TC04377

Appeal number: TC/2012/07163

VALUE ADDED TAX – input tax – denials of right to deduct on grounds that the Appellants knew or should have known that the transactions were part of fraud by others – alleged MTIC – whether shown that the Appellant's transactions connected with fraudulent evasion of VAT – yes – whether Appellant knew or should have known of fraud – yes – valid refusals of right to deduct – appeals dismissed

FIRST-TIER TRIBUNAL
TAX CHAMBER

MY DIGI LIMITED **Appellants**

- and -

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

TRIBUNAL: **JUDGE JENNIFER BLEWITT**
MR DEREK ROBERTSON

Sitting in public at Manchester on 22 – 25 April, 28 – 30 April, 1 – 2 May, 7 – 9 May, 12 May and 16 June 2014

Mr N. Ginniff, Counsel instructed on behalf of the Appellant

Mr P. Taylor, Counsel instructed by HM Revenue and Customs, for the Respondents

DECISION

Introduction

1. This is an appeal against HMRC's decision dated 11 April 2012 by which HMRC denied input tax reclaims in the total sum of £122,937 arising from the Appellant's purchases of Jacobs watches from Jacob & Co UK Limited ("Jacob & Co") and onward sale to Ferenergy Commodities SARL ("Ferenergy") in 4 transactions.

2. The basis of HMRC's decision and its case before this Tribunal is, as set out in its Statement of Case, that the relevant transactions carried out by the Appellant in VAT period 03/11 were connected with the fraudulent evasion of VAT and that the Appellant knew or should have known of this fact.

3. By Notice of Appeal dated 18 July 2012 the Appellant appealed against HMRC's decision. The grounds of appeal relied upon can be summarised as follows:

(i) The company was unwittingly involved in trade that may have resulted in a tax loss and was certainly involved in fraudulent evasion of VAT though the misrepresentation and deceit of unscrupulous traders;

(ii) The Appellant is the ultimate victim;

(iii) The whole trading process was introduced to the Appellant by a senior manager of a multi-national listed French company based at a number of sites in the UK;

(iv) The supply of the product (fashion watches) which was outside the Company's normal area of expertise was provided by an authorised UK distributor of the manufacturer;

(v) The absence of insurance was due to the Company's existing insurer being unable to offer cover for such high value items. Insurance was subsequently put in place for March 2011;

(vi) The use of a freight forwarder was normal practise;

(vii) The source company and sales company were properly constituted companies with valid VAT registrations. This was established before the Appellant commenced trading in December 2010;

(viii) HMRC had witnessed a shipment received by the Appellant and inspected the product and paperwork. HMRC deliberately encouraged further trade by the Appellant in order to accrue a greater amount of VAT to withhold;

(ix) The Appellant did not know nor should it have known that by its purchase it was participating in a transaction connected to the fraudulent evasion of VAT;

(x) The Appellant was taken in by the deceit, lies and plausibility of criminals.

Missing Trader Intra-Community Fraud: Legislation and Case law

4. The legislation governing the right to deduct is contained within Sections 24 – 26 of the Value Added Tax Act 1994 and the VAT Regulations 1995 (SI 1995/2518). If a trader has incurred input tax which is properly allowable, he is entitled to set it against his output tax liability or to receive a repayment if the input tax credit due to him exceeds that liability. Evidence is required in support of a claim (Article 18 of the Sixth Directive and regulation 29 (2) of the VAT Regulations 1995).

5. A description of Missing Trader Intra-Community Fraud, hereafter referred to as "MTIC fraud", can be found in the judgment of Roth J in *POWA (Jersey) Ltd v HMRC* [2012] UKUT 50 (TCC):

"[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:

> *"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.""*

6. This appeal involves allegations of contra-trading.

7. *Kittel v Belgium, Belgium v Recolta Recycling* SPRL (C-439/04 and C-440/04) [2006] ECR 1-6161 *("Kittel")* provided the legal basis for the denial of the right to deduct in certain circumstances:

> *"55. Where the tax authorities find that the right to deduct has been exercised fraudulently, they are permitted to claim repayment of the deducted sums retroactively … It is a matter for the national court to refuse to allow the right to deduct where it is established, on the basis of objective evidence, that that right is being relied on for fraudulent ends...*
>
> *56. In the same way, a taxable person who knew or should have known that, by his purchase, he was taking part in a transaction connected with fraudulent evasion of VAT must, for the purposes of the 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 to do so even where the transaction in question meets the objective criteria which form the basis of the concepts of 'supply of goods effected by a taxable person acting as such' and 'economic activity'.

60. It follows from the foregoing that the answer to the questions must be 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.

61. By contrast, where it is ascertained, having regard to objective factors, that the supply is to a taxable person who knew or should have known that, by his purchase, he was participating in a transaction connected with fraudulent evasion of VAT, it is for the national court to refuse that taxable person entitlement to the right to deduct."

8. The *Kittel* test was further clarified by Moses LJ in *Mobilx Ltd and The Commissioners for Her Majesty's Revenue and Customs, The Commissioners for Her Majesty's Revenue and Customs and Blue Sphere Global Ltd, Calltel Telecom Ltd & another and The Commissioners for Her Majesty's Revenue and Customs* [2010] EWCA Civ 517 ("*Mobilx*") at [24]:

"The scope of VAT is identified in Art. 2 of the Sixth Directive. It applies, in addition to importation, to the supply of goods or services effected for consideration within the territory of the country by a taxable person acting as such. A taxable person is defined in Art. 4.1 as a person who carries out any of the economic activities specified in Art. 4.2. Art. 5 defines the supply of goods and Art. 6 the supply of services. The scope of VAT, the transactions to which it applies and the persons liable to the tax are all defined according to objective criteria of uniform application. The application of those objective criteria are essential to achieve:-

"the objectives of the common system of VAT of ensuring legal certainty and facilitating the measures necessary for the application of VAT by having regard, save in exceptional circumstances, to the objective character of the transaction concerned." (Kittel para 42, citing BLP Group [1995] ECR1/983 para 24.)

And at [30]:

"...the Court made clear that the reason why fraud vitiates a transaction is not because it makes the transaction unlawful but rather because where a person commits fraud he will not be able to establish that the objective criteria which determine the scope of VAT and the right to deduct have been met."

9. As to the issue of connection, in *Blue Sphere Global Ltd and The Commissioners for HM Revenue and Customs* [2009] EWHC 1150 (Ch) the Chancellor stated (at paragraphs 42 – 45):

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

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

10. On the issue of knowledge, Moses LJ in *Mobilx* provided the following guidance:

"4. Two essential questions arise: firstly, what the ECJ meant by "should have known" and secondly, as to the extent of the knowledge which it must be established that the taxpayer had or ought to have had: is it sufficient that the taxpayer knew or should have known that it was more likely than not that his purchase was connected to fraud or must it be established that he knew or should have known that the transactions in which he was involved were connected to fraud?

52. If a taxpayer has the means at his disposal of knowing that by his purchase he is participating in a transaction connected with fraudulent evasion of VAT he loses his right to deduct, not as a penalty for negligence, but because the objective criteria for the scope of that right are not met. It profits nothing to contend that, in domestic law, complicity in fraud denotes a more culpable state of mind than carelessness, in the light of the principle in Kittel. A trader who fails to deploy means of knowledge available to him does not satisfy the objective criteria which must be met before his right to deduct arises…

53. Perhaps of greater weight is the challenge based, in Mobilx and BSG, on HMRC's denial of the right to deduct on the grounds that the trader knew or

should have known that it was more likely than not that transactions were connected to fraud. The question arises in those appeals as to whether that is sufficient or whether, as the Chancellor concluded in BSG, the right to deduct input tax may only be denied where the trader knows or should have known that the transaction was connected to fraud (see judgment, § 52). In short, does a trader lose his entitlement to deduct if he knew or should have known of a risk that his transaction was connected to fraudulent evasion of VAT? HMRC contends that the right to deduct may be denied if the trader merely knew or should have known that it was more likely than not that by his purchase he was participating in such a transaction. It contends that if it was necessary to show more than appreciation of a risk then the Court's decision in Kittel would not represent a development of the law and would fail to achieve the objective, recognised in the Sixth Directive, to which the Court referred at § 54…

56. It must be remembered that the approach of the court in Kittel was to enlarge the category of participants. A trader who should have known that he was running the risk that by his purchase he might be taking part in a transaction connected with fraudulent evasion of VAT, cannot be regarded as a participant in that fraud. The highest it could be put is that he was running the risk that he might be a participant. That is not the approach of the Court in Kittel, nor is it the language it used. In those circumstances, I am of the view that it must be established that the trader knew or should have known that by his purchase he was taking part in such a transaction, as the Chancellor concluded in his judgment in BSG:-

"The relevant knowledge is that BSG ought to have known by its purchases it was participating in transactions which were connected with a fraudulent evasion of VAT; that such transactions might be so connected is not enough." (§ 52)…

58. As I have endeavoured to emphasise, the essence of the approach of the court in Kittel was to provide a means of depriving those who participate in a transaction connected with fraudulent evasion of VAT by extending the category of participants and, thus, of those whose transactions do not meet the objective criteria which determine the scope of the right to deduct. The court preserved the principle of legal certainty; it did not trump it.

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.

83. We also had regard to Christopher Clarke J in *Red 12 v HMRC* [2009] EWHC 2563 at [109] – [111]:

"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.

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.

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.""

