TC03356

Appeal number: LON/2008/00349

VAT – Transactions resulting in a loss of tax connected to MTIC fraud – Whether Appellant knew or should have known – Yes – Appeal dismissed

FIRST-TIER TRIBUNAL
TAX CHAMBER

D D R DISTRIBUTIONS LIMITED **Appellant**

- and -

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

TRIBUNAL: JUDGE JOHN BROOKS
MS JANET WILKINS

Sitting in public at 45 Bedford Square, London on 25 – 28 November 2013

The Appellant did not appear and was not represented

Christopher Foulkes, counsel instructed by Howes Percival LLP, for the Respondents

DECISION

Introduction

1. This is an appeal by DDR Distributions Limited ("DDR") against the decision of HM Revenue and Customs ("HMRC") to deny its recovery of input tax in the sum of £1,013,068.00 incurred in the wholesale purchase of mobile telephones during the VAT accounting period ended 30 June 2006 (06/06). HMRC's decision to deny DDR its input tax was made on the basis that the transactions to which the claims related were connected to the fraudulent evasion of VAT and part of a missing trader intra-community ("MTIC") fraud and that DDR, through its director Michael Peters, knew or should have known that this was the case.

2. The nature and operation of MTIC fraud has been described on many occasions not only by this Tribunal but also the appellate Courts and Tribunals. For example, in *POWA (Jersey) Ltd v HMRC* [2012] UKUT 50 (TCC), Roth J said:

> "[1] This is yet a further case of so-called missing trader or "MTIC" fraud on the system of VAT. The decision of the First-tier Tribunal ("FTT") conveniently describes the nature of a typical MTIC fraud as follows:
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> > "5 … goods (almost always small but valuable items such as mobile phones and computer chips) are acquired by a registered trader in the United Kingdom from a trader in another member State, and sold to a second UK-registered trader. The goods then usually change hands several times within the UK before they are sold to an overseas trader which, if it is located in a member State of the European Union, is registered for VAT in that member State. Commonly the transactions all occur within a few days of the entry of the goods into the UK, sometimes even on the same day, so that goods enter the UK in the morning, pass through the hands of several UK traders during the day, and are exported again in the afternoon.
> >
> > 6. The first UK vendor, the acquirer from overseas, charges VAT on the consideration paid by his purchaser, but fails to account to the respondent Commissioners for that tax, and disappears. Such documentation as he may have had—if any—relating to his acquisition is never produced to the Commissioners. For the scheme to work he must be a VAT-registered trader who provides the purchaser with a genuine VAT invoice, on the strength of which the purchaser claims an input tax credit. The purchaser's own sale, and those of the other UK traders save the last in the sequence, usually generate a small profit and, consequently, a small net VAT liability, for which those traders account. The last trader, selling overseas, claims credit for the input tax he has incurred, but has no output tax liability since the sale is zero-rated.

> Usually this trader makes a significant profit, though that is not invariably the case; occasionally one of the antecedent traders can be shown to have made the greatest profit of all those in the chain. All of these sales and purchases, including the sale to the overseas buyer, are almost always properly documented.

[2] In the jargon that has developed to describe the various participants in such chains, the initial importer of the goods who fails to account for the output tax he has charged to his purchaser and disappears, is known as the "defaulter" or "missing trader." The trader at the end of the UK chain who sells the goods to a purchaser overseas is known as a "broker". The traders between the defaulter and broker are referred to as "buffers". In the present case, it is alleged that PJL was a broker.

[3] There are various variations and developments of this typical scheme of MTIC fraud. One of these, of which three of the transactions in the present case are said to be an example, comprises what is called "contra-trading". I again gratefully adopt the description given by the FTT:

> "9 A contra-trader, a broker in one chain of transactions—again adopting the commonly used jargon, a "dirty" chain—in which a default has occurred, buys goods from a supplier in another member State, and sells them to a UK customer; after one or more further sales and purchases they are sold to a customer in another member State. The contra-trader and, usually, all the other traders in this chain account correctly for their VAT liabilities; taken by itself it is a "clean" chain. The acquirer in the clean chain has incurred a liability for output tax which (because the values are engineered to achieve this result) matches the input tax credit due to him (or ostensibly due to him) as the broker in the dirty chain. He does not need to make a large repayment claim, attracting the Commissioners' attention, but instead makes a modest payment, or a minimal repayment claim. The same result may be achieved by undertaking a number of transactions generating an aggregate input tax credit matching the broker's output tax liability for the relevant accounting period. It is then the broker in the clean chain who has an input tax claim which, unless they can establish a link between the clean and dirty chains, the Commissioners must meet since the goods in the clean chain have not themselves been used for fraudulent purposes.""

3. Like *POWA (Jersey)* the present case concerns allegations of contra-trading.

4. Although throughout this decision we have referred to the respondents as HMRC this should also be read, where appropriate, as a reference to HM Customs and Excise.

Absence of the Appellant

5. The parties had been notified in July 2013 that this appeal had been listed for a ten day hearing, to commence on 25 November 2013. Although DDR had been represented in preliminary hearings dealing with the admission of evidence and costs, on 7 November 2013 its solicitors, Thomas Cooper, wrote to the Tribunal in the following terms:

> Please place this letter before the Tribunal Judge that this matter has been assigned to.
>
> We write to the Tribunal with regret: we have tried to reassure our client that it will receive a fair trial at the final hearing of this Appeal, but it is certain that it will not and considers that the Tribunal is determined to find against it. Consequently we are not instructed to attend the final hearing of this matter and Mr Peters, the director and sole witness for the Appellant, will not attend the Tribunal either.
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> Mr Peters maintains that he operated DDR Limited in exactly the same way as he operated Blue Sphere Global Ltd. Given the foregoing, he submits that he has already spent 2 days giving evidence regarding his trading and has been found to have honestly traded in mobile telephones during the relevant periods. Despite the judgment of the Court of Appeal in his favour, however, Mr Peters is sure that that the Tribunal will simply find against him as it did in the case of Blue Sphere.
>
> Mr Peters has lost all confidence in the Tribunal and its process because HMRC were permitted by the Tribunal to appeal a direction of one Tribunal Judge to another Tribunal Judge:
>
> > (a) On 06/08/11, Judge Cornwell-Kelly directed, inter alia, that HMRC may admit further evidence within 8 weeks, but not in relation to the FCIB and that the Appellant's application for costs resulting from late service of evidence by the Respondents be reserved for later decision by the Tribunal in light of the evidence yet to be served and after full submissions by the parties. Reasons for the decision were also released including the reason for the costs direction.
> >
> > (b) On 29/02/12, Judge Demack directed that HMRC may admit further evidence and that the direction of Judge Cornwell-Kelly in relation to FCIB was set aside and that HMRC be allowed to serve FCIB evidence. Mr Peters contends that this direction involved the Tribunal acting as its own appellate body. When the Appellant attempted to circumvent judicial hierarchy in the same way, its attempts were promptly denied by the Tribunal. Judge Demack also made a costs order that was recorded by HMRC that awarded the Appellant part of its costs of the hearing of 29 February 2012 and reserved again the Appellant's application for costs resulting from the late service of evidence. This Order was not, however, properly recorded in the directions

> released some three months later on 10/05/12. Reasons for the decision were also released, but these only deal with the FCIB issue and do not deal with costs
>
> (c) On 06/07/12, Judge Mosedale stated in her decision (at paragraph 32) "Once the evidence existed (in the sense of a witness statement being compiled in respect of it), a later Tribunal could weight (sic) whether it was of such relevance it should be admitted **despite any procedural unfairness to the Appellant** (emphasis added)." Judge Mosedale identified procedural unfairness to the Appellant but did not consider how, less still ensure that, such unfairness was remedied.
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> The unfairness of the above, Mr Peters submits, was compounded by Judge Bishopp's decision of 01/03/13, in which the Tribunal found against the Appellant in its application for costs resulting from the late admission into evidence of fresh HMRC evidence (despite Court of Appeal guidance to the contrary). Mr Peters and his legal team were faced with a large volume of complex material to read, consider and respond to.
>
> The Appellant believes that it has been disadvantaged as a result of the combination of the overwhelming financial resources of the Respondent (against his own impecuniosity), the effluxion of 8 years and the clear support the Tribunal has given to the Respondents without imposing cost consequences. As a result the Appellant, understandably, believes that the case has been pre-judged and no reassurances from us have prevailed upon it to change this conviction.

6. The Tribunal responded on 18 November 2013, in a letter to the DDR's solicitors, as follows:

> The Tribunal acknowledges receipt of your letter dated 7 November 2013 and notes that the Appellant will neither attend or be represented at the hearing which will, accordingly, take place in its absence.

7. It is implicit from this correspondence that DDR had been notified and was therefore aware of hearing date and that hearing would proceed on 25 November 2013 in its absence in accordance with Rule 33 of the Tribunal Procedure (First-tier Tribunal) (Tax Chamber Rules) 2009. However, for the avoidance of doubt we should state that we were satisfied that DDR had been notified of the hearing and, as we considered it in the interests of justice to do so, heard the appeal in the absence of the appellant, DDR, with Mr Christopher Foulkes of counsel appearing for HMRC.

Law

8. The right to deduct input tax is now derived from Articles 167 and 168 of Council Directive 2006/112/EC (previously Article 17 of the Directive 1977/388/EEC, the Sixth Directive). This has been implemented into UK domestic law by ss 24-26 Value Added Tax Act 1994 and Regulation 29 of The VAT Regulations 1995.

9. However, an exception to this right was identified by the European Court of Justice ("ECJ") (as the Court of Justice of the European Union ("CJEU") was then known) in its judgment of 6 July 2006, in the joint cases of *Axel Kittel v Belgium & Belgium v Recolta Recycling SPRL* (C-439/04 and C-440/04) [2006] ECR 1 – 6161 ("*Kittel*") in which it stated:

> "[51] … traders who take every precaution which could reasonably be required of them to ensure that their transactions are not connected with fraud, be it the fraudulent evasion of VAT or other fraud, must be able to rely on the legality of those transactions without the risk of losing the right to deduct the input VAT.
>
> [52] It follows that, where a recipient of a supply of goods is a taxable person who did not and could not know that the transaction concerned was connected with a fraud committed by the seller, Article 17 of the Sixth Directive must be interpreted as meaning that it precludes a rule of national law under which the fact that the contract of sale is void, by reason of a civil law provision which renders that contract incurably void as contrary to public policy for unlawful basis of the contract attributable to the seller, causes that taxable person to lose the right to deduct the VAT he has paid. It is irrelevant in this respect whether the fact that the contract is void is due to fraudulent evasion of VAT or to other fraud."
>
> …
>
> [56]. … 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, irrespective of whether or not he profited by the resale of the goods.
>
> [57] That is because in such a situation the taxable person aids the perpetrators of the fraud and becomes their accomplice.
>
> [58] In addition such an interpretation, by making it more difficult to carry out fraudulent transactions, is apt to prevent them.
>
> [59] Therefore, it is for the referring court to refuse entitlement to the right to deduct where it is ascertained, having regard to objective factors, that the taxable person knew or should have known that, by his purchase, he was participating in a transaction connected with fraudulent evasion of VAT, and do so even where the transaction in question meets the objective criteria which form the basis of the concept of "supply of goods effected by a taxable person acting as such" and "economic activity".
>
> …
>
> [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 the fraudulent evasion of VAT, it is for the national court to refuse that taxable person entitlement to the right to deduct."

