identified the fraudulent tax loss, and its connection to the Appellant's transactions through the deal chain, only after, and with the hindsight benefit of, an exercise of forensic examination of the deal chains carried out over several years following the transactions. The Appellant contends that at the time at which the Appellant entered into each of the Disputed Transactions the Appellant did not know, nor could it reasonably have known, that those transactions were connected with any fraudulent evasion of VAT which may have occurred in the respective deal chains. The Appellant argues that it took all necessary and reasonable precautions to ensure that, in entering into its transactions, it was not involved in a chain of transactions which involved missing or defaulting traders, carrying out checks at least as extensive in their scope as those recommended by the Commissioners. The Appellant argues, in the alternative, that if it was involved in a contrived fraudulent scheme, it was the innocent dupe who did not know, and could not have known, that it was being manipulated by others for their own ends.

6. There is now a sizeable body of case law relating to MTIC fraud transactions and the claims made by traders to recover input VAT in respect of their transactions when they have become involved in chains of deals where there has been such fraud. Accordingly, both the nature of MTIC fraud and the terminology used in MTIC fraud cases is now widely known. It is therefore not necessary to describe these matters in detail, but for reference Appendix I is a summary of the way in which MTIC fraud occurs in so-called "simple" chains of transactions such as those in the present case, and the resulting loss to the revenue. It also explains the terminology commonly used in cases such as this.

A preliminary matter - the Appellant's application to exclude certain evidence

7. In his skeleton argument on behalf of the Appellant, Mr Ahmed argued that four issues included in the Commissioners' evidence should be disregarded by the tribunal. At the beginning of the hearing he expressed his argument as an application to the tribunal for such evidence to be excluded from the case.

8. The four issues were: the circular nature of money flows passing between the parties to the transactions comprising or connected to the fraudulent tax loss; the circularity of the CPUs traded in the transactions (certain of those goods being imported into and exported from the UK on occasions other than in the course of the deal chains in which the Appellant was involved); whether or not the goods traded by

the Appellant actually existed; and the size of the "grey market" in CPUs at the time the Appellant traded in such goods.

9. The Appellant's case was that none of those issues had been pleaded in the Commissioners' Statement of Case, and that it is well-established by the tribunal and in other jurisdictions that allegations relating to matters of fraud must be fairly and fully pleaded in advance of the hearing so that the party against whom the allegations are made has the proper opportunity to answer those allegations. Mr Ahmed referred us to decisions of the tribunal in the cases of *POWA (Jersey) Limited v HMRC* [2009] UKFTT 360 (TC) and *Flashpoint Technology Limited v HMRC* [2011] UKFTT 353 (TC) and also the decision of the High Court in *Mobilx Limited v HMRC* [2009] EWHC 133 (Ch). He argued that it was not sufficient that these issues are dealt with in witness statements from the Commissioners' witnesses - that does not amount to a proper pleading of the issues.

10. Miss Mannion, who appeared for the Commissioners, pointed out that the Statement of Case was served on 14 March 2008, in accordance with the timetable required by the tribunal's procedural rules. She argued that the Statement of Case sets out in broad terms the case which the Commissioners are making against the Appellant, including that the transactions in which the Appellant was involved comprise a contrived scheme for the fraudulent evasion of VAT, and that the Appellant knew or should have known that this was so. Therefore fraud was pleaded from the outset of the case, as was the Appellant's knowledge of that fraud.

11. Miss Mannion pointed out, more specifically, that reference is made in the Statement of Case to the accounts respectively held by the Appellant, its suppliers and customers in the transactions in question with the First Curaçao International Bank NV ("FCIB") and to the transfer of funds between accounts with FCIB held by MTIC traders. She explained that further investigation by officers of the Commissioners into the affairs of FCIB in the course of preparation of their detailed case against the Appellant (including access by those officers to information not available until after the Statement of Case had been served) had resulted in detailed evidence which fleshed out the broad terms of the Commissioners' case as set out in the Statement of Case.

12. Further, Miss Mannion argued that extensive and formal pleadings are not required, provided that issues and matters in dispute are identified clearly and in good time, and she referred to the case of *McPhilemy v Times Newspapers Ltd and Others* [1999] EWCA Civ 1464. This was especially the case in tribunal proceedings. In the present case the appeal had originally been listed for hearing in December 2011 (that hearing was cancelled at the Appellant's request), and the Commissioners' full written opening submissions and bundles of evidence (in all material respects the same as their opening submissions and evidence for the present hearing) set out in detail the case the Commissioners were now laying before the tribunal. The Appellant has therefore known for at least 11 months the full and detailed extent of the Commissioners' case. The Appellant has no basis to argue at this stage the necessity for formal pleadings: it could have made its application some months ago, in which

case the Commissioners could have remedied the matter in time, had the tribunal entertained such an application, by preparing an amended Statement of Case.

13. We considered the Appellant's application and gave our decision, which was to dismiss the Appellant's application and to direct that the Commissioners' evidence on the issues in question should not be excluded.

14. It is clear that the evidence and issues in question are highly relevant to the questions we have to decide, which concern the actual or putative knowledge of the Appellant as to the connection of the Disputed Transactions to the fraudulent loss of VAT. That being so, the evidence should be admitted unless the Appellant can show that it is prejudiced in preparing its case by the evidence being admitted, and that such prejudice outweighs the prejudice to the Commissioners of excluding the evidence.

15. We cannot see that the Appellant can sustain any argument that the preparation of its case has been prejudiced by admitting this evidence. As Miss Mannion rightly pointed out, in the circumstances of this appeal the Appellant has known for nearly a year (and possibly longer, if one looks to the time when witness statements were served) in full detail the case which the Commissioners are arguing and the evidence they are adducing in support of that case. Their opening submissions, including appendices, run to over 100 pages and include the issues to which the Appellant objects as not being included in the Statement of Case, with cross references to the evidenced adduced. The Appellant had these submissions - or submissions materially the same - not later than December 2011. It cannot reasonably complain now that it has been caught unawares by the evidence in question and thereby has been prejudiced in its attempts to seek to answer the Commissioners' case.

16. The purpose of formal pleadings is to enable the parties to identify clearly the issues in dispute and to be made aware clearly, and in sufficient time and in sufficient detail, of the case they respectively must make or answer. In the tribunal proceedings the Commissioners' Statement of Case is an important part of fulfilling that purpose. But if that purpose is achieved in part by other means in the course of the detailed preparation of a case for hearing, those other means should fairly be regarded as part of the pleadings process. That is so in the present case. The Statement of Case made it clear that the Commissioners would contend that there was fraudulent loss of VAT and that it was connected with the Disputed Transactions. It also made it clear that the Commissioners' case was that the Appellant knew of that connection, or ought to have known of it. The nature and extent of the evidence supporting that case was made known as witness statements were served, if not before, and, in the particular circumstances of this case, in the original opening submissions served by the Commissioners. The Appellant cannot complain that it was not made aware, clearly and in sufficient time and in sufficient detail, of the full extent of the Commissioners' case and of the evidence the Commissioners intend to adduce in making their case.

The issues for determination by the tribunal

17. The parties were agreed that, having regard to the relevant provisions and case law, in determining this appeal the following are the questions of law and fact which have to be considered in relation to each Disputed Transaction:

(1) Has there been a loss of VAT that is attributable to fraud?

(2) If so, was the Disputed Transaction connected with that fraudulent loss of VAT ?

(3) If so:

(a) did the Appellant know that the Disputed Transaction was connected with that fraudulent loss of VAT?

(b) alternatively, should the Appellant have known that the Disputed Transaction was connected with that fraudulent loss of VAT?

18. As mentioned, the Appellant has conceded, in the light of the evidence presented by the Commissioners, that in relation to each of the Disputed Transactions there has been a loss of VAT that is attributable to fraud. The Appellant has also conceded, in the light of such evidence, that each Disputed Transaction was connected with a fraudulent loss of VAT - that connection is by means of the deal chain through which the CPUs in question were traded and in the course of which they were bought and sold by the Appellant in a Disputed Transaction.

19. We therefore are required to decide only question (3) in relation to each Disputed Transaction. If there is an affirmative answer to either (3)(a) or (3)(b), then the Appellant has no right to a deduction for the input tax in relation to the Disputed Transaction in question, and its appeal must be dismissed.

20. Our determination, in relation to each of the Disputed Transactions, is that:

(1) The Appellant knew that the Disputed Transaction was connected with the fraudulent loss of VAT.

(2) If the Appellant did not know that the Disputed Transaction was connected with the fraudulent loss of VAT, the Appellant should have known that to be the case.

Accordingly the Appellant is not entitled to repayment of the input VAT of £402,440.08, and the Appellant's appeal is dismissed.

The legal issues

21. This case is principally concerned with matters of fact, and the legal issues – the domestic statutory and Directive rights of the Appellant to claim a deduction for input tax and the domestic and European case law applying those rights – were not in dispute between the parties. It is, of course, necessary to set out those issues so that the facts can be related to them in order to reach a decision on the Appellant's appeal.

22. At the European level the right to deduct input tax (and therefore to claim a repayment of input tax when, in a VAT accounting period, input tax exceeds output tax) is now found in Articles 167 and 168 of the Council Directive of 28 November 2006 on the common system of value added tax (2006/112/EC) (at the time of the Disputed Transactions corresponding provisions in the Sixth Council Directive applied), which provide (so far as relevant to this case) as follows:

> *Article 167*
>
> *A right of deduction shall arise at the time the deductible tax becomes chargeable.*
>
> *Article 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 he is liable to pay:*
>
> > *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….*

23. These provisions are given effect within the UK by the Value Added Tax Act 1994 ("VATA 1994") and regulations made under VATA 1994.

24. Section 24(1) VATA 1994 provides the definition of "input tax", which, for the purposes of the present case means *"…VAT on the supply to [a taxable person] of any goods or services…being…goods or services used or to be used for the purpose of any business carried on…by him."* Section 24(6) provides for regulations relating to input tax.

25. Section 25(1) VATA 1994 requires a taxable person to account for and pay VAT by reference to VAT accounting periods (monthly periods in the case of the Appellant), and section 25(2) VATA 1994 then provides:

> *Subject to the provisions of this section, [the taxable person] is entitled at the end of each prescribed accounting period to credit for so much of his input tax as is allowable under section 26, and then to deduct that amount from any output tax that is due from him.*

Section 25(3) VATA 1994 then goes on to provide that if at the end of an accounting period the amount of the credit for the input tax exceeds the amount of output tax of the trader for that period, then that amount of such excess will be paid by the Commissioners to the trader.

26. Section 26(1) VATA 1994 provides:

> *The amount of input tax for which a taxable person is entitled to credit at the end of any period shall be so much of the input tax for the period (that is input tax on supplies, acquisitions and importations in the period) as is allowable by or under regulations as being attributable to supplies within subsection (2) below.*

By virtue of section 26(2) VATA 1994, the input tax must, in order to be creditable, be attributable to taxable supplies (or supplies outside the UK which would be taxable supplies if made in the UK) made by the taxable person in the course or furtherance of his business.

27. The regulations referred to in sections 24 and 26 VATA 1994 are the Value Added Tax Regulations 1995. Regulation 29 specifies that a person claiming a deduction for input tax shall make a claim for credit for input tax in his VAT return, on the basis of a VAT invoice in the required form provided to him by the supplier of the goods in question.

28. Turning back to the Appellant's appeal, there is no dispute between the parties as to the interpretation of these various provisions or, setting aside the knowledge of fraud/means of knowledge of fraud issue central to this case, as to their application: the Commissioners accept (subject to that central issue) that the Appellant is a taxable person making taxable supplies in the course or furtherance of his business, that the input tax claimed is attributable to such taxable supplies, and that the input tax claim meets the requirements specified by the applicable regulations.

29. The Commissioners, on the authority of a line of cases before the Court of Justice of the European Union and the UK national courts, have challenged the right of a taxable person to claim credit for input tax where that person otherwise satisfies the legislative requirements to claim such credit, but where there is fraud by another person in a related transaction resulting in tax loss and the taxable person knew, or should have known, that his transaction for which he is claiming the input tax credit was connected with the fraud.

30. As to the European cases, it is sufficient to refer only to the decision in the joined cases of *Kittel v Belgium* C-439/04 and *Belgian State v Recolta Recycling SPRL* C-440 [2006] ECR 1-6161, which sets out the principles which are to be applied by a national court in deciding whether input tax can be claimed as a credit where there has been fraud related in some way to the transactions carried out by the claimant. The following are the key passages of that decision relevant to this appeal:

> "51 …it is apparent that 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 (see, to that effect, Case C-384/04 *Federation of Technological Industries and Others* [2006] ECR I-0000, paragraph 33)…
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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….It is a matter for the national court to refuse to allow the right to deduct where it is established, on the basis of objective evidence, that that right is being relied on for fraudulent ends….
>
> 56 In the same way, a taxable person who knew or should have known that, by his purchase, he was taking part in a transaction connected

> with fraudulent evasion of VAT must, for the purposes of the [VAT] Directive, be regarded as a participant in that fraud, irrespective of whether or not he profited by the resale of the goods.
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> 57 That is because in such a situation the taxable person aids the perpetrators of the fraud and becomes their accomplice.
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> 58 In addition, such an interpretation, by making it more difficult to carry out fraudulent transactions, is apt to prevent them….
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> 61 …where it is ascertained, having regard to objective factors, that the supply is to a taxable person who knew or should have known that, by his purchase, he was participating in a transaction connected with fraudulent evasion of VAT, it is for the national court to refuse that taxable person entitlement to the right to deduct."

31. In the domestic courts the application of the *Kittel* decision has been the subject of a number of cases, and most significantly this whole area was reviewed by the Court of Appeal in the joined cases of *Mobilx Ltd, Blue Sphere Global Ltd, and Calltell Telecom Ltd v HMRC* [2010] EWCA Civ 517.

32. The *Mobilx* case establishes the following:

> (1) The UK domestic VAT provisions as to the right to deduct input tax (set out above) have the same conceptual basis as the Community legislation from which they are derived. That basis is not that the right to deduct the input tax is in some way forfeited or vitiated by the fraud or the connection with the fraud, but rather, that where there is such fraud or connection with fraud, the right to deduct does not exist at all. It follows that if it is objectively established that the taxable supply in question is made to a taxable person who knew or should have know that, by entering into the transaction, he was participating in a transaction connected with fraudulent evasion of VAT (i.e. if the *Kittel* test is satisfied), then it is consistent with domestic law, as with Community law, that there is no right to deduct the relevant input tax (see [47] to [49]).
>
> (2) In cases where the question is not whether the taxable person had actual knowledge that he was participating in a transaction connected with fraud, but whether he should have known that to be the case, then, "if a taxpayer has the means at his disposal of knowing that by his purchase he is participating in a transaction connected with fraudulent evasion of VAT he loses his right to deduct…because the objective criteria for the scope of that right are not met." (see [52]). Thus in determining whether the *Kittel* test is satisfied where the question is whether the taxable person should have known that he was participating in a transaction connected with fraud, the question is not whether the taxable person took reasonable precautions (whether by due diligence enquiries made of his supplier, or otherwise) designed to ensure that his transaction was not tainted, but whether he has the means at his disposal of knowing that his transaction was tainted (see [75]).
>
> (3) In applying the "should have known" test, "a trader may be regarded as a participant where he should have known that the only reasonable explanation

for the circumstance in which his purchase took place was that it was a transaction connected with fraudulent evasion." (see [60]).

(4) A tribunal, in seeking to discover from the facts whether "the only reasonable explanation for the circumstance in which [the] purchase took place was that it was a transaction connected with fraudulent evasion", should look not just at the transactions under immediate scrutiny, but at the wider circumstances and context in which the trader was carrying on his business (including all or other transactions which the trader entered into), being ready to draw inferences from such wider circumstances and context in order to reach a conclusion on this point (see [82] to [85]). Even if the trader has asked appropriate questions (as part of a due diligence exercise), he is not entitled to ignore the circumstances in which his transactions take place if the only reasonable explanation for them is that his transactions are connected to fraud: a trader is expected to take note of the obvious inferences from the facts of his transactions and the circumstances in which he has been trading (see [62] and [82]).

(5) As to the burden and standard of proof, it is for the Commissioners to adduce such evidence as satisfies the tribunal that, on the balance of probabilities, the trader knew that his transaction was connected with the fraud or should have known of that fact (see [81]). The case which has to be established against the trader is that he knew or should have known that his transaction was connected with the fraud (not that he knew or should have known that *there was a risk* that his transaction was connected with fraud (see [55] – [56]) and not that he knew or should have known that his transaction *was more likely than not to be* connected with the fraud (see [77])). If the case is so established there is no infringement of the principle of legal certainty, since the trader will have made an informed choice: "he knows where he stands and knows before he enters into the transaction that if found out, he will not be entitled to deduct input tax" (see [61]).

The evidence before us

33. We had in evidence before us, on behalf of the Commissioners, witness statements from fourteen officers of the Commissioners and a witness statement from an expert in the trade in CPUs; and on behalf of the Appellant we had three witness statements from Mr Dean Johnson, currently the sole director of the Appellant, and although not a director at the time of the July 2006 Disputed Transactions, he was at that time the majority shareholder of the Appellant. Each witness statement was supported by a substantial number of exhibits, and in total there were twenty-three trial bundles, each a lever arch file.

The Commissioners' witness evidence

34. The principal witness for the Commissioners was Feyisola Sheteolu, an officer of the Commissioners who from 1 August 2006 to 31 March 2008 was a member of the Commissioners' MTIC Fraud Team. She was the officer allocated to the Appellant's case in relation to the VAT returns submitted by the Appellant for July

2006 and August 2006. It is Mrs Sheteolu's decision in her letter of 7 January 2008 to the Appellant which denies the Appellant the right to deduct input tax in relation to the Disputed Transactions.

35. Mrs Sheteolu's evidence was based on the enquiries made by her and her colleagues into the business of the Appellant and the trading transactions entered into by the Appellant and also the other transactions comprising the deal chain relating to the Appellant's transactions. Mrs Sheteolu had prepared four witness statements, and she gave extensive oral evidence at the hearing and was cross-examined by Mr Ahmed for the Appellant.

36. Mrs Sheteolu's evidence related to the history and background of the Appellant, its shareholders and directors and the funding of the Appellant for the purposes of its business; the employment history of Mr Dean Johnson (principal shareholder of the Appellant) and of Mr James Prigg (the director of the Appellant); the nature and extent of the Appellant's business including its rapid growth; the trading transactions entered into by the Appellant, including the Disputed Transactions and the profit derived by the Appellant from the Disputed Transactions; the VAT returns made by the Appellant in relation to its July 2006 and its August 2006 accounting periods; the extended verification processes in relation to the Disputed Transactions and the consequent decision to refuse the Appellant the right to recover the input tax relating to the Disputed Transactions; the VAT fraud perpetrated by one or more parties in chains of transactions which included the Disputed Transactions and the connection of the Disputed Transactions with such fraud; the detail of the transactions comprising the chain of transactions connecting the Disputed Transactions to the fraud (including details of all the buffer traders in those chains); the circulation by way of import and export of the CPUs traded in the Disputed Transaction; the location and identity of the Appellant's customers in the Disputed Transactions, and the terms on which the Appellant traded with those customers; the Appellant's compliance record and correspondence and visits made by the Commissioners' officers to the Appellant in order to make the Appellant aware of MTIC fraud, and the Appellant's general awareness of MTIC fraud in the market in which it traded; the nature and extent of the due diligence the Appellant carried out with regard to its suppliers and customers; information concerning companies not in the deal chains, but through whom funds were circulated by the use of FCIB accounts in connection with the Disputed Transactions; and other matters relating to the Commissioners' case as to the Appellant's knowledge or constructive knowledge of fraud in the chains of transactions of which the Disputed Transactions formed part.