84. In *POWA (Jersey) Ltd* (ibid) Roth J also said:

"However, I do not see that there is any requirement that PJL should reasonably have known the identity of the contra-trader. HMRC must establish that fraudulent evasion of VAT took place, and if the form of fraud involved was contra-trading then that is what they have to prove. But it is a misconception to consider that they must also establish that the party seeking to deduct input tax (i.e., here, PJL) should reasonably have known that its own transaction was connected to (or involved in) this particular form of missing trader fraud as opposed to another form. I do not regard the Chancellor's judgment in Blue Sphere Global as authority to the contrary. Moreover, I respectfully agree with the approach expressed by Briggs J in his subsequent judgment in Megtian Ltd v Commissioners [2010] EWHC 18 (Ch) at [37]-[38]"

85. In *Megtian Limited (in administration) v HMRC* [2010] EWHC 18 (Ch) at [34], [37] and [38] Briggs J stated:

> *"I do not read Lewison J's analysis of the issue as to what must be shown that the broker knew or ought to have known in a contra-trading case as amounting to a rigid prescription that, as a matter of law, such an analysis must be performed in every contra-trading case, such that it will be defective unless it identifies one or other of the alternative frauds as being that which the broker knew or ought to have known...*
>
> *In my judgment, there are likely to be many cases in which a participant in a sophisticated fraud is shown to have actual or blind-eye knowledge that the transaction in which he is participating is connected with that fraud, without knowing, for example, whether his chain is a clean or dirty chain, whether contra-trading is necessarily involved at all, or whether the fraud has at its heart merely a dishonest intention to abscond without paying tax, or that intention plus one or more multifarious means of achieving a cover-up while the absconding takes place.*
>
> *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."*

86. The burden of proof in this type of case rests with HMRC; per Moses LJ in *Mobilx* (paragraph 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."*

87. Our approach to the appeals was to recognise that, while we must consider the merits of the individual transactions, we should not view the transactions in isolation as to do so would be an artificial exercise and we were careful to only consider the knowledge of the Appellant, through the Company officers by what was known to them during the relevant period. We disregarded opinions provided by HMRC officers and we did not attach any weight to evidence established with the benefit of hindsight.

Issues

88. The issues to be determined in this appeal are:

(a) Was there a tax loss;

(b) If so, did this loss result from a fraudulent evasion;

(c) If so, were the Appellant's transactions which are the subject of appeal connected with that fraudulent evasion; and

(d) If so, did the Appellant know or should it have known that its transactions were so connected.

89. Mr Ginniff on behalf of the Appellant did not challenge the evidence adduced by HMRC in respect of (a), (b) and (c). However, on behalf of the Appellant it was submitted that although a connection existed the test is not satisfied as the fraudulent evasion of VAT had not been planned at the relevant time, namely at the time of the Appellant's purchase, more about which we will say in due course.

Preliminary Point

90. We should note at this stage that following our reading of the evidence but prior to any witnesses being called we were asked on behalf of the Appellant whether we would provide an indication as to the likelihood of success in this case. Whilst we were sympathetic to the financial implications of running an appeal we did not consider it appropriate to do so on the basis that we had not heard the case fully argued nor had we heard evidence from any witnesses.

Undisputed Background Facts

91. The Appellant was incorporated on 17 August 2010. The company officers are:

- Mr Andrew James Bluffield: appointed at incorporation and has a 23% shareholding;
- Mr Brian Philip Draper: appointed on 23 November 2010 and has a 25% shareholding;
- Mr Matthew Edward Jackson: appointed on 23 November 2010 and has a 23% shareholding; and
- Mr Brant Marcus: appointed on 14 March 2011 and has a 28% shareholding.
- Mr Neil Alan Hart has a 1% shareholding.

92. The Appellant was registered for VAT on 8 September 2010; its VAT registration application declared the intended trade as *"buying electrical products from main UK distributor (Apple) for overseas export"* with a trading category of *"wholesale of electronic and telecommunications."*

93. The VAT 1 completed by Mr Bluffield showed the principal place of business as 93 Kerscott Road, Manchester, M23 0GD which was Mr Bluffield's residential address.

94. On 1 November 2010 HMRC received a request from the Appellant's accountants for HMRC to reconsider its earlier refusal to change the VAT returns to monthly. The letter indicated that the turnover for the following 12 months was now expected to reach £4,000,000 or £5,000,000 as opposed to the £250,000 estimated on the VAT 1 submitted 7 weeks earlier. HMRC upheld its earlier refusal to allow monthly returns.

95. On 15 December 2010 HMRC was notified of a change of registered office and trading address to Unit 17, Birch Court, Grosvenor Grange, Warrington. The premises consisted of a rented warehouse with internal office.

96. At a visit to the company by HMRC on 21 March 2011, officer Shorrock had noted the roles of the four directors as follows: Mr Draper was responsible for book keeping and due diligence, Mr Marcus was responsible for sales, Mr Bluffield dealt with purchases and Mr Jackson married up the deals. It was also ascertained at that meeting that the Appellant had not secured any distribution agreement or contract with Apple directly although the company had traded in Apple I-Pods since becoming VAT registered. The principal trading activity of the Appellant (by sales value) was the wholesale distribution of Jacob & Co watches. The subsidiary trading activity was the wholesale distribution of electronic consumer goods such as Apple I-Pods and electronic games consoles.

97. On 1 April 2011 the Appellant submitted a VAT return for period 03/11 and claimed input tax of £122,937. On 20 April 2011 the Appellant was notified by HMRC that the return was being subjected to extended verification.

98. On 11 April 2012 the Appellant was notified that the input tax claimed had been refused on the basis that the transactions which form the subject of this appeal had been traced back to a defaulting trader via a contra-trader (Master UK Limited) and that the Appellant either knew or should have known of the connection.

Associated Company

99. The four directors of the Appellant are also directors of My Digi Retail Limited ("MDRL") which was a distributor of electronic goods and which shared premises with the Appellant.

100. MDRL was incorporated on 13 September 2010 and became registered for VAT on 13 September 2010. The VAT 1 completed by Mr Bluffield declared the current/intended trading activity as *"online web trading of electrical products"* with a trade category of *"retail sale via mail order houses or via Internet (main activity)."*

101. MDRL was de-registered for VAT with effect from 16 March 2012.

Deal chains and the transactions under appeal

102. The four transactions which form the subject of this appeal were sub-divided by reference to purchase invoice numbers to separately reflect each watch model traded. By way of example, the four separate watch models purchased on supplier invoice number 31 are referenced on deal sheets as 31-1, 31-2, 31-3 and 31-4.

103. The supply chains for all four transaction supply chains are:

Miniteh Treyding ("Miniteh") – Master UK Limited ("Master") – Mistral Marketing Limited ("Mistral") – Jacob & Co – My Digi Limited – Ferenergy

104. The four transactions took place on 16 March 2011 (deals 31-1 to 31-4), 21 March 2011 (deals 32-1 and 32-2), 28 March 2011 (deals 33-1 to 33-3) and 29 March 2011 (deals 34-1 to 34-3).

Master UK Limited

105. HMRC officer Edmead gave evidence relating to alleged contra-trader Master.

106. Master was incorporated on 14 May 2007 as a private limited company. Companies House details show the nature of the business as "*wholesale of other household goods.*" The directors and shareholders are Mr Amit Chauhan and Mr Rajwinder Singh Lashar.

107. The VAT 1 signed by Mr Chauhan on 2 July 2007 declared the business activities as packaging and wholesaler. Mr Chauhan subsequently clarified that the business would be "*wholesaling retail packaging to retail independents nationwide*" and that the packaging would include "*garment covers, paper bags, tissue paper, ribbon and wedding boxes.*"

108. Master was registered for VAT with effect from 14 May 2007. On 11 April 2011 HMRC officers made an unannounced visit to the company because it had acquired high value electrical goods commonly associated with MTIC fraud, the trader had an invoice showing VAT of £98,299.20 charged and no returns had been submitted for 4 quarters. In summary, HMRC ascertained at the meeting with the directors that the company had purchased 3-com switches from Bulgarian company Minitech and which it had sold to Mistral. Both trading partners had been found via websites. In respect of Minitech the only check conducted was an internet address check; Mr Chauhan did not know the position held by his contact Mr Uppal, he had not visited the premises nor did he know if the company was based in the UK or Bulgaria. Mr Chauhan estimated the combined total of invoices was between £800,000 and £900,000. Goods were released on receipt of payment and the goods were transported directly from Minitech to Mistral. Master was informed that the VAT return for 05/11 would be shortened under Regulation 25 and that the return and payment were due the following day.

109. Neither the return nor payment was forthcoming the following day when HMRC officers returned to visit Master. Consequently the company's VAT number was de-registered with effect from 12 April 2011 as a result of the company's pattern of trading, revenue history and its intention to not account for VAT. The decision by HMRC to de-register Master was never appealed.

110. The missing returns for periods 09/09, 03/10, 06/10, 09/10 and 12/10 were received on 4 May 2011. The returns for 02/11 and the period ended 11 April 2011 were received on 6 June 2011. Save for 02/11 all were payment returns but no payments were made. Officer Edmead noted that the return for 12/10 was inaccurate as sales of £6,000,000 were not declared.

111. The records eventually produced by Master showed that it acted in different roles in different transaction chains:

(a) Master acted as a buffer trader in the purchase and onward UK to UK sale of SSD hard drives;

(b) Master acted as an acquirer in the purchase of Jacob & Co watches from Minitech which it sold to Mistral;

(c) Master acted as an acquirer in the purchase of 3-Com switches from Minitech which it sold to Mistral;

(d) Master acted as a broker in its purchase of Juniper products which it purchased from Refill Ink Ltd t/a Computer and Laptop Repair Centre and which it sold to Dosa Consulting in Germany.

