TC03294

Appeal number: LON/2008/01980

VALUE ADDED TAX – input tax – MTIC fraud – credit for input tax denied on grounds that the appellant knew or should have known that its transactions were connected with fraud – fair hearing – appellant unable to fund representation without access to funds in dispute – contra trading – whether appellant knew or should have known of connection with fraud – yes – appeal dismissed

FIRST-TIER TRIBUNAL
TAX CHAMBER

OUTKEY TRADING LIMITED **Appellant**

- and -

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

TRIBUNAL: JUDGE JONATHAN CANNAN
MR RICHARD LAW

Sitting in public in London on 10, 13, 14 and 17 June 2013 with written submissions on 18 and 25 June 2013.

Mr Andrew Young of counsel instructed by D & S VAT Consultants for the Appellant (save on 17 June 2013 when the appellant did not appear and was not represented)

Mr James Waddington and Ms Natasha Barnes of counsel instructed by the General Counsel and Solicitor of HM Revenue & Customs for the Respondents

DECISION

Introduction

1. On 27 August 2008 HMRC wrote to the appellant denying the appellant's claim to a repayment of input tax. The claim related to 6 transactions for the purchase of mobile phones in May 2006. Entitlement to input tax credit was denied on the basis that HMRC considered the purchase of the mobile phones was connected with fraud and that the appellant knew or should have known that this was the case.

2. The amount of input tax for which credit has been denied is £1,900,631.25. The claim for credit was made in the appellant's VAT return for the 05/06 quarter and the appellant has appealed the decision refusing that claim. The grounds of appeal pursued before us may be summarised as follows:

(1) The appellant has been unable to trade since May 2006 because of the refusal to repay input tax. The appellant says that it is not in a position to fund representation to fully argue this appeal on the merits. In the circumstances the Appellant says that it cannot have a fair hearing.

(2) As a matter of law, even on the respondents' factual case they have no power to deny input tax credit where the connection with fraud is alleged to be via a contra trader.

(3) There is no objective evidence that the appellant knew or should have known that its transactions were connected with fraud.

3. The appellant instructed Mr Andrew Young of counsel for the purposes of this appeal. His instructions were limited to pursuing the first two arguments. He also cross-examined two of the respondents' witnesses. In closing submissions lodged by D & S VAT Consultants the appellant relied on the third ground of appeal.

4. The appellant did not call any witnesses, although it had served a witness statement by its director, Mr Shaun Lewis. Mr Lewis however was not tendered for cross-examination. We deal with the circumstances of Mr Lewis' evidence in detail below.

5. Following the evidence we received closing written submissions from both parties on matters of law and matters of fact. The submissions of the appellant were again limited. We have had regard to all material placed before us by the parties. This decision is structured as follows:

(1) Background facts

(2) Analysis of the law

(2.1) Requirement for a domestic statutory provision

(2.2) Application of Kittel to contra trading

(2.3) Guidance as to the practical application of Kittel

(2.4) Fair hearing

(3) Detailed Findings of Fact

(4) Decision on Knowledge

(5) Should the Appellant have known of the Connection with Fraud

(6) Conclusion

(1) Background Facts

6. We find the following background facts on the basis of the evidence before us.

7. The appellant was incorporated on 23 March 2004. Mr Shaun Lewis was the sole director and shareholder and his mother was company secretary, although she was not actively involved in company business. The appellant applied to be registered for VAT on 30 August 2004. There was a pre-registration visit by HMRC following which the appellant was registered for VAT with effect from 20 September 2004.

8. In 2004 Mr Lewis worked for a company called Globaltel Limited which was involved in the wholesale purchase and sale of mobile phones. This was Mr Lewis' first experience of working in this sector and he did so as a consultant through the appellant. He worked for Globaltel on this basis for a short period before effectively trading on his own account through the appellant.

9. The appellant's first transaction in mobile phones took place in April 2005. By this stage the appellant rented an office in Windsor. The appellant's trading resulted in a VAT repayment claim for the first VAT period 05/05 and a verification visit by HMRC on 13 June 2005. During period 05/05 the appellant carried out a mixture of UK purchases and sales and UK purchases sold to customers outside the UK. It was these latter transactions which resulted in VAT repayments. On 23 September 2005 a further verification visit by HMRC took place. This related to a repayment claim in the 08/05 VAT return. Significant repayments were made by HMRC on a without prejudice basis for both of these periods and for periods 11/05 and 02/06.

10. In the periods up to and including 05/06 the appellant's returns may be summarised as follows:

VAT Period	Payment / (Repayment) £	Turnover £
11/04	6,382	36,472
02/05	(201)	0
05/05	(205,843)	4,851,537
08/05	(584,400)	3,538,244
11/05	(724,742)	4,431,944
02/06	(1,282,099)	7,922,400
05/06	(1,900,631)	11,797,931

11. Little or no trading took place after 31 May 2006. The appellant was deregistered for VAT with effect from 2 March 2009.

The Transactions and Associated Payments

12. We are concerned in this appeal with 6 transactions. In 3 of those transactions the supplier to the appellant is Blackstar UK Ltd ("Blackstar"). In the other 3 transactions the supplier is Greystone UK Trading Ltd ("Greystone"). As part of their verification work the respondents have traced other parties involved in the supply and purchase of the phones for each transaction. We find as a fact that the transactions formed part of chains involving the following goods and parties:

1	2	3	4	5	6
09/05/06	10/05/06	26/05/06	31/05/06	31/05/06	31/05/06
Nokia 9300i	Nokia N90	Samsung D600	Nokia 7380	Nokia 7610	Nokia 7610
8,000	9,000	12,500	7,000	12,000	8,000
Prabud	Prabud	Powertec	Prabud	Powertec	Powertec
Blackstar	Blackstar	Digikom	Blackstar	Digikom	Digikom
Outkey	**Outkey**	Greystone	**Outkey**	Greystone	Greystone
Olympic	Olympic	**Outkey**	Nano	**Outkey**	**Outkey**
		Nano		Olympic	Nano

13. The invoicing between each of the parties in each chain took place on the date shown in the table. For example in Deal 1, Prabud supplied the phones to Blackstar which supplied the phones to Outkey which supplied the phones to Olympic Europe BV ("Olympic"). In Deal 3, Powertec supplied the phones to Digikom which were then supplied in turn to Greystone, Outkey and Nano Infinity SARL ("Nano").

14. It was common ground that Mr Lewis was responsible for causing the appellant to enter into each of the appellant's purchase and sale transactions in May 2006.

15. Each company in each of the deal chains had an account with First Curacao International Bank ("FCIB"). Payments and receipts in relation to each transaction in each deal chain were made through those FCIB accounts. HMRC officers Nikolas Mody and Angela McCalmon have analysed evidence originating from FCIB. We are satisfied from the evidence that the associated flow of funds for each deal chain was as follows:

1	**2**	**3**	**4**	**5**	**6**
Bilgisel	**Bilgisel**	**Bilgisel**	**Bilgisel**	**Bilgisel**	**Bilgisel**
Zorba	Zorba	Mundini	Mundini	Zorba	Mundini
Olympic	Olympic	Nano	Nano	Olympic	Nano
Outkey	Outkey	Outkey	Outkey	Outkey	Outkey
Blackstar	Blackstar	Greystone	Blackstar	Greystone	Greystone
Prabud	Prabud	Digikom	Prabud	Digikom	Digikom
Bilgisel	**Bilgisel**	Prabud	**Bilgisel**	Prabud	Powertec / Prabud
		Bilgisel		**Bilgisel**	**Bilgisel**

16. For example in Deal 1 a flow of funds was initiated by Bilgisel. It made payment to Zorba which in turn made payment to Olympic and so on down the chain returning to Bilgisel on the same date. The funds passed through the chain in separate tranches. Prior to these flows of funds the appellant made a separate part-payment to Blackstar of £500,000.

17. In Deal 1 the fund flows occur in the following order:

11 May 2006	28 June 2006	30 June 2006	30 June 2006
	Bilgisel £1,400,000 ↓	**Bilgisel** £800,000 ↓	**Bilgisel** £332,000 ↓
	Zorba £1,400,000 ↓	Zorba £800,000 ↓	Zorba £332,000 ↓
	Olympic £1,400,000 ↓	Olympic £800,000 ↓	Olympic £332,000 ↓
Outkey £500,000 ↓	Outkey £1,400,000 ↓	Outkey £800,000 ↓	Outkey £ 54,000 ↓
Blackstar	Blackstar £1,400,000 ↓	Blackstar £800,000 ↓	Blackstar
	Prabud £1,400,000 ↓	Prabud £800,000 ↓	
	Bilgisel	**Bilgisel**	

18. At some stage, but it is not clear when, the goods were delivered by Prabud to SPF Freight and Logistics Ltd ("SPF") at the request of Blackstar. Invoicing of Deal 1 all took place on 9 May 2006. On 31 May 2006 SPF produced an inspection report. On 1 June 2006 the goods were transported via Eurotunnel to Freight Connection BV in the Netherlands.

19. In each deal the goods were at SPF whilst in the UK. For those deals where Olympic was the customer the goods were shipped to Freight Connection BV, a warehouse in the Netherlands. For those deal where Nano was the customer the goods were shipped to Prologic, a warehouse near Paris.

20. Key dates and other information in relation to each of the deals may be summarised as follows:

Deal	Date of Invoicing	Date of Inspection	Date of Shipment	Date of Payments to Outkey	Date of Payments by Outkey
1	9/05/06	31/05/06	1/06/06	28/06/06 30/06/06	11/05/06 28/06/06 30/06/06
2	10/05/06	7/06/06	8+9/06/06	28/06/06 30/06/06	11/05/06 28/06/06 30/06/06
3	26/05/06	13/06/06	15/06/06	28/06/06	28/06/06 30/06/06
4	31/05/06	8/07/06	10/07/06	30/06/06	30/06/06
5	31/05/06	10/06/06	12/06/06	28/06/06	28/06/06 30/06/06
6	31/05/06	8/07/06	10/07/06	30/06/06 3/07/06	30/06/06 3/07/06

21. In Deal 3 and Deal 5, whilst Powertec supplied the goods to Digikom, payment was made by Digikom to Prabud. We have also simplified the fund flow in Deal 3 a little. £500,000 of the funds passed from Digikom to Bilgisel via First Associates Ltd, PPUH Kamar and Retro Group FZE. In Deal 6, whilst Powertec supplied the goods to Digikom, £660,000 was paid by Digikom to Prabud. There is no obvious link between Powertec and Prabud, although the director of Powertec, Mr Broakim, provided a letter of good standing to FCIB when Prabud opened its FCIB account.

22. The respondents also rely upon deals carried out by the appellant in VAT period 02/06. In February 2006 the appellant carried out 10 transactions in mobile phones and 1 transaction in CPUs. In each transaction the goods were supplied either by Greystone or Blackstar. All its customers were based in the EU and in 3 transactions the customer was Olympic.

(2) Analysis of the Law

23. Domestic legislation governing the recovery of input tax is contained in sections 24 – 26 of the VAT Act 1994 and in the VAT Regulations 1995. In general terms, if a taxable person has incurred input tax that is properly allowable, he is entitled to set it against his output tax liability and, if the input tax credit due to him exceeds the output tax liability, he is entitled to a repayment.