37. We found Mrs Sheteolu to be an entirely credible witness, and we accept her evidence.

38. We had the witness statements of Julie Ann Marshall and Michael Mercer, both being officers of the Commissioners involved in the investigation and analysis of accounts held in FCIB. Their evidence was not objected to by the Appellant, and they did not give oral evidence at the hearing. Their evidence is accepted. It deals with the FCIB accounts of the parties in the deal chains of which the Disputed Transactions form part, and the movements of funds in and between those accounts; the

relationship of movements of funds to the deal chain transactions; FCIB accounts held by other parties and the movement of funds connected to the deal chain transactions; and the circularity of funds in seven of the eight transactions which included the Disputed Transactions.

39. In connection with the witness statements of Miss Marshall and Mr Mercer, the Commissioners also served the witness statement of Andrew Letherby. Mr Letherby is an officer in the Commissioners' Criminal Investigation Directorate, and his witness statement introduced his report on the forensic integrity and cross verification of the computer system servers utilised by FCIB (the content of those servers was available to the Commissioners, and Miss Marshall and Mr Mercer drew on that content in preparing their witness statements). Mr Letherby's evidence was generic, and did not relate specifically to the Appellant. His evidence was not objected to by the Appellant, and he did not give oral evidence at the hearing. His evidence is accepted.

40. We also had the witness statements of Sarah Barker, Dean Foster, Allistair Strachan, Laura Hartell, Norman Tuddenham and Sarah Wynne, all being officers of the Commissioners involved in the investigation of MTIC fraud and traders involved in such fraud. Their evidence related to various traders in the deal chains which included the Disputed Transactions, all of which traders had fraudulently failed to account for VAT due or had fraudulently used another trader's VAT registration number or had facilitated fraud by allowing its VAT registration number to be used by another party, or had otherwise participated in a contrived and fraudulent scheme involving the evasion of VAT. The Appellant raised no objection to their evidence, and these officers did not give oral evidence at the hearing. Their evidence is accepted.

41. We had the witness statement of Stephen Hunter Patterson, an officer of the Commissioners. His evidence related to the trading activity of Johnsons Consultancy Ltd, a company of which Mr Dean Johnson is a director. The Appellant raised no objection to Mr Patterson's evidence, and he did not give oral evidence at the hearing. His evidence is accepted.

42. Stephen Peter Douglas Harrap, a local compliance accountant of the Commissioners and a Fellow of the Institute of Chartered Accountants, appeared at the hearing as a witness for the Commissioners. Mr Harrap had prepared a witness statement which introduced a report on the financial position of the Appellant prior to and at the time of the Disputed Transactions, including matters relating to the Appellant's business model and operations, the working capital requirements and the loan funding of the Appellant to meet those requirements, dividends paid by the Appellant to its shareholders, and emoluments paid by the Appellant to its director and employees. Mr Harrap was cross-examined by Mr Ahmed on behalf of the Appellant. We considered Mr Harrap to be an entirely credible witness, and we accept his evidence.

43. Peter Howard Dean, an officer of the Commissioners, appeared at the hearing as a witness for the Commissioners. Mr Dean is part of the MTIC Fraud Team of the

Commissioners with special responsibility for their project collating and analysing data relating to exports and intra-EU removals of CPUs by MTIC traders. His evidence related to the import and export circulation of Intel Pentium 4 series CPUs in connection with VAT fraudulent deal chains; the box numbering and labelling systems used by Intel (the manufacturer) on their boxes of CPUs packaged in trays; the preparation of an extensive database compiled from traders involved in MTIC fraud deal chains involving Intel CPUs to enable the Commissioners to identify such goods being circulated by import and export, including CPUs traded by the Appellant in the course of the Disputed Transactions. Mr Dean was cross-examined by Mr Ahmed on behalf of the Appellant. We found Mr Dean to be an entirely credible witness, and we accept his evidence.

44. We had two witness statements of Roderick Guy Stone, an officer in the Commissioners' Specialist Investigations Directorate with responsibility for the Commissioners' MTIC Technical Teams. Mr Stone's witness statements were not objected to by the Appellant, and he did not give oral evidence at the hearing. His evidence related to the nature, extent and features of MTIC fraud and the resulting losses to the revenue (see Appendix I); the policies adopted by the Commissioners to combat such fraud (with particular reference to traders in mobile telephones and the "grey market" in such goods); the offshore banking arrangements used by traders; and the internet websites used by traders to seek out or offer trading deals in mobile telephones and CPUs. His evidence was about such matters in general, industry-wide, terms, and did not relate specifically to the Appellant or the chain of transactions with which it was related. His evidence is accepted.

45. Finally, we had the evidence of Kevin William John Findlay. Dr Findlay appeared as an expert witness for the Commissioners. Dr Findlay currently works as a consultant analysing and advising upon the strategy, operations and business prospects of companies in the electronics, semiconductors, IT and software sectors. He has been a Director in the United Kingdom firm of PwC in their Strategy Group (Technology). He has a doctorate in electronic engineering from the University of Edinburgh and has worked for more than 18 years in the IT and electronics industries. Dr Findlay's evidence related to the following matters: the electronic components distribution market and the white market in CPUs; the legitimate grey market in CPUs and the main market opportunities within that market; the size of the CPU distribution market in 2006 and the value of the legitimate UK grey export market in CPUs in that year; the means of assessing whether a transaction is in the legitimate grey market; and the broad tests which may be applied to determine whether a company is genuinely trading in the legitimate grey market. Dr Findlay was cross-examined by Mr Ahmed on behalf of the Appellant. We deal below in detail with Dr Findlay's evidence – at this point is it sufficient to mention that we found Dr Findlay to be an entirely credible witness, and we accept his evidence.

The Appellant's witness evidence

46. The sole witness for the Appellant was Mr Dean Johnson. Mr Johnson founded the Appellant and during the period in which the Appellant traded Mr Johnson was the principal shareholder of the Appellant. He was not, however, a director of the

Appellant until 1 August 2006. In his evidence Mr Johnson states that he arranged on behalf of the Appellant all the trading transactions it entered into and made all decisions as to whether or not the Appellant should trade.

47. Mr Johnson had prepared three witness statements, and he gave extensive oral evidence at the hearing and was cross-examined by Miss Mannion for the Commissioners.

48. Mr Johnson's evidence related to his experience in trading in computer memory products prior to his setting up the Appellant; his setting up of the Appellant; its directors and shareholders; the funding of the Appellant for its working capital; the commencement and growth of the trade of the Appellant; the Appellant's VAT compliance and the extent of its knowledge of the prevalence of MTIC fraud in trading in CPUs; the manner in which the Appellant sought suppliers and customers; the Appellant's procedures for carrying out due diligence enquiries of its suppliers and customers; the Appellant's use of freight forwarders; the terms of trade and insurance arrangements under which the Appellant carried on its business; the Appellant's participation in the Disputed Transactions and the terms of the Disputed Transactions; the extent of the Appellant's knowledge of the suppliers and customers who entered into the Disputed Transactions with the Appellant; the inspections and other checks carried out in relation to goods traded in the Disputed Transactions; the Appellant's bank account with FCIB and the movement of funds through that account in relation to the Disputed Transactions; his understanding of, and experience of, the grey market in CPUs; and the formation and trade of Johnsons Consultancy Ltd following the cessation of trading activities by the Appellant.

49. We comment in detail below on Mr Johnson's credibility as a witness in relation to these various matters.

Findings of fact

50. From the evidence before us we make the findings of fact as set out in paragraphs 51 to 153 below. We make further findings of fact as to the funding of the Appellant's working capital, and as to the grey market in CPU products in the subsequent paragraphs after a review of the evidence in relation to those matters.

The Appellant and Mr Johnson

51. The Appellant was incorporated on 18 June 2004 and registered for VAT purposes on 1 June 2005. Its trading activity at the time of its VAT registration was described as "Distribution of computer components worldwide". In its application for VAT registration the Appellant stated that its anticipated annual turnover was £800,000.

52. At the time of VAT registration the directors of the Appellant were James Christian Prigg and Mrs Jenifer Ann Prigg. Mrs Prigg was also company secretary. She resigned as a director on 5 July 2005 and resigned as company secretary on 1 June 2006. David Paul Clark was appointed company secretary on 1 June 2006. Mr

Johnson was appointed a director on 1 August 2006. Thus at the time of the July 2006 Disputed Transactions Mr Prigg was the sole director, but at the time of the August 2006 Disputed Transactions Mr Johnson had joined him as a director of the Appellant. Mr Prigg resigned as a director on 13 September 2006.

53. As from 1 October 2005 Mr Johnson held 89 per cent of the share capital of the Appellant, Mr Prigg held 10 per cent and Charmaine Lawledge 1 per cent (as mentioned below, Miss Lawledge is the aunt of Mr Johnson).

54. Mr Johnson held a consultancy with the Appellant, and Miss Lawledge was the sole employee. The Appellant's principal place of business was in Chelmsford. The Appellant occupied a small office space there.

55. Prior to his position as a director of the Appellant, Mr Prigg had held, since 1997, a number of employment and director positions, including that of a salesman with GSI Distribution Limited.

56. Mr Johnson worked as an estate agent until he joined Goddard Systems International Ltd which traded in hardware computer peripherals. The owner of that company formed, in 1998, GSI Distribution Limited, which traded in computer electronic memory products. Mr Johnson became a director of that company in 2000, but it ceased trading shortly thereafter. Mr Johnson then established GSI Distribution Europe Limited, of which he was managing director. That company traded in computer memory products, holding stock for its trading purposes. The business proved not to be viable because of the amount of working capital required to finance stock, and because of the risks of stock losing value in a rapidly developing product. Further, its transactions were the subject of an extended verification process by the Commissioners in connection with MTIC investigations, and although an input tax claim of approximately £3,750,000 was initially denied in relation to two monthly accounting periods, that claim was eventually allowed.

57. GSI Distribution Europe Limited ceased trading in 2004. Mr Johnson then purchased an estate agency business, but it failed. In 2005 Mr Johnson acquired the Appellant, which began trading in that year.

58. The working capital of the Appellant was provided by a loan or loans to the Appellant totalling £180,000. The Appellant traded without holding stock, but working capital was required to fund VAT repayments, as all its trades were export trades and the Appellant was therefore in a net repayment position. As at the date of the hearing those loans were not repaid. The evidence in relation to this funding of the Appellant was confusing, contradictory and unconvincing. We deal with that evidence, and our conclusions arising from that evidence, as a separate matter below (see paragraphs 154 to 183).

59. The Appellant effectively ceased trading in September 2006, upon being notified that the Disputed Transactions were subject to the Commissioners' extended verification procedures.

60. Mr Johnson has since formed Johnsons Consultancy Ltd, a company which trades in computer consoles and accessories. All that company's business is on a "UK to UK" basis.

61. The financial statements of the Appellant show that for the year ended 30 June 2006 the Appellant had net pre-tax profits of £385,668 (after deduction of directors' remuneration and wages totalling approximately £104,000). For the year ended 30 June 2007 its net pre-tax profits were £105,485 (after deduction of directors' remuneration of £15,400) – since the company did not trade to a material extent after September 2006 theses figures represent the results of its trade for the months of July, August and September 2006.

62. In the course of the year ended 30 June 2006 (and before the financial statements for that year were prepared) the Appellant paid dividends to its shareholders totalling £127,800. In the course of the year ended 30 June 2007 the Appellant paid dividends to its shareholders totalling £36,700. In the course of the year ended 30 June 2008 the Appellant paid dividends to its shareholders totalling £27,000.

63. During the period from 1 July 2005 to 30 June 2006 Mr Johnson received from the Appellant remuneration for his consultancy of £8,457 and for the year to 30 June 2007 fees and director's remuneration totalling £6,272.

The Appellant's trading transactions

64. The Appellant began trading in July 2005, and in its first twelve months of trading its turnover (as stated in its VAT returns) exceeded £10 million. For the three months July, August and September 2006 its turnover (again as stated in its VAT returns) was approximately £2.75 million.

65. In the period whilst it was trading (July 2005 to September 2006) the Appellant entered into 75 trading transactions.

66. All the Appellant's trading transactions were entered into on a "back-to-back" basis, that is, with the Appellant agreeing to purchase and sell like amounts of CPUs on the same day, and with payment received and made on the same day. This enabled the Appellant to trade without giving credit and without obtaining working capital finance to fund the holding of stock. It also eliminated the risk of the Appellant being left holding stock, and reduced, but did not eliminate, the risks consequent upon financial default by a customer.

67. The terms of sale are referred to in detail below in relation to the Disputed Transactions, and there was no evidence to suggest other than that all other transactions were entered into on similar terms. Terms of sale were set out in purchase orders and invoices. There were no underpinning written contracts with detailed terms of sale, although the "UK Supplier Declaration Contract" referred to below and entered into between the Appellant and its supplier for each transaction had

some terms consistent with those set out in purchase orders and sales and some declarations (akin to warranties) on the part of the supplier.

68. The Appellant purchased CPUs from UK suppliers (paying VAT at the standard rate) and nearly all sales were by way of zero-rated export to overseas customers. This method of trading required the Appellant to finance its input tax for the period until it obtained a repayment of that tax.

69. The Appellant sought both suppliers and customers through personal contacts, recommendations made by third parties (including freight forwarders) and through the agency of trade websites to which it subscribed. It engaged in minimal advertising.

70. All of the trading transactions of the Appellant were made at a profit. As appears from the Disputed Transactions, each unit of CPUs, with a cost to the Appellant of around £67, would be sold by the Appellant at a gross profit ranging from £4 to £5.

71. CPUs traded were held by freight forwarders (in the Disputed Transactions the same freight forwarder, Quest Freight Limited, was engaged by the Appellant, and, indeed, by all parties in the related chains of transactions). The Appellant instructed the freight forwarder to inspect the goods traded (on occasion the Appellant would instruct the agent to carry out an "open box" inspection) and to despatch the goods to customers on "ship on hold" terms, to release the goods on the Appellant's instruction (to be given upon receipt of payment). The Appellant bore the cost of shipping the goods

72. The Appellant insured goods for an amount of between £120,000 and £150,000 per consignment. The sale price of goods sold in all the Disputed Transactions exceeded £150,000.

73. The Appellant held a number of bank accounts. In respect of its trading transactions it used an account it held with FCIB: customers paid the purchase price for CPUs into this account, and the Appellant paid suppliers from this account. All the Appellant's customers and all its suppliers held accounts with FCIB.

74. Of the 75 transactions entered into by the Appellant during its period of trading, the Commissioners have investigated 62. None of those has been traced to a legitimate source (that is, where VAT has been accounted for on import, or by an authorised distributor or manufacturer). As to the remaining 13 transactions, the Commissioners have been unable to trace the deals beyond a missing trader.

The Disputed Transactions and the related deal chains

75. The eight Disputed Transactions comprised the purchases and sales carried out by the Appellant in July and August 2006.

76. Between 3 November 2005 and 17 July 2006 the Commissioners wrote on several occasions to the Appellant to warn the Appellant that, in total, 17 of its deals (including all its deals between January and March 2006) had been traced back to

suppliers in the deal chain who had defaulted on their VAT payment obligations in relation to their supplies in the chain. In several of those deals the Appellant's customer was Independent Management Ltd, its customer in one of the Disputed Transactions, and in two of those deals the Appellant's customer was Bprolific Inc, its customer in two of the Disputed Transactions.

77. In relation to the Disputed Transactions, the Commissioners carried out a detailed investigation to establish the deal chain of which each Disputed Transaction was part; the terms on which the CPUs involved in each Disputed Transaction were traded in the deal chain; the movement of the CPUs within the deal chain and the extent to which those goods had been previously imported into and exported from the UK; and the movement of funds between parties in the deal chain in relation to the trading of the CPUs.

78. That investigation established that each Disputed Transaction is part of a deal chain which originates with a trader who, in relation to the supply of the goods in the deal chain, has defaulted on its VAT obligations or has gone missing with unpaid VAT. In each case fraud was the cause of the resulting loss of VAT.

79. Appendix II contains the detail of the deal chain in relation to each Disputed Transaction, showing the parties to the deal chain; the date on which each trade was carried out; the number of units of CPUs traded in each trade; the price per unit at which the goods were purchased and on-sold in each trade, and the total of such prices; the amount of VAT charged on each "UK to UK" trade; and the profit per unit realised by each trader in the chain.

80. In the case of Disputed Transactions 1, 2, 4, 5, and 8 the traders prior to the Appellant entered into "parallel" trades with small differences as to price, and with the trades "converging" in the sale made by the Appellant's supplier to the Appellant. In the cases of Disputed Transactions 1, 6, and 7 the Appellant did not purchase all of the units traded through the previous transactions in the deal chain.

81. In the case of each Disputed Transaction the gross profit per unit realised by each trader in the deal chain (other than the Appellant) varied from nil to £2.15 (in most cases the profit per unit was in the range of £0.15 to £1.00). The gross profit per unit realised by the Appellant ranged between £4.00 and £5.00.

82. The Appellant's purchase and sale in each of the Disputed Transactions were made on the same day, as "back-to-back" transactions (the Appellant purchasing the same number of units as it sold). In Disputed Transactions 1, 2, 4, 5, and 8 the previous sale and purchase transactions in the deal chain were made on the same date or (at the "head" of the chain) on the previous day. In the remaining Disputed Transactions the previous sale and purchase transactions at the "head" of the chain were made two or three days previously.

83. There is a degree of conformity as to the parties to the deal chains in the Disputed Transactions. Thus in Disputed Transactions 1, 2, and 3 the deal chain parties are identical (other than the Appellant's customer); in Disputed Transactions 4,

5 and 6 the deal chain parties are the same as for 1, 2 and 3 (other than the supplier to the Appellant); in Disputed Transactions 7 and 8 there are different deal chains; in Disputed Transaction 8 the supplier to the Appellant appears as its supplier in Disputed Transactions 4, 5 and 6.

The fraudulent tax losses

84. In Disputed Transactions 1 to 6 the party at the commencement of the deal chain in each case is the same, a company called Environmental Timber Products ("ETP") or its related company, RHF-ETP Limited ("RHF-ETP"). ETP was incorporated in August 2003 and registered for VAT in October 2003. In May 2005 it changed its business activity, for VAT purposes, from "importing timber frames" to "wholesale export and warehousing". Until August 2005 it submitted nil VAT returns. In November 2005 its VAT return showed supplies to the value of £14 million. Investigations by the Commissioners revealed that ETP was engaged in sales of CPU units and that in the period from October 2005 to February 2006 all of those sales were traced back to tax losses. Further, ETP regularly instructed its customers to pay the purchase price for goods it sold to third party businesses, rather than to itself.

85. In May, June and July 2006 ETP made a large number of sales (including sales to Bluestar Electronics Limited and Athol Marketing Limited, both parties in the Disputed Transactions deal chains) which it failed to declare in its VAT returns and for which it failed to account for the VAT on the supplies it thereby made.

86. On 11 July 2006 the Commissioners compulsorily deregistered ETP for VAT purposes. Thereafter ETP continued to trade, using the VAT registration number of an individual, Tammy Potter, who was also a director of ETP.

87. On 12 July 2006 a company known as RHF-ETP Limited began trading (RHF-ETP was possibly the result of the merger of ETP and the company RHF Limited, but it may simply have been a name change for ETP itself). Its first four invoices (to Bluestar Electronics Limited) comprised the transactions heading the deal chains in Disputed Transactions 4 and 5. RHF-ETP had the same numbered bank account with FCIB as ETP. On its invoices it also used the VAT registration number of Tammy Potter.