112. Officer Edmead noted that in the period ended 11 April 2011 Master acted as a contra-trader by offsetting its output tax due on EC acquisitions against its input tax on broker deals as follows:

Date	**Goods**	**Amount**	**VAT**	**Total**	**Total output tax due on all acquisitions**
14 March 2011	3 com switches	£491,496.00	£98,299.20	£589,795.20	-
13 March 2011	Jacob & Co watches	£156,912.52	£31,382.50	£188,295.02	-
18 March 2011	Jacob & Co watches	£184,749.32	£36,949.87	£221,699.19	-
28 March 2011	Jacob & Co watches	£127,249.00	£25,449.80	£152,698.80	-
29 March 2011	Jacob & Co watches	£117,429.00	£23,485.80	£140,914.80	£215,567.17

Date	**Goods**	**Amount**	**VAT**	**Total**	**Total input tax due on all acquisitions**
16 March 2011	Juniper EX2500 (high spec computer component)	£711,360.00	£142,272.00	£853,632.00	-
20 March 2011	Juniper EX2500	£725,040.00	£145,008.00	£870,048.00	-
23 March 2011	Juniper EX2500	£725,040.00	£145,008.00	£870,048.00	£432,288.00

113. It should be noted that the invoices in respect of the Juniper products were recorded between other invoices dated 8 and 11 April 2011. Officer Edmead explained in her written evidence that on 11 April 2011 Master was visited and stated that no EU exports had been made. The following day after HMRC issued a Regulation 25 Notice shortening the VAT period of the company Mr Chauhan

"attempted to contra their output liability by claiming to have sold goods to the German trader Dosa Consulting." Officer Edmead expressed doubt that the Juniper products were supplied.

114. Officer Edmead set out in her written evidence the chain of supply in which Master acted as acquirer purchasing Jacob & Co watches from Bulgarian company Minitech which were then sold by Master to Mistral to Jacob & Co to the Appellant which exported the goods to Ferenergy in France.

115. To offset its tax liability on those goods it had purchased from the EU Master claimed that Juniper EX2500 goods were sold in three transactions to German company Dosa Consulting ("Dosa").

116. The chain of supply was as follows:

Biznesa Meistars S.I.A. (Latvia) ("Biznesa") – PCSG – Refill Ink Ltd t/a Computer Laptop Repair Centre – Master – Dosa.

117. Checks carried out by HMRC into Dosa revealed that Dosa was a missing trader and that PCSG was a defaulting trader. Furthermore, the supplier to Master, Refill Ink Ltd had undertaken transactions in which five of those transaction chains were traced back to a tax loss of £79,598.

118. The EU supplier Biznesa was a company dealing in CO2 gas emission licences on the London Stock Exchange and which was inactive in 2011.

119. The senior compliance manager of Juniper Networks Ltd, Mr Russell Hodgkiss, gave unchallenged evidence regarding the product Juniper EX2500. He confirmed that it was sold directly to customers who are high end internet service providers and indirectly through authorised distributors and resellers. Products that were manufactured in Asia were imported into the Netherlands where they were collected by customers. The product EX2500 was usually sold in small quantities of 10 or less and since its introduction in 2009 up to 29 July 2011 worldwide sales amounted to less than 1000. Master, which was not an authorised distributor, purportedly sold 158 units in 8 days which amounts to 71.5% of the UK market and 15.8% of the global market.

120. On 21 November 2011 Officer Edmead notified Master by letter that the input tax claimed in respect of the Juniper transactions in the sum of £432,288.00 had been denied on the basis that the invoices were deemed to be invalid. Master has not appealed this decision and the debt remains unpaid.

121. On 23 April 2012 Master was wound up.

122. In oral evidence Officer Edmead accepted that it was possible that the Juniper transactions could have been thought up between 11 and 12 April 2011 stating:

> *"It's not something I could really answer other than to say that with the contra-trading, because they're looked at as contrived, that it could very well be that at some point to get them out of that particular hole then there was going to be some contra-trading at some point but other than that, no, I couldn't in all honesty say."*

(Transcript 29/4/14 page 81)

PCSG (Northwest London) Limited ("PCSG")

123. The defaulting trader in this chain of transactions was PCSG.

124. HMRC officer Beaddie gave evidence regarding PCSG which was incorporated on 13 May 2008 and dissolved on 5 December 2012.

125. The company was registered for VAT with effect from 13 May 2008 with a trade classification of computer consultancy activities. At the date of incorporation the directors were Sundesh Niran Kumar Hemraj and Rita Hemraj. The VAT 1 stated the intended business activity as IT consultancy, computer troubleshooting, IT network design/infrastructure, back ups recovery and systems monitoring.

126. There was a significant change in the sales declared by the company which increased from £10,002 in 04/10 to £664,662 in 10/10. At a visit by HMRC to the company on 5 October 2010 it was discovered the Mr Hemraj had sold the company to Mr Paul Kelly; no money changed hands in respect of the sale however Mr Kelly took over the company including the debt of £8,500.

127. The company was again sold at no cost to Mr Darren McDade who took over as sole director in July 2010. At a meeting with the company on 6 December 2010 Mr McDade confirmed that the company was now trading in large screen televisions, games consoles and small electrical goods. IT consultancy had ceased. As regards the dramatic increase in turnover Mr McDade told HMRC that this had been easily achieved as he is a good salesman and found his suppliers and customers through the IPT and IGT websites. Mr McDade had no previous experience in this type of trade but had worked on a market stall.

128. An examination of the accounting records provided by the company revealed significant accounting errors in the manual records and demonstrated that the company had been buying from and selling to the EU in 07/10 and 10/10. Both periods were subjected to extended verification.

129. Following a visit to PCSG's premises on 9 June 2011 the company was compulsorily de-registered for VAT. The letter of the same date notifying the company of the de-registration also requested that all outstanding returns (01/11, 04/11 and period 1 May 2011 to 8 June 2011) be completed for collection by HMRC along with payments due. The reasons given for de-registration was:

> *"…that following examination of your trading pattern and revenue history, HMRC is satisfied that you have been a willing participant in trade in relation to which you had no intention of accounting for the VAT charged on the invoices and for which there was no other purpose other than to secure a financial advantage to others. In these circumstances HMRC consider that you have "abused" your right to be registered for the purposes of the VAT Act 1994 and as required by Community Law."*

130. The company did not appeal the decision to de-register the company or HMRC's decision to withhold the repayment for period 10/10 in the approximate sum of £90,000.

131. An interview was held with Mr McDade on 14 June 2011 at which it was established that HMRC had not been notified of a change to the company's principal place of business nor was there any evidence to suggest that the day to day running of the company actually took place from the new premises which, according to the owner, was only used as a postal address. Mr McDade confirmed that his private residence had also changed and it was noted by HMRC officers that the new address was directly linked to a number of EU companies purported to be run by a Mr Steven Bell as well as a significant number of missing traders. PCSG had purchased and sold stock to these companies and HMRC noted that in almost every supply made to PCSG the supplier could be directly linked to company officials or associates of the company. Mr McDade indicated that the level of trade undertaken by PCSG in 04/11 had been low, however HMRC subsequently established that in excess of £15,900,000 sales had been under-declared in this period.

132. Correspondence subsequently sent by HMRC to Mr McDade was returned marked both "addressee gone away" and "refused".

133. PCSG under-declared it output tax in 10/10 by £343,280.47, in 01/11 by £525,809.75, in 04/11 by £2,659,340.53 and in its final period by £868,970.31. HMRC raised assessments in respect of the outstanding liabilities on 21 December 2011, 11 September 2012 and 23 December 2012. The assessments have not been paid or appealed. The company was placed into liquidation and as at 23 October 2012 HMRC had written off £7,188,166.93.

Findings on whether the tax loss was fraudulent and whether the Appellant's transactions connected with fraudulent VAT losses?

134. We considered the submissions of Mr Ginniff regarding the issue of timing in respect of contra-trader Master's transactions. It was correct that Officer Saxon accepted that there was no fraudulent tax loss in the Appellant's direct chains; as he explained the loss arose in the *"wider scheme of fraud."*

135. Master told HMRC on 11 April 2011 that no exports had been carried out in the period up to that date; it was only when the VAT period was foreshortened to end on 11 April 2011 that it stated exports had taken place. The transactions purported to have been carried out were offset against the VAT liability due. Mr Ginniff submitted that in those circumstances the Tribunal should conclude that the fictitious transactions were an after-thought on 11 or 12 April 2011 and therefore at the time of the Appellant's last transaction on 29 March 2011 the Appellant could not have known nor should it have known of the connection to fraud.

136. We rejected this submission for the following reasons: we did not accept that the relevant invoice had to be created prior to the Appellant's transactions. In our view the invoices could be created at any time and still form part of the fraudulent scheme to defraud (whether in the direct supply chains or via contra-trading) and we found support for this proposition in *Mobilx* at [62]:

> *"The principle of legal certainty provides no warrant for restricting the connection, which must be established, to a fraudulent evasion which immediately precedes a trader's purchase. If the circumstances of that purchase are such that a person knows or should know that his purchase is or will be connected with fraudulent evasion, it cannot matter a jot that that evasion*

precedes or follows that purchase. That trader's knowledge brings him within the category of participant. He is a participant whatever the stage at which the evasion occurs."