24. The starting point when considering the denial of a claim to input tax credit where a transaction is alleged to be connected with fraud is the judgment of the CJEU in *Axel Kittel v Belgium & Belgium v Recolta Recycling SPRL (C-439/04 and C-440/04) [2006] All ER (D) 69 (Jul)*. The respondents say that this provides a legal basis for them to refuse a taxable person the right to deduct in certain defined circumstances. By way of summary the CJEU in *Kittel* held that:

> (1) where the tax authorities find that the right to deduct has been exercised fraudulently, those authorities are permitted to claim repayment of the deducted sums retroactively (at [55]);
>
> (2) in the same way, a taxable person who knew or should have known that, by his purchase, he was taking part in a transaction connected with fraud must be regarded as a participant in that fraud (at [56]);
>
> (3) that is the case, irrespective of whether or not the taxable person profited by resale of the goods (at [56]);
>
> (4) that is because in such a situation the taxable person aids the perpetrators of the fraud (at [57]).

25. The ECJ concluded at [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*."

26. In *Mobile Export 365/Shelford v HMRC [2009] EWHC 797 (Ch)* Sir Andrew Park gives a helpful description of MTIC fraud generally at [19]:

> *"A missing trader intra-community fraud, when conducted in relation to mobile telephones, always involves at least two elements. One of them is that one VAT registered trader acquires and sells telephones in circumstances where it is liable to account to HMRC for VAT but, for whatever reason, it does not in fact pay the VAT. That trader is sometimes described as the defaulting trader... The second element is that another VAT registered trader who is involved in the same chain of sales makes a claim to repayment of input tax. It will, I think, be apparent that, if the first trader had a liability to pay output tax to HMRC but did not meet it (for whatever reason), but the second trader recovers from HMRC an equivalent or possibly somewhat larger amount of input tax, there will be a serious loss of VAT to the Exchequer*."

27. A trader making a claim for repayment of input tax on the dispatch or export of goods where its transactions are allegedly connected with an MTIC fraud is often known as a broker. For the purposes of this decision we use that term as a convenient shorthand but without pre-judging any factual issue.

28. The broker adds liquidity to the supply chains as a well as ensuring that the goods can circulate within the fraud - see Floyd J in *Calltel v HMRC [2009] EWHC 1081 (Ch)* at [81]:

> *"81. It will be recalled that the rationale in Kittel for refusing repayment where the purchaser knows that he was taking part in a transaction connected with fraudulent evasion of VAT was that he "aids the perpetrators of the fraud and becomes their accomplice". For my part I have no difficulty in seeing how the purchaser who is not in privity of contract with the importer aids the perpetrators of the fraud. He supplies liquidity into the supply chain, both rewarding the perpetrator of the fraud for the specific chain in question, and ensuring that the supply chains remain in place for future transactions. By being ready, despite knowledge of the evasion of VAT, to make purchases, the purchaser makes himself an accomplice in that evasion."*

29. The defaulter is usually the original importer but any company in the chain or connected chains might dishonestly fail to account for output tax. See Christopher Clarke J in *Red 12 Trading Limited v HMRC* [2009] EWHC 2563 (Ch) at [84].

30. It is alleged by the respondents that the appellant's transactions are part of a scheme to defraud the revenue which involved a "contra trader". The term contra trader is now well understood and has been considered in many cases by the First-tier Tribunal, the Upper Tribunal and the Court of Appeal. We note the description adopted by the Chancellor at paragraph 4 of his judgment in *Blue Sphere Global [2009] EWHC 1150 (Ch)* as to how contra trading is used to conceal the existence of MTIC fraud. In the present appeal the respondents allege that Blackstar and Digikom acted as contra traders and the appellant's transactions form part of the acquisition chains of those companies, sometimes known as the "clean chains". Tax losses do not appear in the clean chains. Rather they appear in transaction chains in which a contra trader acts as a broker dispatching or exporting goods out of the UK, sometimes known as the "dirty chains".

31. The Chancellor in *Blue Sphere Global* considered and rejected an argument that the connection between the broker's transactions in the clean chain and tax losses in the contra trader's dirty chains was "*unreal and is inconsistent with the principles of legal certainty, fiscal neutrality, proportionality and freedom of movement"***.** That broad submission was dealt with at paragraphs 44 to 46 of the judgment:

> *" 44. There is force in the argument of counsel for BSG but I do not accept it. The nature of any particular*

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

45. Given that the clean and dirty chains can be regarded as connected with one another, by the same token the clean chain is connected with any fraudulent evasion of VAT in the dirty chain because, in a case of contra-trading, the right to reclaim enjoyed by C (Infinity) in the dirty chain, which is the counterpart of the obligation of A to account for input tax paid by B, is transferred to E (BSG) in the clean chain. Such a transfer is apt, for the reasons given by the Tribunal in Olympia (paragraph 4 quoted in paragraph 4 above), to conceal the fraud committed by A in the dirty chain in its failure to account for the input tax received from B.

46. Plainly not all persons involved in either chain, although connected, should be liable for any tax loss. The control mechanism lies in the need for either direct participation in the fraud or sufficient knowledge of it ...”

32. The appellant argues that as a matter of law transactions in a clean chain cannot be connected with fraudulent tax losses in a dirty chain. Hence it argues that the respondents, on their own case, are not entitled to refuse repayment of input tax.

33. Mr Young made a number of submissions as to why, as a matter of law, the respondents were not entitled to refuse to repay the input tax paid by the appellant. In broad terms he submitted as follows:

(1) In the absence of a domestic statutory provision, the respondents have no power to refuse the input tax credit even where there is a connection with fraud.

(2) The principle in Kittel does not apply to contra trading.

34. We deal with each of these submissions in turn.

(2.1) Requirement for a Domestic Statutory Provision

35. Mr Young submitted that the CJEU in Kittel was applying Article 22(8) of the Sixth Directive. Without Article 22(8) he submitted that the CJEU would have had no power to arrive at the decision it did. He argued that Article 22(8) of the Sixth Directive conferred a right on the UK to enact domestic provisions implementing Kittel but it had not done so. Article 22(8) provides as follows:

> " *Member States may impose other obligations which they deem necessary to ensure the correct collection of VAT and to prevent evasion, subject to the requirement of equal treatment as between domestic transactions and transactions carried out between Member States by taxable persons and provided that such obligations do not, in trade between Member States, give rise to formalities connected with the crossing of frontiers.*
>
> *The option under the first paragraph may not be relied upon in order to impose additional invoicing obligations over and above those laid down in Chapter 3.*"

36. The CJEU in Kittel did not refer to Article 22(8). There is reference to Article 22(8) in subsequent cases such as *Mahageben and David v Nemzeti_Case C-80/11* (see below). However those references are in the context of the validity of the specific domestic legislation being considered in the case.

37. For the same reasons as were given by the Court of Appeal in *Mobilx Ltd & Others v Revenue & Customs Commissioners [2010] EWCA Civ 517* at [45] to [49] we consider that the VAT Act 1994 provides sufficient justification for the respondents to refuse input tax credit in circumstances where a trader enters into a transaction which he knows or should have known is connected with fraud. In particular, at [47] the Court of Appeal said:

> "*… the objective criteria which form the basis of concepts used in the Sixth Directive form the basis of the concepts which limit the scope of VAT and the right to deduct under ss. 1, 4 and 24 of the 1994 Act. Applying the principle in Kittel, the objective criteria are not met where a taxable person knew or should have known that by his purchase he was participating in a transaction connected with fraudulent evasion of VAT. That principle merely requires consideration of whether the objective criteria relevant to those provisions of the VAT Act 1994 are met. It does not require the introduction of any further domestic legislation.*"

38. The appellant also relied on what was said by Elias LJ in *Eastenders Cash and Carry plc v Commissioners for HM Revenue & Customs [2012] EWCA Civ 15* at [88]

> " *… since we are dealing with a power to interfere with property rights, that power should not be construed more widely than is reasonably necessary. The*

judge's approach involves reading words into section 139 in order to give HMRC a power which he believes Parliament must have intended them to have. In my judgment before any such implication is made to widen the power of the state to interfere with private property rights, it must be very clear that Parliament intended to confer it. I do not accept that that such intention is manifest here; it cannot be enough that the court considers it desirable that the power should exist."

39. We do not consider that in the present context it is necessary to construe the VAT Act 1994 more widely than is reasonably necessary to limit the scope of the right to deduct input tax. We also note what the CJEU said in Kittel at [54] - [56]:

"54. … *Community law cannot be relied on for abusive or fraudulent ends …*

55. Where the tax authorities find that the right to deduct has been exercised fraudulently, they are permitted to reclaim repayment of the deducted sums retroactively … It is a matter for the national court to refuse to allow the right to deduct where it is established, on the basis of objective evidence, that that right is being relied on for fraudulent ends …

56. In the same way, a taxable person who knew or should have known that, by his purchase, he was taking part in a transaction connected with fraudulent evasion of VAT must, for the purposes of the Sixth Directive, be regarded as a participant in that fraud …"

40. For the reasons set out in *Mobilx* the VAT Act 1994 is to be construed in a way which mirrors the general principle that Community law cannot be relied on for abusive or fraudulent ends. It cannot therefore be said that such a construction is in any way outside Article 22(8) or otherwise inconsistent with Community law.

41. Mr Young submitted that we are not bound by *Mobilx* as matter of precedent, relying on *Second Simmenthal Case 106/77* and *Rheinmühlen Düsseldorf v Einfuhr- und Vorratsstelle für Getreide und Futtermittel Case 6-71* in the CJEU. That submission does not help the appellant because, with respect, we agree with the reasoning in *Mobilx*.

42. We do not consider that the respondents require any additional statutory provision to justify refusal of an input tax credit in circumstances where the underlying transaction is connected with fraud and the party claiming the benefit of the credit knew or should have known of the connection with fraud.

43. Mr Young submitted that if the UK had enacted legislation enabling the respondents to refuse input tax credit where a transaction was connected with fraud via a contra trading scheme then such legislation would have been challenged in the CJEU. He compared the position to section 77A VAT Act 1994 which was challenged, albeit unsuccessfully, before the CJEU in the case of *Commissioners of Customs & Excise v Federation of Technological Industries Case C-384/04*.

44. Mr Young further submitted that in denying input tax credit the respondents have breached the appellant's rights under the *Bill of Rights 1689*. In particular that "*levying money for or to the use of the Crown by pretence of prerogative, without grant of Parliament … is illegal*".

45. We do not accept these submissions. We have concluded that the VAT Act 1994 does provide sufficient statutory basis for the respondents to refuse input tax credit in circumstances falling within the Kittel principle.

(2.2) Application of Kittel to Contra Trading

46. Mr Young submitted that the test in Kittel does not apply to any transaction in a clean chain even where there is a finding that it was part of a contra trading fraud. The appellant relies on a number of recent cases before the CJEU in arguing that the test in Kittel does not apply to contra trading. The cases are *Toth v Nemzeti Case C-324/11*, *Mahageben and David v Nemzeti Case C-80/11* and *Bonik v Direktor Case C-285/11*. In particular Mr Young relied on passages which refer to fraud "*in the chain of supply*" which he says indicate that the principle in Kittel does not apply to any connection with fraud in separate parallel chains of supply leading to a contra trader.