88. On 12 December 2006 the Commissioners issued an assessment against ETP for VAT due totalling £2,691,588.10 in relation to output tax due on transactions undertaken in July 2006, including the transactions it entered into at the head of the deal chains in Disputed Transactions 1, 2 and 3. ETP has gone missing and the assessed tax is unpaid.

89. The Commissioners have also issued an assessment for output VAT due for £586,177 against "the taxable person purporting to be RHF-ETP". The VAT assessed includes the VAT charged by RHF-ETP in relation to the transactions it entered into at the head of the deal chains in Disputed Transactions 4, 5 and 6.

90. On 1 October 2009 Mr Nathan Field, a director of ETP, was disqualified from acting as a director of a company for a period of 12 years on the grounds of ETP's involvement with missing-trader VAT fraud.

91. In Disputed Transaction 7 (carried out between 31 July 2006 and 2 August 2006) the trader at the head of the deal chain is Kaymore Limited. Kaymore Limited was an exporter of motor engines and engine spare parts. Between May 2001and February 2005 it quarterly sales, as reported on its VAT returns, did not exceed £215,000, and between March 2005 and May 2006 it made nil returns. Between 17 July 2006 and 11 August 2007 it carried out trades in mobile telephones and electronic products (including CPUs) to a value exceeding £22 million. Following enquiries which established that the company was a party to VAT fraud the Commissioners deregistered Kaymore Limited on 1 September 2006 and on that date assessed it to VAT in relation to undeclared output supplies for £2,659,347, which included £35,913.94 of VAT on its sale of CPUs to Simply Connect Ltd in the deal chain in Disputed Transaction 7. The assessment has not been disputed and the VAT assessed remains unpaid. Subsequent assessments were issued and in total Kaymore Limited has debts of unpaid VAT of in excess of £7.8 million.

92. In Disputed Transaction 8 (also carried out between 31 July 2008 and 2 August 2009) all the goods can be traced back through the deal chain to the company Carpets with More Limited ("CWM"), and 3,150 of the CPUs can be traced back to the supplier to CWM, the company Carisma Industrial Supplies Ltd ("Carisma").

93. CWM was registered for VAT from 1 February 2006 with a business activity of selling carpets. By July 2006 it had started trading in mobile phones and electronic products, including CPUs. Its sales in late July and early August 2006 exceeded £10 million. CWM refused to provide the Commissioners with information as to its trades or suppliers and closed down its business in September 2006. The Commissioners deregistered CWM on 10 October 2006. On 19 January 2007 CWM was assessed for an amount of £2,967,392.36 of undeclared output tax, which included output tax of £53,912.25 on the supply of 4,725 CPU units in the deal chain in Disputed Transaction 8. The assessed tax has not been paid. The sole director of CWM is, as from 6 May 2009, disqualified from acting as a director of a company for a period of 12 years on the grounds of CWM's involvement with missing-trader VAT fraud.

94. Carisma was registered for VAT from 22 December 2000, its registration showing that its business was supplying industrial commodities, textiles, gloves and paper. Until 2006 its quarterly sales are reported on its VAT return did not exceed £12,000. In the period 28 July 2006 to 4 August 2006 it entered into 29 sales with a value of £21.4 million. Its only known customer was CWM, and investigations by the Commissioners show that CWM made payments to third parties for the goods. Thus in the deal chain in Disputed Transaction 8 (in respect of 3,150 CPUs) where invoices show Carisma selling the goods to CWM for a VAT-inclusive price of £240,396.19, the payment trail shows that CWM paid that amount to a Portugese company, Mountainrix LDA, and not to Carisma. The sales invoices issued by Carisma to CWM in respect of a number of transactions (including in this deal chain) have the

VAT number of another (missing) trader. Since January 2006 Carisma has made no VAT returns nor responded to any enquiries by the Commissioners. Its directors have not been traced. Carisma was deregistered by the Commissioners from 5 August 2006, and assessments for undeclared output tax totalling in excess of £3.5 million have been made. Those assessments include an assessment made on 20 February 2007 for an amount of £620,510 which included Carisma's output tax on the sale of 3,150 CPU units in the deal chain in Disputed Transaction 8. No appeal has been made against the assessments, and the tax remains unpaid.

The Appellant's suppliers

95. In the eight Disputed Transactions three companies supplied goods to the Appellant: in Disputed Transactions 1, 2 and 3 the supplier is Commodity Exports Ltd; in Disputed Transactions 4, 5, 6 and 8 the supplier is Rose Communications Ltd; and in Disputed Transaction 1 the supplier is Leisure Communications Ltd.

96. In Disputed Transactions 1 to 6 the respective deal chains show that, whether the supplier to the Appellant was Commodity Exports Ltd or Rose Communications Ltd, the companies further up the chain were the same: Cellest Ltd sold to either Commodity Exports Ltd or Rose Communications Ltd; Bluestar Electronics UK Limited sold to Cellest Ltd; and ETP or RHF-ETP sold to Cellest Ltd.

97. In Disputed Transaction 7 the supplier of the goods to the Appellant was Leisure Communications Limited.

The Appellant's customers

98. In Disputed Transactions 1, 4, 6 and 8 the Appellant's customer was the company Futures Brokerage Inc. In Disputed Transactions 2 and 5 the customer was the company BProlific Inc. In Disputed Transaction 3 the customer was the company Medius Trading AG. In Disputed Transaction 7 the customer was the company Independent Management Limited.

99. Futures Brokerage Inc is based in Switzerland. The Appellant was unable to provide any information as to the circumstances of Futures Brokerage Inc or how it came to trade with the company. The Appellant had substantial trade with Futures Brokerage Inc (as customer) prior to the Disputed Transactions.

100. BProlific Inc is a US corporation based in Brooklyn, New York. It was incorporated in March 2001. Mr Johnson met a Mr Hecht of BProlific Inc at a trade fair in Hannover in March 2006. The Appellant held on file an undated communication from BProlific Inc addressed "To whom it may concern" by way of introduction of the company with brief details of its business, its trade terms as to delivery and payment, and enclosing details of its bank accounts and the freight forwarders it uses. The Appellant began trading with BProlific Inc (as customer) after the March 2006 meeting between Mr Johnson and Mr Hecht. In total the Appellant sold goods to the value of more than £1.5 million to BProlific Inc.

101. The Appellant was unable to provide any information as to Medius Trading AG. The Appellant's invoice issued to Medius Trading AG shows it to have an address in Zurich.

102. Independent Management Limited was incorporated in July 2003 in Niue. It had an agent in Hong Kong and an agent with an address in Twickenham. The Appellant had substantial trade with Independent Management Limited (as customer) prior to the Disputed Transactions. The Appellant had been advised by the Commissioners, prior to Disputed Transaction 7, that four of its previous sales to Independent Management Limited could be traced back through deal chains to tax losses. The Appellant held on file a copy of Independent Management Limited's certificate of incorporation; a copy of its certificate of good standing issued by the government of Niue; a copy of its memorandum and articles of association; and a general (undated) letter of introduction with details of its agents and its bank details and including a request that all correspondence should be directed to the UK agent.

Negotiations of trades and terms of business

103. The Appellant produced no documentary evidence as to its research in the market to determine pricing or other terms of business.

104. The Appellant produced no documentary evidence as to the negotiation of the individual trades it entered into. The evidence of Mr Johnson was that the Appellant sought customers on any trading day by placing an offer of "ghost" stock on various internet trading sites, to determine prices and stock availability on that day. A price would be agreed with a customer by way of a forward order for a stated number of CPU units. Thereafter, and on the same day, the Appellant would seek a supplier in the market for the goods required by the customer at a price acceptable to the Appellant.

105. The customer would issue a purchase order, and the Appellant would issue a purchase order to its supplier. Invoices would be issued. The purchase orders would contain the terms of sale.

106. Mr Johnson's evidence was that the Appellant recorded the negotiation of its trades with its customers and suppliers by email or MSN "instant messages", which were not retained by the Appellant (and were no longer available from his Hotmail account by the time it required them as evidence for this appeal).

107. The purchase order and invoice documentation relating to the Appellant's trades in Disputed Transaction 1 will serve to illustrate the terms of business on which the Appellant traded:

> (1) Futures Brokerage Inc's purchase order issued to the Appellant is dated 6 July 2006. "Terms" are stated as "CIF Zurich", and "Payment Terms" are stated as "As agreed". The goods are described, and the quantity and price stated. Delivery is expressed to be to Futures Brokerage Inc's freight forwarder agent at Zurich Airport. There is the following additional term: "You as the

supplier must have full legal title to sell the goods to Futures Brokerage Inc, the goods to shipped must be free from any charges or claims from any third party".

(2) The Appellant's invoice to Futures Brokerage Inc is also dated 6 July 2006 and specifies the reference of the purchase order. The goods are described, and the numbers of the boxes in which the CPUs are packaged are identified. The quantity of goods and price are stated. There is the following term of sale: "Goods remain property of JMC until full payment is received".

(3) The Appellant's purchase order issued to Commodity Exports Ltd is dated 6 July 2006. The goods are described, and the quantity and price stated. The numbers of the boxes in which the goods are packaged are stated. There are no other terms of sale.

(4) Commodity Exports Ltd's invoice to the Appellant is dated 6 July 2006. The delivery address for the goods is left blank. The goods are described, and the quantity, price, and VAT are stated. There are no box numbers for the goods. The following are expressed as terms and conditions: "Goods remain the property of Commodity Exports Ltd until full payment has been received. Any discrepancies with the above stock must be notified within 24 hours. Commodity Exports will accept no liability after that period."

108. It is therefore the case that the Appellant's supplier extended credit to the Appellant: the Appellant was able to sell on the goods to its customer, and to ship them to its customer's agent, without paying for the goods (title remained with the supplier until payment).

109. The Appellant also entered into a document entitled "UK Supplier Declaration Contract" with each supplier for each sale. Mr Johnson's evidence was that he used a precedent document from another transaction he had seen. It makes reference to the sale invoice and the sale price and has various standard form provisions. It provides that the supplier will release title to the goods to the Appellant when full payment for the goods has been received. The supplier agrees to pay the VAT on the supply to it of the goods, and makes a declaration as to a number of matters relevant to possible MTIC fraud, including that the goods are sold at an estimated current market value and not at a price lower than purchased; that the supplier has carried out reasonable diligence checks on its suppliers and has no reason to suspect MTIC fraud in relation to the transaction or that VAT has not been paid on the goods; and that it is registered for VAT and will account for the VAT on the supply.

Shipping and insurance arrangements

110. In Disputed Transactions 1 - 6 and 8 the freight forwarding agent which held the CPUs at the Appellant's purchase and arranged their shipment to the Appellant's customers was Quest Freight Ltd. The Appellant's primary contact with Quest Freight Ltd was with a Mr Nathan O'Brien (Mr Johnson had known Mr O'Brien, who had previously operated another freight forwarder, from Mr Johnson's time working for GSI Distribution Limited). Mr O'Brien worked as a consultant to Quest Freight Ltd, introducing exporters to the company for a share of profits generated from the

introduction. Mr O'Brien had his own staff who examined goods, unpacked and repackaged them, and scanned them.

111. Mr O'Brien inspected and arranged for export of the same CPUs on several occasions.

112. Mr O'Brien (who at the relevant time was employed by the freight forwarding agent All-Ways Logistics Ltd) provided the Appellant with a trade reference for each of the suppliers in the Disputed Transactions, as referred to below.

113. In relation to the Disputed Transactions and their related deal chains, Quest Freight Ltd retained no documentation whereby traders released goods and instructed it to hold the goods for customers. Documentation required to establish export of the goods was retained.

114. Quest Freight Ltd held the CPUs to the order of the Appellant's supplier, and at the supplier's request provided an inspection report in relation to the CPUs to the Appellant. In turn, at the Appellant's request Quest Freight Ltd provided an inspection report of the CPUs to the Appellant's customer. The inspection report shows the quantity of CPUs, the unique coded box numbers in which they are packed, the country of manufacture, and the condition of the labelling and seals on the boxes. In some instances the inspection report lists boxes with an invalid code number.

115. The Appellant produced no documentary evidence as to the costs it bore for the storage and shipping of the goods or the other services of the freight forwarder.

116. The Appellant shipped the goods to its customer's agent on terms of "ship on hold", that is, to be held to the order of the Appellant until released by the Appellant, the Appellant ordering the release of the goods to the customer on payment of the purchase price.

117. The Appellant arranged insurance for goods in its ownership whilst those goods were being shipped. At the time of the Disputed Transactions the insurance cover was limited to £150,000 for any shipping consignment (the Appellant divided goods it was selling under a particular contract into separate consignments on shipping to bring each consignment within this limit). The Appellant paid an annual premium of £7,000 for this cover. Since the Appellant was not the owner of the goods whilst they were being shipped (title passed from the supplier to the Appellant only on payment of the purchase price, and in all but Disputed Transaction 7 the Appellant paid its supplier after the goods were shipped) the insurer was not on risk. The Appellant made no enquiries as to whether the supplier had the benefit of any insurance cover.

"Carouselling" of goods traded by the Appellant

118. The Commissioners carried out detailed investigations into the movement of the goods which the Appellant traded in the Disputed Transactions to ascertain the extent to which those goods had been exported in previous transactions and then re-imported for further export.

119. The Appellant's sale invoices quoted specific and unique reference numbers for each box of CPUs traded (each box contained 315 CPUs packaged in 15 trays). These are the box numbers used also in the freight forwarding agent's inspection reports. The Commissioners were able to trace the trading and movement of the goods by reference to the box numbers and references to them in the documentation of other MTIC deal chains.

120. The Commissioners' investigations reveal that at least 95 of the 111 boxes of CPUs traded by the Appellant in the Disputed Transactions had been the subject of such "carousel" trading prior to the Disputed Transactions, and that some of the goods were re-imported and exported again after the Disputed Transactions.

121. Some of the goods were imported and exported on ten different occasions. In Disputed Transaction 2 three of the 15 boxes traded by the Appellant were export traded on the same day by an unrelated company, Kai Components Limited, to different customers.

122. Kai Components Limited exported CPUs with the same box numbers as those traded by the Appellant on 37 occasions. A company known as PGT (UK) Ltd exported CPUs with the same box numbers as those traded by the Appellant on 18 occasions, and a company known as Enta Technologies Limited exported CPUs with the same box numbers as those traded by the Appellant on 15 occasions.

123. In the case of Disputed Transaction 3 the Appellant's customer, Medius Trading AG, had, on 7 June 2006 purchased from Kai Components Ltd one of the boxes of CPUs and on 4 July 2006 two of the boxes of CPUs it purchased from the Appellant on 12 July 2006. In the case of Disputed Transaction 4 the Appellant's customer, Futures Brokerage Inc, purchased from Kai Components Limited, on different occasions before and after the date of Disputed Transaction, 14 of the 20 boxes of CPUs it purchased from the Appellant.

124. Some of the CPUs exported by the Appellant in Disputed Transactions 1 and 3 were on different occasions also exported by Marshland Limited, a company controlled by the UK agent of Independent Management Limited (the Appellant's customer in Disputed Transaction 7).

Circularity of funds and payment directions

125. The Commissioners also carried out detailed investigations as to the movement of funds between parties in relation to each of the Disputed Transactions and the deal chains of which they were part. This they were able to do by having access to the banking records of FCIB, with which all the relevant parties had bank accounts through which funds passed in settlement of accounts in relation to the trades in the goods.

126. Those investigations reveal that in all the Disputed Transactions other than 7, the flow of funds is circular, that is, over a period of a few days funds originating in the account of one account holder pass through the accounts of the traders in the chain

and then through the accounts of certain companies who are "off invoice" (that is, for whom there is no traced trading documentation) and then finally are credited back to the account of the originating account holder.

127. In the seven Disputed Transactions where funds flow through FCIB accounts in a "money chain" circle, the "off invoice" companies are one or more of the following companies: Mountainrix LDA (registered in Portugal); Electrade SA (registered in Luxembourg); and Cubics International Inc (registered in one of the States of the US, and having directors in common with the Appellant's customer Bprolific Inc. In certain cases Bprolific Inc and Future Brokerage Inc had an "off invoice" part in the money chain circle when the Appellant has sold to another customer.

128. The deal chain and flow of funds in Disputed Transaction 3 illustrates, at its simplest, the circular flow of funds:

(1) The trading chain, so far has been traced, begins with the defaulting trader, ETP, which on 7 July 2006 contracted to sell 3,150 CPUs to Bluestar Electronics UK Ltd, which on the same date on-sold them to Cellest Ltd, which on the same date on-sold them to Commodity Exports Ltd, which on 12 July 2006 on-sold them to the Appellant, which on the same date on-sold them to Medius Trading AG.

(2) The flow of funds begins with Commodity Exports Ltd, which on 11 July 2006 paid to Cellest Ltd the invoiced amount for the CPUs purchased from Cellest Ltd. In turn, on that date, Cellest Ltd paid Bluestar Electronics UK Ltd which paid ETP. Also on 11 July 2006, ETP, having received £233,548.88 for the CPUs it had sold (and including VAT of £34,783.88, on which it defaulted), paid Mountainrix LDA £230,735.93 (the narrative for this payment in the bank statement reads: "1459 complete"). On 17 July 2006 Mountainrix LDA paid Medius Trading AG £226,802.36 (the narrative is "3130 IPIV"). Also on 17 July 2006 Medius Trading AG paid the Appellant £220,500.00 (the amount due under the Appellant's invoice), and the Appellant paid Commodity Exports Ltd £244,282.50. The circular flow of funds is thereby completed.

129. The deal chain in Disputed Transaction 2 has the same trading parties (except that the Appellant's customer is Bprolfic Inc, rather than Medius Trading AG), and the payment flow between the "off invoice" companies in the money chain was as follows: ETP paid Mountainrix LDA, which paid Electrade SA, which paid Cubics International Inc, which paid Future Brokerage Inc, which paid Bprolfic Inc (the Appellant's customer in this transaction).

130. The deal chains in Disputed Transactions 4, 5 and 6 have the same parties as far as the traders are concerned (in 4 and 6 the Appellant's customer is Future Brokerage Inc, and in 5, Bprolific Inc) and in each case the circular flow of funds is achieved by payments made by RHF-ETP Limited to Mountainrix LDA, which made payments to Electrade SA, which, either directly or through Cubics International Inc, funded the Appellant's customers for the payments due from them to the Appellant.

131. Similarly in Disputed Transaction 8, the missing trader CWM made payment to Mountainrix LDA (this is so even where CWM has purchased some of the CPUs from Carisma), which paid Electrade SA, which paid either Bprolific Inc or Cubics International Inc, which in turn funded Future Brokerage Inc, the Appellant's customer for its payment due to the Appellant.

132. The position is more complex in the case of Disputed Transaction 1, where there were "parallel" trades of CPUs up to the point of the Appellant's sale to its customer, Future Brokerage Inc. In relation to one of those trades the payments are entirely circular (with payments flowing from ETP to Mountainrix LDA to Electrade SA to Cubics International Inc to the Appellant's customer, Future Brokerage Inc). In relation to the other of those trades ETP paid Mountainrix LDA, which paid Medius Trading AG, which paid a company called Apple Mobile, which paid Commodity Exports Ltd and the funds in this way found their way back into the deal chain. It is not certain, but it is likely that Future Brokerage Inc was funded to make its payment to the Appellant in respect of this part of the trade by funds originating from Electrade SA and received by Future Brokerage Inc in the course of payments made in relation to Disputed Transaction 4.

133. A further line of investigation by the Commissioners related to the actual times of money movement in the money chains and the computer origin of the payment instructions given by the companies in those chains.