137. We carefully considered the evidence in respect of the defaulting trader, contra-trader and the Appellant's transaction chains. We found the evidence cogent and compelling and we were wholly satisfied that HMRC had accurately traced the Appellant's chains of supply to tax losses caused by defaulting trader PCSG via Master acting as a contra-trader. We found as a fact that Master knowingly acted as a dishonest contra trader and that its transactions formed part of an overall scheme to defraud the Revenue.

138. In those circumstances we were satisfied that HMRC had proved to the requisite standard that the Appellants' transactions were connected to fraudulent tax losses.

Did the Appellant know, or should it have known that the transactions in this appeal were connected to fraud?

139. The evidence we heard related mainly to this principal issue. Given the volume of oral and documentary evidence before us the following is intended as an overview of the points raised. However we should make clear that all of the evidence was carefully considered.

140. HMRC relied on a numbers of factors as indicators that the Appellants knew or should have known that their transactions were connected to fraud. The main evidence came from the decision making Officer Saxon. On behalf of the Appellant the evidence came from the four directors.

Awareness of MTIC fraud

141. Mr Marcus had previously been the director of Diverse Product Holdings Limited which was formed on 28 January 2008 under the name Sentry Software Limited. On 8 July 2009 the company changed its name to Diverse Electronics UK Limited and on 9 February 2011 the company name changed again to Diverse Product Holdings Limited ("Diverse"). The company registered for VAT on 28 January 2008 and remains VAT registered.

142. Mr Marcus was a director of Diverse from 28 January 2008 to 3 July 2009 and again from 4 July 2009 to 18 November 2010. The VAT 1 described the business activity as "sale of software product"; the initial trading activity was the sale of software products and subsequently consumer electronics such as I-Pods, games and consoles.

143. On 21 July 2009 HMRC issued a letter to Diverse warning of MTIC fraud in the wholesale of goods and services including electrical goods. The company was advised to verify the VAT registrations of new customers and suppliers via Redhill. Notice 726 regarding joint and several liability and the leaflet *"How to Spot VAT Fraud"* were also enclosed.

144. On 14 December 2009 an identical letter to that of 21 July 2009 was issued to Diverse along with another copy of the leaflet *"How to Spot VAT Fraud"*. On 25 June 2010, 20 July 2010 and 11 January 2011 HMRC notified Diverse that its VAT returns

for periods ended 31 May 2010, 30 June 2010 and 31 December 2010 respectively had been selected for extended verification. The letters each set out HMRC's concerns regarding VAT fraud as a result of MTIC trading.

145. Between 13 January 2011 and 7 April 2011 HMRC also issued a number of letters to Diverse notifying it of its connection to VAT losses in its transactions.

146. Mr Marcus had also been a director of Celltec Limited ("Celltec") which was incorporated on 11 August 2000 and registered for VAT from 1 September 2000 to 1 September 2008. The company's business activity was the wholesale of computer components to other distributors, wholesalers and specialist contractors. Celltec entered into Voluntary Creditors Liquidation on 27 May 2010 and was dissolved on 11 October 2011.

147. On 21 December 2006 HMRC wrote to Celltec regarding verification of its VAT returns. The letter included an explanation of the risks of MTIC fraud. A further letter was sent by HMRC to Celltec on 2 January 2007 which referred to MTIC and carousel fraud.

148. During Officer Shorrock's visit to the Appellant on 21 March 2011 all four directors were present during a discussion regarding carousel/MTIC fraud. Officer Shorrock's visit report recorded that: *"All of the directors were to some extent aware of the MTIC although some knew more than others."* At the meeting the leaflet *"How to Spot VAT Fraud"* was given to Mr Draper and Officer Shorrock advised that there were some features of the Appellant's trade that were common to MTIC fraud. Officer Shorrock followed up the meeting with a letter on 1 April 2011 which stated that watches had been used as a commodity in MTIC frauds in the past.

149. Mr Draper's written evidence accepted that Mr Marcus and Mr Bluffield had knowledge of "*carousel fraud whereby goods would be "exported" but not actually leave the UK"* as a result of experiencing loss of funds while at Diverse in this type of scenario. This was the only knowledge of VAT evasion and none of the directors were familiar with other complex fraudulent activities in relation to VAT.

150. Mr Marcus accepted that he became aware of VAT carousel fraud while at Diverse which was a victim of such fraud in transactions that were controlled by the sales director. This incident was the reason why Mr Marcus resigned and set up the Appellant with Mr Bluffield. In the same witness statement Mr Marcus stated that the Appellant had never heard of *"this type of fraud"* and he questioned how the Appellant could have been aware of the use of watches in MTIC fraud when HMRC officers themselves were unaware of any such intelligence.

151. Mr Jackson's evidence was that prior to joining the Appellant he had no knowledge of MTIC fraud. Thereafter his understanding came from Mr Marcus which he explained as follows:

> *"…that this was related to exportation of goods out of the UK for purposes of a VAT refund, but that the goods never actually leave the country and are then sold again in the same way."*

The Directors and Mr Stout

152. Mr Draper's written evidence explained that in August 2010 he was approached by Mr Marcus to join the Appellant. The pair knew each other from Celltec where Mr Draper had also worked, although there was an issue as to his role:

"You cannot recall. Have you forgotten about Celltec?

A. Yes, well, that's how I got to know Mr Marcus.

Page 457 shows that these are the statements of the administrators' proposals in respect of Celltec. Do you have that?

A. Yes.

Q. If you look at page 463, that is headed "Circumstances giving rise to the appointment of administrators." …A business restructure was required after a review of the running of the company. John Byrne was brought in to review and organise the structure and implement changes in an effort to turn round the company. Phil Draper was brought in as financial director." So you were the financial director of Celltec. Yes? Is that right or wrong?

A. At 288 I was a self-employed consultant to Celltec.

Q. So the administrators of Celltec have got it wrong. You were not the finance director.

A. The director on my involvement with Celltec was – Mr Marcus will be able to give you his name. But he was considered inappropriate to advise the company, given the dire financial circumstances that it found itself in. Can I also point out, because it's being implied or inferred that I neglected to inform the tribunal, I didn't say I've never been involved with Celltec because it's just another company that I was – I advised ----

Q. This is rather curious, Mr Draper, that we went through in some detail various businesses with which you have been connected and one that you missed out was a company where you were a co-director with Mr Marcus. Why did you not tell the tribunal about that? Did it simply slip your mind?

A. Not at all. I didn't think it was appropriate. (A) I was not an executive director of the company…

Q. Look at page 464. There is a heading "Period of involvement by Begbies Traynor. and then it reads as follows: "On 15th June 2009 the director of the above company, Brant Marcus, together with Phil Draper and John Byrne, who were also running the company at the time, met with Paul Stanley and Jason Denalsh(?) to discuss the future of the company." Running the company, not operating in a non-executive capacity. So is that wrong as well?

A. It's a very clever use of words, Mr Taylor, because in the real world non-executive directors do not have any executive authority. I have vast experience of working and reporting to non-exec directors who may as well be executive directors.

Q. Just read to yourself again what it actually says: "…who were running the company at the time." So were you or were you not running the company?

A. I was controlling the finances of the company and liaising with the bank to ensure that the – to give the company as long a life as possible. If you want to go into the specific detail, although you may not want to because it may not suit your argument, within ----"

(Transcript 29/4/14 page 126 – 132)

153. The intention of the directors was to establish retail and trading companies; My Digi Retail Ltd and My Digi Ltd. In September 2010 trial orders on reconditioned consumer electronics were carried out with the goods being sold through an EBay shop. The trading company was intended to complement the retail side by trading in new products only. All reconditioned products for My Digi Retail Ltd were sourced either directly or indirectly from Anovo UK Ltd ("Anovo"), a subsidiary of French listed company Anovo SARL.

154. Mr Draper explained that Mr Bluffield and Mr Marcus had established a trading relationship with Mr Stout who was the Senior Production Manager of Anovo whilst they were at Diverse. Mr Draper met with Mr Stout in early October 2010 when he was given a tour of the company premises and details on the sourcing of goods. In oral evidence Mr Draper stated:

"Everything looked very well organised, very well disciplined…So I have to say I was fairly impressed with the set up of Anovo UK Ltd."

155. During the meeting Mr Stout asked Mr Draper if trade in high value fashion watches had been considered; Mr Marcus and Mr Draper both agreed that this was not an avenue the Appellant intended to pursue as they knew nothing about the products and preferred to focus on IT hardware and consumer electronics.

156. Mr Stout repeated the query regarding trade in watches to Mr Marcus later in the same month. At that point the directors agreed to concentrate on the company's core activities.

157. A letter dated 25 July 2011 from the Appellant to HMRC advised that Mr Stout had verbally advised the Appellant that the watches were sourced from an authorised UK distributor for Jacob & Co Watches Inc, USA. The trading opportunity was said to be a way in which the UK distribution agreement could be circumvented as under the agreement a UK distributor could not sell directly to Europe but it could sell to UK companies. It was said that Anovo had advised the Appellant that it knew of companies within Europe that could wholesale such products. The Appellant explained that it told Anovo that it would consider trading in watches subject to the products being sourced from the UK distributor and there being no credit risk involved.

158. On 27 October 2010 Mr Stout (on behalf of Anovo) emailed Mr Bluffield with a list of watches available to trade for Jacob & Co. Mr Draper's written evidence describes that circumventing commercial agreements is common practice within the grey market in IT and electrical goods. The Appellant agreed to conduct a limited level of business and Mr Marcus contacted his European contacts by telephone and email for interest. Mr Bluffield confirmed in his written evidence that his main role within the company was dealing with the sale and supply of refurbished consumer electronics and his involvement in the watch trading was limited after Mr Stout's approach.