10. The decision of the ECJ in *Kittel* was considered by the Court of Appeal in *Mobilx Ltd (in Administration) v HMRC; HMRC v Blue Sphere Global Ltd ("BSG"); Calltel Telecom Ltd and another v HMRC* [2010] STC 1436 ("*Mobilx*"), where Moses LJ, giving the judgment of the court, said:

> "[59] The test in *Kittel* is simple and should not be over-refined. It embraces not only those who know of the connection but those who "should have known". Thus it includes those who should have known from the circumstances which surround their transactions that they were connected to fraudulent evasion. If a trader should have known that the only reasonable explanation for the transaction in which he was involved was that it was connected with fraud and if it turns out that the transaction was connected with fraudulent evasion of VAT then he should have known of that fact. He may properly be regarded as a participant for the reasons explained in *Kittel*.
>
> [60] The true principle to be derived from *Kittel* does not extend to circumstances in which a taxable person should have known that by his purchase it was more likely than not that his transaction was connected with fraudulent evasion. But a trader may be regarded as a participant where he should have known that the only reasonable explanation for the circumstances in which his purchase took place was that it was a transaction connected with such fraudulent evasion."

11. It is clear from *Mobile Export 365 v HMRC* [2007] EWHC 1737 (Ch), at [20], that when applying the *Kittel* test the Tribunal is entitled to rely on inferences drawn from the primary facts. It is also clear, from the approach taken by Christopher Clarke J in *Red12 v HMRC* [2010] STC 589 which was adopted by Moses LJ in *Mobilx* that the Tribunal should not unduly focus on whether a trader has acted with due diligence, as it did in *BSG*, but consider the totality of the evidence.

12. Moses LJ said, at [83] of *Mobilx*:

> "… I can do no better than repeat the words of Christopher Clarke J in *Red12 v HMRC* [2009] EWHC 2563:-
>
> > [109] "Examining individual transactions on their merits does not, however, require them to be regarded in isolation without regard to their attendant circumstances and context. Nor does it require the tribunal to ignore compelling similarities between one transaction and another or preclude the drawing of inferences, where appropriate, from a pattern of transactions of which the individual transaction in question forms part, as to its true nature e.g. that it is part of a fraudulent scheme. The character of an individual transaction may be discerned from material other than the bare facts of the transaction itself, including circumstantial and "similar fact" evidence. That is not to alter its character by reference to earlier or later transactions but to discern it.

> [110] To look only at the purchase in respect of which input tax was sought to be deducted would be wholly artificial. A sale of 1,000 mobile telephones may be entirely regular, or entirely regular so far as the taxpayer is (or ought to be) aware. If so, the fact that there is fraud somewhere else in the chain cannot disentitle the taxpayer to a return of input tax. The same transaction may be viewed differently if it is the fourth in line of a chain of transactions all of which have identical percentage mark ups, made by a trader who has practically no capital as part of a huge and unexplained turnover with no left over stock, and mirrored by over 40 other similar chains in all of which the taxpayer has participated and in each of which there has been a defaulting trader. A tribunal could legitimately think it unlikely that the fact that all 46 of the transactions in issue can be traced to tax losses to HMRC is a result of innocent coincidence. Similarly, three suspicious involvements may pale into insignificance if the trader has been obviously honest in thousands.
>
> [111] Further in determining what it was that the taxpayer knew or ought to have known the tribunal is entitled to look at the totality of the deals effected by the taxpayer (and their characteristics), and at what the taxpayer did or omitted to do, and what it could have done, together with the surrounding circumstances in respect of all of them.""

13. On 21 June 2012 judgment was given by the CJEU in the joined cases of *Mahagében kft v Nemzeti Adó-és Vámhivatal Dél-dunántúli Regionális Adó Főigazgatósága* and *Pétér Dávid v Nemzeti Adó-és Vámhivatal Dél-dunántúli Regionális Adó Főigazgatósága* [2012] EUECJ C-80/11.

14. In *Mahagében* the question before the CJEU was whether the Hungarian tax authority could refuse the right to deduct on the grounds of improper conduct on the part of one of his suppliers without establishing whether the taxpayer had been aware of that improper conduct. In *Pétér Dávid*, heard at the same time as *Mahagében*, the issue before the CJEU was whether the tax authority could refuse the right to deduct on the grounds that the taxpayer had not satisfied himself of specific matters relating to his supplier. Both decisions were consistent with the principles the ECJ had enunciated in *Kittel*.

15. As Moses LJ noted when dismissing an oral application for permission to appeal from the Tax and Chancery Chamber of the Upper Tribunal in *POWA (Jersey) Ltd v HMRC* at [11], the CJEU:

> "… 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 lose his right to deduct. That is plain from *Optigen*; it is plain from *Kittel*; and the court in *Mahageben* was saying nothing different."

Contra-Trading

16. We are aware, from other "MTIC" appeals, that it has been suggested that the principles established by *Kittel* do not extend to contra-trading which has not been specifically considered by the CJEU or ECJ and address this issue because, as we have previously noted (at paragraph 3, above) that this case concerns allegations of contra-trading. However, in our judgment, any argument that the knowledge of the taxable person should be confined to one chain of supply, thereby excluding contra-trading, is misconceived.

17. We find support for our view from the following passage of decision of the Upper Tribunal (Sales J and Judge Berner) in *Fonecomp Ltd v HMRC* [2013] UKUT 599:

> [24] Mr Patchett-Joyce [counsel for Fonecomp] also submitted that the principle laid down by the Court of Justice is only referable to VAT fraud which occurs in the *same* chain of supply of goods or services, and does not extend to cover VAT fraud which occurs in another chain of supply, as happens in a "contra-trading" case such as the present. We do not accept this submission either. The authoritative statement of the principle given by the Court at paras. [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. Since it is readily possible to conceive of situations in which contra-trading occurs, whereby transactions in the so-called clean chain of supply can provide material assistance for VAT fraud in the so-called dirty chain of supply (as the FTT [First-tier Tribunal] found had happened in this case), there is no basis at all for reading down and limiting the *Kittel* principle in the manner contended for by Mr Patchett-Joyce. The rationale and explanation given by the Court in *Kittel* for the principle it stated in that case apply with equal force in a contra-trading situation as in relation to a simpler type of case involving a single chain of supply. It should be borne in mind that the primary mechanism to control the application of the principle which disallows a trader from claiming input VAT is that the national authorities have to establish that he knew or should have known that his transaction was connected with the fraudulent evasion of VAT, and that mechanism is equally available to protect a trader in both a simple chain of supply case and in a contra-trading case. The applicability of the *Kittel* principle in a contra-trading case was very fully explained by Lewison J in *Revenue and Customs Commissioners v Livewire Telecom Ltd* [2009] EWHC 15 (Ch); [2009] STC 643.
>
> [25] The Court of Appeal in *Mobilx* gave detailed consideration to the proper interpretation of the judgment in *Kittel*. The Court of Appeal held that it was not arguable that the principles of fiscal neutrality, legal certainty, free movement of goods and proportionality were infringed by the Court of Justice in laying down the principle in *Kittel*,

on the Court of Appeal's reading of that principle and its judgment: see [66]. The principles of proportionality and legal certainty are respected in the balance struck by the Court of Justice between the interests of the tax authorities and the interests of the taxpayer in its formulation of the *Kittel* principle. Since the contrary was not arguable, there were no grounds for a reference to be made to the Court of Justice.

[26] As regards the principle of proportionality, we also reject a further submission made by Mr Patchett-Joyce that the principle of proportionality is not properly respected by application of the *Kittel* principle by reference to VAT fraud in the dirty chain in a contra-trading case. In our view, the principle of proportionality is respected in the same way in a contra-trading case as in a case involving a single chain of supply, essentially for the same reasons given by the Court of Appeal in *Mobilx*. There is no relevant ground of distinction between the two types of case so far as proportionality is concerned.

[27] Nonetheless, despite the conclusion of the Court of Appeal in *Mobilx*, on this appeal Mr Patchett-Joyce submitted that we should review the European authorities and concluded that the Court of Appeal had (at least arguably) misconstrued them so that a reference to the Court of Justice should be ordered for it to clarify the law. As a further and alternative submission, he submitted that the judgment in *Mahagében and Dávid* involved a significant modification of the approach of the Court of Justice in *Kittel*, such that it was now clear that a narrow test of connection between a transaction in respect of which input VAT is claimed and VAT fraud applies, on the basis of which either it is *acte clair* that Fonecomp must be allowed to reclaim its input VAT or there is such doubt about whether it is entitled to do so that a reference to the Court of Justice should be ordered.

[28] We regard both these submissions as misconceived. The Court of Appeal in *Mobilx* read and interpreted the judgment in *Kittel* with meticulous care. We do not consider that it is open to this Tribunal to second guess the Court of Appeal's interpretation of that judgment, laid down in authoritative fashion in *Mobilx*. But even if it were open to us to do so, we should record our full agreement with the Court of Appeal's interpretation. There is, in our view, no lack of clarity in the position. Accordingly, there is no proper basis on which it would be right to contemplate making a reference to Luxembourg to test whether the Court of Appeal in *Mobilx* was correct in its interpretation.

[29] Moreover, we do not consider that the judgment in *Mahagében and Dávid* creates any doubt or uncertainty about the interpretation of the judgment in *Kittel* where there was none before. *Mahagében and Dávid* concerned two cases in which the Hungarian tax authorities sought to operate rules which prevented traders from reclaiming input VAT in circumstances in which the Hungarian authorities had not established that the taxable person concerned was aware of improper conduct on the part of the person supplying services to him or colluded in that conduct himself (paras. [36], [61] and [66]). The judgment involves a straightforward reiteration and application of the *Kittel* principle in these circumstances, making it clear that the operation of such rules which do not comply with the test set out by the Court in

> *Kittel* would breach EU law. This is unsurprising and does not involve any departure from or re-formulation or modification of the *Kittel* principle, as interpreted by the Court of Appeal in *Mobilx*.

18. Therefore, if it is established, as a matter of fact, that a transaction is connected to a fraudulent tax loss, it does not matter if the connection is via contra-trading or a single supply chain as in a "typical" MTIC and if the taxable person knew or should have known of this connection his right to deduct will be lost.

19. In reaching this conclusion it follows that we reject any suggestion that properly understood contra-trading is jargon for a conspiracy which must include the fraudster, the contra-trader, the broker and all parties in between.