134. Funds were transferred rapidly between accounts. Thus in the money chain in Disputed Transaction 3 the payments made on 11 July 2006 between the five companies involved in the money chain on that date were all carried out between 12.30 pm and 1.10 pm. The payments made on 17 July 2006 to complete the money chain were made between 10.45 am and 1.10 pm. In the money chain in Disputed Transaction 2 the money flows are more complex, but payments made on 2 August 2006 pass between seven parties in the period 6.00 pm to 8.50 pm and between five parties in the period 12.55 pm to 2.00 pm.

135. The Commissioners' investigation shows that certain of the parties in the money chains instructed FCIB to transfer funds from computers using the same internet protocol address. Thus in the money chains in Disputed Transactions 1 and 2 Electrade SA, Cubics International Inc and the Appellant's customer on those occasions, Futures Brokerage Inc all used a computer (or computers) with the IP address 80.178.139.111 (Disputed Transaction 1) and 80.178.59.47 (Disputed Transaction 2). This is so notwithstanding that the three companies are respectively based in Luxemburg, the US, and Switzerland. The evidence of Mr Mercer (who had carried out this investigation), and of Mr Letherby (who gave generic evidence in relation to these matters) is that the use of a common IP address is a strong indication that either the same computer hardware was physically used by the three parties concerned, or that they each connect remotely to the same computer, or that they have some kind of shared hosting on a proxy server. It would be an extremely remote coincidence for three traders independently and without connection to use the same IP address within a matter of minutes.

The Appellant's knowledge of the extent of and the risk posed by MTIC fraud

136. Mr Johnson was the managing director of GSI Distributions Europe Limited until it ceased trading in 2004. That company traded in computer memory products, and certain of its trading transactions were the subject of the Commissioners' extended verification procedures to determine whether or not those transactions were connected to MTIC fraud.

137. On 4 July 2005, at the time the Appellant began trading, the Commissioners wrote to the Appellant advising it of the presence of MTIC fraud in the trade sector in which the Appellant proposed to operate. Included with that letter was a copy of Public Notice 726 issued by the Commissioners relating to joint and several liability. The letter advised the Appellant to verify with the Commissioners the VAT registration details of its suppliers and customers and to make other appropriate enquiries in relation to proposed transactions having regard to the fraud risk. This letter was followed by a visit to the Appellant on 7 July 2005 when officers of the Commissioners discussed Public Notice 726 with Mr Johnson, and the due diligence the Appellant should carry out upon suppliers and customers.

138. Further visits were made by officers of the Commissioners to the Appellant in each of the subsequent five months, where the Appellant's documentation of transactions was reviewed, and its due diligence procedures discussed.

139. On 3 November 2005 the Commissioners advised the Appellant by letter that, in connection with investigations made in the course of MTIC fraud enquiries, the Commissioners had discovered that two of the Appellant's seven deals in respect of its VAT claim for the period 08/05 had commenced with defaulting traders, resulting in the loss of revenue. The customer for both transactions was Comex Ltd (a Hong Kong company). The Appellant was warned in that letter that it might be subject to the joint and several liability provisions if it knew, or had reasonable grounds to suspect, that VAT would go unpaid, and that it might wish to consider what appropriate action it might need to take with regard to its suppliers to ensure that VAT would not go unpaid in respect of any future transactions. The Appellant was also informed that the Commissioners' letter was without prejudice to any further enquiries the Commissioners might make into other transactions in which the Appellant had been involved. A warning formulated in these terms was included in each of the subsequent letters sent by the Commissioners to the Appellant as detailed below.

140. The supplier to the Appellant in the two transactions identified by the Commissioners in this letter was Leisure Communications Limited (which was its supplier in Disputed Transaction 7).

141. On 25 January 2006 the Commissioners advised the Appellant by letter that two out of six of its transactions in its first VAT period (07/05) had been traced to defaulting traders, with a consequent loss of revenue. The Appellant's customer for those two transactions was Independent Management Ltd (its customer in Disputed Transaction 7).

142. In a further letter dated 25 January 2006 the Commissioners advised that, in respect of period 08/05, a further two transaction had been traced to defaulting traders, with a consequent loss of revenue.

143. On 10 February 2006 the Commissioners advised the Appellant by letter that one of its eight transactions in the period 10/05 had been traced to a defaulting trader, with a consequent loss of revenue. The Appellant's customer in that transaction was Independent Management Ltd.

144. On 7 April 2006 the Commissioners advised the Appellant by letter that all of its four transactions in the period 01/06 had been traced to defaulting traders, with a consequent loss of revenue.

145. In a further letter dated 7 April 2006 the Commissioners advised the Appellant by letter that all of its four transactions in the period 02/06 had been traced to defaulting traders, with a consequent loss of revenue. The Appellant's customer for one of those transactions was Independent Management Ltd.

146. On 17 July 2006 the Commissioners advised the Appellant by letter that both of its transactions in the period 03/06 had been traced to defaulting traders, with a consequent loss of revenue. The Appellant's customer for both those transactions was Bprolific Inc, its customer in Disputed Transactions 2 and 5.

The Appellant's due diligence procedures

147. The Appellant was aware of the checks on suppliers and customers which the Commissioners suggested in Notice 726 that a trader should make to ascertain the integrity of a supply. The general approach of the Appellant was to carry out, with respect to its suppliers, such procedures as were consistent with the guidance given by the Commissioners in Notice 726. As detailed below, the Appellant carried out little, if anything, by way of due diligence enquiries with regard to its customers in the Disputed Transactions.

148. The Appellant's due diligence procedures and documentation with regard to its supplier Commodity Exports Ltd were as follows:

(1) The Appellant holds a letter from Commodity Exports Ltd dated 29 November 2005 (not specifically addressed to the Appellant) by way of introduction (it referred to its involvement in the telecommunication industry, but not to any trade in computer electronic components), offering stock, and enclosing a copy of its VAT registration certificate and its certificate of incorporation.

(2) Further information was provided in a "New Account Application" requested by the Appellant, giving details of Commodity Exports Ltd's bank account (with Allied Irish Bank, and details of the FCIB account were supplied later), and the names, home addresses and specimen signatures of its directors. This information was supported by copies of passports of the directors, and for each director a utility bill showing the name and home address of the director.

(3) Commodity Exports Ltd provided a trade reference, given by Nathan O'Brien on 26 March 2006 (Mr O'Brien was then with All-ways Logistics Ltd).

(4) The Appellant made a number of "Redhill" checks, seeking confirmation from the Commissioners that the VAT registration of Commodity Exports Ltd remained valid. The most recent to the Disputed Transactions was made on 20 June 2006.

(5) The Appellant obtained a copy of the frontsheet of a lease of the premises shown by Commodity Exports Ltd as its business premises on which Commodity Exports Ltd is shown as lessee.

(6) The Appellant made a search of Commodity Exports Ltd's details filed at the Companies Registry.

(7) On 13 June 2006 Commodity Exports Ltd completed a standard form supplier's declaration supplied to it by the Appellant, stating that it will pay in full all output VAT; it will seek representation from its suppliers that they are VAT-compliant; that it is aware of the terms of Notice 726; that it has carried out reasonable checks as to the legitimacy and integrity of its suppliers and customers; that it has not been involved in a missing trader supply chain; and that it has been in no dispute with the Commissioners.

149. The Appellant's due diligence procedures and documentation with regard to its supplier Rose Communications Ltd were as follows:

(1) The Appellant holds an undated letter of introduction from Rose Communications Ltd (not specific to the Appellant, but apparently faxed to the Appellant on 2 May 2006). It describes Rose Communications Ltd as "a company dealing with GSM phones, electronic supplies, computer components and in car media devices" which has been in business since 2002. It says that it sells large quantities of products to local and international markets and in the retail market through its store outlets, and that it is expanding its trade division by contacting new companies in the UK and abroad. It encloses a copy of its VAT registration certificate, its certificate of incorporation, and details of its bank account with FCIB.

(2) Further information was provided in a "New Account Application" requested by the Appellant, giving details of Rose Communications Ltd's UK bank account, and the names, home addresses and specimen signatures of its directors. In this document Rose Communications Ltd describes its main trading activity as "Phones, Acces" (presumably, "accessories"). This information was supported by copies of passports of the directors, and a copy of a bank statement showing the name and home address of one of the directors and a utility bill with corresponding information about the other director.

(3) Rose Communications Ltd offered to provide two trade references, one of those being All-ways Logistics Ltd (there is no evidence that the Appellant took up this reference).

(4) The Appellant made a number of "Redhill" checks, seeking confirmation from the Commissioners that the VAT registration of Rose Communications

Ltd remained valid. The most recent to the Disputed Transactions was made on 20 June 2006.

(5) The Appellant obtained a copy of a lease of Rose Communications Ltd's business premises for use as "sales of communication and mobiles telephone" for a term of 15 years from 8 November 2004 at an annual rent of £17,160, subject to a three-yearly review, with Rose Communications Ltd appearing as lessee.

(6) Mr Johnson and Mr Prigg visited the premises of Rose Communications Ltd and met the directors. Mr Johnson took photographs of Mr Prigg and the directors in the company's retail and office premises.

(7) On 13 June 2006 Rose Communications Ltd completed a standard form supplier's declaration supplied to it by the Appellant in the same form as that completed by Commodity Exports Ltd.

150. The supplier Leisure Communications Ltd had previously supplied CPUs to the Appellant in circumstances where the Commissioners had notified the Appellant on 3 November 2005 that the transactions (in its VAT period 08/05) had been traced to a VAT loss. The Appellant's due diligence procedures and documentation with regard to its supplier Leisure Communications Ltd were as follows:

(1) Leisure Communications Ltd provided information in a "New Account Application" requested by the Appellant and dated 7 August 2005, giving details of Leisure Communications Ltd's UK bank account with Royal Bank of Scotland (on a subsequent occasion the company gave the Appellant details of its FCIB account), the company's business address, and the name and home address and signature of its managing director. In this document Leisure Communications Ltd describes is main trading activity as "Wholesale". Two trade references are given one of which is All-ways Logistics Ltd. Similar information was given in an undated document prepared by Leisure Communications Ltd (headed "Profile"), which describes the company as "a distributor and wholesaler of technology products in the European market. We deal daily in mobile phones, computer parts & hi-tech gadgets".

(2) Leisure Communications Ltd also supplied to the Appellant a copy of its VAT registration certificate, a copy of its certificate of incorporation, and a photocopy of the driving licence of the company's managing director.

(3) The Appellant made a search of Leisure Communications Ltd's details filed at the Companies Registry, and obtained a copy of its abbreviated accounts for the year to 31 March 2004 (those accounts are limited to a balance sheet which shows a deficiency in shareholders' funds at that date of £50,854: the balance sheet also shows the comparative position in 2003, where there are shareholders' funds of £2,479). On 31 August 2005 Mr Neil Macpherson of Salmac Management Limited (Mr Macpherson was an accountant adviser to the Appellant, as mentioned below) wrote to the Appellant, saying: "I have looked at the accounts for both Leisure Communications Limited and Trans Global Trading Limited. Whilst both Companies have submitted abbreviated Balance

Sheets which limits the amount of information provided there is nothing that would give me cause for concern."

(4) The Appellant was given a copy of an invoice dated 31 July 2005 from Westmead Business Group addressed to Leisure Communications Ltd at its business address relating to postage and call charges.

(5) On 7 August 2005 Leisure Communications Ltd completed a standard form supplier's declaration supplied to it by the Appellant in the same form as that completed by Commodity Exports Ltd.

(6) On 27 January 2006 (after the Commissioners had advised the Appellant in November 2005 that its previous trades with Leisure Communication Ltd had been traced back to a tax loss) Mr Manir Mohammed, the managing director of Leisure Communications Ltd wrote to the Appellant in response to the Appellant's enquiry: "...we pride ourselves in making sure we buy and sell to bona fide traders and conduct reasonable enquiries to ensure legitimacy of each & every trade we do. Our procedures are improving constantly and include, but not limited to, collecting company documents, application forms, ID's and photos, in recent days this has been updated to site visits and credit checks. We are not aware of any such defaulting trader as most of our suppliers are still supplying goods to us. I am sure you are also aware of the recent ECJ ruling in reference to Bond House and will draw your attention to the same."

(7) The Appellant made a number of "Redhill" checks, seeking confirmation from the Commissioners that the VAT registration of Leisure Communications Ltd remained valid. The most recent to the Disputed Transactions was made on 20 June 2006.

151. The Appellant's due diligence procedures and documentation with regard to its customer Bprolific Inc were as follows:

(1) Bprolific Inc provided the Appellant with a copy of an undated and unaddressed letter of introduction setting out the nature of its trade (a trade in "high value commodities as electronic devices Etc for our clients worldwide"), its business address, a summary of its business terms as to delivery and payment, and attaching a company registration certificate, details of its bank accounts (including its account with FCIB), and details of its freight forwarder in New York state.

(2) On 17 March 2006 Mr Josh Hecht of Bprolific Inc emailed Mr Prigg (copy to Mr Johnson) in these terms: "How are you? I hope this mail meets you back home in good health. It was a pleasure meeting you in personal (*sic*) on my visit to Hanover, as it's always good to put a face to the name. We are looking forward to a further healthy business relationship between our companies. Further to our conversation regarding the Data Restore disk key we are looking for local distribution, please find below some links to some Press announcements regarding this product... ."

(3) Mr Johnson met a Mr Hecht of BProlific Inc at a trade fair in Hannover in March 2006.

152. The Appellant's due diligence procedures and documentation with regard to its customer Independent Management Limited were as follows:

(1) Independent Management Limited provided the Appellant with a copy of an undated and unaddressed letter of introduction setting out the nature of its trade ("Importers/Exporters of computer components worldwide"), its business address in Niue; the UK address "where all the accounts are held"; details of its account in the UK with Barclays Bank; and the name and contact details of its European sales manager and its Hong Kong agent; and attaching a copy certificate of incorporation and a certificate of good standing issued by the government of Niue.

(2) The Appellant was also provided with a copy of the Memorandum of Association and the Articles of Association of Independent Management Limited.

153. The Appellant holds no documentation with regard to its customer Medius Trading AG.

The evidence as to the funding of the Appellant's working capital

154. We have already mentioned that the Appellant's working capital was provided by a loan or loans totalling £180,000. We have also said that the evidence of the Appellant in relation such funding was confusing, contradictory and unconvincing. The matter is important because a company trading as the Appellant traded (purchasing goods from UK suppliers and exporting them to non-EU customers) must finance itself, at the least, for the delay in recovery of the VAT it has paid on the supplies made to it. It may also require working capital finance to hold stock, or to bridge the period between payment to the supplier and payment by the customer, although in the Appellant's case it appears that the "back-to-back" nature of its trades had the effect that its suppliers extended trade credit to it for this purpose.

155. The matter is important, too, in the context of possible MTIC fraud, since an export trader may, as part of the wider conspiracy, obtain, from unusual or undisclosed sources, funding of the VAT to be recovered. Such funding is an inducement to take the risk of having the VAT recovery denied. If the export trader is not in fact required to repay any such funding if the VAT recovery is denied then the commercial risk is shifted to the funder.

156. This is the context in which we have regard to the evidence before us on this matter.

157. We also regard the matter of the Appellant's evidence on this point as being of significance because it informs us as to the credibility of Mr Johnson as a witness.

158. The Appellant's bank statement for its account with Natwest Bank shows the following entries (the first three of which relate to the period prior to the Appellant commencing its trade):

(1) Paid in on 1 July 2005 £50,000 from Jenson Button Limited;

(2) Paid in on 6 July 2005 £30,000 from Jenson Button Limited;

(3) Paid in on 7 July 2005 £13,000 from Jenson Button Limited;

(4) Paid in on 1 August 2005 £87,000 from Charmaine Lawledge.

159. On 7 July 2005 Mr Johnson told officers of the Commissioners visiting the Appellant's office that the start up capital of the Appellant's business was £90,000, and that "the £90k came from a bank account in Gibraltar & belonged to his auntie who is UK resident & had won money on the lottery" [extract from the officer's note of visit].

160. On a subsequent visit, on 11 August 2005, the officers were shown bank statements showing money received from Jenson Button Ltd and money received from Charmaine Lawledge. Mr Prigg stated that the money received from Jenson Button Limited was an investment, and referred the officers to Mr Neil Macpherson of Salmac Management Ltd, the Appellant's then accountant adviser.

161. On 11 August 2005 Mr Macpherson sent a fax to the officer investigating this matter. It is headed "JMC Electronics Limited" and says:

> "The Director of my client Company has asked me to write to you regarding a loan made to the Company which you have queried.
>
> The loan is not in fact from Jenson Button Limited; the Directors of that Company manage several Companies and made the transfer from the wrong account. This has been corrected by the two Companies involved.
>
> The lender is a non-UK resident who has no involvement in the operation of JMC Electronics; it is simply an arms length investment for an interest return.
>
> Incidentally, the Jenson Button Limited, which is a Gibraltar company, has no connection with the racing driver of the same name."

162. The Appellant has provided no documentary evidence that funds were returned to Jenson Button Limited.

163. Records at the Companies Registry for England and Wales show that a Mr David Burton was company secretary of Salmac Management Ltd, a director of a company Jenson Button (UK) Limited and the secretary of both GSI Distribution Europe Limited and GSI Holdings Limited. Jenson Button (UK) Limited is shown as dissolved on 11 September 2007.

164. A questionnaire of the Appellant (completed following a visit of officers to the Appellant in October 2005) has the following entries:

(1) What was the cost to purchase the company? – Initial investment of £90k from Gibraltar bank account;

(2) How is the VAT input financed? – Investment from Dean Johnson (consultant) Aunt and Jenson Button Ltd;

(3) Are there any private investors? – Dean Johnson's Aunt - £137k.

165. A report prepared by the Commissioners headed "Summary of MTIC Assurance Activity" completed following a visit by officers to the Appellant on 21 September 2006 states the following: "Mr Johnson's Aunt Mrs C Lawlage (*sic*) by re-mortgaging home, invested £93k; Private off-shore investor, invested £87k".

166. In reply to a further enquiry by the Commissioners, Mr Johnson wrote as follows on 20 November 2006: "The business was funded by a family member there were no contracts in place and it was purely agreed on a trust basis."

167. In reply to a further enquiry by the Commissioners, Mr Johnson wrote as follows on 6 December 2006: "I enclose the information you have requested, it clearly states that the initial investment was a grand total of £180,000 GBP. The investment was from C Lawledge however as you can see from the statements enclosed part of the investment was received from Jenson Button Ltd this was an error and I informed my local officer of this."

168. In his witness statement of 30 September 2008 Mr Johnson states: "I was able to gain working capital from a family member who loaned me £180,000. This was money raised from the sale of a house by my aunt Ms C Lawledge."

169. This statement was revised in Mr Johnson's witness statement of 9 November 2009, where Mr Johnson states:

> "The sole investor in JMC was my Aunt. My Aunt had two sources of capital that she was willing to invest. £87,000 came from the sale of a house in the UK, and a further £93,000 came from abroad. The £93,000 were the lottery winnings referred to previously.
>
> My accountants were Salmac Management Ltd, specifically its employee Neil McPherson *(sic)*. Mr McPherson acted as a tax advisor to my Aunt on the most efficient way to bring her money into the UK. Originally I had thought that my Aunt sent the money to Salmac's holding company as requested, but Mr McPherson incorrectly sent the funds incorrectly to a different company instead of to us. However, in preparing this witness statement I have discovered that she actually had begun to invest in a company called Bastia Investments Ltd, a sister company of Jensen (*sic*) Button Ltd. After she changed her mind and decided to invest in JMC, the funds were sent via the accounts of Jensen Button Ltd, I do not know the mechanics of how this was done. I exhibit an e-mail from Neil MacPherson explaining this to me. I had thought that the payment was as a result of Mr McPherson's error, but only so far as it should have come straight from Salmac. I did not seek any correction of the error in our accounts as we were supposed to have the money, just not via that route. I do not know why the funds were sent in three tranches."