159. Towards the end of November 2010 Mr Marcus received an enquiry from Mr Fermor at Ferenergy, a Paris based broker. The enquiry related to electronic products and also watches.

160. In cross-examination Mr Draper was questioned about the efforts made to find customers for the watch trading:

"I am talking about October 2010. Do you have any emails that you have sent to anybody in October 2010 saying, "Would you like to buy some Jacob watches"?

A. I am aware that emails were sent but ---

Q. No, please answer the question. I asked did you send any emails.

A. No, and it's been said by your own witness that I was very little to do with the

sales operation.

Q. I am asking perfectly simple questions and you can answer these questions simply. So, you did not send any. Did Mr Marcus send ---

A. Not until 11 March.

Q. Yes, that is five months later. Did Mr Marcus send any?

A. Yes.

Q. Where are they?

A. The laptop that was used by Mr Marcus had to be reformatted and unfortunately all correspondence from Mr Marcus, the only -- within the witness bundle there are some emails that have been submitted by either Mr Jackson or by me and they were only available because they had been forwarded to me by Mr Marcus. So, unfortunately -- and this happens with laptops; they don't last for ever -- his laptop required reformatting. Whether it was a virus or what -- I do not know whether it was a hardware problem. Q. Mr Draper, there are four directors in MDL and no doubt you talked about this case over many, many hours and you have talked about Ferenergy and the Jacob watch deal for hour after hour but you don't seem to know whether Mr Bluffield tried to sell the watches in October 2010. Is that the position?

A. I don't believe -- as I have just said, I don't believe he felt he had contacts that would be interested in that type of product.

…

Q. Yes. What about Mr Jackson? What was his input in terms of finding buyers?

A. I believe he assisted -- and he will be taking the stand at some point this week. I believe he assisted Mr Marcus in the email campaign.

Q. There was an email campaign. So, how many emails were sent out then?

…

A. I don't know the quantity…

Q…So you know you are getting the right product, an authorised product, and yet MDL, according to your evidence, did not contact any other authorised suppliers to find out whether you could buy the watches more cheaply.

A. We did not.

Q. That's the position, isn't it?

A. That is correct.

Q. All right. Did you try and find any other customers?

A. Yes.

Q. Which other customers did you approach?

A. The only customer that I approached, or potential customer, was a company based in the north west who were opening a Chinese office, which I thought was something worth considering. I think the other companies, I don't know who we approached. Wycom and Keki I have mentioned. The other directors are best to answer that.

Q. Mr Draper, you know perfectly well that I am cross-examining you about the period between 27 October and following 29 November, a few days thereafter. You are telling us yet again about something you did in March 2011. That's when the Chinese email was sent, isn't it?

A. That's correct.

Q. So in the time period, let's say the week following 29 November 2010, did you try and find any other customers?

A. I did not.

Q. Did Mr Marcus?

A. I do not know.

Q. Did he try?

A. I do not know.

Q. Did Mr Bluffield try?

A. I do not know.

Q. Did Mr Jackson try?

A. I know he has – I do not know the date of his attempts for customers."

(Transcript 30/4/14 page 7,16 & 53 – 54)

161. In oral evidence Mr Jackson explained that a pamphlet was made and emailed to various customers, although it was not a:

"blanket kind of million strong email campaign… obviously Richard Baldwin didn't want the watches going out all over the show. I think it was more regarding his distribution agreement in the UK. He wanted to select where he sold the watches. He said we could sell one or two to individuals in the UK but not kind of in bulk in the UK. So, I think I sent this out to a couple of individuals I knew within the UK and the main people we sent it to were companies in Europe that Brant knew of in the past who he knew and the directors who would be interested but it was a test in the water kind of thing to get feedback.

Q. Do you remember the sort of numbers?

…

A. I would probably say initially maybe 10."

(Transcript 7/5/14 page 14)

162. In cross-examination Mr Jackson subsequently confirmed that no other suppliers were ever sought for Jacob watches once Ferenergy had approached the company and that he did not believe that any customers were sought at the time of the first transaction in December 2011; the emails that were sent were in or around March 2011.

163. Mr Bluffield explained in oral evidence that as his role mainly involved the purchase of electronics he had only emailed a couple of contacts based in Germany regarding potential watch trades.

Trading model

164. The Appellant conducted its first sale of watches on sales invoice dated 9 December 2010. A visit report dated 21 March 2011 of HMRC officer Shorrock noted that the Appellant became aware of its customer Ferenergy through Anovo UK Ltd ("Anovo"). Officer Shorrock's visit note recorded that the directors were asked how a typical deal was put together. He noted that:

"the reply was somewhat vague. Initially it was stated that they 'put the deal out.' AS asked what they meant by this…they stated it was a process of ringing around contacts and establishing who had what stock and who wanted what stock"

165. At a meeting with HMRC on 3 May 2011 Mr Draper explained how the watch transactions were conducted. He stated that Ferenergy made a stock enquiry which would prompt an availability and pricing enquiry from the Appellant to Jacob & Co. Once an answer was received, Ferenergy would be given a quote and, if accepted, an invoice raised. Ferenergy would make payment for the goods and when the funds cleared the Appellant arranged delivery of the watches in Warrington. When the goods arrived the Appellant paid Jacob & Co at which point title passed to the Appellant. A brief inspection was carried out (a box count) and the goods were sent to a freight forwarder in either France or Holland. Malca Amit was used to transport the watches.

166. In cross-examination Mr Draper stated that the email from Ferenergy on 29 November 2010 was an *"unsolicited"* email:

"Did you ever ask yourself why is Fermor, why is Ferenergy coming to MDL? Did you ever ask yourself that question?

A. If I hadn't, it wouldn't have been a surprise, which I've already said it was a surprise when that email came through.

Q. Did you think it was fishy – yes or no?

A. At the time, I said: "Are we putting our family funds at risk? Are we at risk of MTIC fraud? Are we getting rich out of this deal? Are we defrauding HM Treasury? Are we in control of the goods? Have we established, are we satisfied that we're buying from an authorised UK distributor?" All of these questions I asked myself. Brant Marcus had asked the customer regarding warranties and serial numbers and ---

Q. No, no, you are straying from the point. This is 29th November I am talking about, not when you decided to do the deal. You get the email and you got something which is totally outside your normal experience. I am asking you a really, really simple question.

A. I thought it was more ---

Q. Did you think it was fishy?

A. I thought it was more – very coincidental...

Q. No, please answer the question. Concentrate on the question, if you would, please, rather than the answer you want to give. Did you voice any concern or unease to your brother directors?

A. I recall having a discussion with my co-directors where we did discuss: "What can we do to mitigate our position in the event of this not being a good deal," which is why we all discussed the source of the product, the control of the product, the pricing of the product -----

Q. Did you say to your brother directors: "It seems like a bit of a coincidence to me that we get an email on 27 October 2010 from Anovo, and then on 29 November 2010 we get an email from Ferenergy about precisely the same goods?" Did – pause a moment. Did you articulate that to your brother directors?

A. (Pause) I do not recall."

(Transcript 30/4/14 page 46 - 48)

167. In a letter dated 16 June 2011 the Appellant provided further details as to how the first transaction came about. The letter stated that Anovo was known to Mr Marcus and Mr Bluffield through their company Diverse Electronics. Anovo subsequently became a supplier of refurbished electronic products to MDRL and during a meeting the two companies in October 2010 Philip Stout (the production manager of Anovo) asked MDRL if it could trade in high value fashion watches. At that time MDRL declined the offer in order to concentrate on trading new and refurbished electrical products.

168. In cross-examination Mr Draper initially stated that as far as he was aware Mr Stout played no part in any future transactions following the initial introduction of the opportunity to trade. Mr Draper agreed that it was not normal business practice for someone to pay such a large amount of money prior to receiving any goods when the parties had never traded before and were in different countries, as had been the case with the Appellant and Ferenergy. However Mr Draper clarified that he had thought it unusual for Jacob & Co to provide the watches to the Appellant prior to payment and explained that he believed the reason was that Jacob & Co was in direct contact with Ferenergy and the Appellant was simply used to circumvent the distribution agreement. In cross-examination Mr Draper agreed that the Appellant would have had no reason to tell its supplier the name of its customer.

169. HMRC enquired into the contractual terms between the Appellant and its supplier. It was noted by Officer Saxon that Jacob & Co signed the Appellant's Account Application Form on 6 December 2010 in which the purchasing terms and conditions were set out. The document provided that *"ownership in the goods will pass to My Digi on payment or when delivery is completed…"* The Appellant subsequently confirmed by letter dated 28 February 2011 that no other contractual documents existed between the Appellant, it supplier or customer. Officer Saxon noted that there was no clause in the document to specify that the watches supplied by Jacob & Co must be sourced directly from the manufacturer under the terms of an authorised distribution agreement.

170. Ferenergy signed the Appellant's Trade Account Application form on 30 November 2010. The terms were identical to those set out in the document signed by Jacob & Co.

Funding and the Appellant's projection of anticipated trading in watches

171. The Appellant provided HMRC with a financial summary dated as at 2 May 2011. It showed an overdraft facility with HSBC of £100,000 secured by the directors' personal guarantees of double that facility; specifically £50,000 for each of the four directors. Further funds introduced included business start up loan funds totalling £67,000: £22,000 from Mr Marcus' wife, £10,000 from Mr and Mrs Draper, £10,000 from Mr Bluffield's father, £10,000 from Mr Jackson's mother and £10,000 from Mr Hart (the Appellant's warehouse manager) and Mrs Hart. Further loans had been sourced from Mrs Draper (£20,000) and Animal World (£10,000).