20. As Briggs J said in Megtian Limited (in administration) v HMRC [2010] STC 840:

> "[37] … 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."

We note that, in *POWA (Jersey) Ltd*, Roth J, at [52], expressly agreed with what Briggs J had said in *Megtian*.

Burden and Standard of Proof

21. HMRC bears the burden of proof in this appeal. As Moses LJ said, in *Mobilx* at [81]:

> "It is plain that if HMRC wishes to assert that a trader's state of knowledge was such that his purchase is outwith the scope of the right to deduct it must prove that assertion."

22. Although the standard of proof was not considered in *Mobilx* it is accepted that the civil standard, the balance of probabilities, applies (see *Re B* [2009] 1 AC 1). As

Lady Hale, giving the judgment of the Supreme Court in *Re S-B (Children)* [2010] 1 AC 678 said, at [34]:

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

Adverse Inference

23. It is clear that the failure to call a witness does not automatically lead to an adverse inference being drawn. However, after an extensive review of the authorities, Brooke LJ, after in *Wisniewski v Central Manchester Health Authority* [1998] PIQR 324, said, at 340:

> "From this line of authority I derive the following principles in the context of the present case:
>
> (1) In certain circumstances a court may be entitled to draw adverse inferences from the absence or silence of a witness who might be expected to have material evidence to give on an issue in an action.
>
> (2) If a court is willing to draw such inferences they may go to strengthen the evidence adduced on that issue by the other party or to weaken the evidence, if any, adduced by the party who might reasonably have been expected to call the witness.
>
> (3) There must, however, have been some evidence, however weak, adduced by the former on the matter in question before the court is entitled to draw the desired inference: in other words, there must be a case to answer on that issue.
>
> (4) If the reason for the witness's absence or silence satisfies the court then no such adverse inference may be drawn. If, on the other hand, there is some credible explanation given, even if it is not wholly satisfactory, the potentially detrimental effect of his/her absence or silence may be reduced or nullified."

Issue for Determination

24. On 27 June 2013 DDR's solicitors wrote to the Tribunal in compliance with the direction of Judge Bishopp released on 5 March 2013 ("the Order"). In the letter it was stated that "fraudulent tax loss" and "connection" were conceded and "in issue is the Appellant's knowledge and means of knowledge of the fraud."

25. Therefore, the issue before the Tribunal is whether DDR, through Mr Peters, knew or should have known that its transactions were connected to that fraudulent evasion of VAT.

Evidence

26. We heard oral evidence from Stephen Munroe-Birt of HMRC and John Fletcher of KPMG who was called as an expert witness by HMRC.

27. Mr Munroe-Birt who had made a pre-registration visit to DDR and met with its director, Mr Peters had replaced the original decision making officer, Gillian Magnay. He had made four witness statements and, having confirmed the statement of truth of each, these were accepted as his evidence in chief.

28. Mr Fletcher had provided a witness statement, dated 23 October 2008, in the form of a report and has the heading *Mobile Phone Handset Distribution Authorised and Grey Markets in 2006*. This contained evidence about the mobile phone industry and the wholesale "grey market" for mobile phones in the UK during 2006. However, on 2 September 2011 Mr Fletcher had made a second witness statement which amends his first statement having reviewed "evidence in a recent Tribunal which pertains to the trading of handsets in the grey market." For some reason this had not been included within the material provided to the Tribunal and DDR before the hearing. There were also a series of corrections that Mr Fletcher wished to make to his original statement.

29. As these amendments did not affect the conclusions Mr Fletcher had reached in his initial statement and were matters that could properly be dealt with by way of supplementary questions in examination in chief we admitted these statements into evidence.

30. In addition to the witness statements of Mr Munroe-Birt and Mr Fletcher we were provided with witness statements from the following HMRC Officers:

(1) Lisa Orr – in respect of Blue Sphere Global Limited ("BSG"). Her statement referred to the oral evidence given by Mr Peters before the Tribunal in the appeal of Blue Sphere Global Limited ("BSG") of which Mr Peters was a director and included, as an exhibit, a copy of the transcript of the two days of this evidence to which the letter of 7 November 2013 from DDR's solicitors refers (see paragraph 5, above);

(2) Jane Holden – in respect of Infinity Holdings Limited ("Infinity");

(3) Peter Birchfield – in respect of the First Curacao International Bank ("FCIB");

(4) Nigel Humphries – who was authorised to exchange information with the German authorities and obtained information on Boston Freight a Belgian freight forwarder;

(5) Rod Stone – whose statement consisted of generic evidence, which has been used in many MTIC proceedings, providing an overview of the history of HMRC's policies and some of the commercial practices relevant to this and similar cases;

(6) Kenneth Rhodes – in respect of Soul Communications Limited ("Soul");

(7) Judith Clifford – in respect of Future Communications Limited ("Future");

(8) Graham Taylor – in respect of C&B Trading (UK) Limited ("C&B");

(9) Peter Cameron-Watson – in respect of UK Communication Limited (UK Communication");

(10) Rupinder Kandola – in respect of Time Corporates Limited ("Time");

(11) Vivien Parsons – in respect of RS Sales Agency, RS Sales Agency Limited and Wade Tech Limited;

(12) Vincent D'Rozario – in respect of AS Genster Limited ("Genster");

(13) Wendy Byford – in respect of Universal Trade Supplies Limited;

(14) Charlotte-Rebecca Jackson – in respect of Power and Civil (UK) Limited;

(15) Gavin Wafer – case officer for "Operation Inertia" a criminal investigation begun in May 2006;

(16) Rita Coelho – in respect of ETGlobalSolution Limited ("ETGlobalSolution"); and

(17) Colin Needs – in respect of Okeda Limited ("Okeda").

31. In the absence of any representation on behalf of DDR, although it had been indicated in a letter to the Tribunal, dated 27 June 2013, from its solicitors that "the appellant will wish to cross-examine the witnesses which the respondents call", this was not possible and these statements were therefore admitted in evidence. However, it is apparent, having read them, that in addition to evidence of fact these witness statements also include comments and opinions by the officers concerned.

32. In *Megantic Services Ltd v HMRC* [2013] UKFTT 492 the Tribunal (Judge Berner and Judge Walters QC), in relation to an application to exclude "opinion" evidence, observed at [15]:

> "… is not a matter of fact but a matter of opinion. It is merely a view of a witness on a matter on which the tribunal itself must reach its own conclusion, and as such is of no value as evidence. Such evidence may rightly be excluded on that basis. In most cases, however, we would not see it as necessary, or indeed proportionate, for a forensic exercise to be undertaken, either by the parties or by the tribunal, to identify any such matters in each witness statement and for the tribunal formally to direct that they be excluded. Generally speaking, we think that the parties can rely upon the good sense of the tribunal to disregard purported evidence that represents conclusions that the tribunal itself must reach. That can usually conveniently be the matter of submission at the substantive hearing, rather than a formal application to exclude."

The Tribunal also noted, at [20], that:

> "… we indicated to the parties that there were in the witness statements clear expressions of view on the conclusions that could be drawn from the analysis presented, and that such expressions of view, on matters which it is for the tribunal to determine, did not amount to evidence to which the tribunal would have regard. … the tribunal itself is quite capable of distinguishing between the evidence on which a conclusion

> falls to be drawn by the tribunal and an attempt by a witness to draw that conclusion themselves.

33. We have adopted such an approach in the present case in respect of the opinions, comments and conclusions drawn by witnesses of fact.

34. Although DDR was not represented, Mr Peters its director had made two witness statements on its behalf. Despite this evidence being challenged by HMRC Mr Peters did not attend the hearing even though it was clearly understood that each party was entitled to require the attendance of any of the other party's witnesses it wished to cross-examine. However, HMRC did not object or seek to exclude the admission of these statements into evidence and, in any event rule 15(2)(a) of the Tribunal Procedure (First-tier Tribunal)(Tax Chamber) Rules 2009 provides that the Tribunal may "admit evidence whether or not the evidence would be admissible in a civil trial in the United Kingdom".

35. We therefore considered it appropriate to admit the evidence contained in the witness statements of Mr Peters as hearsay evidence (ie a statement made otherwise than by a person while giving oral evidence in proceedings, which is tendered as evidence of the matters stated) but attach less weight to this evidence than would have been the case had he given oral evidence under oath or affirmation which could have tested under cross examination.

36. On the basis of this evidence we make the following findings of fact.

Facts

Incorporation to 30 April 2006

37. DDR was incorporated on 19 September 2002. Its sole director from the time of its incorporation and during the time of the transactions with which this appeal is concerned was Mr Peters. His wife, Michelle Peters, was the company secretary.

38. On 4 October 2002 DDR applied to be registered for VAT. In its application form (Form VAT 1) its business was described as a "distributer of computer equipment" and estimated its taxable supplies in the next 12 months to be £500,000, of which £400,000 was expected to be derived from sales to other European Union ("EU") Member States.

39. An unannounced pre-registration VAT visit to DDR was undertaken by HMRC Officer Stephen Munroe-Birt on 24 October 2002. He interviewed Mr Peters and in his report of the visit Mr Munroe-Birt noted that:

> Whilst the business set up would appear close to MTIC – EC purchases and computer hardware – Mr Peters gave a credible description of his proposed trading as a genuine hardware dealer.
>
> Mr Peters admitted he was aware of MTIC and traders involved in it, he also said that within the industry there was a split between the genuine hardware dealers and the MTIC dealers who are disliked as they taint the rest of the trade.

> Mr Peters is very clear - he will not be involved in MTIC type trade. I explained that if he did get involved he would be deemed to have lied during his pre-reg interview.
>
> Whilst I believe Mr Peters explanation of his business we will obviously have to keep an eye on this one. However for now I recommend the issue of a VAT number.

40. Consequently DDR was registered for VAT on 1 November 2002 and was required to submit quarterly VAT returns.

41. DDR's turnover in each quarterly VAT period from 12/02 to 06/05 was as is shown in the table below:

Period	Turnover £
12/02	15,788.00
03/03	81,387.00
06/03	82,719.00
09/03	101,127.00
12/03	44,911.00
03/04	63,112.00
06/04	14,081.00
09/04	62,857.00
12/04	38,028.00
03/05	9,003.00
06/05	11,892.00

42. In addition to his role with DDR Mr Peters was also a director of BSG, a company which was incorporated on 6 September 2004. At the date of incorporation the directors of BSG were Gary Winston Gibbs and Mr Peters. In its Form VAT 1, signed by Mr Gibbs and submitted to HMRC on 4 October 2004, the intended main business activity of BSG was to be a "Network Reseller". BSG was registered for VAT with effect from 18 November 2004. Further clarification of BSG's business activity was provided to HMRC in its "Request for Information" form where it was stated the business of BSG was to "resell networking products like Cisco/Juniper/Extreme to end users". On 29 March 2005 after a disagreement Mr Gibbs resigned leaving Mr Peters as sole director of BSG.