170. The email referred to in Mr Johnson's witness statement is dated 9 November 2009. Mr Macpherson states that he has no paperwork relating to the investment by Mrs Lawledge, but that his recollection is that she had agreed to invest money in Bastia Investments Limited, a sister company of Jenson Button Limited, and then she had changed her mind as she wished to invest in the Appellant.

171. Under cross-examination Mr Johnson stated that the entirety of the £180,000 had come from Mrs Lawledge, in part from some of the proceeds of the sale of a house and in part from lottery winnings which had been deposited abroad. He said that there was no agreement in writing between Mrs Lawledge and the Appellant, but that his recollection was that it was agreed that the Appellant would pay Mrs Lawledge interest of either 1% or 1.5% per month on the loan. There was no agreement as to the terms on which the principal should be repaid.

172. Mr Johnson further stated that no interest was actually paid on the loan, and that, to date, the loan has not been repaid.

173. In 2008 Mr Macpherson was convicted for money laundering offences in connection with MTIC and carousel VAT fraud for which he was given a custodial sentence.

174. We consider Mr Johnson's evidence to be unreliable on this question of the manner in which the Appellant was funded.

175. We note, first, that there is nothing to corroborate Mr Johnson's evidence that the whole of the funding was provided by Mrs Lawledge (the bank statement entry of 1 August 2005 supports his contention that £87,000 came from Mrs Lawledge). The bank statement entries show that £93,000 came from a Gibraltar company, Jenson Button Limited, and if those funds were mistakenly advanced by that company, there is no evidence that the funds were repaid. The contemporaneous evidence (the visit reports of the Commissioners' officers, and the fax from Mr Macpherson of Salmac Management Ltd) is that the £93,000 was provided by "a non-UK resident who has no involvement in the operation of JMC Electronics" (Mr Macpherson's fax of 11 August 2005) or "private offshore investors" (the visit report of 21 September 2006, although Mr Johnson appears to have confused the loan of £93,000 with that of £87,000).

176. Mr Johnson is more consistent in the later evidence in asserting that all the funds were advanced by Mrs Lawledge, and in that has the support of the November 2009 email from Mr Macpherson (although Mr Macpherson's reliability as a witness in these matters must be highly questionable in view of his criminal conviction). However, we give more credence to the contemporaneous evidence, not only because it is contemporary to the advance of the funds, but because the later evidence dates from the time of, and was provided in the specific context of, the Commissioners' investigations into possible fraud in relation to the Appellant's export trades.

177. Further, there are a number of factors and anomalies which raise questions about the commercial reality and credibility of the working capital funding.

178. First, there is an absence of any record of the terms upon which the funds were advanced. Normal and prudent practice would require that in the case of such a substantial loan, even if advanced by a family member, there would be documented at least rudimentary terms as to interest (if any) payable and repayment of capital, to protect both borrower and lender. A proper commercial arrangement is likely to have provision also by way of security for the loan.

179. Secondly, the lender (whether Mrs Lawledge or some other party) has no equity interest in the Appellant (other than a nominal 1% shareholding in Mrs Lawledge's case) notwithstanding that the lender was (and remains) by far the principal financial backer of the company and the person whose financial interests were most at risk. Mrs Lawledge was employed by the Appellant and received a salary, but Mr Johnson's evidence was that she provided services to the Appellant in the course of that employment. One might, however, regard the employment in some way and to some extent as a return or *quid pro quo* for the loan, but that is not an equity share in the business, nor does it provide any measure of security for repayment of the loan.

180. Thirdly, at the time the loans were made, the Appellant was little more than a shell company, and certainly had no trading record to induce a lender to provide financial backing. We had no evidence of any business plan to justify such an investment. Further, the shareholdings in the company were, unusually for a private company, at odds with the management arrangements: Mr Prigg was the sole director, but Mr Johnson held 89% of the share capital. The role and equity interest of Mr Prigg raises the further question of why (if Mrs Lawledge was obliging her nephew by making the funds available) she was prepared to benefit Mr Prigg also.

181. Fourthly, it defies commercial logic that no interest should have been paid on the loan (if, as Mr Johnson asserts, it was interest-bearing), or that the loan should not at least in part have been repaid, in circumstances where the Appellant made very substantial profits from the beginning, and paid out dividends and salaries in its first year of an aggregate amount far exceeding the amount of the loan. In other words, one would expect the shareholders to shoulder the provision of working capital once the profits of the business began to accrue. Mr Johnson's evidence is that the loan is still outstanding, so that it appears that the lender alone is fully at risk if the Appellant is unsuccessful in its claim to recover the VAT at issue in this appeal.

182. It was open to the Appellant to clarify some of these matters by presenting evidence from Mrs Lawledge, but it did not do so, nor did it provide any explanation as to why such evidence was not available to it.

183. For these reasons we do not accept as credible the evidence of Mr Johnson in relation to this matter. The source of the funding is a matter of doubt, and the nature of the funding leaves open the question of whether it was provided to fund the recovery of VAT – or the loss should VAT would not be recovered – in circumstances where the Appellant knew that the transactions it would undertake carried that risk.

The evidence as to the legitimate grey market in CPUs

184. As mentioned, we had in evidence a report prepared by Dr Kevin Findlay, who was put forward as an expert witness by the Commissioners. Dr Findlay also gave oral evidence at the hearing. The scope of his evidence is set out in paragraph 45 above. In broad terms that evidence related to the nature and extent of the legitimate grey market in CPUs (and Intel CPUs of the kind traded by the Appellant in particular). Dr Findlay's evidence related to that market in general terms, and the inferences which could be drawn from that market when examining the trades carried out by the Appellant.

185. Dr Findlay outlined the history of the development of computer microprocessors and the principal CPU manufacturers. In 2006 Intel accounted for over 75% by volume of the total CPUs manufactured and sold.

186. He identified three distribution sub-markets: the legitimate authorised market (the "white market"), in which the manufacturer sells to the computer assembler/manufacturer (directly or through component distributors ("Authorised Distributors", or "ADs") who are accepted by the manufacturer as a legitimate intermediary), which sells to an end-user supplier (such as a major retailer); the legitimate grey market (which is a non-authorised market); and the black market, which is an illegal market trading in stolen and counterfeit goods.

187. In 2006 industry figures show that the weighted average profit margin for manufacturers was 14.8%, for computer assemblers was 3.2%, and for ADs was 2.3%. The margin for an AD distributing Intel CPUs is particularly low as a result of Intel's dominant position in the market and its preference to sell directly and in bulk to computer assemblers. In consequence smaller distributors trading in Intel CPUs have greater difficulty in trading profitably in the product.

188. The legitimate grey market arises out of five opportunities:

(1) Sub-distribution: an AD trading in the white market will not be able to hold stock covering all the demands of its computer assembler customers. A sub-distributor (who holds stock acquired from another AD) will fill a particular gap which the AD has in supplying its customer. Characteristically, a sub-distributor will be a specialist either in a particular component category or in a particular customer category – essentially filling a gap as a specialist which the AD as a general distributor cannot always cover. A sub-distributor's margin is likely to be less than that of an AD, and the sub-distributor will seek to protect that margin by selling large batches of components and by ensuring the shortest possible deal chain between its AD supplier, itself, and its computer assembler customer.

(2) Distribution of obsolete/niche components: specialist distributors trading in older (or obsolete) or specialised components supplying specialist customers are legitimate traders outside the white market. The characteristics of a distributor trading in this market are that he will hold highly specialist stock for long periods and will have a continuing relationship with ADs and specialist

customers. It is a relatively small and highly distinctive market, and gross margins are relatively high. Sales will be on "bespoke" terms, with little or no opportunity for a deal chain.

(3) Emergency suppliers: a computer assembler may require an "emergency supply" if it has underestimated its requirements for a particular CPU. It will then look for a supplier, which may be an AD or a sub-distributor which holds sufficient stock to meet the requirement. The characteristics of a distributor trading in this market are that it holds stock and has a relationship with the assembler customer. Again, margins are relatively high in what is essentially an opportunistic market. Sales will be tailored to a specific and immediate customer need, with little or no scope or purpose for a deal chain.

(4) Offloading of excess inventory: a computer assembler or an AD may have over-estimated demand, or may have deliberately over-stocked in order to obtain a volume discount offered by the manufacturer, or may be left with "old" stock if an updated product has been released to the market. In such a case the assembler or AD will wish to sell excess stock to a competitor requiring the product, but will typically do so through an intermediate broker. The characteristics of this market are that the broker will have supplier and customer relationships with assemblers and ADs; it will trade on a back-to-back basis with a known AD or assembler supplier and customer; the component goods traded will be full specified; margins are likely to be low; sales will be tailored to the needs of both supplier and customer; and there is little scope or purpose for a deal chain.

(5) Arbitrage: manufacturers may charge different prices in different geographic markets, and where the price difference merits it, a distributor may source products in a "cheap" market for sale in an "expensive" market. The characteristics of this market are that any unauthorised distributor or broker must be experienced and active in both markets in order to identify the arbitrage opportunity; the components traded are likely to be standard; a broker will have established supplier and customer relationships in the respective markets; the broker will be sensitive to the market and to his margin in pricing his deals; and there is little scope or purpose for a deal chain.

189. Thus the legitimate grey market for brokers (as opposed to sub-distributors) who do not hold stock is limited to situations of excess inventory and arbitrage. To participate in those markets a broker must be experienced and knowledgeable in the market, and have working relationships with computer assemblers and ADs. To preserve their profit margin they will wish to keep deal chains to the minimum length. Any trader taking a legitimate part in a commercially-based deal chain will have to add some value to justify his position in that chain: that added-value may be found in the volume of goods traded (for which a discount has been obtained); a particular and valuable supplier or customer relationship; the ability to buy and hold stock to take advantage of market movements; knowledge of specialist products; or knowledge of international markets (so as to take advantage of arbitrage opportunities).

190. Further, in any excess inventory deal chain, the chain will begin with an assembler and end with an assembler. Similarly, where the grey market opportunity

arises from the scope to arbitrage markets, any deal chain will begin with a manufacturer or (more likely) an AD and end with an assembler.

191. By reference to the worldwide value of CPUs sold through distributors (as opposed to direct sales by manufacturers to computer assemblers), and the size of the UK market relative to the global market, and taking account of the proportion of their total stock which ADs purchase in the grey market, it is possible to calculate a figure for the UK grey market. Dr Findlay estimates that figure to be £9.8 million for all CPUs (£7.3 million for Intel CPUs). Of that figure only a proportion will be grey market products which are exported, and Dr Findlay's analysis from their financial statements is that the average UK electronic component distributor derives approximately 19% of its revenue from exports. This suggests that about 19% of the estimated UK grey market in CPUs is an export market, having a total annual value (2006 figures) of £1.9 million.

192. In cross-examination Mr Ahmed challenged Dr Findlay's calculations as to the size of the legitimate grey market. He first questioned whether, if a broker imports products into the UK and then they are eventually exported, such exports would feature in the export grey market as identified by Dr Findlay. Dr Findlay's response was that his estimate, based on third party research, was that 6% of the identifiable export grey market is attributable to exports made by unauthorised distributors and unidentifiable small brokers. The figure is an estimate, and there is some scope for varying that figure, but on any basis the small brokers (essentially those who are not significant enough to be generally known as a permanent feature of the market) form a small proportion of the overall export grey market. A particular trade, if carried out in the legitimate grey market, will be part of this estimated value of the export grey market: if it is not carried out in the legitimate grey market it will not be.

193. Mr Ahmed also challenged Dr Findlay's evidence concerning the size of the grey market having regard to the practice of computer assemblers deliberately over-purchasing products from manufacturers (to secure a discount) and then selling them into the grey market. Dr Findlay accepted that computer assemblers will supply the grey market with excess inventory (it is one of his five "grey market opportunities"), but he said that the manufacturers endeavour to guard against such action, by contractual restrictions placed on their assembler customers. He said that his estimates of the size of the grey market were based on the revenues earned by distributors, who would be in the chain of any products released into the grey market by assemblers.

The submissions of the parties

The Commissioners' submissions

194. Miss Mannion, for the Commissioners, pointed out that the Appellant accepts that the Disputed Transactions were connected to a loss of VAT, and that such loss of VAT resulted from fraud, so that the principal issue for the tribunal is to determine whether the Appellant knew that its transactions were connected to that fraudulent loss, or should have known that to be the case. Nevertheless, the Commissioners

wished to show both the nature of the fraudulent loss and the manner in which it was connected to the Disputed Transactions, as in their submission those were material matters in establishing that the Appellant knew of the connection. The Commissioners' case is that the Appellant was a knowing participant in an orchestrated scheme of VAT fraud.

195. Miss Mannion set out the approach which she said the tribunal should take in considering the evidence as to whether the Appellant knew of its connection to the fraudulent VAT loss. She referred to the case of *Hall (Inspector of Taxes) v Lorimer* [1992] STC 599, which refers (at 612) to the evaluation of the overall effect of the detail of the evidence in the process of standing back and qualitatively viewing the entirety of the case. She also referred to passages in the *Mobilx* decision (and the citation, with approval, in that decision of passages in the judgment of Christopher Clark J in *Red 12 v HMRC* [2009] EWHC 2563) which emphasise the importance of the circumstances in which a trader's transactions take place in determining whether the only reasonable explanation for those transactions is that they are connected to fraud.

196. The Commissioners submitted that the Appellant's knowledge comprises Mr Johnson's knowledge. Mr Johnson was the principal shareholder in the Appellant, and although he was a consultant and not a director at the time of the Disputed Transactions, it is clear that he was the individual who represented the Appellant in its trading transactions, and Mr Johnson had not sought to argue otherwise. Further, the Appellant had not put forward as a witness on its behalf its director at the material time, Mr Prigg.

197. The Commissioners submitted that Mr Johnson's evidence on key issues lacked credibility, in that he was unable to recall essential elements of the Appellant's trading transactions and its relationships with its suppliers and customers, and his evidence was inconsistent when he was cross-examined. In consequence the Commissioners invited the tribunal to reject his evidence.

198. The Commissioners referred to the following matters of evidence which in their submission demonstrated that the Appellant, through Mr Johnson, knew of the connections with fraud:

(1) The size of the trade conducted by the Appellant in its first year (a turnover of £10 million, when its estimated turnover for its VAT registration was £800,000);

(2) The substantial and commercially unrealistic profits earned in that year, and extracted by way of dividends and salaries;

(3) The inconsistency in the evidence as to the source and terms of the working capital funding of the Appellant for its delay in recovering VAT, and the fact that such funding has not been repaid out of the Appellant's profits;

(4) The very high proportion of the Appellant's total of 75 deals which can be traced back to a tax loss or a "non-legitimate" source;

(5) The Appellant's readiness to continue trading in the same manner notwithstanding that it was advised (at the time of the first of the Disputed Transactions) that 15 of its deals (including a deal with a supplier it continued to trade with) could be traced back to a tax loss;

(6) The formulistic nature of the due diligence carried out by the Appellant on its suppliers which Mr Johnson accepted was undertaken to meet the published requirements of the Commissioners; in the Commissioners' view, especially after the Appellant was on notice that a growing number of its deals could be traced back to a tax loss, the Appellant, if an innocent trader, would have been more thorough and searching in its due diligence enquiries;

(7) The almost total failure of the Appellant to carry out any due diligence on its export customers;

(8) The absence of any evidence as to the negotiation of very substantial deals by the Appellant, the fixing of prices, and other essential commercial terms; and Mr Johnson's indifference to the legal consequences of the terms of sale in the purchase order and invoice documentation, to insurance risks and cover, and to the way in which his suppliers were able to extend credit to him. In the Commissioners' submission such matters clearly indicated that all such issues were irrelevant to transactions which were orchestrated; and

(9) The relative (and consistent) size of the profit earned by the Appellant on each deal, relative to the other parties in the deal chain, which resulted in the Appellant receiving 30 – 45% of the VAT fraudulently extracted in the course of the deal chain transactions – a result which the orchestrating fraudsters would permit only to a person who was a crucial player in the overall scheme.

199. The Commissioners referred to the following matters which in their submission established that the Disputed Transactions were part of an orchestrated fraud:

(1) The use of a common, and little-known, bank by all the parties in the deal chains to enable the easy transfer of funds;

(2) The "circular" transfer of funds around the parties to the deal chains (in seven of the Disputed Transactions), including the VAT fraudsters, enabling successive deals to be financed without requiring new funds and enabling also the VAT loss to be extracted from the system;

(3) The use by a number of parties in the deal chains of the same IP address, indicating the same individuals manipulating transactions on behalf of a number of entities;

(4) The repeated import and export ("carouselling") of a large proportion of the CPUs traded in the Disputed Transactions, many of which were repeatedly purchased on other occasions by persons who were the Appellant's customers in the Disputed Transactions;

(5) Trading in volumes of goods by the Appellant alone far in excess of those which could possibly be available in the legitimate grey market; and

(6) The involvement of Nathan O'Brien with a number of parties in the deal chains, who introduced suppliers to the Appellant, and who, acting for freight forwarding agents, inspected the same CPUs which were repeatedly exported from the UK. He had a long-standing association with Mr Johnson, and Quest Freight Ltd, for whom Mr O'Brien worked, acted as freight forwarder in seven of the Disputed Transactions.

200. It is the Commissioners' case that the Appellant was an integral and complicit party to this orchestrated scheme. The scheme would not have functioned if the Appellant had acted independently (for example, sold the CPUs to a customer outside the scheme), since the CPUs would not then have been available for further import, the funds would not have flowed back to their originator, and the respective parties would not have taken their respective profit-shares out of the transaction.

201. For these reasons the Commissioners make their primary submission that the Appellant knew of the connection of the Disputed Transactions to the fraudulent VAT loss, and therefore, on the authority of the European and domestic case law, is not entitled to recover the input VAT paid on the supplies it received on its purchase of the goods in the course of the Disputed Transactions.

202. The Commissioners' secondary submission is that, if the Appellant did not know of that connection, it should have known, in all the circumstances of its trade and of the Disputed Transactions, of that connection, and on that ground it is not entitled to recover the relevant amount of input VAT.

The Appellant's submissions

203. For the Appellant Mr Ahmed submitted that the evidence did not establish that the Appellant had actual knowledge of a connection of the Disputed Transactions to the VAT loss which the Commissioners had subsequently identified, nor did it establish that the Appellant could have known of that connection.

204. Mr Ahmed pointed out that the case the Commissioners had presented had been gathered together over a long period of time after the Disputed Transactions had been completed, using the enormous investigation and other resources available to the Commissioners. The tribunal must not be beguiled by all the resulting information now presented to it into thinking that the Appellant, at the time it entered into the Disputed Transactions in July and August 2006, had knowledge of those matters. The Appellant's position as to what it knew or ought to have known must not be judged with the benefit of hindsight.

205. The Commissioners had not shown that the Appellant had any dealings with persons who committed fraud or with any persons at all beyond its immediate suppliers and its immediate customers, and the freight forwarders who inspected the goods and arranged their export. Those dealings were on a perfectly normal commercial basis, and conducted with the benefit of certain due diligence enquiries with regard to the suppliers to a standard which was the norm in the business in which the Appellant traded. Nothing in any of the documentation received by the Appellant or to which it was a party could have alerted it to the existence of fraud, the

circulation of funds, or the "carouselling" of the goods which the Appellant traded. That is the context in which the knowledge of the Appellant must be assessed – a trader who seeks business on recognised trade websites; who puts together a purchase and a sale for an identified amount of stock at prices which yield an acceptable profit; who carries out checks on the existence and *bona fides*\of its suppliers; who ensures that the goods traded do exist and are held to the order of the supplier; who arranges for their shipment on export to the customer's agent; and who ensures that it both receives and makes payment for the goods.