47. We do not accept that these cases support the argument advanced by the appellant. Indeed such arguments were rejected by Lord Justice Moses in an oral application for permission to appeal in *Powa (Jersey) Ltd v Commissioners for HM Revenue & Customs [2013] EWCA Civ 225*. The argument has also been rejected by the Upper Tribunal in *Fonecomp Ltd v Commissioners for HM Revenue & Customs [2013] UKUT 0599 (TCC)* which was released after final submissions were given in the present appeal.

48. In *Powa (Jersey) Ltd* the appellant's transactions took place as part of a contra trading scheme. Moses LJ refused permission to appeal to the Court of Appeal. At [11] he said this:

> " *…it seems to me quite clear that, whilst it is true that from to time the court [in Mahageben] referred to another trader at an earlier stage in the transaction, it was accepting the principle that, so far as participation in the fraud was concerned, if a person had knowledge or the means of knowledge that fraud was being carried out at an earlier stage in the chain of supply, that would denote that he was a participant in the fraud and thereby loses his right to deduct. That is plain from Optigen; it is plain from Kittel; and the court in Mahageben was saying nothing different. Indeed those references on which Mr Patchett-Joyce relies at paragraph 45 and at paragraph 59 must be read in the context of what it clearly says in paragraph 49. If the court intended to cut down the principle it had identified in the case-law exemplified in Kittel and was changing the law, it would have said so. On the contrary it was not. It was merely applying it.*"

49. In *Fonecomp* the Upper Tribunal said in response to a submission that the principle in *Kittel* only applies where the fraud occurs in the same chain of supply as follows at [24]:

> "*The authoritative statement of the principle given by the Court at [56] and [61] of its judgment in Kittel is not qualified in this way, and such an arbitrary and excessively narrow focus would not accord with the usual purposive approach to interpretation of EU legislation.*"

50. Similarly, the test in *Kittel* does not require a connection amounting to privity of contract between the broker and the defaulter. Such arguments were rejected by the Court of Appeal in *Mobilx* at [62]:

> "*The principle of legal certainty provides no warrant for restricting the connection, which must be established, to a fraudulent evasion which immediately precedes a trader's purchase ... He is a participant whatever the stage at which the evasion occurs.*"

51. Where a connection with fraud is established the focus of the Tribunal is on the control mechanism described by the Chancellor at [46] of *Blue Sphere Global*, namely whether the appellant knew or should have known of the connection with fraud.

52. The cases in the CJEU since Kittel are clearly not to be interpreted as restricting the general principle described in Kittel. It is the connection with fraud that is important, and if a trader knew or should have known of that connection then it will lose entitlement to input tax credit. There is no reason for the general principle to be restricted to frauds in the same transaction chain, especially where the clean chain is part of an overall scheme to defraud HMRC. Imposing such a restriction would be an arbitrary refinement of the simple test outlined in Kittel.

53. We do not consider that refusing input tax credit to a person making an intra community supply as opposed to other traders participating in a fraud violates the principle of neutrality or the principle of non-discrimination encapsulated in Article 22(8).

54. Mr Young argued that the respondents' case applying the test in Kittel to refuse input tax in relation to transactions in a clean chain is inconsistent with established authority that it is not permissible to take a globalised view of the affairs of a taxable person. In particular he referred us to *Commissioners for Customs & Excise v Thorn Materials Supply Ltd [1998] WLR 1106* and *HM Revenue & Customs v Aimia Coalition Loyalty UK Limited [2013] UKSC 15.*

55. In *Thorn*, the Supreme Court was concerned with the timing of a supply between members of a group of companies where before the transaction was

completed the supplier had left the group. The facts are far removed from MTIC fraud but Mr Young relies on a passage from Lord Hoffmann's dissenting opinion at p1120F:

> " *I think that in any case [HMRC's argument] must fail because it involves taking a "global view" of what are accepted to have been genuine contracts between the outside supplier and Materials and between Materials and Home. This is contrary to the principle laid down by the European Court of Justice in B.L.P. Group Plc. v. Customs and Excise Commissioners [1996] 1 W.L.R. 174, as applied by your Lordships in Robert Gordon's College v. Customs and Excise Commissioners [1996] 1 W.L.R. 201.*"

56. Lord Hoffmann was addressing an argument raised by the Commissioners based on the Ramsay principle which enables a court, in deciding whether a transaction falls within the provisions of a taxing statute, to ignore steps inserted without commercial purpose except for the avoidance of tax.

57. In *Aimia* the Supreme Court was dealing with the correct VAT analysis of transactions involving the use of loyalty cards. Lord Walker referred to linear transactions now being relatively unusual with contractual relationship increasingly becoming more like a web than a chain. Even so, he stated at [115] that it was still necessary "*to look separately at different parts of the web of transactions*".

58. We do not consider that HMRC in the present case are taking a globalised view of taxable transactions in seeking to apply the principle in Kittel to an alleged contra trading fraud. They are simply seeking to identify the nature and extent of the alleged fraud before then asking in relation to the appellant's specific transactions whether the appellant knew or should have known of the alleged connection with fraud.

59. The appellant invited us, in its closing submissions, to refer this question to the CJEU if we did not consider the position to be clear. Whilst we have not heard submissions from the respondents in relation to that invitation, for the reasons given above we consider it to be clear that the Kittel principle can be applied to input tax claimed in transactions in a clean chain leading to a contra trader.

(2.3) Guidance as to the Practical Application of Kittel

60. The Court of Appeal in *Mobilx* considered in detail the "knowledge" element of the Kittel principle. It stated in terms at [59]:

> "*The test in Kittel is simple and should not be over-refined. It embraces not only those who know of the connection but those who 'should have known'.*"

61. The respondents must satisfy us that the appellant knew, or should have known that the transaction was connected with fraud. They do not need to establish knowledge of a particular fraud or the fraudulent intent of specific individuals. In *Megtian v HMRC [2010] EWHC 20 (Ch)* Briggs J stated as follows:

> *"37. In my judgment, there are likely to be many cases in which a participant in a sophisticated fraud is shown to have actual or blind-eye knowledge that the transaction in which he is participating is connected with that fraud, without knowing, for example, whether his chain is a clean or dirty chain, whether contra-trading is necessarily involved at all, or whether the fraud has at its heart merely a dishonest intention to abscond without paying tax, or that intention plus one or more multifarious means of achieving a cover-up while the absconding takes place.*
>
> *38. Similarly, I consider that there are likely to be many cases in which facts about the transaction known to the broker are sufficient to enable it to be said that the broker ought to have known that his transaction was connected with a tax fraud, without it having to be, or even being possible for it to be, demonstrated precisely which aspects of a sophisticated multifaceted fraud he would have discovered, had he made reasonable inquiries. In my judgment, sophisticated frauds in the real world are not invariably susceptible, as a matter of law, to being carved up into self-contained boxes even though, on the facts of particular cases, including Livewire, that may be an appropriate basis for analysis."*

62. In any particular case there may be specific details of the fraud that the broker knew about or should have known about. HMRC do not need to establish knowledge of such details. However they must establish that the appellant knew or should have known that there was a connection with fraud. It is not sufficient for HMRC to establish that the broker knew or should have known that its transactions were *likely* to be connected with fraud (see *Mobilx* at [60]). Each case must be dealt with by reference to its own facts and on the basis of the test outlined in *Mobilx*.

63. The respondents' case on knowledge is based on drawing inferences from a wide range of facts in order to establish that the appellant must have known that its transactions were connected with fraud (see the same approach recorded at [66] and [67] of the Judgment of Floyd J. in *Calltel Telecom Limited v HMRC [2009] EWHC 1081 (Ch)*).

64. In the alternative the respondents maintain that in all the circumstances the appellant should have known that its transactions were connected with fraud.

65. The meaning of "should have known" is considered at [50] – [52] of the judgment in *Mobilx*. The Court of Appeal's conclusions at [52] were that:

> *"If a taxpayer has the means at his disposal of knowing that by his purchase he is participating in a transaction connected with fraudulent evasion of VAT he loses his right to deduct, not as a penalty for negligence, but because the objective criteria for the scope of that right are not met."*

66. The Court of Appeal gave valuable guidance as to how the "should have known" test actually operates. The guidance is first articulated at [59], where, having observed that the test in *Kittel* "*... is simple and should not be over-refined,*" Moses LJ stated as follows:

> *"If a trader should have known that the only reasonable explanation for the transaction in which he was involved was that it was connected with fraud and it turns out that the transaction was connected with fraudulent evasion of VAT then he should have known of that fact."*

67. Similar guidance appears elsewhere in the judgment. We approach our task on the basis that the respondents have to satisfy us that the evidence, looked at objectively, demonstrates that the connection with fraud was "*the only reasonable explanation*", or the only "*reasonable possibility*" or the "*only realistic possibility*" to explain the circumstances in which the appellant entered into the transaction.

68. As well as clarifying what is meant by the concept of "should have known", the Court of Appeal also offers some clear and helpful guidance as to how tribunals should approach their fact-finding task.

69. In addressing the question of whether a trader knew or should have known of the connection with fraud, the Tribunal must have regard to all the surrounding circumstances. The relevance of the "surrounding circumstances" is apparent at [59] and [60] of the *Mobilx* Judgment and at [84] where Moses LJ adopts paragraphs [109] – [111] of the judgment of Christopher Clarke J in *Red 12*. At [111] of *Red 12* Christopher Clarke J said,

> *"... 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."*

70. As well as having regard to all the surrounding circumstances, the trader and consequently the tribunal must have regard to the inferences that can properly be drawn from the primary facts. This is pointed out at [61] of the judgment in *Mobilx*:

> *"If he [the trader] chooses to ignore the obvious inferences from the facts and circumstances in which he has been trading, he will not be entitled to deduct."*

71. In relation to the significance of due diligence, the Court of Appeal in *Mobilx* said this at [75]:

> "*The ultimate question is not whether the trader exercised due diligence but rather whether he should have known that the only reasonable explanation for the circumstances in which his transaction took place was that it was connected to fraudulent evasion of VAT.*"

72. Then at [82] it said:

> "*…Tribunals should not unduly focus on the question whether a trader has acted with due diligence. Even if a trader has asked appropriate questions, 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 have been or will be connected to fraud. The danger in focussing on the question of due diligence is that it may deflect a Tribunal from asking the essential question posed in Kittel, namely, whether the trader should have known that by his purchase he was taking part in a transaction connected with fraudulent evasion of VAT. The circumstances may well establish that he was.*"

73. We take into account all the principles and guidance set out above when we come to our decision on this appeal.

(2.4) Fair Hearing

74. Mr Young on behalf of the appellant contends that it cannot receive a fair hearing. This argument was based principally on a submission that there was a severe inequality of arms between the appellant and the respondents. In particular he relied on the following matters:

(1) The respondents had refused a request for funding of legal expenses by way of an interim payment of £60,000 from the sum in dispute.

(2) The appellant was unable to fund counsel's opinion on the contra trading evidence. It was limited to funding counsel's submissions on the law and a limited cross-examination of two of the respondents' witnesses.

(3) The appellant was unable to fund its own expert evidence to counter that relied on by the respondents.