43. Mr Peters, in his capacity as director of BSG received a telephone call from Officer Andrew Nunn of HMRC's New Business Team on 11 April 2005. A note of that conversation, taken by Officer Nunn records that Mr Peters described BSG's main business activity as "telecommunications sales", a change from that stated in its VAT 1.

44. However, it was not until 9 June 2005 that Mr Peters informed HMRC, in a telephone call to their National Advice Service, that Mr Gibbs had left BSG.

45. On 26 July 2005 HMRC Officers Teresa McLennan and Ian Simmons undertook an MTIC post-registration visit to BSG and were told by Mr Peters that he had been approached about mobile telephones but was not interest in trading in these at that time.

46. Having previously sent BSG a "Redhill Verification Letter" on 12 July 2005, HMRC sent such a letter to DDR on 27 July 2005. The letter, which enclosed a copy of HMRC's Public Notice 726 "Joint and Several Liability", stated:

> HM Revenue and Customs are still experiencing certain problems with businesses in your sector offering commodities regularly involved in Missing Trader Intra Community (MTIC) VAT fraud. MTIC fraud may involve all types of VAT standard rated goods and services including computer equipment, mobile phones and ancillary items. The current estimate of the VAT loss from this type of fraud in the UK alone is between £1.06 and £1.73 billion per anum.

47. Although the title of Notice 726 is "Joint and Several Liability" it is made clear (at section 1.3) that it should be read by all VAT registered businesses that trade in goods or services that are subject to MTIC fraud. This includes mobile phones (section 1.4). Section 4.4 of the Notice asks "How can I avoid being caught up in MTIC fraud?" It is answered in section 4.5 which advises that "reasonable steps" are taken to "establish the legitimacy of your supply chain and avoid being caught up in a supply chain where VAT would go unpaid." It continues:

> We [HMRC] do not expect you to go beyond what is reasonable. You are not necessarily expected to know your supplier's supplier or the full range of selling prices throughout the supply chain. However, we would expect you to make a judgement on the integrity of your supply chain.

Examples of checks are contained at section 8 of the Notice. However, section 4.6 makes it abundantly clear that these are "guidelines" only, as "a definitive checklist would merely enable fraudsters to ensure that they can satisfy such a list."

48. In letters dated 4 August 2005 DDR and BSG requested that they be permitted to change from quarterly to monthly VAT returns. HMRC replied to both letters on 10 August 2005 requesting evidence to support the applications for monthly returns.

49. On 17 August 2005 Ms McLennan and Mr Simmons met with Mr Peters on a further visit to BSG. During the visit Mr Peters explained that he was preparing for future trading in memory components and had spoken to a Barry Eitchie of Xicom

Europe Limited ("Xicom Europe") and Ultimate Security Agency Limited and had received trading advice from a Mr B Khan regarding Xicom Systems Limited ("Xicom Systems") and a Mr A Perez regarding Scand Solutions Limited ("Scand") and had verified each of the companies with HMRC's Redhill office. Mr Peters was asked to send Ms McLennan all relevant paperwork relating to the deals and was reminded about the importance of due diligence checks

50. On 23 August 2005 Mr Peters wrote to HMRC in support of DDR's application for monthly returns in the following terms:

> As DDR Distribution has strong/direct relationships with major manufacturers, we have opportunities to supply products to resellers and end users in the EU and not EU states.
>
> By going onto monthly returns this will help with our cash flow on both our EU and domestic sales.
>
> At this moment in time I can not calculate the percentage of EU sales as this is a target area at the moment.

A letter in identical terms, save that it referred to BSG and not DDR, was also sent to HMRC on 23 August 2005. On 26 August the applications for monthly returns were refused by HMRC on the grounds of insufficient evidence of a regular repayment position.

51. On 7 September 2005 Mr Peters telephoned HMRC and, although he asked for Ms McLennan, spoke with another HMRC Officer, Steve O'Hara. The purpose of the call was to ascertain the checks he should perform on a European trader. Mr O'Hara explained that HMRC could not provide a conclusive list of checks but asked if Mr Peters had been issued with Notice 726 and referred to the checks within the Notice. Mr Peters confirmed that a copy Notice 726 had been received by DDR.

52. On 28 September 2005 DDR made a further request for monthly returns when, according to the letter sent by Mr Peters to HMRC, it was "currently in a reclaim position of £65,000" and anticipated that this would "increase to £150,000 by the end of the month". This was because in September 2005 DDR had entered into two wholesale deals in which it exported Nokia mobile telephones having been supplied by Xicom Systems. DDR's 09/05 VAT return declared a turnover of £404,223 giving rise to a repayment claim of £62,901.39. However, on 30 September 2005, in a letter issued by HMRC's National Registration Service in Carmarthen, the request for monthly returns was refused.

53. In a letter from Mr Peters to HMRC, dated 5 October 2005, DDR made a further request for monthly returns. Mr Peters wrote:

> Please let me begin this letter by advising you of DDR's history. After many years working in the Electronic Component industry for another Company I decided in October 2002 to start DDR Distribution. My main business was the distribution of Memory, however soon after opening I found myself dealing in CPU's, Hard Drives and many other electronic components.

> For the past 3 years my business has been steady and we have never been late with our VAT returns or VAT Payments.
>
> Recently I had to look for other work as things were drying up, and we found opportunities to work in the Export market, rather than the Import and UK Market that I normally trade in. However, I found out that in order to survive I would need to be on Monthly Returns. The reason for this is purely cash flow. With the small amount of money DDR has to utilise trades, we earn enough to survive and try and grow each month. If we have to wait 3 months for our money to come back, I am certain that this will cause a major problem and could force me to close things down.
>
> After a recent discussion with Ms Non Jones from the variation unit and another officer beforehand I was led to believe that as long as my Company was in a reclaim position and that I requested to go on Monthly's, then within 24-48 hours Monthly returns would be authorised.
>
> I took the above information on board and entered into some transactions that took me into a reclaim position for the previous quarter. This return is now in.
>
> Once I receive this money back I would like to continue looking for exports as it has thrown me a life line.
>
> I would really appreciate your assistance with this matter as I feel this is DDR's only hope to survive.

By way of a postscript the letter stated:

> Please note we have had a number of meetings with VAT officers to ensure that when we trade we are complying with all the requirements. Furthermore I am performing a lot more due diligence myself. This includes meeting suppliers, customers, checking stock and even sending someone to the customer to ensure the stock is used for what they said.

54. HMRC's reply of 5 October 2005, written by Ms McLennan, referred to DDR trading "in a high risk sector, where substantial amounts of VAT have gone missing in the past" and requested further information to verify the repayment claim for 09/05 that had arisen as a result of the export of mobile telephones by DDR. The information requested included the electronic copy of all IMEI numbers involved with the September transactions undertaken by DDR, details of the inspection report of the goods and documentary evidence of "all checks and results carried out on customers and supplier". The letter concluded by explaining that the request for monthly returns was not her normal area of responsibility and referred Mr Peters to the letter issued by the registration unit in Carmarthen of 30 September 2005 which had refused the claim (see paragraph 52, above).

55. A further letter from HMRC's National Registration Service to DDR, dated 12 October 2005, confirmed that "monthly returns cannot be allowed" as monthly returns are generally only allowed for those businesses that are "entitled to regular repayments of VAT or who show a pattern of repayments because of the nature of

their expenditure" and on the basis of information supplied by DDR is did not meet these conditions as the rendering of one repayment return did not constitute a regular trading pattern.

56. On 3 November 2005 Emma Cooper, a HMRC Assurance/Audit Officer, wrote to Mr Peters at DDR as follows:

> Dear Mr Peters,
>
> As you are aware Teresa McLennan has been making enquiries into DDR's export of 500 Nokia 9300 and 1000 Nokia 6680 mobile phones, on 22 September 2005, and the subsequent repayment claim of £62,901.39 for period 09/05, which has been released on a 'Without Prejudice' basis.
>
> HM Revenue and Customs have reviewed the documents provided by yourself in relation to the transactions, and we have identified them as being in the trade sector affected by MTIC (Missing Trader Intra-Community) Fraud.
>
> The commodities regularly involved in this fraud are computer chips, mobile phones and other high value electrical goods and the last estimate of VAT loss from this type of fraud in the UK alone is between £1.7 and £2.6 billion per annum. The investigation into MTIC fraud is Customs' top VAT fraud priority and the Department will continue to tackle the criminals behind this type of fraud. It is not a victimless crime; it is robbing the honest taxpayer of monies that could be used to fund essential public services.
>
> My enquiries into DDR's September consignments show that some of the same goods have been imported into the UK on a previous occasion.
>
> On these previous occasions the goods passed through businesses, which did not pay the VAT due on the transaction, resulting in a substantial VAT loss to the UK economy. The goods were subsequently exported.
>
> After these events D D R Distribution have bought and sold the same phones, which must therefore have been re-imported into the UK.
>
> Enquiries are continuing and the legitimacy of your VAT repayment claim for this period is now in doubt.
>
> In accordance with Public Notice 726, Joint and Several Liability, you have an obligation to make every effort to ensure the integrity of any supply chain you are involved in. Any information provided by an existing or potential supplier, including requests to make a 3rd [party] Payment, must be viewed with caution. You must demonstrate that you have undertaken reasonable steps to ensure that VAT has not gone unpaid in your transaction chain. Please note that it is how you respond to the results of checks made that is important just to carry out checks and overlook the results is not considered as taking reasonable steps.
>
> If you have any queries please contact me on the above phone number.

57. However, DDR continued its wholesale trade and its turnover during its 12/05 VAT accounting period was £823,260, more than double the turnover of the previous quarter, and a repayment of £52,456.17 was claimed.

58. In a letter, dated 25 January 2006, Ms Cooper informed DDR that following a review of the progress of its 12/05 claim she had authorised a discretionary repayment of £52,456.17 on a "without prejudice" basis subject to "any post payment activity authorised by Customs."

59. Having submitted £nil VAT returns in its 06/05 and 09/05 in its VAT accounting periods BSG, in its 01/06 VAT accounting period (which included the period from 1 October 2005 to 31 January 2006 owing to a change in the date in which it was required to submit VAT returns) BSG commenced wholesale trading in mobile telephones and CPUs. Its turnover during this period, as a result of three export sales of 3,150 CPUs and 9,300 mobile telephones to two companies in Israel, was £4.5 million and a claim was made for repayment of input VAT in the sum of £749,680.75.

60. On 7 February 2006 Ms Cooper, together with HMRC Officer Graeme Stewart visited DDR's business premises and interviewed Mr Peters regarding DDR's business activities and procedures using a questionnaire referred to by HMRC as the "aide memoir" and used to assess the risk of a business being involved in MTIC fraud and raise a trader's awareness of how to reduce such risks. They were told by Mr Peters that the principal business activity of the company was the sale of mobile telephones and MP3 players.