172. At the time of the financial summary Officer Saxon noted there were indicative trading losses of £38,278 (including the loans above) and a debt to HSBC of £60,243 supported by the overdraft facility.

173. Mr Draper provided Officers Shorrock and Marsh with a document entitled *"31 Week Summary"* at their visit on 21 March 2011. Officer Shorrock confirmed that he was told by Mr Draper that the document reflected a projection of future trade in watches although there was no discussion as to how the computation was calculated.

174. The document showed a monthly projected turnover from March 2011 to September 2011 steadily rising from £1,057,592 in March to £3,518,325 in September with a total projected turnover over the seven month period of £14,172,775.

175. An Orbis report on the manufacturing company Jacob & Company Watches Inc (undated) indicated that the Appellant's projected sales of £3,500,000 in September 2011 would have exceeded the manufacturer's total estimated annual turnover in 2010. Officer Saxon noted that the trade description of the company showed that the wholesale of watches formed only part of the company activity. In cross-examination Officer Saxon's evidence was as follows:

"MR GINNIFF: Earlier in your evidence you noted about the 18 limited edition Quentin Tourbillon watches, do you remember that?

A. Yes.

Q. They had a recommended retail price of £270,000. I can take you to these if you want.

A. Yes, it is familiar.

Q. Would you accept that if Jacob & Co had sold those direct to the public, all 18 of those, that their turnover would have been 4.8 million in pounds not in dollars and, therefore, that would have far exceeded the 4.3 million that was recorded on the report. Would that not have encouraged you to question whether, not that it is wrong but there is something more to the information that you do not have or you are not appreciating?

A. I didn't do any further research than the report I have in front of me.

Q. You see, even if they sold them at a 50 per cent discount, those watches, and the exchange rate was 1.5 dollars to the pound, that would be 85 per cent of the turnover that is declared on this Orbis report. Therefore, if one was to look particularly at information that one had available at the time, which is the Orbis report, would one not objectively come to the view, "I see that, but something is wrong about that"?

A. Well that was the information that I used to prepare my evidence. The question really that came from looking at this was that what did My Digi do as far as checking with the manufacturer as to whether it was capable of providing the goods which appear on the projection. I've had nothing in evidence to suggest that the directors had any view on the Orbis report or any other evidence which helps to, if you like, support their projections which have some relationship between what they were intending to do and what Jacob & Co (US) could produce.

(Transcript 25/4/14 page 69 – 70)

176. Mr Draper's witness statement stated that the spreadsheet did not consider any constraint of demand or supply and market size; "*it assumed a fixed margin with fixed monthly overheads being incurred. The only constraint was "cash" or working capital available. It was compiled and presented to HMRC to demonstrate that if trade continued, the level of repayment due to MDL could escalate to substantial levels.*"

177. In cross-examination Mr Draper clarified that he did not believe the figures in the document "*because they were purely an arithmetic linear progression*" (Transcript 30/4/14 page 72) and was adamant that he had told Officer Shorrock that the figures were based on various assumptions, although we must note that this was not put to Officer Shorrock in evidence.

Due diligence

178. It was noted by Officer Saxon that HMRC's first visit to the Appellant was carried out on 2 February 2011 by Officer Simpson in order to verify the first VAT return submitted in respect of the period ended 31 December 2010. The return, which showed a repayment due to the Appellant of £20,828.50 was not subject to extended verification and was subsequently repaid.

The Appellant's customer: Ferenergy

179. Ferenergy was registered for VAT in France between 6 May 2009 and 7 September 2011. The trading address was recorded as 30 Av George V, 75008, Paris 08. In response to an enquiry from HMRC, the French Authority stated that the company had failed to cooperate with it and it had not been possible to obtain any records relating to business transactions, including those involving the Appellant. The French Authority strongly suspected that the company was involved in VAT fraud and acted as a conduit company involving electronic components.

180. The French Authority stated that the company had been registered by UK national Gareth Gamble on 1 May 2009 under the name International Carbon Trading. On 8 January 2010 Edward Fermor became the sole shareholder and "gerant" (manager) and the business activities were expanded to include energy and commodities trading. The trading address was an accommodation address used by entities implicated in carbon quota fraud. No returns had been submitted since the company was set up.

181. Enquiries with Prologic, the freight forwarder in France to whom the Appellant purportedly shipped the goods revealed that no documentation relating to the Appellant could be found. Information obtained from the Dutch tax authorities included an Incoming Hardware Inspection sheet dated 14 December 2010 from Geo warehousing and Logistics at Rotterdam Airport which showed 10 Jacob & Co watches from the Appellant to Ferenergy. Officer Saxon noted that the Appellant's first deal involving Jacob & Co watches which it sold to Ferenergy was dated on the sales invoice as being on 9 December 2010 which led Officer Saxon to conclude that these were the same goods shown on the Incoming Hardware Inspection sheet and therefore were subsequently shipped to Geo Warehousing.

182. Mr Fermor was also the director of I.T. Fast Track Ltd which was incorporated on 15 July 2004 and dissolved on 11 May 2010. In a decision dated 14 April 2008

HMRC denied I.T. Fast Track the right to recover input tax in excess of £9,000,000 in respect of purchases in March and April 2006 on the grounds that the transactions were connected to fraud and that the company either knew or should have known of the fact. The company's appeal against this decision was struck out because the company had been formally dissolved.

183. Mr Fermor was also the director and company secretary of The Big Store Limited which was incorporated on 2 November 1999. Mr Fermor was appointed company secretary on 10 April 2000 and director from 17 August 2000 to 5 February 2001. The company was registered for VAT from 1 September 2000 to 10 March 2004. The company traded in mobile phones, computer chips, phone cards, software and electronic goods, carrying out UK to UK deals which were connected to tax losses. A notice of assessment was issued in the sum of £143,591 in period 11/03 on invalid supplier invoices where the supplier's identity had been hijacked. In the relevant transactions The Big Store had made third party payments. The company went into Creditors Voluntary Liquidation on 30 September 2004 and was dissolved on 13 May 2008.

184. At a meeting with HMRC on 21 March 2011 the directors of the Appellant told officers that Ferenergy had advised that it sold the stock to French jewellery shops. Officer Saxon noted that this appeared to contradict Mr Draper's later comment to HMRC officers on 3 May 2011 that he had been told by Mr Fermor that one of Ferenergy's customers was a German company which had retail outlets and another was a company run by a Polish national who sold to Germany and Italy.

185. In a telephone conversation with Officer Shorrock on 25 March 2011, it was recorded that clarification had been sought as to how initial contact was arranged with Ferenergy and Jacob & Co. Officer Shorrock's note recorded:

> *"PD was unsure. He stated that Anovo had provided the contact for Jacob and Co and PD thought that Ferenergy might have come from the old Celltec contact list."*

186. At the meeting with Officer Shorrock on 3 May 2011 the visit note recorded:

> *"CS clarified how they had met FC. PD advised that Brant Marcus had exchanged business cards with Fermor when he had been involved in Celltec at the Cebit fair. (NB as far as I know Celltec ceased in 2008 and FC started in 2009 so how is this possible?)"*

187. On 19 April 2011 Mr Draper telephoned HMRC officer Shorrock to advise that he was flying to France to meet with Mr Fermor. Officer Saxon noted that this visit post-dated all of the Appellant's transactions with Ferenergy. On 3 May 2011 Mr Draper told officer Shorrock that he had visited the private residence of Mr Fermor in Montpellier, he had been told by Mr Fermor that business was not going well and he was intending to vacate the Paris office which was chosen for its prestigious address. Mr Fermor was also reported to have stated that he had a current income tax debt to HMRC of £500,000.

188. In a letter dated 16 June 2011 the Appellant stated that Ferenergy approached the company via email on 29 November 2010 asking if the Appellant was able to trade in various products including Jacob watches. The Appellant stated that this approach

was unlikely to be coincidence; from which Officer Saxon inferred that it followed an introduction by Anovo although there he noted that there was no evidence to show that Mr Stout passed the Appellant's details to Ferenergy.

189. In the same letter of 16 June 2011 it was stated that the principal of Ferenergy, Mr Edward Fermor believed he had previously met Mr Marcus at a trade fair. The letter also stated that the Appellant had queried why Anovo did not trade directly with Jacob & Co and had been told by Anovo that the watch trade was outside of the company's core activities and would not be permitted by the head office in France.

190. Mr Marcus stated in evidence that when approached by Ferenergy he had *"obviously asked around to see if people knew who Ferenergy were. I could not recollect that I knew them. I may well have heard of Ed Fermor previously but I didn't know Ferenergy at the time"* (transcript 9/5/14 page 15).

191. Mr Draper's witness statement set out what he described as *"our standard due diligence checks"* which included:

- Proof of identity (copy of passport accepted);
- Signed terms and conditions of purchase or sale;
- Company registration (Certificate of Incorporation);
- VAT registration (verified);
- Main bank details; and
- 2 trade references.

192. Mr Draper also confirmed in his oral evidence that he was predominantly responsible for carrying out due diligence although Mr Marcus spoke to a number of trade referees.

193. The following documents were produced by the Appellant in respect of its due diligence on Ferenergy:

- Copy of Mr Fermor's passport;
- Europa validation of VAT registration dated 15 March 2011;
- Introduction letter from Ferenergy;
- Trade Account Application form completed by Ferenergy for the Appellant;
- A company extract form for Ferenergy headed "Extrait Du Registre Du Commerce Et Des Societes" dated 3 March 2010;
- A document in French dated 24 February 2010 providing registration and contact information;
- A Creditsafe report dated 9 December 2010.