75. On 15 March 2011 the appellant requested the respondents to release £60,000 in order to enable the appellant to fund this appeal. The request briefly identified that the respondents were withholding some £1.9 million of the appellant's funds, the matter was complex and the appellant would require a significant amount of advice. By letter

dated 18 March 2011 the respondents refused that request without giving any reasons. As far as we are aware it was not suggested by the appellant at that time that the decision of HMRC was unlawful in a public law sense, and there was no subsequent challenge to that decision.

76. Mr Young accepted that we had no supervisory jurisdiction over the decision of HMRC to refuse to make an interim payment in order to help the appellant fund the appeal. However he submitted that "*if the Crown chooses to breach the Appellant's rights, then it is the Crown that should bear the prejudice*". By this he meant that the appeal should be allowed.

77. If the respondents had acted unlawfully in refusing to release funds then we consider the appellant ought to have challenged that decision in judicial review proceedings. It is not appropriate for this tribunal to revisit a decision taken more than 2 years prior to the hearing when a challenge ought properly to have been made at the time of the decision.

78. In the alternative Mr Young submitted that the issues before us should be restricted to those issues of law that he had instructions to argue and which he did argue fully.

79. We do not see how the alternative put forward could be a practical means of ensuring a fair hearing. In essence it amounts to the appellant saying that if it succeeds on the law then the appeal should be allowed, but if it doesn't succeed on the law then it cannot have a fair hearing and the appeal should be allowed.

80. It was submitted on behalf of the appellant that it could not have a fair hearing because the respondents had no power to withhold the input tax credit repayment claimed by the appellant, part of which it could have used to fund this appeal. Put in those terms, we would have to consider whether the respondents did have a power to withhold the repayment before being able to say whether the appellant could have a fair trial. We do not think that approach can be right. The appellant is entitled to a fair hearing of his appeal. Whether or not he is given a fair hearing cannot depend on the answer to the question to be determined on the appeal.

81. It is undoubtedly the case that an appellant before this tribunal is entitled to a fair hearing and Mr Waddington did not suggest otherwise. The right to a fair hearing is recognised by the overriding objective of the Tribunal Rules which is to enable the tribunal to deal with cases fairly and justly. Indeed Rule 2((2)(a) expressly states that one aspect of this is "*dealing with cases in ways which are proportionate to the importance of the case, the complexity of the issues, the anticipated costs and the resources of the parties*". Similarly, Rule 2(2)(c) sets out a further aspect which is to ensure "*so far as practicable, that the parties are able to participate fully in the proceedings*".

82. Mr Young relied on a decision of the CJEU in *Sosnowska v Dyrektor Izby Skarbowej we Wrocławiu Ośrodek Zamiejscowy w Wałbrzychu Case C-25/07*. One of the questions considered by the CJEU in that case concerned the period of time during

which a member state could inquire into a VAT repayment claim and the domestic requirement for a security deposit. At [24] the court stated:

> " *It is clear from the case law that national legislation determining conditions for repayment of excess VAT which are more onerous for one category of taxable persons because of a presumed risk of evasion, without making any provision for the taxable person to demonstrate the absence of tax evasion or avoidance in order to take advantage of less restrictive conditions, is not a means proportionate to the objective of combating tax evasion and avoidance and has a disproportionate effect on the objectives and principles of the Sixth VAT Directive.*"

83. Mr Young suggested that in failing to make provision for the appellant to have access to some of the funds in dispute the respondents had prevented the appellant from demonstrating the absence of a connection with fraud. He also relied on the decision of the CJEU in *Ordre des barreaux francophones et germanophone Case C-305/05* to the effect that a fair trial consists of various elements including respect for the rights of the defence, the principle of equality of arms, the right of access to the courts, and the right of access to a lawyer.

84. *Sosnowska* was concerned with a procedural hurdle preventing the taxpayer from putting forward its case. There is no such procedural hurdle here.

85. In *Francophones* various European bar associations sought to annul the effect of an EU Directive on money laundering which placed various disclosure requirements on lawyers. It was alleged that the provisions would infringe the right of clients to a fair trial. The court emphasised that the right to a fair trial was a fundamental right. As we have said, the respondents accept that the appellant is entitled to a fair hearing.

86. We are aware of only one case where a party to civil proceedings has successfully argued that a lack of funding prevented that party from having a fair hearing. That was the decision of the European Court of Human Rights in *Steel and Morris v United Kingdom [2005] EMLR 15* which involved the notorious libel action by McDonald's which had been targeted by two campaigners. It was the longest ever trial in English legal history. The Court found that the denial of legal aid and the inequality of arms between the applicants and McDonald's amounted to a violation of the right to a fair trial under Article 6 of the European Convention on Human Rights.

87. We invited the parties to make submissions in the light of that case. We consider that the following principles emerge which we should take into account in considering whether in the circumstances of this appeal the appellant can have a fair hearing:

> (1) It is central to the concept of a fair trial, in civil as in criminal proceedings, that a litigant should not be denied the opportunity to present his or her case effectively before the court and that a litigant should be able to enjoy equality of arms with the other party.

(2) The institution of a legal aid scheme constitutes one of those means but there are others, such as procedural measures which in appropriate circumstances might include the making of an interim payment.

(3) The question whether legal aid or some other procedural measure is necessary for a fair hearing must be determined on the basis of the particular facts and circumstances of each case. It will depend inter alia upon the importance of what is at stake for the litigant, the complexity of the relevant law and procedure and the litigant's capacity to represent him or herself effectively.

(4) The right of access to a court is not, however, absolute and may be subject to restrictions, provided that these pursue a legitimate aim and are proportionate It is not incumbent on the State to ensure total equality of arms between a litigant and the opposing party, as long as each side is afforded a reasonable opportunity to present his or her case under conditions that do not place him or her at a substantial disadvantage.

88. Mr Lewis attended the hearing of this appeal for three days during the first week when the appellant was represented by Mr Young together with those instructing Mr Young. In addition we had two reading days during that week. We heard the evidence of Ms Sarah Barker of HMRC and Mr John Fletcher of KPMG on one of the hearing days. On the other two hearing days counsel for each party opened the case and we heard full submissions on the law from Mr Waddington and Mr Young.

89. On 17 June 2013, which was the first day of the second week, neither Mr Lewis nor his representatives attended the hearing. There was no discourtesy in that because we had been told that the appellant could not afford any further representation. However we observe that there was no apparent reason why Mr Lewis should not have attended the hearing on 17 June. On that day the respondents addressed us on the remaining evidence in the appeal.

90. There was nothing unfair in our proceeding in the absence of the appellant on 17 June 2013. We considered the position under Tribunal Rule 33. Our continuation of the appeal was subject to whatever decision we might reach on Mr Young's submissions both as to the law in the context of a contra trading fraud and in relation to a fair hearing. The appellant's representatives were aware that was the approach we intended to take and no objection was put forward.

91. In the present appeal the issues of law are well defined and we have had the benefit of Mr Young's extensive submissions. We are therefore left with issues of fact relating to the nature and extent of the alleged fraud and the extent to which Mr Lewis knew or should have known of any connection with fraud. We do not consider that there is any reason why Mr Lewis should not have given evidence as to what he knew or what he should have known. The circumstances of the present case are not comparable by any stretch of the imagination with the McDonald's libel litigation. The issue of what Mr Lewis knew or should have known is a relatively straightforward factual issue. It is an issue we would have expected Mr Lewis who, on his own case is a successful businessman, to have been able to deal with. We were certainly not told of any specific reason why Mr Lewis could not be expected to deal with that issue, other than the fact that he would be a litigant in person.

92. Mr Young told us that he had advised Mr Lewis not to give evidence during the hearing in the absence of legal representation. Whilst he accepted that we as a tribunal would strive to ensure procedural fairness, he submitted that the nature of the tribunal process was adversarial rather than inquisitorial. The tribunal would not be in a position to effectively prepare a case for the appellant, especially where it was being alleged that Mr Lewis was a fraudster.

93. We acknowledge that in a case such as this the hearing involves what is primarily an adversarial process. However as a specialist tribunal we are also well able to take on an inquisitorial role and in practice the tribunal often does so where the appellant is a litigant in person. That is not to say that it can or should effectively prepare the case for an appellant. However it can and often does assist an appellant to identify and fully present all relevant evidence and arguments.

94. We do not lose sight of the fact that the allegations against Mr Lewis include to all intents and purposes serious allegations of dishonesty. Namely that he caused the appellant to enter into the transactions in May 2006 knowing that they were connected with fraud.

95. It is relevant to record that the appellant served a detailed witness statement from Mr Lewis dated 7 December 2009. At that time, and since, the appellant has had professional representation. There was a reply by Ms Barker in a second witness statement dated 3 December 2010. In that witness statement Ms Barker made a number of observations as to Mr Lewis' evidence from which it was clear that in a number of significant respects the respondents did not accept Mr Lewis' evidence. In some respects Ms Barker points to an absence of evidence to support Mr Lewis' assertions. In other respects she points to inconsistencies between Mr Lewis' witness statement and the documentary evidence. She also makes observations as to the inferences which the respondents invite us to draw based on all the evidence.

96. Mr Lewis and those representing the appellant have therefore known for some considerable time the case the appellant has to meet. The appellant sought to respond to that case by adducing the witness statement of Mr Lewis. There is no suggestion that Mr Lewis might have been taken by surprise by any line of cross-examination.

97. In the absence of oral evidence from Mr Lewis we have no explanation as to why certain matters are not supported by other evidence, no explanation of the alleged inconsistencies and no rebuttal of the inferences Ms Barker invites us to draw. These are all matters which we consider Mr Lewis might reasonably have been expected to address in his oral evidence without the benefit of representation.

98. During the course of the hearing Mr Waddington applied for Mr Lewis' witness statement to be admitted in evidence before us. Mr Young on behalf of the appellant objected to that application. Both parties were content that we should read the statement and consider it over the weekend following the hearing on Friday 14 June 2013, knowing that the appellant would not be present or represented on Monday 17 June 2013. Having read Mr Lewis' witness statement and having considered the circumstances, we told Mr Waddington on 17 June 2013 that we would admit the

statement in evidence. We have admitted it not as witness evidence but as documentary evidence in much the same way that a letter written by Mr Lewis in correspondence would have been admissible. The fact that it is hearsay evidence and Mr Lewis has not given evidence before us does of course affect the weight we should attach to it.

99. It was submitted on behalf of the appellant that if the witness statement of Mr Lewis was admitted in evidence then we must accept Mr Lewis' evidence. In making that submission the appellant relied on the following points:

(1) Mr Lewis had no opportunity to correct any errors there might have been in his witness statement.

(2) The witness statement was adduced by the respondents and they must accept the contents of the statement. They would not be entitled to cross-examine their own witness and there was no question of Mr Lewis being a hostile witness.

100. We do not accept these submissions. As we have said Mr Lewis made his witness statement on 7 December 2009 at a time when the appellant had professional representation. Mr Lewis has had ample opportunity to correct any errors.

101. The witness statement was served by and on behalf of the appellant. It was documentary hearsay evidence before us. It was not witness evidence because Mr Lewis did not give evidence at the hearing. Mr Lewis was not in any sense the respondents' witness. We admitted the witness statement because we considered that it was relevant to the issues of knowledge and means of knowledge which we would have to determine if we rejected Mr Young's submissions on the law and as to a fair hearing. We did not consider that there was any unfairness or prejudice to the appellant in our having before us as much material as possible relevant to those issues, including material which Mr Lewis had produced with a view to giving evidence.