61. HMRC sent two letters to Mr Peters at BSG on 13 February 2006. One requested further information relating to BSG's 01/06 transactions and was superseded by a further request on 17 February 2006. The other advised Mr Peters that until satisfactory enquires into its 01/06 return were concluded any repayment would be withheld. In a letter, dated 17 February 2006, Mr Peters informed HMRC that the third transaction had been cancelled as the goods had not been supplied quickly enough for the customer and repayment claim was reduced to £347,180.75. By a letter, dated 23 February 2006, Mr Peters was notified that repayment was being made to BSG by HMRC on a "without prejudice" basis whilst enquires continued.

62. On 23 March 2006 Ms Cooper wrote to DDR in the following terms:

> Dear Mr Peters
>
> **Trading in Mobile Phones, Computers and Associates Components**
>
> As you know the investigation of Missing Trader Intra-Community (MTIC) Fraud continues to be Customs top VAT fraud priority, and the Department will continue will continue to tackle the criminals behind this type of fraud. It is not a victimless crime; it is robbing the honest taxpayer of monies that could be used to fund essential public services. In addition to its criminal powers Customs has in place powers enabling it to impose joint and several liability on VAT unpaid in the type of traders mentioned above.

> I am writing to you because as a result of our enquires in respect of your 12/05 VAT claim, we now know that the 1 transaction selected for verification commenced with a defaulting trader, resulting in a loss of revenue. The deal is detailed below.
>
> Invoice No: 280313 Dated: 08/12/05 Customer: Q Evolutions Trading Supplier: Phone City Ltd Goods: 2,000 Nokia 6630 and 2,000 Nokia 3230 Net Value: £570,860 VAT reclaimed on purchase invoice: £93,800.
>
> As explained in Notice 726, where you have genuinely done everything you can to check the integrity of the supply chain, can demonstrate you have done so, have taken heed of any indications that VAT may go unpaid and have no other reason to suspect VAT would go unpaid, the joint and several measure will not be applied to you.
>
> However, if you knew, or had reasonable grounds to suspect that VAT would go unpaid then the measure will be applied to you. From your records you may be able to ascertain who supplied you with the goods detailed above, and you may wish to consider what appropriate action is needed to ensure that the VAT does not go unpaid in respect of any future transactions.
>
> For the avoidance of doubt I should finally tell you that this letter is without prejudice to any enquiries Customs may be making, or have made, into transactions with which you have already been involved and which are in a chain of transactions in which VAT has gone unpaid.
>
> In order to continue verifying your records I still require and electronic copy of the IMEI numbers of all the mobile phones sold for VAT period 12/05. Please email these to me.

63. DDR's 03/06 VAT accounting period saw a further substantial increase in its turnover to £3,777,724 (from £823,363 in its 12/05 VAT accounting period) and a claim for repayment of £580,955.43 was made in its return for the period submitted on 10 April 2006. The next day, 11 April 2006, HMRC wrote to DDR acknowledging receipt of the claim and supporting documents. The letter and stated that until satisfactory verification enquiries had been made any VAT repayment would not be released. However, after further information had been requested and received from DDR, on 24 April 2006 DDR was notified by letter from HMRC that a "discretionary" payment of £580,955.43 had been authorised in respect of the 03/06 claim on a "without prejudice" basis.

64. In its 04/06 VAT accounting period 2006 BSG entered into two deals in which it sold mobile telephones to Universal Handels GmbH ("Universal"), an Austrian company, and a German company, Allimpex Handels GmbH. BSG's supplier in both deals was Infinity. BSG's turnover as a result of these deals was over £6 million and it sought to recover input tax of £1,106,976.06.

65. On 19 June 2006, HMRC Officers Lisa Orr and Doug Armstrong visited BSG and met with Mr Peters and Martin O'Neill of Vantis Tax, a VAT consultant retained by BSG. The purpose of the visit was, according to the Report written by Ms Orr, to

go through the "aide memoir", as Officers Cooper and Stewart had previously done with DDR (see paragraph 61, above). Ms Orr recorded:

> I explained the reasons for the visit and also advised that were currently encountering problems on obtaining information about the transaction chain, as notified in correspondence issued last week.

66. The problems to which Ms Orr referred in her note were related to the failure by Infinity to produce books and records for the company during the period in which it traded with BSG. Although the letter to BSG from HMRC of 13 June 2006 had only referred to "certain suppliers" which had "not provided records" to HMRC it is clear from the following extract from the visit Report that Mr Peters and Mr O'Neill clearly understood that this was a reference to Infinity, BSG's supplier:

> Mr O'Neill stated that they had contacted their supplier who told them records had been produced to HMRC on the previous Wednesday. Advised that as of Friday I was still not in a position to progress enquiry but would make enquiries once I was back in the office on 20/6.

67. During the visit Mr Peters was issued with a further copy of Notice 726 and due diligence, as well as the situation with regard to 04/06 repayment being withheld was discussed. Ms Orr explained that enquiries into this claim were continuing and that in the circumstances she did not consider it appropriate to pre-determine the outcome.

DDR's 06/06 VAT Accounting Period

68. In its 06/06 VAT accounting period DDR entered into three export deals resulting in a turnover of £6,170,228, a gross profit of £348,768 and a repayment claim of £1,019,211.71. As these deals constitute the subject matter of this appeal it is necessary to consider each in more detail below.

Deal 1

69. On 27 June 2006 DDR sold 2,000 Nokia 9300i and 1,357 Nokia 8800 mobile telephones to Universal, the Austrian company that had previously been a customer of BSG, for £708,000 and £575,368 respectively.

70. DDR had acquired the mobile telephones from Infinity on 27 June 2006 by way of two purchases ie one for each model of mobile telephone at £668,000 (net of VAT giving a mark-up of 5.98%) and £542,800 (net of VAT giving a mark-up of 6%) respectively.

71. Infinity had been supplied on the same day with the Nokia 9300is by Danish company Alpha C Aps which had also supplied Infinity with 550 of the Nokia 8800s. The remaining 807 Nokia 8800s had been acquired by Infinity from Vertex Trading SARL ("Vertex"), a Luxembourg company. Information supplied about Universal to HMRC by the Austrian tax authorities includes details of a report to the Netherlands authorities stating that:

> … supplies invoiced to several European companies by the Austrian company did not take place. The goods were sent back to Great Britain directly.

The report concluded that Universal:

> … seems to be the first company in a chain of several invoice proceedings (intracommunity supplies) across the single market. Therefore our competent tax office presume that Mr Jason Davis (director of Austrian company) is substantially part maybe even the man in charge regarding the carrousell (sic) fraud.

72. Other than a minimal description of the goods, such as make, model and number of handsets and occasionally "C/E Spec", and what was stated on purchase orders and invoices, there were no detailed written terms and conditions setting out the basis of the trading relationship between DDR and Infinity in this deal or deals two and three.

73. Infinity was a contra-trader as described by Roth J in *POWA (Jersey) Ltd* (see paragraph 2, above) deliberately disguising part of its input tax claim in respect of its broker transactions undertaken in deal chains which contained a fraudulent tax loss by offsetting it against an output tax liability in respect of its acquisition deals in which the goods it imported were exported by DDR and other traders.

74. The invoices issued to DDR by Infinity provide that:

> Goods remain the property of Infinity Holdings Ltd until paid in full

However, on 12 July 2006 Infinity instructed freight forwarders Aquarius Logistics Limited and Courier Plus Limited ("Courier Plus") to release stock to DDR even though DDR had not made any payment for these goods.

75. Although the goods had not been released to DDR on 3 July 2006 it instructed Courier Plus to deliver the mobile telephones to the warehouse of Boston Freight in Belgium on a "ship and hold" basis. DDR released these goods to Universal on 3 July 2006 even though they did not leave the UK until 4 July 2006. Payment for the goods was received by DDR from Universal on 27 July 2006.

76. Information received by HMRC from the Belgian VAT authorities (with emphasis as stated in the report) regarding Boston Freight states that it:

> … was only able to provide the records, comprising mainly of CMRs and its own sale invoices in respect of logistics services in relation to **in-coming consignments**, which appear to come exclusively from the UK. A representative of Boston Freight has recently claimed that the records relating to outgoing consignments were destroyed due to a leaking roof.
>
> Boston Freight operates from a farm close to the frontier with France, and appears to offer logistics services to traders involved in the mobile phone and CPU industry. The representative of BOSTON FREIGHT has also claimed that there are no storage facilities at its premises, the goods remain in the vans which have arrived from the UK, before

> being onward shipped. The Belgian VAT authorities suspect that the goods, **which on some occasions may not exist**, are in fact immediately returned to the UK in the same vans. Analysis of OASIS records may confirm this or otherwise.
>
> **THE BELGIAN VAT AUTHORITIES ALSO STRONGLY SUSPECT THAT A NUMBER OF THE TRADERS USING BOSTON FREIGHT'S SERVICES ARE INVOLVED IN VAT CAROUSEL FRAUD**

77. An inspection of the goods by A1 Inspections Limited ("A1") took place on 3 July 2006 at Courier Plus where a 10% IMEI scan and 10% box check was undertaken. The report in respect of the Nokia 8800s describes the type of charger as "2 pin/3 pin" without stating whether this was a mixed consignment or further detail was available. With regard to the Nokia 9300is the software languages of these mobile telephones which were supplied with three pin chargers which could only be used in the UK, are described as "English, Netherlands" and not German despite the sale to an Austrian company.

Deal 2

78. On 28 June 2006 DDR sold 2,000 Nokia N80, 2,500 Sony Ericsson W900i and 700 Samsung P850 mobile telephones to Elandour Developments SARL ("Elandour"), a French company.

79. DDR's supplier, as in deal one, was Infinity and as previously DDR had acquired each model of mobile telephone by way of a separate purchase. Net of VAT DDR paid £390,000 for the Nokia N80s which it sold for £413,500 (a mark-up of 6.02%), £740,000 for the Sony Ericsson W900is which it sold for £783,750 (a mark-up of 5.91%) and £238,000 for the Samsung P850s which it sold for £252,350 (a mark-up of 6%).

80. On 28 June Infinity 2006 issued DDR with a credit note which reduced the quantity of Nokia N80s from 1,000 to 500 units. Infinity had been supplied, on 28 June 2006, with the Nokia N80s and Samsung P850s by Esat APS ("Esat"), a Danish company and Sony W900is by Vertex.

81. HMRC requested information regarding Elandour from the French tax authorities in relation to exports undertaken to Elandour by Infinity Distribution Limited, an associate company of Infinity. The reply from the French authorities explains that:

> We ran up against an obstruction to audit proceedings, as the company adopted a "no show" strategy. Therefore, the company was subject to the arbitrary assessment procedure excluding input with their director and incurred special penalties, that were notified on March 9th 2007.

It also noted the director of Elandour is a Dutch National whose home is in Rotterdam and who has never had any French source of income or rented or owned any accommodation on French territory which led the French authorities to conclude that Elandour "is a missing trader."