194. In cross-examination Mr Draper accepted that the French documents had not been translated due to cost, although he had made no enquiries as to how much a translation service would charge. He explained that his French was not good enough for a full translation but he believed the key words had been picked out *"to make sure that we knew what the titles were"*:

"Q: What was the view taken? Why did you not think it was worth getting translated? Was it because you did not think it was important?

A. Not ... our normal due diligence tick box, and sadly tick boxes are very often abused, as I have said, certificate of incorporation, VAT registration, ideally certificate of registration, proof of identity and our terms and conditions.

JUDGE BLEWITT: So you did not think this document was important.

A. Not ... no, we ---

MR TAYLOR: Even though you did not know what it said.

A. Yes."

(Transcript 30/4/14 page 93 & 95)

195. It was accepted by Mr Draper that the company trading information provided on one of the documents made no mention of watches but referred to metals and electronics. Mr Draper stated that he believed Mr Marcus had attempted to telephone one of the trade references provided, a firm of accountants/management consultants called THB, but he was not aware of the outcome. He agreed that the firm had no link to trading products but stated that this was not uncommon: *"I considered the THB would be a professional firm. God forbid we had professionals that conducted fraud"* (Transcript 30/4/14 page 120).

196. Mr Marcus explained that his research on Jacob and Co involved checking the company's website and speaking to the references given. He could not recall speaking to THB and explained that the purpose of the trade was as follows:

"A. No, because trade references were there for one reason only, that we would independently confirm the details, call them, and if they could confirm that they knew of them then that was trade reference for us. It could have been a freight forwarder, it could have been a solicitors' firm, it could have been accountants. As long as there was a trade reference, that was enough.

Q. So as long as a crook has an accountant he gets through your due diligence, is that right?

A. We weren't aware of him being a crook at the time -----

Q. No, just answer the question. As long as a crook has an accountant or a lawyer, he gets through your due diligence.

A. Yes, then, if you want to put it like that.

Q. Not very robust, is it?

A. It's not perfect, no."

(Transcript 12/5/14 page 37)

197. Mr Draper's second witness statement dated 10 January 2014 added that in early January 2011 Mr Fermor contacted Mr Marcus regarding the availability of watches. It transpired that Mr Fermor was due to be in the UK the week of the Appellant's visit to Jacob & Co and a meeting was therefore arranged with Mr Fermor at a London hotel. In oral evidence Mr Draper stated:

"Q. You met Mr Fermor of Ferenergy in London, that is correct, isn't it?

A. Yes.

Q. What were the circumstances of that meeting?

A. This is – I'm probably not the best witness, but I can vouch for having been there. I think he was advised that we were in London on business and he said: "I can make – there's an opportunity that we can meet up," which we did, we met him at a hotel the name of which I forget – all I remember is the cost of the coffee per cup, which was exorbitant, but I would remember that."

(Transcript 29/4/14 page 99)

"A. … We met with Edward Fermor in a hotel, the name of which I forget. Mr Marcus and Mr Jackson may remember the name of the hotel. They were present, yes.

Q. I asked you whereabouts it was.

A. In London.

Q. Yes, a big place, whereabouts? (Pause).

A. It was about five miles from Euston, I think.

Q. In which direction?

A. I don't know. I don't recall.

Q. And how did you get there?

A. By cab.

Q. From where?

A. From Jacob and Co (UK).

Q. Oh, so it was the same day as the Jacob and Co meeting, was it?

A. Yes, and we ---

Q. That is the first time I have heard that, you see, Mr Draper.

A. It has never been denied.

Q. It has never been offered before, Mr Draper. So it is about five miles from Portland Square….

A. Jacob and Co.

Q. So you went to Jacob and Co and when did you travel down?

A. By train on the same day.

Q. From where?

A. Runcorn I think we ---

Q. Which train did you catch? Roughly what time?

A. Eight or 9 o'clock I would think. No, I would think we probably got the 10 o'clock so as to make it a cheaper train ticket….

Q. Who went down on the visit?

A. Mr Marcus, Mr Jackson and myself."

(Transcript 1/5/14 page 31 – 33)

198. At a visit to the Appellant on 21 March 2011 HMRC officer Shorrock expressed a number of concerns regarding Ferenergy. By way of example he noted that the company was new, no company accounts were held by the Appellant, the Creditsafe

report warned *"caution - credit at your discretion"* and the original company name indicated carbon credit trading. It was noted that none of the documentation relied upon by the Appellant referred to watches and there were no signed terms and conditions between the parties. The concerns were reiterated by officer Shorrock in a telephone call with Mr Draper on 25 March 2011.

199. In oral evidence Mr Jackson recalled that they met Mr Fermor a week or two before Mr Baldwin. Mr Marcus recalled an occasion when Mr Fermor was met on the same day as a visit was carried out to Jacob & Co. In cross-examination he could not recall who went on the visit, stating that it was either himself and Mr Jackson or himself and Mr Draper or himself, Mr Draper and Mr Jackson. A second visit to Jacob and Co was carried out by himself and Mr Jackson. Mr Marcus could not recall if they went to London by car or train.

200. Mr Bluffield stated he had never met anyone from Ferenergy but was aware that Mr Jackson and Mr Draper had flown out to meet Mr Fermor. He stated in oral evidence that he was with his co-directors when they visited Mr Baldwin at his office in London. In cross-examination he stated:

"Q. Okay. You went with your colleagues to see Mr Baldwin in London.

A. Yes.

Q. It wouldn't be fair of me to ask you for the date. I am not going to do that.

A. Okay.

Q. But can you recall what time of year it was?

A. No.

Q. Can you remember how you got back?

A. By car.

Q. So, did you travel down by car?

A. Yes.

Q. You travelled down -- just remind me; I am sorry that I can't remember. Can you just remind me who was on that visit?

A. I think all four of us were there.

Q. So, whose car did you drive down in, can you remember?

A. I think Mr Marcus's.

Q. What sort of car was it?

A. It was an Audi…

Q. If you can't remember, just say.

A. Yes, I honestly can't remember, even four years back.

Q. Can you remember whether you were there for 10 minutes or an hour or two hours or was it half a day? Can you help us with that?

A. Maybe, like, an hour.

…

JUDGE BLEWITT: I think you said you met Mr Baldwin once at his office, was that right?

A. Yes.

JUDGE BLEWITT: That was the day you had all travelled down together in the car.

A. Yes.

JUDGE BLEWITT: Then did you all travel back together in the same car?

A. Yes."

(Transcript 8/5/14 page 98 – 99, 193)

201. In an email dated 24 March 2011 to Officer Marsh and Officer Shorrock, Mr Draper referred to the Appellant's *"trading and due diligence processes"* as *"robust"*.

202. In a note of a telephone call on 25 March 2011 with Mr Draper, Officer Shorrock recorded that he had advised Mr Draper that it was for the directors of the Appellant to decide what deal to conduct and that HMRC could not red light or green light a transaction. Officer Shorrock also noted that he told Mr Draper that he *"did not consider that the due diligence was robust as he had indicated in his email"* and that a number of features of the Ferenergy due diligence caused him concern *"and I had pointed them out at the visit."* Mr Draper stated in the telephone call that he had asked himself whether the deals were too good to be true. Officer Saxon noted that despite this, the Appellant had conducted two further deals with Jacob & Co on 25 March 2011 and 29 March 2011.

203. Mr Draper's written evidence explained that he had contacted the accounts department at Anovo UK as part of the due diligence on Ferenergy which had named Mr Stout at Anovo UK as a trade reference. Mr Draper stated that the accounts department confirmed that it had traded with Ferenergy and that payment had been made in accordance with the terms set. In cross-examination Mr Draper was questioned about this issue:

"Q. So, you've got Stout in effect introducing the possibility of trade with Jacob and you've got a company closely connected to Stout standing as the trade reference. Did that not at the time strike you as being quite a coincidence?

A. It was a coincidence for trade reference in relatively all industries, companies know other companies and yes, it is a coincidence, but ---

…

Q. Did you discuss this with your fellow board directors? Here we are, we have Phil Stout introducing the potential trading and we have Phil Stout vouching for the company which out of the blue sent it an email a few days ago. Did you talk -- did you discuss that with your fellow directors?

A. Yes, we did and the words, "That's very cosy, isn't it?" were used and I don't know whether it was by me -- I just remember the words, "That's very cosy".”

(Transcript 1/5/14 page 18 & 20)

204. In cross-examination Mr Marcus was unable to recall whether the email from Ferenergy addressed to him was unsolicited. He stated that it did not strike him as odd that the email from Ferenergy on 29 November 2010 followed that of Mr Stout on 27 October 2010 in which the possibility of trading watches had been mooted by Mr Stout, although with hindsight he accepted it was quite a coincidence. He could not recall Mr Draper raising the issue or his view that it was "cosy".

205. In his written evidence Mr Jackson stated that:

"Prior to any business transactions, our company performed what I saw as thorough due diligence on buyer and seller. This due diligence consisted of phone conversations, ID verification, reference follow up and meetings with the parties face to face. This included two visits to Richard Baldwin's offices in London…"

Jacob & Co UK Ltd

206. Jacob & Co was incorporated at Companies House on 24 May 2006. Mr Richard Baldwin was appointed as director from 24 May 2006 as was Mr Andrew Clive Hind who was also company secretary.

207. Officer Saxon's checks revealed that according to Companies House the last accounts filed by the company were to 31 October 2010, prior to the date of the first transaction between Jacob & Co and the Appellant.