102. Tribunal Rule 15 provides that we may admit evidence whether or not that evidence would be admissible in a civil trial. We have not been addressed on whether in the circumstances Mr Lewis' witness statement would have been admissible in a civil trial. However Rule 15 clearly gives us a wide discretion. The witness statement provides relevant material going to the issue of what Mr Lewis knew at the time of the transactions and what he should have known. We recognise that we must be cautious as to the weight we attach to what is said in the witness statement, both in so far as it might be said to be favourable to the appellant's case and in so far as it might be said to be favourable to the respondents' case. At the end of the day we must consider what weight should be attached to the witness statement in the light of all the evidence before us.

103. In relation to a fair hearing Mr Young also complained that the respondents had provided the appellant with only one bundle for the hearing and that this had hampered his preparation. We were not taken to any correspondence or other material in relation to this matter of complaint, but in any event we are satisfied that Mr Young

was fully and properly able to prepare for this appeal taking into account the limited extent of his instructions.

104. In all the circumstances we are satisfied that the appellant has had a fair hearing. It had the opportunity to call Mr Lewis to give evidence and be cross-examined on his witness statement. The overriding objective requires us to be fair and just to both parties. In our view the circumstances did not justify the appellant failing to tender Mr Lewis for cross-exmination, even though such cross-examination would have been in the absence of any legal representative. We should also say that during the hearing we made the appellant aware through counsel that it may be prejudiced if it did not call Mr Lewis to give evidence.

105. The absence of legal representation during the course of Mr Lewis' evidence might have placed the appellant at a disadvantage but not so substantial that it could not have had a fair hearing. In particular we are satisfied that Mr Lewis would not have been the subject of any unfair questioning and that he would have had every reasonable opportunity to present all relevant evidence and the appellant's case on the facts. We are also satisfied that Mr Waddington would have been astute to ensure that there was no unfairness in the cross-examination or the presentation of the respondents' case.

106. We should mention that Mr Waddington invited us to draw an adverse inference from the fact that Mr Lewis has not given evidence. In particular that we should infer that his failure to give evidence was to avoid exposure to cross-examination because he knew that his evidence would not stand up to scrutiny. On balance, and particularly in the light of what we have been told by Mr Young as to the advice he has given his client, we do not consider it appropriate to draw such an adverse inference in this appeal.

(3) Detailed Findings of Fact

107. The respondents accept that the burden of proof is on them to establish the connection with fraud and that the appellant knew or should have known of that connection. Both parties accept that the standard of proof by reference to which we must make our findings of fact is the balance of probabilities.

108. We must consider in our findings of fact the evidence before us, including Mr Lewis' witness statement. We must also consider what inferences we can properly draw from the underlying evidence. We do so without the benefit of full arguments or submissions on behalf of the appellant. We did have some closing submissions from D & S VAT Consultants, although those submissions in relation to factual matters and the evidence were not intended to be comprehensive.

109. Based on our analysis of the law set out above, the factual issues which we have to resolve on this appeal may be summarised as follows:

(1) Are there tax losses in transaction chains leading to dispatches by Blackstar and Digikom?

(2) If so, do those tax losses result from the fraudulent evasion of VAT?

(3) If so, were the appellant's transactions connected with the fraud?

(4) If so, did the appellant know or should it have known of the connection with fraud?

110. Before considering each of these headings in turn we make various findings of fact in relation to Blackstar and Digikom. The respondents allege that both of those companies dishonestly acted as contra traders in a scheme set up to defraud the Revenue.

Blackstar

111. The evidence in relation to Blackstar came from Ms Julie Sadler of HMRC. We are satisfied on the basis of Ms Sadler's evidence that Blackstar was operating dishonestly as a contra trader. In reaching that conclusion we have taken into account in particular the following matters which we find as facts:

(1) Blackstar was on quarterly VAT returns. It commenced trading in or about December 2004 and by period 06/06 its net quarterly sales were some £305,657,432. The return for that period showed a net repayment of VAT claimed amounting to £3,896,978.

(2) The trading in 06/06 comprised (i) 26 "broker deals" where Blackstar purchased from a single UK supplier (Red WM Ltd) and sold to a single EU customer (Vista Assistance), and (ii) 87 acquisition deals where Blackstar acquired goods from two EU suppliers (Avoset and Prabud) and sold to 10 UK traders, including the appellant, which then sold on either directly or through another UK trader to EU customers.

(3) The 26 broker deals all traced back to two defaulters, Fastec Solutions Ltd and Bright Time UK Ltd. The deal chains were longer than the acquisition chains and included 3 or 4 UK companies. The same companies appeared regularly in the same order. Payments were arranged so that funds did not pass to the alleged defaulters.

(4) The 87 acquisition deals all traced to a small number of EU customers. The deal chains were shorter than the broker chains and included only 2 or 3 UK companies. The same companies appeared regularly in the same order, but were not the same as those companies in the broker chains, apart from Blackstar.

(5) Blackstar made consistently larger profits in its broker deals (between £1 and £2 per phone) than in its acquisition deals (between 10p and £1 per phone). Brokers in Blackstar's acquisition chains always made a significantly greater profit than Blackstar. For example the appellant made a profit of between £21.50 and £23.50 per phone against Blackstar's profits of either 40p or 45p.

(6) Similar patterns appear in Blackstar's earlier VAT periods, including period 03/06 where it also sold goods to the appellant.

(7) Analysis of cashlows based on evidence originating from FCIB shows a circular flow of funds in a sample of Blackstar's broker transactions. In addition, there was a circular flow of funds in the three acquisition transactions where Blackstar supplied the appellant.

112. In two of Blackstar's broker transaction chains the circular flow of funds includes NZ Associates. FCIB's transaction numbers for those fund movements, described as "EB numbers", suggest and we find that the fund flows commenced with NZ Associates and ended with NZ Associates.

113. In a separate police investigation, 2 CD-Roms were discovered at premises searched by West Midlands Police in May 2006. Analysis of the CD-Roms disclosed files and folders containing details of transaction chains which clearly implicated Blackstar's deals in a pre-ordained series of transactions amounting to an MTIC fraud. The CD-Roms also included templates and documents necessary to commit the fraud. Transactions in the chains purportedly took place in the period July to October 2005 and led to the fraudulent evasion of VAT. A number of individuals have since been convicted of conspiracy to cheat the public revenue although the directors of Blackstar were not prosecuted.

114. Blackstar was denied input tax claims of £28,623,000 for period 06/06. The value of the claim denied for 03/06 is not entirely clear but it is certainly significant. Blackstar did not pursue appeals against those decisions and subsequently went into liquidation.

115. We are satisfied that the defaulters in Blackstar's tax loss chains were all fraudulent defaulters.

116. Fastec Solutions Ltd ran a computer software business and also built computers and networks. Its officers denied any knowledge of selling wholesale electronic goods. The transactions which were part of Blackstar's broker chains did not appear in Fastec's records. There are only two possible explanations both of which involve fraud. One is that the VAT number was hijacked and the persons responsible have failed to account for VAT on their outputs. Alternatively the officers of Fastec have lied about its involvement in the transactions and have failed to account for VAT on its outputs.

117. Bright Time was originally registered for VAT as a takeaway restaurant. Its director retired on 1 March 2006, but in the period 1 March 2006 to 31 May 2006 records from other sources show it carrying out sales of £174 million. It failed to declare any underlying transactions and was deregistered as a missing trader. It has been the subject of VAT assessments totalling some £30.5 million. It was plainly a fraudulent defaulter and never intended to account for VAT on its transactions.

118. We are also satisfied that Blackstar operated dishonestly as a contra trader in its previous VAT period 03/06. It traded in a similar fashion in that period with broker transactions traced to Fonezville Limited and Termina Computer Services Ltd. We are satisfied that they were both fraudulent defaulters.

119. On the balance of probabilities we are satisfied that Blackstar was knowingly engaged in an orchestrated VAT fraud involving contra trading in the period 1 January 2006 to 30 June 2006.

Digikom

120. The evidence in relation to Digikom also came from Ms Julie Sadler. We are satisfied on the basis of Ms Sadler's evidence that Digikom was operating dishonestly as a contra trader. In reaching that conclusion we have taken into account in particular the following matters which we find as facts:

(1) Digikom was on quarterly VAT returns. It commenced trading in or about May 2005 and by period 06/06 its net quarterly sales were some £223,428,201. The return for that period showed a net repayment of VAT claimed amounting to £7,435,637.

(2) The trading in 06/06 comprised (i) 118 broker deals where Digikom purchased from UK suppliers and sold to three EU customers (Phista Trading, Scorpion Electronics and Estocom Distribution), and (ii) 109 acquisition deals where Digikom acquired goods from four EU suppliers (Dunas & Pinheiros, Powertec, Georitual Unipessoal and Prabud) and sold to six UK traders including the appellant which then sold on either directly or through another UK trader to EU customers.

(3) The 118 broker deals all traced back to two defaulters, Pentagon (UK) Ltd and UR Traders Ltd. Payments were arranged so that no funds passed to the alleged defaulters.

(4) Digikom generally made much larger profits in its broker deals (up to £15 per phone) than in its acquisition deals (40p to 45p per phone). Brokers in Digikom's acquisition chains always made a significantly greater profit than Digikom. For example the appellant made a profit of between £10.50 and £14.50 per phone against Digikom's profits of either 20p or 25p.

(5) Similar patterns appear in Digikom's earlier VAT periods including period 03/06 where it also sold goods to Greystone which in turn sold goods to the appellant.

(6) Analysis of cashlows based on evidence originating from FCIB shows a circular flow of funds in the three acquisition transactions where Digikom's customer Greystone supplied the appellant.

(7) Visits to freight forwarders purportedly used by Digikom disclosed no physical movements of mobile phones on dates when Digikom's transaction documentation would suggest mobile phones were moving.

121. Analysis of the CD-Roms obtained by West Midlands Police also disclosed files and folders containing details of transaction chains which clearly implicated Digikom's deals in a pre-ordained series of transactions amounting to an MTIC fraud. Transactions in the chains purportedly took place in the period July to November

2005 and led to the fraudulent evasion of VAT. The directors of Digikom were not prosecuted.

122. Digikom was denied input tax claims of £28,797,432 and £37,107,969 for periods 03/06 and 06/06 respectively. It did not pursue appeals against those decisions and was dissolved on 23 June 2009.

123. We are satisfied that the defaulters in Digikom's tax loss chains were both fraudulent defaulters.

124. Pentagon (UK) Ltd was a licensed debt management company. It had been registered for VAT in 1997. The majority of its supplies were exempt from VAT. HMRC Officers visited its offices in Bedford in August 2007 from which it was apparent that the letterhead in use by Pentagon was completely different to that on deals purportedly between Pentagon and Digikom. The landline area code was incorrect on documentation purportedly between Pentagon and Digikom. Pentagon's accountant had never heard of Digikom.

125. We are satisfied that Pentagon's VAT registration had been hijacked for the purposes of the MTIC fraud in which Digikom was engaged.

126. UR Traders Ltd was registered for VAT in May 2005. It made a first return for period 10/05 showing nominal output tax of £126. Thereafter it made nil returns for periods 01/06 and 04/06. It failed to make any return for the final period from 1 May 2006 to 26 July 2006 when it was deregistered. HMRC has been unable to trace any of the company's officers.