82. On 10 July 2006 DDR instructed Courier Plus to ship the goods to Boston Freight for Elandour on a "ship and hold" basis. The instruction to release the goods was given on 11 July 2006, the day they were transported by ferry from the UK. Payment was made by Elandour to DDR for these goods on 27 July 2006.

83. Inspection reports from A1 indicate that although the Nokia N80s and Sony W900is were inspected on 10 July 2006 at the premises of Courier Plus, the Samsung P850s had also been inspected at Courier Plus on 20 June 2006, eight days before they had been purchased by DDR and eight days before they entered the UK from Luxembourg.

84. The inspection report in relation to the Sony P850s noted that the software languages on the mobile telephones were English, Indonesian, Tieng Viet Oriental and Malaysia. French was not included. The A1 report also notes that one of the Nokia N80 handsets is damaged and that the 500 Nokia N80s were supplied with UK three pin chargers.

Deal 3

85. DDR sold Elandour 2,600 Nokia 8800, 2,020 Nokia 9300i, and 6,120 Nokia 8910i mobile telephones. As in the previous 06/06 deals DDR's suppler was Infinity. Infinity had been supplied with 1,300 Nokia 8800s, 2,020 Nokia 9300is and 3,060 Nokia 8910is by Esat and 1,300 Nokia 8800s and 3,060 Nokia 8910is by Vertex.

86. All transactions took place on 29 June 2006.

87. Net of VAT DDR had purchased the Nokia 8800s from Infinity in two separate purchases paying of £520,000 for each before making two sales to Elandour for £551,200 (a mark-up of 6%). It did the same in respect of the Nokia 8910i mobile telephones selling these in two equal instalments to Elandour paying £765,000 for each purchase and selling at £810,900 (a mark-up of 6%) on each sale. The purchase price of the Nokia 9300is was £672,660 and these were sold by DDR for £713,060 (a 6% mark-up).

88. On 12 July 2006 DDR instructed Courier Plus to ship the goods to Boston Freight on a "ship and hold" basis before giving instructions for these to be released on 13 July 2006, the day the ferry left the UK but before receiving payment on 27 July 2006.

89. A1 inspected these goods for DDR on 12 July 2006. The report states that software languages for the Nokia 9300is are English and Dutch but not French.

Movement of funds

90. Analysis of the FCIB accounts of the participants in the above deals show the following movement of funds in what Mr Foulkes described as four "loops" all of which took place on 27 July 2006.

91. The movement of funds concerning deal one took place in the first of these loops. It commenced with a payment to DDR of £1,283,368, from its customer, Universal. The funds originated from the accounts of two companies, Peoria in the Czech Republic and MMW in Italy. The funds passed through a Cypriot company, Lassi; a Polish company, Tolus, then on to Universal. The computer IP address used to make all of the payments from Peoria and MMW through to Universal was the same. These payments took place in 12 minutes.

92. Having received the funds from Universal, DDR paid them, less £14 (the FCIB transaction charge was £13.56) to its supplier Infinity which then paid Vertex. Vertex made a payment to MMW which then paid Peoria. The payments from Infinity and MMW were made using the same IP address that had been used by Peoria, MMW, Lassi and Tolus used to make the payments an hour or so earlier.

93. It should be noted that the total funds used in loop one exceeded the amount paid to DDR. The additional funds were used by Universal to pay CCA Distribution Limited ("CCA") a UK broker that paid Future, a contra-trader, which paid Vertex. Therefore, the full amount of funds are split and then re-joined with Vertex paying MMW £1,825,281 which it then paid to Peoria. The complete set of transactions took place within an hour and 51 minutes.

94. It is necessary, according to Peter Birchfield, the HMRC Officer who undertook the analysis of the FCIB accounts, to view the payment of funds in respect of deals two and three together.

95. In the second "loop" DDR received a total of £4,678,467 from Elandour although the total amount on the invoices DDR issued was £4,886,860 leaving a shortfall of £208,393. The credit note from Infinity in respect of 500 of the 1,000 Nokia N80 handsets would, if that credit note had been carried through to the sale to Elandour, have resulted in an amount due of £4,680,110, a deficit of £1,643, but no credit note from DDR to Elandour has been provided.

96. The £4,678,467 received by Elandour was received in four payments of £582,000, £1,242,250, 1,824,024 and £1,030,013. The first two payments occurred at precisely the same time and made a combined sum of £1,824,250. This was paid to Elandour via Estocom, an Estonian company, by Peoria less than three minutes after it had received the sum of £1,025,281 from loop one. The same computer IP address was used for the transactions by Peoria, Estocom and Elandour.

97. After receiving payment from Elandour, DDR paid the funds, less £50, to Infinity. Infinity paid Vertex which paid MNW in four payments totalling £1,824,204 and then in two payments amounting to the same sum to Peoria. The payments from MMW were made from the same IP address as Peoria, Estocom, Elandour and Lassi. It would appear that the operator of the computer at this IP address made an error at this point in loop two as the funds were first paid from MMW to Lassi and immediately paid them back again before payment was made to Peoria. This loop of payments took place in 54 minutes.

98. The third "loop" involved the movement of the same monies as the previous loop to fund the payment of £1,824,204 to DDR by Elandour. These funds passed from Peoria via Estocom to Elandour to DDR as in loop two with the same IP address controlling each of the paying accounts up to DDR, although it must be emphasised that DDR had a different IP address. On receipt of the money DDR paid the full sum on to Infinity. The "Peoria" IP address was again used to pay £1,824,300 from Infinity to Vertex which paid MMW. MMW paid Peoria which then paid Lassi.

99. This loop of payments from Peoria to Peoria/Lassi took place in 48 minutes.

100. In Loop four the "Peoria" IP address made payments of the same funds in the same amounts from Peoria and Lassi to Estocom and Tolus respectively. The same IP address is then used to pay £1,030,013 from Estocom through Elandour to DDR and £794,000 from Tolus to Universal which then paid via CCA the full amount to Future.

101. DDR paid its full amount to Infinity. Infinity paid Vertex, as did Future. However, the IP address for Infinity on this occasion was not the "Peoria" address previously used. The payments for this fourth loop from Peoria to the contra-trader Infinity all took place in 15 minutes.

Due diligence

102. DDR provided HMRC with due diligence documents, some of which were in the name of BSG, it obtained on its supplier and customers. In addition documents were provided in relation to this appeal by DDR. These demonstrate that the following checks were undertaken.

103. With regard to Infinity DDR obtained:

(1) verification of VAT number with HMRC's Redhill office;

(2) a letter of introduction;

(3) confirmation of HSBC and FCIB details;

(4) copy of its VAT registration certificate;

(5) copy of its certificate of incorporation;

(6) a completed DDR trading form;

(7) names of two trade references;

(8) a due diligence visit report completed by Mr Peters;

(9) a Creditsafe report;

(10) a copy of a director's passport; and

(11) photographs of its business premises.

104. The "Due Diligence Visit Report" was prepared by Mr Peters after a visit to Infinity sometime in April 2006. Mr Peters recorded that the due diligence undertaken by Infinity comprised of a Redhill and EU VAT checker verification of VAT

numbers, a minimum of 1½ years trading relationship with suppliers, inspection of all stock including a physical check and confirmation that all stock is "brand new". Although this was not equal to the extent of due diligence undertaken by DDR Mr Peters nevertheless concluded:

> We are satisfied with every aspect of this company and have decided to open trading with Infinity Holdings.

105. The Creditsafe report, which DDR obtained on 8 June 2006 states that neither a credit rating nor a credit limit could be given for Infinity. The reason for this was "financial statements not filed/too old". The report also describes Infinity's business as "other computer related activities" whereas it supplied DDR with mobile telephones.

106. For every supply of mobile telephones that it made to DDR Infinity sent, by fax the following declaration:

> Dear Michael [Peters],
>
> All the stock bought for our deal is imported stock. No goods were bought in the UK. The goods are all sound and secure and are original as the seals are not broken.
>
> Any problems please do not hesitate to contact me.
>
> Thanks
>
> Sarj

107. For Universal DDR obtained:

(1) verification of VAT number with HMRC's Redhill office;

(2) a letter of introduction;

(3) confirmation of bank details;

(4) three page document in German regarding Universal;

(5) a completed trading application form;

(6) names of two trade references;

(7) due diligence report;

(8) photographs of its business premises;

(9) completed supplier declaration; and

(10) a signed declaration that goods will not be sold back to the UK.

108. In her evidence Ms Orr refers to the documentation in German and notes that no English translation was provided although Mr Peters confirmed that he could not read German. Mr Peters said the due diligence report was conducted by a company called Petrel which offered to undertake DDR's due diligence at the same time as carrying out its own.

109. The due diligence undertaken on Elandour consisted of:

(1) verification of VAT number with HMRC's Redhill office;

(2) a letter of introduction;

(3) three page document in French;

(4) a completed trading application form;

(5) confirmation of FCIB account details;

(6) names of two trade references;

(7) copy of director's passport; and

(8) a signed declaration that goods will not be sold back to the UK.

110. DDR requested that its customers sign and date a declaration that the goods supplied by DDR would not be sold in the UK. The declaration stated:

> Dear Sir/Madam,
>
> DDR Distribution prides itself in the thoroughness of our due diligence, and we are constantly improving our checks that we undertake with both our suppliers and customers in the bid to make our chosen industry more secure.
>
> We would therefore like to reiterate that DDR Distribution Ltd will not assist in the onward transit of goods via the UK or sold specifically into the UK once we have exported from the UK.

In the case of Universal the declaration was made on 14 July 2006, 11 days after the goods had been released to it by DDR.

111. Although DDR obtained the names of two trade references from its supplier and customers there is no evidence that these were ever taken up. Also DDR does not appear to have obtained any sort of credit report on its EU customers.

112. No due diligence appears to have been undertaken by DDR on its UK freight forwarder Courier Plus, the transport agents, Advanced Transport Limited, A1 Inspections Limited or its EU freight forwarder Boston Freight.

Post 06/06

113. On 20 July 2006 HMRC wrote to DDR stating that its 06/06 repayment claim was subject to verification. Information regarding the deals was provided to HMRC which, in a letter dated 30 January 2008, notified DDR that its claim for input tax for this period, the subject matter of this appeal, had been denied.

114. In a letter dated, 25 April 2007 HMRC denied BSG's 04/06 repayment claim. BSG appealed to the VAT and Duties Tribunal, the predecessor of this Tribunal, against that decision on 21 May 2007.

115. Although, as we discuss in more detail below, the appeal was dismissed by the Tribunal, BSG's appeal to the High Court (in accordance with the procedure in place before the establishment of the Tax Chamber of the First-tier Tribunal and Tax and

Chancery Chamber of the Upper Tribunal) was successful and was subsequently upheld by the Court of Appeal.

Discussion

116. Before turning to the substance of DDR's appeal, given their nature, we consider it appropriate to address the two issues raised in the letter of 7 November 2013 from DDR's solicitors, which we have set out at paragraph 5, above.