206. The Appellant acknowledges that it was aware of the risks of MTIC fraud in its trade, and for that reason was careful to ensure that it carried out such enquiries of its suppliers as the Commissioners had indicated in their published guidance was appropriate. The Appellant had concentrated making those enquiries of its suppliers as it was aware that any VAT fraud would have been perpetrated in the supply chain. In that context the Appellant had concluded that correspondingly detailed enquiries were not required of its export customers, although it did ensure that they existed and were incorporated in their country of origin.

207. With regard to its suppliers and the goods they offered to trade, the Appellant's enquiries ensured that it knew the following:

(1) The identity of the directors of the supplier companies supported by third party documentation and with the benefit of face to face meetings to establish not just their identity but also their industry experience;

(2) The continuing VAT registration of the suppliers at, or shortly before, the date of dealing, through "Redhill" verification checks;

(3) The goods offered for trade by suppliers were current products at prices consistent with their value in the UK market; and

(4) All the products traded were genuine Intel products of the description set out in the purchase documentation and were shown by inspection to exist.

208. The Appellant carried out no credit checks on its suppliers or customers, a matter of criticism by the Commissioners, but the commercial arrangements, whereby goods were shipped on hold, with title to goods passing only on payment, did not warrant such checks: the Appellant was not exposed to any credit risk.

209. The Appellant's dealings with Quest Freight Ltd were perfectly normal, and the Appellant could not have known that it, or Mr O'Brien, were engaged in any fraudulent activities (if this were the case). The Appellant employed their services to inspect the goods purchased (which they did) and to arrange their shipment on export to the customer's agent. Nothing in the provision of those services indicated the possible existence of fraud. It is the case that Mr O'Brien provided trade references in respect of suppliers, but that was because the suppliers used Quest Freight Ltd, and so they were known to him.

210. As to the absence of any evidence as to negotiation of trading terms with suppliers and customers, Mr Johnson's evidence was that such evidence existed in the

form of MSN "instant messages", but this evidence was not requested by the Commissioners when they were making their investigations, and subsequently it was deleted from his Hotmail account.

211. The Appellant submitted, in the alternative, that even if the tribunal were to find that the Appellant, in its trading transactions, was manipulated by persons engaged in a contrived fraud, it was perfectly credible that the Appellant was an innocent dupe, with the fraudsters controlling traders who offered to supply goods to the Appellant, and other controlled traders offering to buy those goods, both those parties attracting the Appellant's attention on the trade websites used by the Appellant, and making offers which were attractive enough to secure the deals without being so far off the market rates as to arouse the Appellant's suspicions. The fraud chains are sufficiently complex and sophisticated to permit a range of possible suppliers and a range of possible customers to "entrap" the *bona fide* exporter. Mr Ahmed referred to the tribunal decisions in *JDI Trading Limited v HMRC* [2012] UKFTT 642 (TC) and *Else Refining and Recycling Ltd v HMRC* [2012] UKFTT 470 (TC), in both of which the tribunal accepted that the export trader was, innocently on its part, duped into facilitating a contrived scheme for the fraudulent evasion of VAT by the manipulation of its suppliers and export customers. Those cases explain the attractions to the fraudsters of having an innocent party as the exporter.

212. Mr Ahmed argued that it was perfectly credible, and consistent with all the evidence in this case, that the Appellant was such an innocent dupe. It had not been established by the Commissioners that the Appellant knew of the connection of its transactions to the fraud they subsequently discovered, nor that the circumstances were such that it ought to have known of such connection. Nothing was established beyond the fact that the Appellant knew that there was a risk that its transactions might be linked to fraudulent loss of VAT, and that was not sufficient to deny the Appellant its right to recover the input VAT it claims.

Discussion and conclusions

213. We have set out in paragraphs 17 to 19 above the issues we have to determine in relation to each Disputed Transaction. The Appellant has conceded that, in relation to each Disputed Transaction, there has been a loss of VAT that is attributable to fraud, and that each Disputed Transaction was connected with that loss. We therefore have to determine whether the Appellant knew that each Disputed Transaction was so connected with the fraudulent loss of VAT, or, if it did not know that to be the case, if it should have known that to be the case.

214. In setting out our conclusions on these issues we deal first with the disputed evidence of Dr Findlay on the subject of the grey market in CPUs; we then deal with the fraudulent loss of VAT in relation to each Disputed Transaction, the connection of each Disputed Transaction with such loss, and the contrived nature of the deal chains; we then deal with the question of whether the Appellant knew that the Disputed Transactions were connected to the relevant fraudulent loss of VAT; and finally we deal with the question of whether the Appellant should have known of such connection.

The grey market in CPUs

215. As we have recorded, the Commissioners presented expert evidence as to the nature of the legitimate grey market in CPUs of the type traded by the Appellant in the Disputed Transactions. Dr Findlay's evidence related to that market as he understood it to be in 2006. He identified the different opportunities which allowed a grey market to exist, and the characteristics of the market which exploited those different opportunities. He also estimated the likely size of the entirety of the legitimate grey market in these products. His evidence is summarised in paragraphs 184 to 193 above. Dr Findlay's evidence was generic and did not relate to the particular circumstances of the Appellant.

216. The significance of this evidence to the Commissioners' case is that they contend that the scale of the Appellant's trading in the course of 2006 was such that it could not have been trading as part of the legitimate grey market in CPUs, which is a serious challenge to the Appellant's case that it was engaged in genuinely commercial trading. They argue that the Appellant must have known that its trades in the Disputed Transactions were not part of a legitimate market since they self-evidently did not comply with any of the characteristics of the markets identified by Dr Findlay.

217. As we have noted in paragraphs 192 and 193 above, the Appellant challenged Dr Findlay's evidence as to the size of the legitimate grey market.

218. The evidence as to the opportunities which may be exploited by sub-distributors or brokers by means of a grey market was not challenged. Nor was there challenge to the characteristics of those individual markets and of the parties likely to be trading in those markets. We found this evidence of Dr Findlay to be compelling, and accept it in full.

219. The principal feature of the legitimate grey market arising out of each of the five opportunities which Dr Findlay identified is that the participants each have a distinct value to contribute (specialist knowledge; ability to hold stock against a particular eventuality; ability to source and hold special products; a relationship with a range of particular customers; knowledge of international markets; and so forth) and thereby justify their position in that market. Market forces will always have effect to eliminate from any genuine trading chain any trader who does not, in one form or another, add value to the transaction. For whatever reason CPUs enter the grey market, those CPUs will be destined for a computer assembler (they have no other purpose or function) and that assembler is looking for products in an open, transparent and competitive market. It must follow that the parties in any transactions in the grey market will act so as to maximise their profit by ensuring that the chain between source and assembler is as short as possible. Only those who in some way or other add value to a transaction will have a genuine part to play in such a chain, where market forces will ensure that the market functions with the sole purpose of matching the source of supply to the assembler customer's requirements as price-efficiently as possible.

220. The Appellant offered no evidence that it had a distinctive part to play in any such market. Mr Johnson had some experience in dealing in electronic components

prior to acquiring his interest in the Appellant, and he made himself familiar with the products the Appellant dealt in and the transactions of the type it undertook. But nothing in that amounted to the "added value" trader who in Dr Findlay's evidence would be a justified participant in a transaction in the legitimate grey market in the UK in CPUs.

221. This becomes more apparent if the enquiry is broadened to the entire deal chain relating to each of the Disputed Transactions: what we see is a series of traders each taking small (or even no) profits for no apparent reason other than being a party in the chain, and where no commercial source of the products is apparent, nor any end consumer in the form of a computer assembler. Even if we look at matters unquestionably within the Appellant's knowledge, that is, if we take the parties comprising the Appellant, its supplier and its customer, we can see no "added value" which any of them might have contributed to a legitimate market transaction, other than, perhaps, the export function provided by the Appellant, and even that was routine and requiring little exertion or expertise on the Appellant's behalf.

222. We therefore conclude that the Disputed Transactions were not undertaken in the course of the legitimate grey market in CPUs.

223. As to the size of the legitimate grey market, even if we take account of the challenge Mr Ahmed made to Dr Findlay's assumptions and calculations underlying his evidence on this issue, it remains the case that in the course of its first year of trading the Appellant traded in CPUs to the value of more than £10 million. Mr Johnson was aware that the Appellant was but one of a number – perhaps many – traders engaged in similar transactions. Had the Appellant (by Mr Johnson) properly and reasonably addressed the question – had it, in the terms of the *Mobilx* decision, taken note of the obvious inferences from the facts of its transactions and the circumstances surrounding its trading activities - it must have concluded that it and its like traders were dealing in volumes and values of goods which far exceeded those which could be traded in, and by export from, the UK by way of legitimate supply chains to meet the requirements of computer assemblers.

The fraudulent loss of VAT in relation to the Disputed Transactions

224. The evidence put forward by the Commissioners in respect of the fraudulent loss of VAT in relation to each of the Disputed Transactions is not challenged by the Appellant. That evidence is summarised in paragraphs 84 to 94 above.

225. That evidence is substantial and detailed and was compiled by the Commissioners after extensive investigation on the part of a number of their officers. We accept that evidence, and find that, for each of the Disputed Transactions, there was a loss of VAT, and that loss was attributable to fraud.

The connection of the Disputed Transactions with the fraudulent loss of VAT and the contrived nature of the deal chains

226. The evidence adduced by the Commissioners in relation to the connection of each of the Disputed Transactions with the fraudulent loss of VAT and the contrived nature of the deal chains is also substantial and detailed, and in relation to the "carouselling" of goods and the circularity of funds, is particularly complex. That evidence, as it concerns the Disputed Transactions and the related deal chains, is summarised in paragraphs 75 to 83 above; as it concerns the Appellant's suppliers and customers is summarised in paragraphs 95 to 102 above; as it concerns the "carouselling" of goods traded by the Appellant is summarised in paragraphs 118 to 124 above; and as it concerns the circularity of funds and payment directions is summarised in paragraphs 125 to 135 above.

227. That evidence was not challenged by the Appellant. In particular, there was no challenge by the Appellant to the continuity of the deal chains whereby, in relation to each of the Disputed Transactions, goods sold by the defaulting traders (and in respect of which they unlawfully defaulted on the payment of VAT due on such sales) were shortly thereafter purchased by the Appellant and sold on to its customers. We observe that, for there to be for these purposes a connection between the Appellant's transactions and the VAT loss it is not required that there should be privity of contract between the Appellant and the entity creating the VAT loss: if a trader's purchase and sale of the goods in question forms part of a chain of transactions in the course of which a VAT fraud was perpetrated, then the trader's transaction is connected with that fraud, since the trader aids the perpetrators of the fraud by supplying liquidity into the supply chain: *Calltel Telecom Limited v The Commissioners for Her Majesty's Revenue and Customs* [2009] EWHC 1081 (Ch).

228. Dealing first with the issue of the connection of each of the Disputed Transactions with the fraudulent loss of VAT, we accept the Commissioners' evidence as to the deal chains and find that each of the Disputed Transactions formed part of a chain of transactions in the course of which a VAT fraud was perpetrated resulting in loss. Accordingly each Disputed Transaction was connected to the fraudulent loss of VAT.

229. It is an important part of the Commissioners' case as to the Appellant's knowledge of that connection that the Disputed Transactions were an integral and essential part of a contrived and orchestrated fraud. In this regard they relied in particular on the evidence of funds relating to the purchase of the goods passing in a circular "money chain", not just between those who were parties to the known deal chain in the goods, but between other, "off invoice", parties (always including a company registered in Portugal, Mountainrix LDA, and usually also a Luxembourg company, Electrade SA, and a US company, Cubics International Inc). It cannot be established whether those "off invoice" parties actually traded in the goods, as the Commissioners have no way of obtaining invoices or other evidence from them. The Commissioners were not able to establish such a circular "money chain" in relation to Disputed Transaction 7.

230. The evidence is clear beyond any doubt that, in all but Disputed Transaction 7, funds representing the price of the CPUs traded along the deal chains were circulated between the parties, and then through parties which did not necessarily deal in the goods, so that the money flowed in a circle between the accounts which the respective parties held with FCIB. The timings, sequence and amounts of the respective fund movements comprise convincing evidence that they were, in one way or another, made in settlement of or otherwise in connection with contractual or other obligations relating to the CPUs entering and then leaving the respective deal chains. In this way the purchase price paid by the Appellant's customers to the Appellant for the CPUs it traded rapidly found its way back to reimburse those customers. In some cases different parties in the "money chain" used the same IP address to provide access to the internet for the purpose of instructing FCIB to make the relevant payments, evidencing, at the very least, a close working relationship between those parties, and in all probability the same individuals operating the respective FCIB accounts.

231. The only reasonable inference to draw from this evidence is that the deal chains of which the Disputed Transactions formed part were contrived and predetermined – specifically put in place for a purpose – and not randomly formed through the operation of free and unrelated parties competitively trading on an open market. Further evidence to this effect is found in the deal chains themselves, with a series of buffer traders trading on "back-to-back" terms in the same quantities of goods at similar small margins and adding no value to justify their position in the deal chain. It was essential, in order for the right amount of funds to end up with the right persons in the right sequence at the right time, that each company in the relevant deal chain purchased the prescribed number of CPUs at the prescribed price from the prescribed supplier and sold them at the prescribed price to the prescribed customer. In the course of those prescribed transactions the VAT which should have been accounted for to the Commissioners was extracted from the chain. The Appellant was a component part of these contrived arrangements – for the respective deal chains and money chains to function it was required to purchase the relevant CPUs from a prescribed supplier and to sell them to a prescribed customer. We deal below with the question of whether the Appellant was knowingly such a participant, or was, without its knowledge, manipulated into taking the key role as the exporter of the goods.

232. As mentioned, the Commissioners were not able to establish from their lengthy investigations that the funds in the deal chain of which Disputed Transaction 7 formed part were remitted in the same circular fashion. The funds can be traced between certain "off invoice" companies, but not back to the Appellant's customer in that deal chain, Independent Management Ltd. Although it is the case that the parties to this deal chain, including the Appellant's customer, differ from those which make several appearances in the other deal chains, the deal chain has the same characteristics as the other deal chains, with goods traded between buffer dealers at small margins (but the Appellant's supplier sold to the Appellant fewer CPUs than were traded by the prior parties in the deal chain). The evidence that this deal chain is contrived in its nature is weaker than the evidence in relation to the other deal chains, but if we have regard to the context provided by the other seven deal chains, and to the characteristics of the deal chain so far as it has been traced (what Christopher Clarke J in *Red 12 v HMRC* refers to as "similar fact" evidence), we conclude on balance that it also was

contrived, with the parties entering into their respective transactions as predetermined and not as a matter of independent commercial reality or purpose.

233. We have regard also to the Commissioners' evidence that many of the CPUs traded by the Appellant in the Disputed Transactions were the subject of other export trades – in some cases many times over. It is the case that they were not exported by the Appellant other than in the Disputed Transactions, but the Appellant's customers in the Disputed Transactions purchased some of those CPUs on other occasions, and other parties in the supplier deal chain also traded in them more than once (and in deals involving the Appellant's customers. We agree that this further establishes that there was an orchestrated scheme or schemes in operation, essentially with the same funds circulated to facilitate the trading of the same goods between the same group of parties.

Did the Appellant know that each of the Disputed Transactions was connected to the fraudulent loss of VAT?

234. It is clear from the *Mobilx* case that if we are to determine this question in the affirmative we have to be satisfied, on the balance of probabilities, that the Appellant knew, taking each Disputed Transaction in turn, that the Disputed Transaction was connected to the fraudulent loss of VAT – not merely that it knew that there was a risk of such a connection or that it knew that the Disputed Transaction was more likely than not to be connected to the fraudulent loss.

235. It is also clear that it is sufficient if it is established that the Appellant knew of the connection to a VAT fraud perpetrated at some point by some party in the chain of transactions, and not that the Appellant knew of the connection to the specific VAT fraud that occurred in the course of the relevant chain of transactions (i.e. the VAT fraud perpetrated by ETP, RHF-ETP, Kaymore Limited, CWM and Carisma, as the case may be). As is made clear in the *Mobilx* case, the heart of the decision in the *Kittel* case is that the trader has no right to recover input tax if he is a participant in the fraudulent evasion of VAT, and he is such a participant if he knew or should have known that his transaction was connected with fraudulent evasion of VAT, whether that evasion occurs before or after the trader enters into his transaction:

> "A trader who decides to participate in a transaction connected to fraudulent evasion, despite knowledge of that connection, is making an informed choice; he knows where he stands and knows before he enters into the transaction that if found out, he will not be entitled to deduct input tax." – *Mobilx* at [61]

It is knowledge of connection to fraudulent evasion which results in the trader having no right to deduct, so the trader is not protected if he knew that there was fraudulent evasion within the chain even if he did not know in terms how or by whom the fraud was perpetrated.

236. We agree with Mr Ahmed that, in assessing the actual (or constructive) knowledge of the Appellant, we must look to its state of knowledge at the time it entered into the relevant transactions, refraining from using hindsight to attribute

knowledge to the Appellant which, in July and late August 2006, it did not have or could not have had. We take note of Mr Ahmed's warnings that, when matters are all laid out in a case which it has taken the Commissioners some years to investigate and compile, it is easy to impute knowledge of some or all of those matters to the Appellant when at the time of its transactions it participated only in the trade with its supplier and the trade with its customer.

237. In speaking of the state of knowledge of the Appellant we are in this case concerned with the knowledge of Mr Johnson: Mr Johnson was at all material times the principal shareholder of the Appellant, and although he was not a director at the time of the July 2006 Disputed Transactions, it was clear from Mr Johnson's evidence that he was also the mind of the Appellant controlling its decisions and actions. The role of the sole director, Mr Prigg, was not made clear to us, and the fact that the Appellant put forward Mr Johnson alone as its witness is the Appellant's implied acceptance that Mr Johnson is to be equated, in terms of knowledge at least, with the Appellant.

238. Finally, by way of our general approach to determining this question, we take from the case law authorities that we should have regard not only to the evidence as to the primary facts but also to the circumstantial evidence before us and that we should draw such inferences from the evidence as a whole as appear to us to be reasonable so as to discern the state of knowledge of the Appellant: that, it is clear, is the approach required of the tribunal in MTIC cases by the authorities, in particular the cases of *Red 12 v HMRC* [2009] EWHC 2563 and *Megtian Limited v HMRC* [2010] EWHC 18 (Ch), as well as in the *Mobilx* case. The matter was summarised in these terms by Christopher Clarke J in *Red 12 v HMRC* at [111] (and approved by the Court of Appeal in the *Mobilx* case):

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

In the *Mobilx* case, having cited this paragraph, Moses LJ continues (at [84]):

> "Such circumstantial evidence, of a type which compels me to reach a more definite conclusion than that which was reached by the Tribunal in Mobilx, will often indicate that a trader has chosen to ignore the obvious explanation as to why he was presented with the opportunity to reap a large and predictable reward over a short space of time."

239. Turning now to the circumstances of the Appellant's case, before considering the facts and circumstantial evidence relating to the Disputed Transactions, we draw some general conclusions about the Appellant and its business.