127. Documentation available to HMRC justified it in making assessments on UR Traders totalling some £73 million. Some £43 million of this related to supplies made in period 04/06 when it had made a nil return.

128. We are satisfied that UR Traders was a fraudulent defaulter and never intended to account for VAT on its transactions.

129. We are also satisfied that Digikom operated in a similar fashion in its previous VAT period 03/06. Broker transactions in that period can be traced to Termina Computer Services Ltd and Lets Talk Ltd. Termina Computer Services Ltd was a fraudulent defaulter and Lets Talk Ltd was a hijacked VAT number.

130. On the balance of probabilities we are satisfied that Digikom was knowingly engaged in an orchestrated VAT fraud involving contra trading in the period 1 January 2006 to 30 June 2006.

Are there Tax Losses?

131. In the light of our findings above, we are satisfied that there are tax losses in the broker deal chains of Blackstar and Digikom.

Do the Tax Losses result from Fraudulent Evasion?

132. In the light of our findings above, we are satisfied that the tax losses resulted from the fraudulent evasion of VAT. We also consider in this section further evidence relevant to the existence of a wider scheme to defraud the revenue

133. We have summarised above the evidence originating from FCIB which was adduced by Officers Mody and McCalmon who analysed material available from the computer records of the bank. We are satisfied that the circular flow of funds involving the appellant's transactions supports the existence of a highly orchestrated fraudulent scheme extending beyond the fraudulent defaulters.

134. There is further evidence from Officer McCalmon as to the computer IP addresses used to give online instructions to FCIB and the precise timings of the fund flows. For example, in Deal 1 a number of companies are recorded by FCIB as using the same IP addresses to give transfer instructions. Transfers by Bilgisel, Blackstar and Olympic used IP address 59.144.46.195. The same IP address was used by Digikom, Greystone and Prabud in the appellant's other 5 deal chains. Similarly we are satisfied that the circular flow of funds in Deals 1-6 took place in a very short space of time. For example in Deal 1 the sum of £1.4 million passed from Bilgisel, through the accounts of Olympic, Outkey, Blackstar and Prabud, then back to Bilgisel in less than 25 minutes. We are satisfied that this evidence is at least indicative that the fund flows were orchestrated.

135. Bilgisel is a Cypriot company with a director based in North London. It was the source and recipient of funding in each of the 6 transaction chains involving the appellant. Bilgisel was also the source and recipient of funding in the fund flows of many other transaction chains involving the deals of Blackstar and Digikom.

136. There are also a number of connections between companies identified by Officer Mody as taking part in the flow of funds.

137. A number of companies in the 6 deal chains and the associated circular fund flows were linked by individuals living in or near Malaga. These included Zorba, Mudini, Powertec, and Nano Infinity. For example, Mr Joakim Broberg was a Swedish national living in Malaga. He was a director of Mundini, a Bulgarian company identified in the fund flows. He was also a director of Powertec, the EU supplier to Digikom and Blackstar in deal chains involving the appellant.

138. The respondents rely on evidence that a number of EU companies involved in the deal chains of Blackstar and Digikom were suspected by their national tax authorities of involvement in fraud. Similarly in relation to the warehouses in Paris and Holland where the goods were taken following dispatch from the UK. The evidence of this is comprised in responses to various mutual assistance requests but it is quite superficial. It is not evidence we attach weight to in this decision.

139. The respondents rely on evidence in relation to the freight forwarder used by the appellant and other companies in the deal chains to support the existence of a fraudulent scheme. Investigations by Dutch authorities led to an admission by a

director of Worldwide Logistics BV that it dealt with fictitious consignments of goods for which it produced fictitious documentation. There is no suggestion that the goods in the appellant's deal chains did not exist or that the documentation was fictitious. However the fictitious documentation included international consignment notes ("CMRs") for goods purportedly shipped from SPF and CMRs for goods purportedly dispatched from UK traders to Olympic. Again, we do not attach any weight to this evidence in considering the existence of a fraudulent scheme connected with the present deals. We cannot infer on the basis of the evidence before us that SPF or Olympic were complicit in the production of false documentation.

140. The respondents relied on the expert evidence of Mr John Fletcher, a director with KPMG in relation to the grey market in mobile phones. On the basis of his evidence they submitted that the pattern of companies appearing in the deal chains, the mark ups in the deal chains and the volume of phones dealt with in the deals were inconsistent with legitimate trade in what they said was a small grey market in mobile phones. Further they relied upon Mr Fletcher's evidence that the opportunities to trade Nokia phones in the grey market were very limited. Five out of the six transactions we are directly concerned with involved Nokia mobile phones.

141. Mr Young cross-examined Mr Fletcher with a view to establishing that he was not an independent expert witness. In the light of Mr Fletcher's qualifications and evidence we accept that he is an independent expert witness and in so far as relevant we should take into account his evidence.

142. The appellant also cross-examined Mr Fletcher by reference to the findings of another First-tier Tribunal where he has given evidence on the same issues and where that tribunal had the benefit of an expert appearing for the appellant. We must decide this case on the basis of the evidence before us. The evidence of an expert in other appeals is not before us. It would not be right for us to take into account the findings of fact of another tribunal based on that evidence. That is so even where, for financial reasons, the appellant has been unable to fund his own expert evidence.

143. Mr Fletcher has not looked at the appellant's transactions or the deal chains involving those transactions for the purpose of producing his witness statement. His evidence, in so far as it is relied on by respondents, may be summarised as follows:

(1) Legitimate grey market trading is unlikely to involve long deal chains. This is because greater profits will be available to traders in shorter deal chains and unless a trader "*adds value*" that trader would be "*vulnerable to disintermediation*". By this term Mr Fletcher was referring to the likelihood that traders who do not add value would in practical terms be excluded from participating in any profits available in the grey market.

(2) Long deal chains might conceivably occur, but only on isolated occasions and not where the same parties appeared in the same position in the deal chains.

(3) The greatest profits in the legitimate grey market are likely to be earned by traders who are close to both an authorised distributor or mobile network operator on the one hand and the retailer or end customer on the other. A short

deal chain is one which has only one wholesaler between the authorised distributor or mobile network operator and the retailer or end customer.

(4) Transactions which comprised an unreasonable proportion of the total volume of a particular model of mobile phone traded in the authorised market were unlikely to be legitimate grey market transactions.

(5) Grey market arbitrage trading in Nokia phones was unlikely to occur because of Nokia's homogeneous pricing policy across all European markets.

144. During the course of his oral evidence in chief Mr Fletcher was asked to comment on the appellant's deal documents, in particular the appellant's invoice to Olympic in Deal 1. He said that the invoice lacked the detail he would expect to find in such a transaction, in particular the colour of the phone, the type of charger and details of the warranty. Mr Fletcher also considered the volume of mobile phones in Deal 1 (8,000 Nokia 9300i) to be unreasonable when compared to retail sales data from a market research company exhibited to his witness statement. Mr Young cross-examined Mr Fletcher as to the adequacy and relevance of the retail sales data relied on by Mr Fletcher.

145. We have not taken this latter aspect of Mr Fletcher's evidence into account in our decision.

146. Firstly Mr Fletcher was presented as a witness in relation to the legitimate grey market and as to certain general indicators as to whether transactions were likely to be part of the legitimate grey market. He had not been asked to look specifically at the appellant's transactions and he has not done so in detail. It is dangerous in our view to take selective aspects of the deals and form a conclusion based on Mr Fletcher's opinion in relation to those selective aspects.

147. Secondly, the evidence as to the volume of handsets in Deal 1 seems to go to whether the goods actually existed or not. It has never been the respondents' case on this appeal that the goods did not exist. Nor is there any evidence that Mr Lewis knew or could have known whether he was dealing with a large or small number of handsets in Deal 1.

148. Mr Fletcher was also asked in chief to consider what profit margins were available in the grey market. He said that it was impossible to say. The margin would depend on the specific nature of the trade. We cannot say therefore whether the appellant's margins were objectively large or small. The most we can say is that overall the appellant was earning a large profit from its 6 deals in May 2006.

149. On the basis of Mr Fletcher's evidence we are satisfied that long deal chains could occur on isolated occasions but were unlikely to be repeated especially with the same traders in the same position. The greatest profits in the legitimate grey market are likely to be earned by traders who are close to both an authorised distributor or mobile network operator and the retailer or end customer. Grey market arbitrage trading in Nokia phones was unlikely to occur because of Nokia's homogeneous pricing policy across all European markets.

150. We consider that these findings based on Mr Fletcher's evidence go to the existence of the fraud rather than whether Mr Lewis knew or should have known that his deals were connected with fraud. We cannot say that Mr Lewis knew or should have known of the factors identified by Mr Fletcher at the time the appellant entered into the deals.

151. Taking into account all the evidence we are satisfied on the balance of probabilities that the fraud goes beyond the failure of particular defaulters to account for and pay VAT due to the respondents. It extends to a much wider scheme whereby Blackstar and Digikom sought to offset output tax due on their acquisition transactions against input tax credits on their broker transactions. We are satisfied that Blackstar and Digikom dishonestly participated in a scheme the purpose of which was to evade significant amounts of VAT. The scheme involved those companies seeking to conceal the evasion of VAT so as to make it more likely that other UK traders would be repaid input tax claims by HMRC.

152. The wider scheme involved a number of other UK companies in the same position as the appellant, purchasing goods originally acquired by Blackstar and Digikom. Those UK companies sold to a small group of EU companies including Olympic and Nano. Blackstar and Digikom acquired from a small group of EU companies including Prabud and Powertec. Deal chains within the scheme showed a number of patterns including the same companies appearing in the same or similar order making similar profits.

153. We have concluded that Blackstar and Digikom were operating dishonestly as contra traders as part of an orchestrated fraud. Our conclusion is not affected by Mr Young's submission that their VAT returns properly reflected the underlying transactions. The fact is that they entered into those transactions with a view to defrauding HMRC.

Were the Appellant's Transactions connected with Fraud?

154. In *Blue Sphere Global* the Chancellor described the necessary connection with fraud in what were essentially accounting terms. On that basis, the fact that a contra trader offsets input tax incurred in tax loss chains against output tax on chains involving UK traders who ultimately make intra community supplies would be a sufficient connection. That connection certainly exists on the facts we have found.

155. In addition we find that there was a more direct connection between the appellant's transactions and the fraud. We have found that Blackstar and Digikom were acting dishonestly in deliberately engineering their offsetting in order to assist the wider fraudulent scheme. Blackstar's transactions with the appellant and Digikom's transactions which led to the appellant through Greystone were a part of the fraudulent scheme. Without assuming knowledge on the part of the appellant, those transactions were engineered so that the connection with fraud was more likely to go undetected and the repayments from HMRC were more likely to be made. This

in turn helped to fund the fraud and to ensure that goods remained available for use in subsequent frauds.

Did the Appellant Know of the Connection with Fraud?

156. The respondents must satisfy us that the appellant knew of the connection with fraud at the time it entered into the 6 deals. Alternatively that it should have known of that connection. There is no direct evidence that the appellant knew or should have known of the connection with fraud. Much of the evidence is material from which the respondents invite us to infer that the appellant either knew or should have known of the connection with fraud.

157. The appellant denies that it knew or should have known of the connection with fraud. Mr Lewis in his witness statement says that the appellant's transactions were conducted in the open market and were not to his knowledge contrived or orchestrated.