117. First, that Mr Peters, who maintains that he operated DDR in exactly the same way as he operated BSG and despite the judgment of the Court of Appeal in BSG's favour, is sure that that the Tribunal will simply find against DDR as it did with BSG; and secondly, that he has lost all confidence in the Tribunal and its process because HMRC were permitted to appeal a direction of one Tribunal Judge to another Tribunal Judge. In doing so it is necessary to set out the procedural background and nature of these matters.

BSG

118. As the VAT and Duties Tribunal which heard BSG's appeal noted in its decision (which is reported at [2008] UKVAT V20901), at [91]:

> "Allegations relating to actual knowledge were not admissible, in the light of the basis on which Mr Wallace had, following a preliminary hearing, directed that the appeal should proceed."

This refers to an application by HMRC to amend its Statement of Case to allege actual knowledge of fraud by BSG. That application had been dismissed at a preliminary hearing on the ground that the substantive hearing before the Tribunal was imminent. An application made at the same time for DDR's appeal to be heard by the Tribunal together with that of BSG was also dismissed.

119. The issues and the nature of proceedings before the Tribunal in that case are apparent from the following extract from the opening of counsel for BSG:

> "… the [BSG] appeal is unusual in that the only allegation levelled against [BSG] is that its due diligence was insufficient, and as a result it is said by the Commissioners it ought to have been aware of the alleged fraudulent background
>
> There is no allegation that [BSG] itself operated fraudulently, and indeed there is a procedural background to that.
>
> The issues thus are first, HMRC must demonstrate that there has been a VAT loss, and that is not admitted by [BSG]. If there was a loss, [BSG] was very remote from the loss, knows nothing of it and HMRC is put to proof of the loss.
>
> Second, and again this is citing a lengthy line of authorities, if the Commissioners succeed in demonstrating a loss that the loss resulted from a fraudulent evasion by some party or other.

> If the Commissioners surmount those two hurdles they must demonstrate that the fraudulent evasion was connected with the [BSG] transaction, the subject of this appeal, and to all intents and purposes there are only two [BSG] transactions. Indeed, one could say that there is only one, because there are two purchases from a UK supplier, Infinity – there are purchases from a UK supplier, Infinity, which is one aspect of the transactions, and then onward sales to two separate customers who throughout are referred in shorthand as Universal and a different company, Allimpex.
>
> So the Commissioners must demonstrate that any fraudulent evasion that they can show was connected with those transactions.
>
> And then the fourth issue to which the meat of the evidence will go, if the Commissioners surmount those four hurdles, they must show that [BSG] ought to have known that its purchases were connected with the fraudulent evasion of VAT"

120. Having found that there were tax losses which resulted from fraudulent evasion, that BSG's April 2006 transactions were connected with such fraudulent evasion and that BSG should have known of that connection the Tribunal dismissed the appeal saying, at [162], that:

> "We consider that the due diligence exercise relating to Universal was inadequate, as was the failure to follow up outstanding questions where matters did not appear to be in satisfactory order. The exercise was not sufficient to protect BSG from the risk of involvement in transactions which might turn out to have undesirable associations."

At [223] the Tribunal concluded:

> "As we have already described, the process of reviewing Mr Peters' (and thus BSG's) actions and omissions in relation to the two April 2006 deals is one of painting a picture from the details put before us. Our overall conclusion, taking into account the deficiencies in BSG's due diligence procedures and the dating of the commitments to buy and sell the stock, before those procedures had even been completed, is that Mr Peters did not do enough to protect himself (and therefore BSG) from the risk of becoming enmeshed in transactions which might prove to be connected in some way to fraud. The ease with which he was able to find purchasers of large consignments of mobile phones, as well as a supplier able at virtually no notice to fulfil orders for precisely the types of phones required, should have put him on notice that the arrangements called for further investigation, particularly as the invoicing for the transactions was organised to coincide on the same day for all stages in each chain. This insufficiency of action to protect BSG leads us to the view that, in terms of the statement in *Kittel* at [61] he
>
> > ". . . should have known that, by his purchase, he was participating in a transaction connected with fraudulent evasion of VAT"."

Given the emphasis placed on the adequacy of BSG's due diligence by its counsel in his opening it is perhaps not surprising that the Tribunal reached such a conclusion.

121. BSG appealed to the High Court against this decision where the case was heard by the Chancellor.

122. As HMRC were prohibited from alleging actual knowledge of fraud by BSG before the Tribunal there would seem to be little significance in the observation by the Chancellor, in his decision to allow BSG's appeal (reported at [2009] STC 2239) at [47] that:

> "… there is no suggestion that BSG knew of any fraudulent evasion of VAT. Further the Tribunal rejected the suggestions either that BSG had been controlled or manipulated as part of some wider conspiracy or that its controlling director, Mr Peters had 'turned a blind eye' to the various elements of the transactions."

However, at [52] the Chancellor considered the approach of the Tribunal cited above to be:

> "… misleading for two reasons. First the burden is on HMRC to prove that BSG ought to have known that by its purchases it was participating in transactions connected with fraudulent evasion of VAT. It is not for BSG to prove that it ought not. Second, it is not sufficient to demonstrate that BSG was involved in transactions which "might" turn out to have undesirable associations. The relevant knowledge is that BSG ought to have known that by its purchases it was participating in transactions which were connected with the fraudulent evasion of VAT; that such transactions might be so connected is not enough."

123. HMRC appealed against the decision of the Chancellor to the Court of Appeal where the case, was heard together with that of Mobilx Limited (in Administration), Calltel Telecom Limited and Opto Telelinks (Europe) Limited and is reported at [2010] STC 1436. It has, as is apparent from our reference to it in paragraph 10 above, become the leading domestic authority in relation to MTIC fraud.

124. Moses LJ, giving the judgment of the Court of Appeal, in relation to the BSG appeal said:

> "[68] … the question arises whether the Tribunal applied the test in *Kittel* correctly. If it did not, the question then arises as to whether, on the application of the correct test, the true and only reasonable conclusion is that the trader knew or should have known that his transactions were connected with fraud or that there was no reasonable possibility other than they were was connected with fraud. If a decision either way would fall within the bounds of reasonable conclusion, this Court ought not to interfere.
>
> [69] In BSG, the Tribunal posed the question correctly (see § 105) and framed its conclusion in terms of the correct test:-

> "Our conclusion is that *BSG* ought to have known that, by its purchases, it was participating in transactions connected with fraudulent evasion of VAT." (§ 228)

[70] However, the problem identified by the Chancellor, particularly at § 52, is that the Tribunal appears to have approached the evidence by asking whether Mr Peters, the sole director and shareholder in BSG, exercised sufficient care and diligence when faced with what the Tribunal regarded as the uncommercial features of the deals being offered to BSG. It focussed on what he might have discovered had he made further investigations (see § 228). This approach, in the view of the Chancellor, led it into error. The Chancellor pointed out that no amount of enquiry would have revealed knowledge of the fraud with which Infinity's transactions were connected in the dirty, but not the clean chain, of which BSG's transactions formed part (see judgment, §§ 54-55).

[71] The Tribunal set out a number of features of the deals which appeared to be uncommercial. It is unnecessary to list them but they led the Tribunal to say:-

> "225. Having regard to Mr Peters in relation to his own companies and his previous employers, we consider that the absence of any such investigation by Infinity into BSG should have raised suspicions in his mind.
>
> 226. We do not find on the evidence before us that there was control and manipulation, although we do consider that Mr Peters was much too ready, without careful and detailed review and exhaustive checks of all aspects of the proposed transactions, to become committed to them. It is not correct that he turned a blind eye to various elements of the transactions, but his enquiries were not sufficiently exhaustive to protect *BSG*."

[72] The Tribunal set out a number of important questions:-

> "(1) Why was BSG, a relatively small company with comparatively little history of dealing in mobile phones, approached with offers to buy and sell very substantial quantities of such phones?
>
> (2) How likely in ordinary commercial circumstances would it be for a company in BSG's position to be requested to supply large quantities of particular types of mobile phone and to be able to find without difficulty a supplier able to provide exactly that type and quantity of phone?
>
> (3) Was Infinity already making supplies direct to other EC countries? If so, he could have asked why Infinity was not making supplies direct, rather than selling to UK traders who in turn would sell to such other countries.

> (4) Why are various people encouraging BSG to become involved in these transactions? What benefit might they be deriving by persuading BSG to do so? Why should they be inviting BSG to join in when they could do so instead and take the profit for themselves?" (§ 227)

[73] Finally, the Tribunal concluded that:-

> "We think that if he had asked and obtained answers to the appropriate questions, he (Mr Peters) would have concluded that the uncommercial features of the deal being offered to BSG could only be explained by taking into account other transactions which Infinity was entering into, and that the most probable explanation was that those other transactions were connected in some way with fraud." (§ 228)

[74] I am not prepared to reject the Chancellor's conclusion that the Tribunal's findings were insufficient to establish that BSG ought to have known that by its past purchases it *was* participating in transactions which were connected with fraudulent evasion of VAT (judgment, § 52). But I put my view in that guarded way for this reason. Read as a whole, the Tribunal does not appear to have found that BSG should have concluded that the only reasonable explanation for the circumstances in which it entered into the impugned transactions was that those transactions were connected with fraud. But the Tribunal came very close to making such a finding and I have only stepped back from reaching that conclusion myself because of the Tribunal's references to risk (§§ 162 and 226) and in particular because of the Tribunal's undue focus on whether Mr Peters had exercised due diligence or done "enough to protect himself". That is not the only question.

[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. The Tribunal might have concluded that Mr Peters should have known that the transactions into which he entered were connected with fraud, by reference to the unconventional nature of those circumstances (a finding it came close to making at § 228). But it was not the only decision within the bounds of reasonable conclusion.

[76] Accordingly, the importance of BSG may be in the Tribunal's recognition of the surrounding uncommercial circumstances which it identified in the questions I have set out above. But for the reasons I have given I would dismiss HMRC's appeal.

125. It is clear from the procedural history, as set out above, and nature of BSG's appeal that the allegations made and evidence presented in the present appeal is materially different from that case. In addition we have the benefit of the Court of Appeal decision in *Mobilx* in relation to the "should have known" issue.

126. Therefore, unlike the Tribunal in BSG, it is open for us to consider allegations of actual knowledge of fraud as well as whether DDR should have known its transactions were connected to fraud and, as is clear from the Court of Appeal decision, the ultimate question is not whether DDR through Mr Peters exercised sufficient due diligence, as the Tribunal had asked in BSG, but rather whether he should have known that the only reasonable explanation for the circumstances in which the transactions took place was that they were connected to fraudulent evasion of VAT.

127. In reaching our conclusions in this appeal we will not, despite Mr Peters' belief to the contrary, simply find against DDR just because a Tribunal dismissed BSG's appeal. Not only are findings of fact by one Tribunal not binding on another it would be wholly inappropriate to do so and contrary to the overriding objective of the Tribunal Procedure (First-tier Tribunal)(Tax Chamber) Rules 2009 to deal with cases "fairly and justly".