240. We note first that Mr Johnson had experience in trading in electronic computer components. In the period 2000 to 2004 he was a director of, first GSI Distribution Limited and then his own company, GSI Distribution Europe Limited. Neither of those companies sustained their trades. GSI Distribution Europe Limited was an

exporting company, but its business model of purchasing stock to hold it whilst seeking customers proved not to be viable. Nonetheless, although the Appellant itself began trading during the high tide of MTIC fraud, Mr Johnson's involvement with trading preceded that period. Although Mr Johnson had this prior experience in trading in goods similar to those traded by the Appellant, there was little sense from his evidence that this experience brought particular insight or expertise to the Appellant's trade, and little evidence that trading relationships established in the period to 2004 were revived or exploited for the benefit of the Appellant's trade.

241. It is the case that the Appellant was fully aware that MTIC fraud was rife in the trading sector in which the Appellant was active, and that the Appellant was at risk that its transactions might be connected to such fraud. Our findings on this are set out in paragraphs 136 to 146 above. In our view it is an important factor that, by the time at which the Appellant entered into each of the Disputed Transactions, the Appellant had been informed by the Commissioners that at least 15 of its transactions over the previous months had been traced to parties who had defaulted on their VAT payments. (Before the Appellant embarked on Disputed Transaction 6 the Appellant was advised that a further two transactions had been so traced.) In one of those cases the Appellant's supplier was a supplier from which it purchased goods in one of the Disputed Transactions, and in four of those cases the Appellant's customer was a customer to whom it sold CPUs in one of the Disputed Transactions. At the time of the Disputed Transactions the Appellant knew not just of the risk in theory, so to speak, but that in a series of its prior VAT return periods its transactions had actually been connected to MTIC fraud.

242. Given these encounters with MTIC fraud one might have expected the Appellant to have approached subsequent transactions with particular caution, circumspection and care. We discuss this below in the context of the Appellant's due diligence enquiries of its suppliers and customers. It is sufficient to say at this point that we saw no evidence of measures taken by the Appellant to increase its guard or protection against possible involvement in further transactions connected with defaulting traders. In cross-examination, when asked why the Appellant had traded further with the supplier Leisure Communications Limited (Disputed Transaction 7) when the Appellant knew at that time that it had been its supplier in two of the earlier "tainted" transactions, Mr Johnson's response was to say that since that company had not been deregistered by the Commissioners, he assumed that the Commissioners no longer regarded it as involved in MTIC fraud. Whilst we see some force in that point, it nevertheless indicates a certain complacency on the Appellant's part, which is the more apparent when, as we must assume to be the case from the absence of any evidence to the contrary, the Appellant, before entering into that subsequent transaction with Leisure Communications Limited, made no enquiries beyond its standard due diligence procedures in any endeavour to check that that company was not complicit in any VAT fraud (although it appears some limited enquiry was made at an earlier stage, after the Appellant was first informed that Leisure Communications Limited had participated in a "tainted" chain).

243. We turn next to the financial returns achieved by the Appellant from its trading activities. The Appellant had considerable and immediate success, far exceeding that

which it forecast to the Commissioners in its VAT registration application form. In its first twelve months of trading its turnover was in excess of £10 million (and £2.7 million in total in July, August and the first part of September 2006, when it ceased trading). For the year ended 30 June 2006 its pre-tax profits (after payment of directors' and other remuneration) were £385,668; for the following two and a half months pre-tax profits were £105,485. We were given no information as to the financial performance of Mr Johnson's previous company, GSI Distribution Europe Limited, but we infer from the fact that its business proved not to be viable that it did not enjoy anything like the success of the Appellant.

244. As the Commissioners point out, that rapid and substantial growth of business, and the resulting financial success, was achieved with modest outlay of capital and minimal manpower and other resources.

245. The Appellant's financial success enabled it to pay substantial remuneration to its directors and even more substantial dividends to its shareholders.

246. Such rapid, substantial and profitable business growth, which Mr Johnson could not point to as part of a consistent pattern of success in his other ventures, is the more surprising since the Appellant brought no special expertise or relationships to the marketplace in which it traded, or to the deals it transacted. Mr Johnson's evidence was that the Appellant traded on an open and genuine market, but we cannot see, if that were the case, that such success, without further explanation, would be achieved in that situation. In the terms of Moses LJ in *Mobilx*, the Appellant was presented with "the opportunity to reap a large and predictable reward over a short space of time", and no reason is offered for why that was the case. We regard these matters as credible, if circumstantial, evidence pointing to the Appellant knowing that its transactions were part of a contrived arrangement. At the very least these matters should have put the Appellant on notice that it was engaged in transactions that could not be attributed to normal commercial circumstances.

247. This brings us to a closer examination of the nature of the business undertaken by the Appellant and the transactions it entered into. The Commissioners, in their closing submissions in which they reviewed Mr Johnson's oral evidence, pointed to a number of areas where, in relation to the Appellant's business, Mr Johnson's evidence lacked credibility, either because his answers under cross-examination were vague or uncertain, or were evasive or implausible, or because he contradicted himself or changed his evidence as the cross-examination unfolded.

248. Whilst we understand that Mr Johnson was asked to recall the detail of matters which occurred more than six years previously, the lengthy preparation of the case gave him opportunity to refresh his memory and to prepare his evidence. More significantly, at the time of the Disputed Transactions Mr Johnson, at the very least, knew of the risks that the Appellant's trades would be connected to MTIC fraud, and within weeks after the Disputed Transactions he was on notice that they would be scrutinised by the Commissioners. He had ample time to gather his evidence, in the knowledge of the position the Appellant was likely to have to defend, whilst the

relevant matters were fresh in his mind and the relevant documentary evidence was available.

249. This was the case in respect of the question of the negotiation by the Appellant of the purchase and sale deals which comprised the Disputed Transactions. Mr Johnson was pressed on such matters as the way in which he found a supplier and a customer to trade the same number of goods on the same day; what negotiations took place to reach the prices eventually agreed in those deals; whether he sought a range of suppliers and customers, and if so, whether they offered different terms; and what discussions there had been about other terms of sale and purchase, such as delivery, title and payment. The only evidence Mr Johnson had to offer was that he used trade websites to put into the market what he referred to as an offer of "ghost" stock to judge the state of the market and to seek possible counterparties, whether as suppliers or customers.

250. Mr Johnson's evidence was that the terms of trade were agreed orally (and subsequently recorded in purchase orders and invoices) or were recorded between the parties in "instant messaging" through the Appellant's Hotmail internet account. He said that the Commissioners' investigating officers had not initially asked for this information, and that anything recorded on his Hotmail account had eventually been deleted by Hotmail.

251. We found Mr Johnson's evidence as to these matters wholly unconvincing. There was no sense of a trader actively at work in a genuine market seeking deals from a range of possible suppliers and customers and negotiating the best deal available. There was no sense of deals being negotiated and then for some reason falling through. There was no sense of to-ing and fro-ing between potential customer and potential supplier to match their different requirements whilst preserving an acceptable profit margin for the Appellant. There was no evidence as to the margin which the Appellant regarded as acceptable, or how it was able to secure a reasonably consistent margin (between £4 and £5 per unit) in all the Disputed Transactions. There was therefore little or no evidence of all those matters which characterise trades genuinely negotiated between independent parties acting commercially in an open market.

252. The context here is individual deals in goods traded at values of several hundred thousand pounds (except that in Disputed Transaction 7 the value was less – about £45,000). It is also the context, as we have mentioned, that the Appellant knew of the high risk that it would be required to verify the transactions. For that reason, if not for the commercial reason of maintaining a record for use in the event of any future dispute with a counterparty, the Appellant could be expected to have maintained copies of any papers or internet-based record of negotiations and the terms agreed on the conclusion of negotiations.

253. It is a reasonable inference, and one which we draw, that the deals comprising the Disputed Transactions were not the subject of genuine negotiation in the course of a trade carried out commercially in an open market.

254. We also agree with the Commissioners that Mr Johnson was unclear as to the significance and consequences of the terms of trade as recorded in the purchase orders and invoices, and showed an ignorance or indifference to essential matters such as transfer of title, the allocation or risk and the effectiveness of insurance cover. Again, in the context of substantial transactions one would expect a trader engaged in a genuine commercial transaction to appreciate the significance of such matters and to have at least a businessman's understanding of them.

255. The terms of the Appellant's business in relation to the Disputed Transactions are summarised in paragraphs 103 to 109 above. In each case title to the goods sold does not pass until payment is received – that is a term of the supplier's contract and is also a term of the Appellant's contract with its customer. The customer's terms (at least where the customer was Futures Brokerage Inc) required that the Appellant should have "full legal title to sell the goods" to the customer. This was a term the Appellant could not comply with, since when the customer paid the price (and would expect to take title to the goods) the Appellant did not have title. It is true that matters were perfected when the Appellant paid the supplier, but the Appellant was at risk that the supplier would not have title. Mr Johnson's understanding of these risks, and of the consequences if a party defaulted, was perfunctory. The Appellant traded in goods of high value essentially on the basis that "everything would work on the day", without any analysis of what the position might be if something intervened to prevent that being the case, or any analysis of where risk was allocated between the parties, or any analysis of what precautions might be taken to minimise such risks as the Appellant might be exposed to. All the trades with customers were export trades with parties outside the English jurisdiction, but no thought was given, it would appear, to the question of governing law should a contractual dispute arise. We accept that the standard of knowledge of such matters is not that of the commercial lawyer, but that of a businessman trading substantial volumes of goods on substantially similar terms. Mr Johnson did not come near reaching that standard.

256. There was similar indifference exhibited by Mr Johnson as to the insurance arrangements entered into by the Appellant. In particular, he could not explain why the Appellant arranged at its cost insurance cover as owner of the goods against loss of those goods in transit when at that time the Appellant did not have title to the goods. Nor did he suggest that enquiries were made as to whether the person holding title (the supplier, or the supplier's supplier, and likewise down any chain if each party in turn had sold on terms that title did not pass until payment) either consented to the goods being shipped outside the UK or had insurance cover against loss of the goods whilst they were being shipped.

257. We turn next to the Appellant's relationship with its suppliers and customers. A significant part of the Appellant's case was that the Appellant had taken all the steps available to it, by way of its due diligence enquiries of its suppliers, to ensure that its deals were not connected to MTIC fraud. It had, so it argued, substantially complied with all the guidelines published in Notice 726 by the Commissioners, and the Commissioners had not indicated, in the course of their investigations or in the course of the appeal, what further enquiries the Appellant could possibly have made to uncover the connection to fraud.

258. The enquiries which the Appellant made are summarised in paragraphs 147 to 153 above.

259. When Mr Johnson was cross-examined on these matters it was clear that his attitude was to make such enquiries as would show compliance with the published guidelines, rather than to make detailed and tailored enquiries designed to put the Appellant in a position to decide whether or not to deal with the party against whom the enquiries were made. Thus, by way of illustration, the Appellant asked each of its suppliers to complete a standard form declaration as to its VAT compliance and that it had itself made reasonable checks as to the integrity of its supply chain. There was no evidence of further, and individual, enquiries, for example as to what was the nature of the "reasonable checks" which a supplier had made of its supply chain. Mr Johnson visited one of its suppliers, Rose Communications Ltd, but no evidence was given as to whether that visit was used as an opportunity to make further and specific enquiries about the supplier's business or the circumstances of its supply chain. References were not sought beyond those provided by Mr O'Brien of All-ways Logistics Ltd (later of Quest Freight Ltd).

260. We observe in particular that the Appellant made no attempt to extend the range or depth of its enquiries after it was on notice that previous transactions had been connected to fraud, that is, when it knew that there were high risks that the deal chains in which it was taking part would be tainted by fraud. The only case where, it seems, the Appellant followed up on its general enquiries was with Leisure Communications Ltd: after the Commissioners had notified the Appellant in November 2005 that it had been a party to a chain of transactions connected to fraud where that company was the Appellant's supplier, the Appellant obtained from the company in January 2006 a letter of reassurance as to its due diligence procedures. However, taking the position as a whole, we accept the Commissioners' point that in the circumstances in which the Appellant found itself at the time of the Disputed Transactions it should have made more specific enquiries to enable it to form a view as to whether it was prudent to continue trading with a particular supplier.

261. The Appellant's enquiries of its customers were, at the highest, cursory and, in the case of Medius Trading AG, non-existent. In the case of Bprolific Inc Mr Johnson met a Mr Hecht of that company (although the email confirming the meeting is addressed to Mr Prigg), and Mr Johnson was uncertain whether that was the occasion he first had dealings with this company, or was after a connection had been made. There was no evidence as to whether any enquiries were made on that occasion as to the business of Bprolific Inc or any other matters of genuine business concern.

262. The Appellant was entering into substantial transactions with these customers, and was prepared to do so with little or no knowledge of their commercial standing, the nature, extent and legitimacy of their businesses, their ability to pay for the goods, or their reasons for sourcing goods from the Appellant. These are matters which would be of concern to a genuine businessman entering into a genuine business transaction. Mr Johnson claimed that the Appellant did not need to be concerned with these matters, since if the customer were to default in making payment for the goods, title would not be transferred. That, however, is to disregard the cost to the Appellant

of shipping the goods back to the UK, and the claims to which the Appellant would remain liable if the supplier were to seek to enforce its sale contract.

263. Quite apart from these business issues, the Appellant made no enquiries in any attempt to satisfy itself that its customers were genuine businesses and were not parties to a contrived VAT fraud scheme – this notwithstanding that the Appellant was on notice that previous of its trades were connected to fraud. The Appellant argues that any VAT loss must take place in its supply chain, so that enquiries into such matters should be directed to that chain, and not to the customer. That, as the Appellant must have known, is too narrow a view of the workings of a scheme for MTIC fraud, where an export customer is required to bring the fraud to its fruition. For this reason, no doubt, the Commissioners' published guidance recommends that traders undertake commercial checks as to the legitimacy of their customers as well as their suppliers.

264. We therefore cannot accept that, in all the circumstances in which the Appellant was placed, the Appellant's enquiries as to its suppliers and (such as they were) as to its customers were adequate, or demonstrate that it was an honest and diligent trader making every reasonable effort to avoid entering into deals which might be connected with VAT fraud.

265. A further matter which we take into consideration in assessing the Appellant's knowledge of connection with VAT fraud is that of the working capital funding of the Appellant. We have dealt with this in detail in paragraphs 154 to 183 above, where we have also set out our conclusions.

266. The final matter we have to deal with at this point is the Appellant's alternative submission that, if it is the case that the Appellant was a party to a contrived scheme for the loss of VAT through fraud, then it was the innocent dupe, cleverly manipulated by persons who could complete their chain by proffering to the Appellant a range of possible suppliers and possible customers.

267. We acknowledge that in other tribunal decisions this has been found on the facts to be the case. We do not, however, consider that the evidence in this case supports such a contention on the Appellant's behalf. We have set out a number of key factors which in our judgment show that the Appellant did not act in a manner consistent with that of a genuine trader concerned to protect its commercial interests and to take the best action open to it (including if necessary refraining from carrying out a trade) to ensure so far as reasonable that its trading deals were not connected to VAT fraud. The Appellant could not reasonably have thought that it was dealing in any kind of legitimate grey market in CPU products, when its dealings, and those of the parties it dealt with, showed none of the characteristics of such a market, and it could not have been under any illusions as to its own shortcomings in terms of adding particular value to any deal chain.

268. Furthermore, we observe that the terms on which the Appellant traded in the Disputed Transactions secured a profit for the Appellant of amounts equating to between 30% and 45% of the fraudulent VAT loss. Whilst we can see that the

promoters and executors of any scheme would so stage manage matters as to ensure that an innocent and duped exporter made a profit, it is highly improbable that they would concede such large proportions of the spoils of their complex activities to the only innocent party in the whole affair.

269. In conclusion, taking account of the circumstances and factors we have referred to, we find that the Commissioners have established, on the balance of probabilities, that the Appellant colluded in contrived transactions designed to bring about the fraudulent loss of VAT and that the Appellant knew that its purchase of the relevant CPUs and its sale of them in the course of each of the Disputed Transactions was connected with such fraudulent loss of VAT.

Should the Appellant have known that each of the Disputed Transactions was connected to the fraudulent loss of VAT?

270. Having found that the Appellant knew that each of the Disputed Transactions was connected to the fraudulent loss of VAT that disposes of the Appellant's appeal. However, if for any reason we are held to be wrong in reaching that conclusion we need to consider whether the Appellant should have known of the connection to the VAT fraud.

271. On the question of the constructive knowledge of a trader in a deal chain where there is fraudulent loss of VAT the guidance provided in the *Mobilx* case is clear. In applying the *Kittel* principle that a trader who is a participant in a transaction connected with VAT fraud has no right to recover input tax, Moses LJ said as follows (at [60]):

> "…a trader may be regarded as a participant where he should have known that the only reasonable explanation for the circumstances in which his purchase took place was that it was a transaction connected with such fraudulent evasion."

The question for us therefore is whether the evidence shows that, applying an objective test, the only reasonable explanation for the circumstances of the Appellant's purchases in each of the Disputed Transactions was that such purchases were connected with the fraudulent evasion of VAT.

272. It is not necessary to repeat here our findings set out above as to the prevalence of MTIC fraud in the "market" in which the Appellant traded and the Appellant's knowledge of the risks of such trading; the contrived nature of the deal chains of which the Disputed Transactions formed an essential part; the absence of any negotiations or other matters which characterise a genuine trade on commercial terms in an open market; the scale of the Appellant's trading, which exceeded the bounds of what might reasonably be estimated to be the extent of the legitimate grey market in the goods in which the Appellant traded; the Appellant's ignorance of and indifference to key terms of its trading transactions when it was trading in goods having a substantial value; the lack of certainty as to the terms of trade relating to title to the goods and indifference to the commercial risks presented by trading on such terms; the routine nature of the Appellant's due diligence enquiries made of its

suppliers notwithstanding that the Appellant was aware of a significant risk that its trades would be connected to a fraudulent loss of VAT; the absence of any meaningful enquiries of its customers; the working capital funding of the Appellant in a manner which lacked commercial credibility and where the origins of the funds have not been satisfactorily explained; and the opportunity presented to the Appellant "to reap a large and predictable reward over a short space of time" in the context of transactions which, because of their back-to-back terms, carried no commercial risk or required no substantial venturing of capital on the part of the Appellant, and where the Appellant provided no discernible added value to justify its position in the deal chain.

273. These matters comprise circumstantial evidence which taken together compels us to conclude that the Appellant, on any objective test, and in relation to each of the Disputed Transactions, "should have known that the only reasonable explanation for the circumstances in which [its] purchase took place was that it was a transaction connected with fraudulent evasion." No other explanation, and certainly none based on any true commercial rationale, presents itself. If the Appellant did not actually know that the Disputed Transactions were connected to fraud, it was because it chose to ignore the many factors which individually indicated such a connection, and which taken together comprised convincing evidence that such a connection was the only explanation for its opportunity and ability to enter into and complete those transactions. If the Appellant was duped into entering into the Disputed Transactions it was duped because it chose to disregard the circumstances then prevailing and the evidence then before it which showed its involvement in a wider scheme of VAT fraud.

274. We therefore find that, if the Appellant did not know that its relevant transactions were connected to the fraudulent loss of VAT, it nevertheless should have known this to be the case.

275. Accordingly, the Appellant has no right to repayment of the input VAT of £402,440.08 which is the subject of this appeal.

276. The Appellant's appeal is dismissed.

Costs

277. These appeal proceedings began before 1 April 2009. Either party may therefore apply to the tribunal for it to exercise its discretion to direct that, in relation to costs, the transitional provisions in paragraph 7 of Schedule 3 to the Transfer of Tribunal Functions and Revenue and Customs Appeals Order 2009 should be applied, entitling the tribunal to make a costs order in relation to the proceedings under The Value Added Tax Tribunal Rules 1986.

278. Neither party has made such an application, and at the hearing both parties indicated that they would not be making such an application. In view of the guidance on the matter given by the Upper Tribunal it is in any event unlikely that any such application at this stage of the proceedings would be allowed.