158. In the following paragraphs we consider the evidence relevant to the question of actual knowledge and what the appellant should have known. We record our findings of fact relevant to these issues and the inferences we draw from those facts. There is no single circumstance from which we can infer that the appellant knew or should have known of the connection with fraud. It is a matter of considering all the circumstances and then whether, on balance, we are satisfied that the appellant knew or should have known of the connection with fraud.

159. The appellant contends that prior to making the decision on 27 August 2008 the respondents never put their case to Mr Lewis that he had entered into the transactions in circumstances where he knew or should have known that they were connected with fraud. We can see that it would generally be desirable that such an allegation is put to a trader before a decision is taken. However there is no requirement that it should be put to the trader. The implications for HMRC are that they risk criticism for making a decision without relevant information which could have been provided to them by the appellant. They may also risk the costs of an appeal if the decision is appealed and information which could easily have been provided prior to the decision causes the decision to be withdrawn or the appeal to succeed. However a failure by the respondents to put their case does not in any way vitiate the decision. There is no basis upon which it could do so, certainly in the absence of bad faith on the part of the respondents. We are not satisfied that the failure by HMRC to put their case to Mr Lewis prior to making a decision in this case was motivated by bad faith.

160. We are satisfied that Mr Lewis was aware that there was a serious risk of fraud in the wholesale mobile phone market. That is why he appointed Veracis Limited, a specialist consultancy, to assist with due diligence. We have no reason to think that Mr Lewis was aware of contra trading in May 2006, or how that form of trading might assist a fraud. Whether he knew the full extent of mobile phone fraud or the detailed manner in which it might be carried out is beside the point. This is not a case

where the respondents contend that his knowledge of the risk of fraud was such that he should no longer have continued trading in the market. However we must judge Mr Lewis' dealings on behalf of the appellant in the context of someone who was aware that there was a serious risk his trading partners might be implicated in a fraud.

161. The respondents rely on a number of matters which, if they are right, are at least consistent with Mr Lewis having knowledge of the connection with fraud.

162. The respondents suggest that Mr Lewis initially set up the appellant with a view to participation in MTIC fraud. It is suggested that his consultancy with Globaltel was simply a means to obtain a VAT registration for the appellant. They suggest that there was no reason why Mr Lewis through the appellant should not have traded on his own account rather than as a consultant. In particular that there was no advantage to either the appellant or Globaltel in the arrangement. We do not accept that the evidence before us supports that conclusion. The respondents have not considered whether the appellant could have funded deals in 2004 and they accept that Mr Lewis did not have much if any experience in mobile phone trading at this time.

163. Mr Lewis was less than forthcoming at a visit on 13 June 2005 as to the appellant's funding. The visit note records and we find that he told the visiting officer that the appellant's 'start up' capital came from the sale of his home. He failed to mention that the appellant also had funds available from NZ Associates following a loan agreement made in May 2005. Mr Lewis did subsequently at a visit made on 23 September 2005 inform the officer of the existence of those funds. In the absence of a direct account of these visits from the officers concerned or from Mr Lewis we give this aspect of the respondents' case little weight.

164. In period 08/05 the appellant made a repayment claim of £584,400. This related to transactions involving the wholesaling of computer parts and accessories. Based on the notes of a visit to verify the repayment claim on 23 September 2005 we find that Mr Lewis had little knowledge about the products he was dealing in. However we are unable to conclude, based on the evidence before us, that these transactions were connected with fraud.

165. The respondents submit that the level of profits made by the appellant on the 6 deals is a factor from which we can infer that Mr Lewis knew or should have known of the connection with fraud. The following table summarises the gross profit made by the appellant:

Deal	Invoice Price £	Gross Profit %	Profit/phone £	Profit £	Input Tax Claim £
1	2,532,000	8.02	23.50	188,000	410,200
2	2,632,500	8.33	22.50	202,500	425,250
3	2,000,000	9.97	14.50	181,250	318,381
4	1,928,500	8.46	21.50	150,500	311,150
5	1,620,000	8.43	10.50	126,000	261,450
6	1,084,000	8.84	11.00	88,000	174,300
				TOTAL: £928,750	

166. It appears from this table that the appellant made relatively consistent profits. Mr Lewis' states in his witness statement that he had a target gross margin of 5% and would negotiate with suppliers and customers to achieve that margin. He said that he prided himself on his ability to negotiate prices.

167. The respondents say that in each deal chain it was the appellant which made by far the most substantial profits of all the companies in the chains. They further submit that it is unlikely in an orchestrated fraud that the appellant would be given the largest profit without knowing of the connection with fraud.

168. It is striking that Mr Lewis should be able to generate gross profits of £928,750 through 6 deals concluded in the space of approximately 3 weeks. It is also striking that the profits made by the appellant were much greater than those made by other companies in the deal chains. In a highly orchestrated fraud this is a factor which points towards Mr Lewis being a knowing participant in the fraud.

169. We appreciate that the table refers to gross profit. There was no suggestion that the other costs and expenses identified by Mr Lewis in his witness statement would be significant. These related principally to freight, inspection, storage and insurance.

170. The evidence is that Mr Lewis simply identified a willing buyer and a willing seller and did not otherwise add any value to the distribution chain. We have no evidence from the appellant as to the details of Mr Lewis' business relationships with the suppliers and customers in these deals. Mr Lewis' witness statement simply states that he was able to make such profits because of his "*ability to negotiate prices*". Without hearing from Mr Lewis we are left with a business that, at first sight, seems too good to be true.

171. Closely connected with evidence as to the appellant's business relationships is the due diligence and commercial checks it carried out on existing and potential trading partners. In considering the evidence as to the checks carried out by the appellant we acknowledge that that the significance of that evidence will very much depend on the particular circumstances of the deals. We also accept Mr Young's submission that no amount of due diligence on the appellant's trading partners would have identified the existence of the dirty chains.

172. Mr Lewis states in his witness statement that "*My understanding of why Outkey did the due diligence was to ensure we did not get involved in fraud either knowingly or unknowingly*". He accepted that it was important to know his customers and suppliers and asserted that he carried out "*proper commercial checks*" on customers and suppliers.

173. We do not know from the evidence the circumstances in which Mr Lewis came to identify Blackstar, Greystone, Olympic and Nano as trading partners. Mr Lewis' witness statement does not deal with the circumstances other than to say that he used the "IPT website" and "personal contacts".

174. The appellant did not initially supply documentary evidence to confirm the nature and extent of its due diligence checks. The original decision by HMRC to refuse input tax credit was therefore taken without access to such documentation. For the purposes of this appeal the appellant has provided such evidence as an exhibit to Mr Lewis' witness statement. He exhibited the material relied on as constituting his commercial checks. We have considered that material and find as follows.

175. The appellant instructed Veracis as a consultant to assist in carrying out due diligence checks on suppliers and customers. Veracis also corresponded with the respondents on behalf of the appellant in December 2005 when it was seeking to move to monthly rather than quarterly VAT returns.

176. Checks on Greystone and Blackstar involved visits to their premises. A reasonable amount of material appears to have been obtained to confirm the identity of the directors and their experience in the mobile phone trade. Trade references were obtained together with reports from Veracis. Some of this material was available to Mr Lewis at the time he started trading with Greystone and Blackstar, and some of it was obtained after the trading relationships were established. It is difficult to reach any conclusion on the adequacy of that material and Mr Lewis' commercial checks without hearing from Mr Lewis. However this is not a case where little or no due diligence was performed on suppliers.

177. Commercial checks on Olympic and Nano contrast markedly with the checks made on Greystone and Blackstar. There was no indication in Mr Lewis' witness statement that he took any different approach in the commercial checks he carried out on customers to those he carried out on suppliers. Indeed his witness statement suggests that he viewed such checks as equally important.

178. Much of the material in relation to Nano was obtained after the deals with which we are concerned in this appeal. The only material which Mr Lewis had prior to entering into the deals does nothing more than confirm the existence and VAT registration details of Nano. There was more information on Olympic which appears to have been available to Mr Lewis prior to the deals. However, what there is would still be wholly inadequate to form any opinion on the commercial risks involved in dealing with Nano and Olympic.

179. Putting the risk of fraud to one side for a moment, real commercial risk in the appellant's transactions came from its dealings with customers. In particular the risk that they would not be in a position to complete the transactions and pay for the goods, or would otherwise be difficult customers. We are not satisfied on the evidence available to us that Mr Lewis took any real steps to ascertain the extent of that risk. His failure to do so in transactions worth several million pounds is a factor that points towards knowledge on his part that the transactions were pre-ordained and did not in reality involve any commercial risk.

180. The respondents rely on the fact that the transactions entered into by the appellant and by all others in the deal chains were back to back transactions for exactly the same quantities of mobile phones throughout a chain. However Mr Fletcher accepted that back to back deals were consistent with deals in the legitimate grey market. We do not consider that this evidence supports the respondents' case on knowledge.

181. The appellant has produced separate certificates of insurance from a Dutch insurance company which purport to relate to each of the deals. These refer to the insured party as "bearer" and no copy of the policy was provided by the appellant. We cannot be satisfied on the evidence before us that there was adequate insurance cover in place. More importantly, we are not satisfied that Mr Lewis could reasonably have thought that such cover was in place.

182. The respondents say that Mr Lewis ought to have queried the fact that his deals involved EU specification phones which had been imported into the UK only to be exported by the appellant. We do not regard that as a significant factor.

183. The respondents rely on the appellant's rapid increase in turnover and profits as described above. We accept that it is striking that the appellant was able to achieve the level of profits it did, especially in May 2006. The rate at which its turnover increased is less significant, but nonetheless noteworthy.

184. The respondents contend that the volume of mobile phones traded by the appellant was inconsistent with legitimate grey market trading. On the basis of the evidence before us we cannot make any findings as to the scale of the legitimate grey market. Nor can we conclude that the volume of phones traded is inconsistent with legitimate trade. In the circumstances of this case the volume of goods traded is not an indicator that Mr Lewis knew or should have known of a connection with fraud.

185. It is a small point, but the appellant's deals in 02/06 and 05/06 were all concluded in the last month of each quarter. We can see that this would give cashflow benefits to the appellant but it is notable that the appellant was able to arrange its trading activity on such a basis.

186. On 31 May 2005 Mr Lewis entered into a loan agreement on behalf of the appellant with NZ Associates, a New Zealand registered company. The agreement provided for a loan of £175,000 for a term of one year. Interest was payable at the rate

of 2% for every three months on the balance outstanding. If it was not repaid at the end of the term, interest was payable at the rate of 1% per month.

187. A further loan agreement for a sum of £230,000 was entered into on 18 August 2005 on the same terms as the existing loan.

188. NZ Associates was incorporated in New Zealand on 19 April 2005. It opened an FCIB account in April 2005. It had a director called Asif Ramzan who had an address at 117 Seymour Grove Manchester. The correspondence address for the company held by FCIB was 271 Kemp House, 152-160 City Road, London EC1.

189. The correspondence address of NZ Associates shown in the FCIB records is the same address as Olympic. However there is no evidence that Mr Lewis knew or should have known of this connection.