128. It is therefore incumbent upon us not to unduly focus on the question whether DDR has acted with due diligence but to consider the totality of the evidence before the Tribunal in this appeal in order to consider the inferences to be drawn and conclusions to be made from that evidence in the light of the applicable legal principles.

Directions

129. As stated in the 7 November 2013 letter from DDR's solicitors, the direction of Judge Cornwell-Kelly released on 12 August 2011 that "no evidence may be served in relation to dealings with or at" the FCIB was set aside by the direction of Judge Demack, after a hearing on 29 February 2012. This direction was released on 10 May 2012. On 26 June 2012 an application was made by DDR for the direction of Judge Demack to be set aside and that of Judge Cornwell-Kelly be restored and DDR be awarded its costs resulting from the late service of evidence by HMRC.

130. The letter from DDR's solicitors in which the application was made stated:

> It is essential that these applications are heard only by Judge Malachy Cornwell-Kelly and not referred to yet another tribunal…

131. As Judge Bishopp (the President of the Tax Chamber of the First-tier Tribunal) noted, in his "Reasons for Direction" in the subsequent application by DDR for a direction that HMRC pay its costs of "considering and responding to the matters arising from the late served witness statements and exhibits":

> "8. … Judge Mosedale dealt with the application [for the direction of Judge Demack to be set aside and that of Judge Cornwell-Kelly be restored] without a hearing, in accordance with rule 29 of the Tribunal Procedure (First-tier Tribunal)(Tax Chamber) Rules 2009. She refused the request that Judge Cornwell-Kelly should deal with the matter on the ground that by virtue of para 14 of Sch 4 to the Tribunals, Courts and Enforcement Act 2007 the determination of the panel to hear any matter is the responsibility of the Senior President of Tribunals. He has

> in fact delegated that responsibility to Chamber Presidents, and it is not within Judge Mosedale's power to make such a determination. Moreover, had I been asked to nominate Judge Cornwell-Kelly to deal with the application I would not have done so since it seems clear to me that the motive for the application is the hope that he would prefer his own direction to that of Judge Demack.
>
> 9. Judge Mosedale made various observations about the scope of the powers to set directions aside, but went on to conclude that there was no obvious error of law in Judge Demack's directions, sufficient to enable her to set it aside under any of the rules – 6, 38 or 41 – which provide for the setting aside of decisions and directions, but instead gave permission to appeal to the Upper Tribunal against those of the directions which set aside para 3 of Judge Cornwell-Kelly's direction [that no evidence may be served in relation to dealings with or at the First Curacao International Bank] and admitted Mr Birchfield's evidence [in relation to the FCIB]. The appellant did not however, pursue such an appeal"

132. If, as the 7 November 2013 letter suggests, Mr Peters and/or DDR considered that there had been procedural irregularity or unfairness in that one Tribunal judge set aside the direction of another, and we express no view on this, as Judge Mosedale noted, at [35] of her decision on this matter (reported at [2012] UKFTT 443 (TC)), it does not leave the appellant without a remedy as it is possible to appeal against a direction made in such circumstances.

133. We note that Judge Mosedale granted permission to appeal against the directions of Judge Demack and that DDR chose not to do so.

134. Turning to Judge Bishopp's decision on DDR's application for costs, although, at [14], he dismissed the application as "misconceived" as evidence admitted later than the time originally prescribed is:

> "... evidence like any other in the case; it is not as the application suggests in a different category. Specifically, it is no longer "late", because it has been adduced in accordance with a direction of the tribunal. Whether the time limit is extended or the evidence is admitted notwithstanding its expiry is immaterial; all that matters is that the evidence has been admitted.

He continued, at [15]:

> "The appellant may, of course, recover its costs of considering and dealing with it [the evidence] if, at the conclusion of the case, the tribunal thinks it appropriate to make a direction to that effect, either because the appellant succeeds and the tribunal considers it should have its costs of the appeal as a whole, or because the tribunal perceives a reason to make a direction specifically relating to this evidence."

As Judge Bishopp recognised, at [15]:

> "… these are matters to be determined after the hearing."

And as such, we consider the question of costs in general and these costs in particular below.

135. However, the fact that Judge Bishopp refers to costs being awarded "because the appellant succeeds" is another clear indication that, contrary to what Mr Peters believes, this case has not been pre-judged.

DDR

136. We now turn to the substantive issues raised in this appeal and remind ourselves that, having accepted that there was a fraudulent loss of tax and that its transactions were connected to this loss, the issue for us to determine is whether DDR through Mr Peters knew or should have known of this connection and in doing so must consider the totality of the evidence and not unduly focus on due diligence.

137. However, it is first necessary to consider the awareness and knowledge that Mr Peters, and therefore DDR, had of MTIC fraud at the time of the transactions.

138. As early as 24 October 2002, during DDR's pre-registration visit Mr Munroe-Birt recorded that Mr Peters was not only aware of MTIC fraud but said that within the industry there was a split between genuine dealers and the MTIC dealers who are disliked as they taint the rest of the trade (see paragraph 39, above).

139. There were also the letters from HMRC to DDR and BSG that warned of the prevalence of MTIC fraud and that its investigation was HMRC's "top priority" (see paragraphs 56 and 62, above). Mr Peters was also provided with several copies of Notice 726 eg enclosed with the letter of 12 July 2005 to BSG and that of 27 July 2005 to DDR (see paragraph 46, above) as well the issue of MTIC fraud being raised in the "aide memoir" visit by HMRC on 7 February 2006 (see paragraph 60, above). Mr Peters was also provided with a further copy of Notice 726 during the visit by HMRC on 13 June 2006 shortly before the deals in question took place (see paragraph 66, above).

140. We therefore have no hesitation in finding that Mr Peters was fully aware of the prevalence of MTIC fraud and the measures necessary to combat it.

141. Also, given the timing of the movement of funds through the FCIB accounts of the participants and use of "Peoria" IP address by several of them it would seem highly improbable, if not impossible, for these to be arms-length commercial transactions between unconnected parties. Indeed the evidence leads us to conclude that there was a contrived scheme for the fraudulent evasion of VAT with each of the deals having been pre-arranged.

142. Mr Foulkes contended that the only way a trader without knowledge of the connection to fraud could operate within a contrived scheme would be if it was an "innocent dupe" being manipulated into buying and selling to the right people at the right price in the right type and quantity of goods and this would be an inherently difficult situation to control and would carry considerable risk that the manipulation

would fail and the scheme frustrated with the circularity identified in the FCIB accounts being lost.

143. We accept his submission that in order to involve an innocent dupe those manipulating him would have to exercise such control that it would be obvious to the dupe that he was being controlled and discount the possibility that DDR was such an innocent dupe in the transactions with which we are concerned. We find support for such a conclusion in the timing and speed of the movement of funds through the FCIB accounts in which DDR clearly played its part (see paragraphs 90 – 101, above).

144. In our judgment it is extremely unlikely that the payments through the FCIB accounts could have been made without the knowledge of each of the participants, including DDR, otherwise it would not have been possible to ensure that payments were made on time and in the correct order to complete their circularity.

145. Further factors lead us to the same conclusion, namely that Mr Peters, and therefore DDR, must have known of the connection of the transactions to fraud.

146. These include:

(1) The release of goods before payment when they were transported on a "ship and hold" basis – the only reasonable explanation as to why goods transported on such a basis were being released before payment is that it was known that payment was to be received in any event;

(2) Minimal commercial risk – DDR did not make any payment to its supplier until it had been paid by its customer;

(3) The consistent mark-ups in all of the transaction of approximately around 6% irrespective of the type of mobile telephone involved or the quantities traded;

(4) DDR continued to purchase goods from Infinity seemingly without raising any questions despite concerns being raised about the company by HMRC Officers Lisa Orr and Doug Armstrong during their visit to BSG on 19 June 2006 when they met with Mr Peters shortly before transactions with which this appeal is concerned took place (see paragraph 65, above)

(5) The failure by DDR to react when told by HMRC that transactions in its 12/05 repayment claim had been traced to fraud (see paragraph 62, above); and

(6) The anomalies in the inspection reports mentioned in paragraphs 77, 84 and 89, above.

147. There is also the question of due diligence.

148. In his second witness statement Mr Peters accepts that "the due diligence of DDR was no better than that of BSG". He also accepts the criticism of the Tribunal which found the due diligence of BSG to be "inadequate" (see paragraph 120, above). Having considered the due diligence undertaken by DDR we find it to be no better eg although a Creditsafe report was obtained for Infinity, it does not appear to have had any effect on DDR's decision to trade with Infinity despite neither a credit rating nor

a credit limit being given. No such reports were obtained in respect of Universal or Elandour; also there was a failure to take up any trade references or carry out any due diligence on Courier Plus or Boston Freight despite relying on these to handle millions of pounds worth of goods.

149. Clearly there would be not be any need for a knowing participant in the deals to undertake out any effective or thorough due diligence.

150. DDR being such a participant would also explain the exponential increase in its turnover from £11,892 in its 06/05 VAT accounting period to £6,170,228 in equivalent period twelve months later.

151. However, even if DDR was not a knowing participant we find, for the above reasons, that the only reasonable explanation for the transactions in which DDR was involved is that they were connected with the fraudulent evasion of VAT and that Mr Peters and DDR should have known that this was the case.

152. We therefore consider that HMRC were correct to deny DDR's input tax claim

Decision

153. For the above reasons the appeal is dismissed.

Costs

154. The directions made by Judge Cornwell-Kelly, released on 12 August 2011, included a direction (which was not subsequently set aside by Judge Demack) that rule 29 of the Value Added Tax Tribunals Rules shall have effect in substitution for rule 10 of the Tribunal Procedure (First-tier Tribunal)(Tax Chamber) Rules 2009. The effect of this direction is to give the Tribunal a general discretion as to costs.

155. In view of our conclusion that HMRC were correct to deny DDR its input tax we consider that it is appropriate to direct that, other than those costs which were the subject of the application before Judge Bishopp (ie the costs of DDR "of considering and responding to the matters arising from the late served witness statements and exhibits"), it should pay HMRC its costs of, incidental to and consequent upon the appeal with such costs to be assessed if not agreed.

156. With regard to its costs that were subject to the application before Judge Bishopp we direct that the appellant may, if so advised, within 28 days following the release of this decision make an application to the Tribunal in respect of these costs together with either written submissions in support of the application on the Tribunal and HMRC (to which HMRC may respond within 28 days of receipt) or alternatively make an application for an oral hearing within that time. In the absence of any application for an oral hearing and should DDR apply for costs, it will be decided on the basis of written representations.

Right to apply for Permission to Appeal

157. 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.

JOHN BROOKS
TRIBUNAL JUDGE

RELEASE DATE: 21 February 2014