279. These proceedings are therefore subject to The Tribunal Procedure (First-tier Tribunal) (Tax Chamber) Rules 2009 and accordingly we have no jurisdiction to make any order as to costs.

Right to apply for permission to appeal

280. 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.

EDWARD SADLER
TRIBUNAL JUDGE

RELEASE DATE: 30 May 2013

Authorities before the tribunal and not referred to in the decision:

Blue Sphere Global v HMRC [2009] EWHC 1150 (Ch)
G Comms Limited v HMRC [2010] UKFTT 605 (TC)
Blada Limited v HMRC [2010] UKFTT 131 (TC)
Brayfal Limited v HMRC [2010] UKFTT 99 (TC)

APPENDIX I

The nature of MTIC fraud

The evidence of the Commissioners (given by Mr Roderick Stone) is that MTIC fraud has been responsible for enormous losses to the UK Treasury – estimated for the fiscal year 2005-06 to be between £2bn and £3bn, and for 2006-07 between £1bn and £2bn. MTIC fraud is attracted to the trading of goods which are of high value and small bulk, typically hi-tech goods, such as mobile telephones and, as in the present case, CPUs. They can be traded easily and in large quantities at very high values, and physical delivery (as opposed to the goods being held by an intermediary to the order of a trader) is not necessarily taken by each of the traders in the chain.

In the case of a "simple" fraud chain (in contrast to the more complex "contra" fraud chain, which is not relevant in the present case) Trader A (who will perpetrate the fraud) is a UK trader who purchases the goods from a trader usually located in another EU Member State. Trader A is registered (or appears to be registered) for UK VAT purposes. Trader A is importing the goods into the UK, and pays no VAT at that point. Trader A sells on the goods to Trader B, and charges VAT on that supply of the goods. Trader B is also registered for UK VAT purposes, and is known as a "buffer" trader. Trader A fails to pay to the Commissioners the VAT it has charged to Trader B and the Commissioners are unable to recover that amount from Trader A, who is now the "defaulting trader" or the "missing trader". The Commissioners cannot recover because Trader A simply goes missing, or because Trader A has used ("hi-jacked") another trader's VAT registration number.

Trader B might or might not know of Trader A's fraud, but in any event sells at a small profit to Trader C, another "buffer" trader, charging VAT on the supply, and, in the normal way, accounting to the Commissioners for the difference between the input tax it paid to Trader A and the output tax charged to Trader C. Trader C then trades on the goods, and there may be a chain of "buffer" traders, each UK VAT registered, and each making a small profit and accounting for VAT in the normal way. In due course the goods are purchased by Trader X (again, UK registered for VAT purposes), who sells them by way of export to an EU purchaser or, as in the present case, to an overseas purchaser outside the EU. Trader X may or may not know of Trader A's fraud. In MTIC fraud terminology Trader X is known as the "broker" or the "exporter". As he is exporting the goods to an EU trader who is registered for VAT in his own country, or to a non-EU trader who is outside any system of VAT, Trader X is not required to charge VAT to his customer, and so in his VAT return claims, by way of repayment, the full amount of his input tax paid, that is to say, the VAT which the "buffer" trader charged to Trader X on that trader's supply of the goods to Trader X.

Thus the loss to the Commissioners is the VAT which Trader A, the "defaulting trader", fails to pay to them, although the loss is manifested when the Commissioners repay to Trader X, the "broker", the input tax which he is claiming. If the

Commissioners can legitimately deny Trader X the right to claim repayment of his input tax, they have repaired the loss from Trader A's fraudulent default, so that, in the result, Trader X bears that loss. The courts have held that the Commissioners cannot recover their loss in this way from Trader X unless the circumstances are such that Trader X's export transaction is connected in some way with the fraudulent default and, additionally, Trader X either knew of that fraud or should have known of it.

In some cases the goods traded may have been imported into and subsequently exported from the UK on more than one occasion, used as the basis for fraudulent tax loss on each such occasion (but not necessarily involving the same fraudulent defaulting Trader A or the same exporter Trader X). Where the goods are traded in this circular manner, the fraud is referred to as "carousel" fraud.

If it is possible to identify the flow of money between parties perpetrating the fraud through their transactions and parties connected to that fraud through their transactions, it may be the case that funds flow in a circular manner, with the party at the start of the chain of transactions directly or indirectly funding the non-UK party purchasing from exporter.

In the present case, the Appellant is in the position of the "broker" or "exporter" (Trader X), who exported the goods in question and now claims repayment from the Commissioners of the input tax it paid on purchasing the goods from a "buffer" trader.

APPENDIX II

The Deal Chains in the Disputed Transactions

Deal Chain in Disputed Transaction 1 – 6 July 2006

ETP	06.07.06	**BLUESTAR ELECTRONICS**	06.07.06	**CELLEST**	06.07.06	**COMMODITY EXPORTS LTD**	06.07.06	**JMC**	06.07.06	**FUTURE BROKERAGE INC**
	PO 6152	Buy at £59.45. Total Net = £187,267.50. VAT = £32,771.81. Total = £220,039.31	PO 464	Buy at £59.60. Total Net = £187,740.00. VAT = £32,854.50. Total = £220,594.50	Inv 464	Buy at £60.25. Total Net = £189,787.50. VAT = £33,212.81. Total = £223,000.31	PO Comm015			
	Inv 1454		Inv 4152							
Sell for £59.45. Total Net = £187,267.50. VAT = £32,771.81. Total = £220,039.31	→ 3150 units	Sell for £59.60. Total Net = £187,740.00. VAT = £32,854.50. Total = £220,594.50	→ 3150 units	Sell for £60.25. Total Net = £189,787.50. VAT = £33,212.81. Total = £223,000.31	→ 3150 units	Sell for £62.00. Total Net = £195,300.00. VAT = £34,177.50. Total = £229,477.50	Inv 0707 ↘ 3150 units	Buy at £62.00. Total Net = £292,950.00. **VAT = £51,266.25**. Total = £344,216.25	PO 5491	Buy at £66.00 each. Total = £311,850.00
		+ £0.15		+ £0.65		+ £1.75			Inv 87 → 4725 units	
	PO 6151	Buy at £59.15. Total Net = £186,322.50. VAT = £32,606.44. Total = £218,928.94	PO 463	Buy at £59.30. Total Net = £186,795.00 VAT = £32,689.13. Total = £219,484.13	Inv 463	Buy at £59.95. Total Net = £188,842.50. VAT = £33,047.44. Total = £221,889.94	PO Comm015	Sell for £66.00. Total = £311,850.00		
	Inv 1453		Inv 4151				Inv 0708			
Sell for £59.15. Total Net = £186,322.50. VAT = £32,606.44. Total = £218,928.94	→ 3150 units	Sell for £59.30. Total Net = £186,795.00 VAT = £32,689.13. Total = £219,484.13	→ 3150 units	Sell for £59.95. Total Net = £188,842.50. VAT = £33,047.44. Total = £221,889.94	→ 3150 units	Sell for £62.00. Total Net = £97,650.00. VAT = £17,088.75. Total = £114,738.75	↗ 1575 units	+ £4.00		
		+ £0.15		+ £0.65		+ £2.05				

Deal Chain in Disputed Transaction 2 – 7 July 2006

ETP	07.07.06	BLUESTAR ELECTRONICS LTD	07.07.06	CELLEST	07.07.06	COMMODITY EXPORTS LTD	07.07.06	JMC	07.07.06	BPROLIFIC INC
		Buy at £62.20. Total Net = £195,930.00. VAT = £34,287.75. Total = £230,217.75		Buy at £62.35. Total Net = £196,402.50. VAT = £34,370.44. Total =		Buy at £63.00. Total Net = £198,450.00. VAT = £34,728.75. Total =				
	PO 6155		PO 466		PO 563		PO COMM016			
	Inv 1457		Inv 4155		Inv 466					
Sell for £62.20. Total Net = £195,930.00. VAT = £34,287.75. Total =	→	Sell for £62.35. Total Net = £196,402.50. VAT = £34,370.44. Total = £230,772.94	→	Sell for £63.00. Total Net = £198,450.00. VAT = £34,728.75. Total =	→	Sell for £63.00. Total Net = £198,450.00. VAT = £34,728.75. Total =	Inv 0715 ↘	Buy at £63.00. Total Net = £297,675.00. **VAT = £52,093.12**. Total = £349,768.12		Buy at £67.00 each. Total = £316,575.00
	3150 units		3150 units		3150 units		3150 units		PO 1177 Inv 88	
		+ £0.15		+ £0.65		+ £0.00			→ 4725 units	
		Buy at £62.20. Total Net = £97,965.00. VAT = £17,143.88. Total = £115,108.88		Buy at £62.35. Total Net = £98,201.25. VAT = £17,185.22. Total = £115,386.47		Buy at £63.00. Total Net = £99,225.00. VAT = £17,364.38. Total = £116,589.38				
	PO 6156		PO 467		PO 564		PO COMM016	Sell for £67.00. Total = £316,575.00		
	Inv 1458		Inv 4156		Inv 467		Inv 0717			
Sell for £62.20. Total Net = £97,965.00. VAT = £17,143.88. Total = £115,108.88	→	Sell for £62.35. Total Net = £98,201.25. VAT = £17,185.22. Total = £115,386.47	→	Sell for £63.00. Total Net = £99,225.00. VAT = £17,364.38. Total = £116,589.38	→	Sell for £63.00. Total Net = £99,225.00. VAT = £17,364.38. Total = £116,589.38	↗	+ £4.00		
	1575 units		1575 units		1575 units		1575 units			
		+ £0.15		+ £0.65		+ £0.00				

Deal Chain in Disputed Transaction 3 – 12 July 2006

ETP	07.07.06	**BLUESTAR ELECTRONICS**	07.07.06	**CELLEST**	07.07.06	**COMMODITY EXPORT LTD**	12.07.06	**JMC**	12.07.06	**MEDIUS TRADING**
	PO 6157 Inv 1459	Buy at £63.10. Total Net = £198,765.00. VAT = £34,783.88. Total = £233,548.88	PO 468 Inv 4157	Buy at £63.25. Total Net = £199,237.50. VAT = £34,866.56. Total = £234,104.06	PO 565 Inv 468	Buy at £63.85. Total Net = £201,127.50. VAT = £35,197.31. Total = £236,324.81	PO Comm 017 Inv 0719	Buy at £66.00. Total Net = £207,900.00. **VAT =£36,382.50**. Total = £244,282.50	Inv 89	Buy at £70.00 each. Total = £220,500.00
Sell for £63.10. Total Net = £198,765.00. VAT = £34,783.88. Total = £233,548.88	→ 3150 units	Sell for £63.25. Total Net = £199,237.50. VAT = £34,866.56. Total = £234,104.06	→ 3150 units	Sell for £63.85. Total Net = £201,127.50. VAT = £35,197.31. Total = £236,324.81	→ 3150 units	Sell for £66.00. Total Net = £207,900.00. VAT =£36,382.50. Total = £244,282.50	→ 3150 units	Sell for £70.00 each. Total Net = £220,500.00	→ 3150 units	
		+ £0.15		+ £0.60		+ £2.15		+ £4.00		

Deal Chain in Disputed Transaction 4 – 14 July 2006

RHF-ETP	13.07.06	BLUESTAR ELECTRONICS	13.07.06	CELLEST	14.07.06	ROSE COMMUNICATIONS LTD	14.07.06	JMC	14.07.06	FUTURES
	PO 6167 Inv 1002	Buy at £66.95 Total Net = £210,892.50. VAT = £36,906.19. Total = £247,798.69	PO 477 Inv 4166	Buy at £67.10. Total Net = £211,365.00. VAT = £36,988.88. Total = £248,353.88	PO 5360 Inv 477	Buy at £67.25. Total Net = £211,837.50. VAT = £37,071.56. Total = £248,909.06				
Sell for £66.95 Total Net = £210,892.50. VAT = £36,906.19. Total = £247,798.69	→ 3150 units	Sell for £67.10. Total Net = £211,365.00. VAT = £36,988.88. Total = £248,353.88	→ 3150 units	Sell for £67.25. Total Net = £211,837.50. VAT = £37,071.56. Total = £248,909.06	→ 3150 units	Sell for £67.50. Total Net = £212,625.00. VAT = £37,209.38. Total = £249,834.38	Inv 5360 ↘ 3150 units	Buy at £67.50. Total Net = £425,250.00 **VAT = £74,418.76**. Total = £499,668.76	PO 5495 Inv 90	Buy at £71.75. Total = £452,025.00
		+ £0.15		+ £0.15		+ £0.25				
	13.07.06		13.07.06		14.07.06		14.07.06		→ 6300 units	
	PO 6166 Inv 1003	Buy at £66.95 Total Net = £210,892.50. VAT = £36,906.19. Total = £247,798.69	Inv 4167	Buy at £67.10 Total Net = £211,365.00. VAT = £36,988.88. Total = £248,353.88	PO 5366 Inv 478	Buy at £67.25 Total Net = £211,837.50. VAT = £37,071.56. Total = £248,909.06.	Inv 5366 ↗ 3150 units	Sell for £71.75. Total = £452,025.00 + £4.25		
Sell for £66.95. Total Net = £210,892.50. VAT = £36,906.19. Total = £247,798.69	→ 3150 units	Sell for £67.10 Total Net = £211,365.00. VAT = £36,988.88. Total = £248,353.88	→ 3150 units	Sell for £67.25. Total Net = £211,837.50. VAT = £37,071.56. Total = £248,909.06	→ 3150 units	Sell for £67.50 Total Net = £212,625.00. VAT = £37,209.38. Total = £249,834.38				
		+ £0.15		+ £0.15		+ £0.25				

Deal Chain in Disputed Transaction 5 – 14 July 2006

RHF-ETP	13.07.06	BLUESTAR ELECTRONICS	13.07.06	CELLEST	14.07.06	ROSE COMMUNICATIONS UK LTD	14.07.06	JMC	14.07.06	BPROLIFIC INC
	PO 6165	Buy at £66.95. Total Net = £147,624.75. VAT = £25,834.33. Total = £173,459.08	PO 476	Buy at £67.10. Total Net = £147,955.50. VAT = £25,892.21.Total = £173,847.71	Inv 476	Buy at £67.25. Total Net = £148,286.25, VAT = £25,950.09. Total = £174,236.34				
	Inv 1001		Inv 4165							
Sell for £66.95. Total Net = £147,624.75. VAT = £25,834.33. Total = £173,459.08	→	Sell for £67.10 Total Net = £147,955.50. VAT = £25,892.21.Total = £173,847.71	→	Sell for £67.25. Total Net = £148,286.25, VAT = £25,950.09. Total = £174,236.34	→	Sell for £67.50. Total Net = £148,837.50. VAT = £26,046.56. Total = £174,884.06	Inv 5367 ↘ 2205 units	Buy at £67.50. Net Total = £297,675.00. **VAT = £52,093.12**.Total = £349,768.12	Inv 91 → 4410 units	Buy at £71.75 each. Total Net = £316,417.50
	2205 units		2205 units		2205 units					
		+ £0.15		+ £0.15		+ £0.25				
	PO 6168	Buy at £66.95. Total Net = £147,624.75. VAT = £25,834.33. Total = £173,459.08	PO 479	Buy at £67.10. Total Net = £147,955.50. VAT = £25,892.21.Total = £173,847.71	Inv 479	Buy at £67.25. Total Net = £148,286.25, VAT = £25,950.09. Total = £174,236.34	Inv 5368 ↗ 2205 units	Sell for £71.75. Total = £316,417.50		
	Inv 1004		Inv 4168							
Sell for £66.95. Total Net = £147,624.75. VAT = £25,834.33. Total = £173,459.08	→	Sell for £67.10 Total Net = £147,955.50. VAT = £25,892.21.Total = £173,847.71	→	Sell for £67.25. Total Net = £148,286.25, VAT = £25,950.09. Total = £174,236.34	→	Sell for £67.50. Total Net = £148,837.50. VAT = £26,046.56. Total = £174,884.06		+ £4.25		
	2205 units		2205 units		2205 units					
		+ £0.15		+ £0.15		+ £0.25				

Deal Chain in Disputed Transaction 6 – 18 July 2006

RHF-ETP	14.07.06	BLUESTAR ELECTRONICS	14.07.06	CELLEST	18.07.06	ROSE COMM. UK LTD	18.07.06	JMC	18.07.06	FUTURE BROKERAGE INC
		Buy at £66.95. Total Net = £253,071.00. VAT = £44,287.43. Total = £297,358.43		Buy at £67.10. Total Net = £253,638.00. VAT = £44,386.65. Total = £298,024.65		Buy at £67.25. Total Net = £254,205.00. VAT = £44,485.88. Total = £298,690.88		Buy at £67.50. Total Net = £212,625.00. **VAT = £37,209.38**. Total = £249,834.38		Buy at £71.75 each. Total = £226,012.50
	PO 6173 Inv 1009		PO 486 Inv 4173		Inv 486		ROSE003 Inv 5382		PO 5382 Inv 92	
Sell for £66.95. Total Net = £253,071.00. VAT = £44,287.43. Total = £297,358.43	→ 3780 units	Sell for £67.10. Total Net = £253,638.00. VAT = £44,386.65. Total = £298,024.65	→ 3780 units	Sell for £67.25. Total Net = £254,205.00. VAT = £44,485.88. Total = £298,690.88	→ 3780 units	Sell for £67.50. Total Net = £212,625.00. VAT = £37,209.38. Total = £249,834.38	→ 3150 units	Sell for £71.75. Total = £226,012.50	→ 3150 units	
		+ £0.15		+ £0.15		+ £0.25		+ £4.25		

Deal Chain in Disputed Transaction 7 – 2 August 2006

KAYMORE		SIMPLY CONNECT	31.07.06	IMANG	31.07.06	ULTIMATE WHOLESALE	31.07.06	BLUESTAR TRADING	31.07.06	LEISURE COMM.	02.08.06	JMC	02.08.06	INDEPENDENT MANAGEMENT LTD
			PO 3077	Buy at £65.15. Total Net = £205,222.50. VAT = £35,913.94. Total = £241,136.44	PO 1890	Buy at £65.20.Total Net = £205,380.00. VAT = £35,941.50. Total = £241,321.50	PO31.07-02	Buy at £65.25. Total Net = £205,537.50. VAT = £35,969.06. Total = £241,506.56	P706025	Buy at £65.50. Total Net = £206,325.00. VAT = £36,106.88. Total = £242,431.88	LES0014	Buy at £66.50 each. Net Total = £41,895.00. **VAT = £7,331.63**. Total = £49,226.63	PO JMC0020	Buy at £71.50 each. Total = £45,045.00
	Inv 174		Inv 174		Inv 3077		Inv 1930		31.07-02		Inv 1806003		Inv 93	
	→		→		→		→		→		→		→	
		Sell for £65.15. Total Net = £205,222.50. VAT = £35,913.94. Total = £241,136.44	3150 units	Sell for £65.20. Total Net = £205,380.00. VAT = £35,941.50. Total = £241,321.50	3150 units	Sell for £65.25. Total Net = £205,537.50. VAT = £35,969.06. Total = £241,506.56	3150 units	Sell for £65.50. Total Net = £206,325.00. VAT = £36,106.88. Total = £242,431.88	3150 units	Sell for £66.50 each. Net Total = £41,895.00. VAT = £7,331.63. Total = £49,226.63	630 units	Sell for £71.50 each. Total = £45,045.00	630 units	
				+ £0.05		+ £0.05		+ £0.25		+ £1.00		+ £5.00		

Deal Chain in Disputed Transaction 8 – 1 August 2006