190. It is notable that NZ Associates appears as a recipient and payer of funds in circular cashflows involving Blackstar's tax loss chains. It is clear that NZ Associates played a role in financing the fraud, both in terms of Blackstar's tax loss chains and acquisition chains. It is clear therefore that the appellant's connection with the fraud extended to dealing directly with Blackstar and at the same time being funded, apparently independently, by another company which must have been complicit in the fraud. There is no reason to consider that Mr Lewis is naïve in business matters. Whilst it is possible that Mr Lewis was unwittingly being manipulated in this way, his dealings with NZ Associates are an indicator that he was aware of the connection with fraud.

191. There is little evidence as to the circumstances in which the appellant obtained the loans from NZ Associates, or indeed as to precisely what use was made of the funds, other than to finance the appellant's deals. Mr Lewis has stated that he met the director of NZ Associates at a trade fair in 2004, although NZ Associates had not at that time been incorporated. There is no evidence that the funds have ever been repaid so it appears they were still outstanding at the time of the deals in this appeal. Nor is there any evidence as to the nature of the ongoing relationship between Mr Lewis and NZ Associates. For example there is no evidence that NZ Associates has ever pressed for repayment. Indeed a company search made on 5 October 2010 shows that NZ Associates was struck off the New Zealand Companies Register on 18 July 2006.

192. The respondents contend that the circumstances in which these loans were obtained and the connection between NZ Associates and the flow of funds in Blackstar's tax loss deal chains lead to an inference that these were not commercial loans but were a means of funding the fraud. Further that Mr Lewis must have known that to be the case.

193. We agree that in the circumstances it is appropriate to infer that the loans from NZ Associates were not commercial loans and were a means whereby the fraud was funded. The evidence adduced by the respondents in relation to the loans is also an indicator that Mr Lewis knew or should have known of the connection with fraud. We have no evidence from Mr Lewis that explains the circumstances of these loans in any

detail. All he says in his witness statement is that he successfully negotiated the loans from NZ Associates with the result that he did not need to use his own personal funds to enter into transactions.

194. At a visit on 18 August 2006 Mr Lewis is recorded as saying that he had worked in the mobile phone industry for over 6 years. Taken at face value that was plainly not true. There is no evidence that Mr Lewis had any experience of mobile phone markets at any time prior to working for Globaltel in 2004. However in the absence of any direct evidence from any person present at the visit we give this little weight.

195. The respondents contend that there are factors in the appellant's transactions themselves from which we can infer knowledge of a connection with fraud on the part of Mr Lewis. In this regard we make the following findings of fact and draw the following inferences:

(1) There is no evidence that in entering into the transactions Mr Lewis agreed key terms which we would expect to be agreed. In his witness statement Mr Lewis refers to discussion of detailed terms, mentioning price and delivery. However the deal documentation supplied by the appellant makes no reference to dates of payment or dates of delivery. The one exception to this is purchases from Greystone where Greystone include a date of delivery on their invoice and their purchase order, although it was invariably the same date as the invoice. We find this very strange in what Mr Lewis himself described as "*a market involving fast changing demand [where] prices are unstable*" and a market where "*a supplier would not want the goods sitting on the warehouse floor waiting for a drop in price*". Mr Lewis recognised in his witness statement the difficulties that could arise were a supplier to promise stock on a specific day but fail to keep that promise. We find it very surprising that these terms were not agreed or recorded in writing.

(2) The key dates identified for each of the deals in the table above demonstrate that inspection of goods did not occur until several weeks after the deal was agreed and invoiced. In Deal 6 the inspection was some 5½ weeks after the deal was agreed. Generally inspection took place 1 or 2 days prior to the goods being shipped out of the UK. There is no explanation as to why the deals should be concluded and the mobile phones then left "*sitting on the warehouse floor*" to use Mr Lewis' words for so long.

(3) As far as payment is concerned, Mr Lewis said that he "*would expect to be paid as soon as the customer could do so*". Again we find that strange in commercial deals involving millions of pounds. In fact the payments generally took place several weeks after the date of shipment. There were exceptions to this. In Deals 1 and 2 the appellant made a relatively small part payment shortly after the deal was agreed but most of the price was paid 4 weeks after shipment. In Deals 4 and 6 payments were made some 2 weeks prior to shipment.

(4) In Deals 1-6 where the appellant was involved in circular fund flows it made payments to its supplier within about 10 minutes of being paid by its customer. There is no explanation from Mr Lewis as to how and why he ensured that payments were made so quickly. In his witness statement he simply states

that it was important to immediately pay the supplier once the appellant had been paid by its customer.

(5) We accept that the basis of the deals was what Mr Lewis described as "*ship on hold*". The appellant was permitted by the supplier to ship the goods to a location specified by the appellant's customer. However the goods would not be released until both the supplier and the appellant had authorised release. Release would not take place until payment had been received.

(6) There is no evidence that the appellant gave authority for its customers to inspect the goods at any stage. Mr Lewis in his witness statement simply refers to his "*understanding*" that his customer would arrange to inspect the goods. Similarly there is no evidence that the appellant authorised SPF to release the goods to its customers.

196. We find the structure of the deals, where goods are left in a warehouse for weeks on end and payment is often left outstanding for even longer to be an indicator that the deals were not legitimate commercial deals. In a fast moving market any delay in completing a deal would give rise to considerable risk that the goods might fall in value and the purchaser may not make payment or might seek to re-negotiate the deal. Alternatively the goods could rise in value and the supplier might find a better deal elsewhere or try to re-negotiate. In any event we would expect to see correspondence chasing payment, both by the suppliers to the appellant and by the appellant to its customers. The evidence contains no such correspondence.

197. Mr Lewis in his witness statement said that he tried but failed to negotiate a significant number of deals. He said that he did not retain any documentation in relation to such deals. We find it odd that the only documentation provided by Mr Lewis is the formal documentation associated with successful deals. There is no evidence of any emails, letters, faxes or other correspondence dealing with the nuts and bolts one would expect to find in significant commercial transactions, such as offers, counter-offers or any discussions about delivery, payment, shipping, inspection and release. Again this is an indicator that Mr Lewis knew that the deals were orchestrated and pre-ordained.

198. Blackstar provided a document to the appellant in relation to each of its deals certifying that it had imported the goods from another EC member state. This is material which could support the appellant's case on knowledge. Unless Mr Lewis knew the nature of a contra trading fraud these documents could have provided him with comfort that there would be no tax losses in his transaction chains. We had no evidence from Mr Lewis in this regard, other than that he did not understand contra trading fraud. Even if that is true, it is not necessary for a denial of input tax that the trader knows the detail of the fraud, only that there is a connection with fraud. The fraud could have been either a contra trading fraud or a straightforward MTIC fraud in another member state. Further, the extent to which Mr Lewis was entitled to take Blackstar's declaration at face value would depend on his knowledge and trust in Blackstar. We are not satisfied therefore that these declarations could have given Mr Lewis any comfort that those transactions were not connected with fraud.

199. SPF produced inspection reports for the appellant in relation to the goods in each deal. These were generally produced a day or two prior to shipment. The respondents took no points in relation to the adequacy of those inspection reports, other than to say that they were a "box ticking exercise". They did not rely on any particular aspects of the inspection reports to support that submission. We cannot infer from the reports themselves that they were not the result of a genuine inspection of the goods.

200. The respondents also relied on the fact that the inspection reports were not produced until several weeks after the deals had been agreed and invoiced. We do not consider that this, in itself, suggests that the deals were non-commercial. From a commercial point of view the goods were held by the supplier's warehouse albeit allocated to the appellant. A commercial buyer would be entitled to expect that the goods were in a saleable condition. It might only require an inspection report when it was to take title to the goods or when the goods were to be shipped out of the UK to a different warehouse. We do not consider that the content or timing of the inspection reports in this case suggests that the deals were not commercial.

201. In Deal 1 and Deal 2 payments of £500,000 and £475,000 were made by the appellant to Blackstar before the goods had been inspected. We do not consider that this is evidence the deals were not commercial. Indeed it might be said to support the appellant's case on knowledge because it at least suggests that the involvement of the appellant in the fund flows was not wholly reliant on a pre-ordained circular flow of funds.

202. It is significant that the appellant is never recorded as using the same IP address as any other company in the deal chains. Nor is there any known connection between the appellant and any of the companies identified above as taking part in the fraud, other than the relationship with direct trading partners and with NZ Associates. We take these factors into account in favour of the appellant's case that he did not know of the connection with fraud. Further it is true that there is no evidence that Mr Lewis had any knowledge of the identity of companies appearing in the deal chains or the fund flows other than between the appellant and its immediate trading partners.

203. Finally we record that Ms Barker accepted in cross-examination that she did not know whether Mr Lewis knew or should have known of the connection with fraud. We took this to mean that she could not know, other than from the inferences she invited us to draw, whether Mr Lewis had actual knowledge or the means of knowledge that the transactions were connected with fraud.

(4) Decision on Knowledge

204. We have considered all the factors and inferences referred to above. As we have previously said there is no one circumstance from which we can infer knowledge. It is a process of considering all the circumstances as a whole.

205. The appellant contends that there is no objective evidence from which we can be satisfied that the appellant knew or should have known of the connection with

fraud. We do not accept that submission. The evidence we have referred to is all objective evidence in the sense that it does not rely on the subjective opinions of HMRC officers or Mr Lewis.

206. The appellant says that any evidence of what Mr Lewis knew or should have known is circumstantial evidence. The fact that it is circumstantial evidence simply means that it is not direct evidence of knowledge or means of knowledge. It is still evidence we must take into account in considering whether Mr Lewis had knowledge of the connection with fraud.

207. Looking at all the circumstances we have described above we consider on the balance of probabilities that Mr Lewis did know that the transactions he was entering into in May 2006 were connected with fraud.

(5) Should the Appellant have Known of the Connection with Fraud?

208. The respondents contend that if the appellant did not know of the connection with fraud then it should have known of that connection. The appellant denies that it should have known of any such connection.

209. The facts and matters relied upon by the respondents in this regard are much the same as those set out above in relation to actual knowledge. Even if Mr Lewis did not have actual knowledge, we consider that he should have known of the connection with fraud. There were sufficient indicators available to him from which he should have drawn a conclusion that the deals were connected with fraud. Those indicators include:

(1) He was aware there was a serious risk of fraud in the market which ought to have caused him to be cautious in his dealings.

(2) He was able to make large profits on rapidly increasing turnover in circumstances which he ought to have regarded as too good to be true.

(3) He had no material from which he could form any reasonable opinion as to the commercial risks of dealing with Nano and Olympic.

(4) He was being presented with deals and funding for those deals in circumstances where he ought to have realised the deals were not legitimate commercial transactions.

210. We have considered whether the circumstances described above might reasonably have been taken by Mr Lewis to represent the trade customs of a legitimate grey market. In relation to some aspects of the deals we cannot discount that as a possibility. However taking the circumstances of the transactions as a whole Mr Lewis at least should have known that the only reasonable explanation for the appellant's transactions was that they were connected with fraud.

(6) Conclusion

211. In the light of our findings and for the reasons set out above we dismiss this appeal. Any application for costs should be made in writing within 56 days of the release of this decision. The requirement of Rule 10(3)(b) to include a schedule of costs in so far as it applies to this appeal may be dispensed with.

212. 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.

JONATHAN CANNAN
TRIBUNAL JUDGE

RELEASE DATE: 30 January 2014