208. The company was registered for VAT on 1 July 2006. The VAT 1 completed by Mr Hind described the business activity as "distributor of watches" with an expected annual taxable turnover of £2,000,000.

209. Officer Saxon noted that the company's turnover showed a dramatic decline save for the 12 months to 31 July 2011:

- 13 months to 31 July 2007 = £984,015
- 12 months to 31 July 2008 = £1,309,208
- 12 months to 31 July 2009 = £714,574
- 12 months to 31 July 2010 = £91,027
- 12 months to 31 July 2011 = £1,065,613
- 12 months to 31 July 2012 = £4,083

210. Although the 12 months to 31 July 2011 showed £1,065,613 Officer Saxon noted that this included sales to the Appellant totalling £1,055,610 between 7 December 2010 and 31 March 2011.

211. In a telephone conversation with HMRC on 14 April 2011 Mr Baldwin informed HMRC that Jacob & Co was the sole UK distributor of the watches but a distribution agreement prevented Jacob & Co selling the watches wholesale. Mr Baldwin also stated that goods were not supplied on credit but that payment was required prior to the despatch of goods to the customer. Officer Saxon noted that this contradicted the account given by Mr Draper on 3 May 2011 when he stated that the Appellant paid for the goods once they had arrived at the Appellant's premises. When asked what steps were taken to ensure the watches were genuine Mr Baldwin told HMRC that he had traded in watches for over 20 years and nobody could or would dare sell him a fake.

212. The documents provided by the Appellant in respect of due diligence on Jacob & Co were as follows:

- A Trade Account Application signed by Mr Baldwin on 6 December 2010;
- A Creditsafe report dated 7 December 2010.

213. Mr Draper's witness statement explained that *"…having completed our initial due diligence the Directors stressed to JUK that as this was to be our first consignment in an area with which we were not familiar we would therefore not bear any financial risk and would only pay JUK when we had been paid by our customer."*

214. Mr Draper's witness statement described the visit to Jacob & Co on 12 January 2011 as follows:

> *"His office had a Jacob clock on the wall as its centrepiece and Jacob marketing material was festooned throughout the various desks and cabinets. There was no doubt in anyone's mind that RB appeared to be a legitimate distributor for Jacob and to a lesser extent, other watches. A big hint was in the*

trading name of his company, Jacob & Co UK Ltd…RB came across as a very credible individual as I now believe do most "con-men"."

215. On 1 April 2011 HMRC officer Shorrock wrote to the Appellant expressing concern that the Creditsafe report showed that Jacob & Co had been trading at a loss since 2009, the address on the report was different to that held by the Appellant, no trade references had been taken up and the terms and conditions contained in the Trade Account Application referred to "My Digi" rather than the full company name.

216. On 25 July 2011 the Appellant responded by letter stating that the checks carried out had included a Companies House check, credit agency check, VAT validation and at least one verbal trade reference.

217. Officer Saxon's written evidence also highlighted the following concerns:

- The Creditsafe report indicated creditworthiness as at 7 December 2010 however the previous credit ratings had fluctuated dramatically dating back to 2 April 2008 which appeared not to have been questioned by the Appellant;

- The Creditsafe report indicated that Jacob & Co was running at a loss in 2009 and the company's net worth had declined from £196,690 in 2007 to a negative worth of £7,988 in 2010 yet the Appellant had not sought up to date information;

- There was no evidence to show that the Appellant had obtained written confirmation that Jacob & Co was an authorised distributor at the time of the transactions or that it had had sight of the distribution agreement;

- The two aspects emphasised by the Appellant for entering into transactions with Jacob and Co were that the product was sourced from an authorised distributor and that there had been no reason to doubt the veracity of Mr Stout who introduced the deals. However, Officer Saxon noted that there was no evidence that the Appellant verified that the supplier was an authorised distributor for the manufacturer nor was documentary evidence obtained to confirm that the watches came to Jacob & Co from the manufacturer.

218. In oral evidence Officer Saxon accepted that the Appellant had visited the offices of Jacob & Co to satisfy themselves as to the company's status and standing. However he noted:

"…but what was important was that, the evidence I have, is that that visit took place in January 2011, which was after trading had started."

(Transcript 24/4/14 page 69 – 70)

219. In cross-examination Mr Draper stated that he believed the Appellant had received the trade reference documents prior to the first transaction and that they were considered at the same time as the first deal took place. He did not agree that it would have been prudent given that the companies had never traded with each other before to wait and consider the documents prior to concluding the deal, explaining that the

Appellant's main consideration was the correct incorporation and VAT registration verification. Mr Draper agreed that he was aware prior to the first transaction that a VAT fraudster would have a valid VAT registration number in order to participate in fraud. Mr Draper went on to say:

"The bottom line is that the directors at that time were satisfied that the introduction had been made by, at the time we thought was a senior, respectable individual. We had no reason to doubt the authenticity of Jacob & Co. However, irrespective of that, we ensured that his company registration and his VAT number were valid, and it was important for our personal – the company protection, that the terms and conditions were in place.

Q. In the context of this case why did you need trade references?

A. It was a standard form.

Q. Window dressing is another word for standard form, Mr Draper, isn't it?

A. Not at all…

Q. But in the context of this case, they were absolutely irrelevant to you because Jacob hand you the watches before you pay them, and they are prepared to wait until Ferenergy pay you, so according to the financial model that you are presenting to this Tribunal you do not actually need trade references, do you?

A. No, we don't."

(Transcript 1/5/14 page 88 - 89)

220. In cross-examination Mr Marcus stated that he was unaware of the Appellant's credit score in December 2010 but stated the company did not receive or give credit:

"Q. But you did in effect get credit, didn't you, because what happens here is: Baldwin sends you the watch, so it leaves his possession. It could be something worth £120,000.

A. Mm-hm.

Q. He does not know you. It is not like you have been doing business for two or three years and there is a build up of: "Well, they pay us within four days of us sending the goods out." In December there is absolutely no previous dealing between you and Jacob, is there?

A. That's correct.

Q. Yet he was willing to trust you with £68,000 worth of watches.

A. Yes.

Q. Ferenergy were willing to put that £60,000 into your bank account before they got the watches.

A. Yes.

Q. If you had not actually supplied the watches, what would Ferenergy have had to do?

A. I would imagine try to obtain retention of title over the product, i.e. take legal action against us.

Q. Yes, sue you – that is the simple Anglo Saxon word for it. So you would have a French company having to sue in a foreign country your company.

A. Yes.

Q. What if you simply put your company into liquidation? What would happen then?

A. I have no idea. I don't know what -----

Q. Of course you know what would happen. There would be no money for Ferenergy to get their money back, would there?

A. I don't understand the process of liquidation in that terminology. I wouldn't know if we could just walk away with the cash, is what I think you are asking."

(Transcript 12/5/14 page 34)

221. Officer Saxon confirmed that HMRC Officer Simpson who visited the Appellant on 2 February 2011 had recorded in her visit note that: "*Records are reasonably were maintained and organised. The trader appears to take all due diligence checks on customers. No reason to doubt the credibility of this business at this stage*" (Transcript 24/4/14 page 13). Officer Simpson's visit report refers to the Appellant having conducted all due diligence checks on customers, although Officer Saxon noted that the report did not indicate what checks those may have been.

222. The Appellant relied on Officer Simpson's visit as evidence that HMRC had approved the company's due diligence and trading.

223. Officer Simpson gave the following oral evidence regarding her meeting with the Appellant on 2 February 2011:

> *"Q. Did you give them any sort of steer as to HMRC, as it were, "green lighting" any exports they made? Do you know what I mean by that?*
>
> *A. Not really, no, I don't.*
>
> *Q. All right. I will try and rephrase it. If we look at paragraph 12 of your witness statement, "Mr Jackson states among other things, 'I spoke with all directors present and gave assurance that from HMRC's perspective all transactions and all the companies involved in the supply and sale of goods satisfied HMRC". Did you tell them, "As far as I am concerned, Jacob (UK) are a fantastic company, you can do business with them"?*
>
> *A. Absolutely not.*
>
> *Q. Did you tell them that, "Ferenergy are a fantastic outfit. You've got nothing to worry about with them"?*
>
> *A. Absolutely not.*
>
> *Q. Would it ever be appropriate for you to give traders HMRC's stamp of approval of another trader?*
>
> *A. No, it would not".*

(Transcript 28/4/14 page 18)

224. Officer Simpson also confirmed in oral evidence that although due diligence was mentioned by Mr Draper who produced a file containing various documents, she did not review the documents in any depth and her conclusion that the Appellant carried out due diligence was based on what Officer Simpson was told by Mr Draper. The issue of due diligence was not a priority to Officer Simpson nor was it within her remit to check the Appellant's due diligence.

225. Mr Draper explained in his written evidence that following Officer Simpson's visit the Appellant's December 2010 repayment claim was released within a couple of days and HMRC granted the company's request for monthly returns. As a result the Appellant believed that everything was in order. He also confirmed that the credit worthiness of Jacob & Co was reviewed and the Appellant concluded that as there was no credit risk to the Appellant the status of Jacob & Co did not cause concern.

Inspections, serial numbers and certification

226. Officer Shorrock's visit report dated 21 March 2011 recorded Mr Draper having been asked if the watches had serial numbers, to which Mr Draper responded *"no, just model numbers."* It transpired that in fact the watches did have serial numbers; a fact which was publicly available via internet research. The interview, it was noted, took place more than 3 months after the Appellant's first transaction. Officer Saxon also noted that the Appellant contended that the first consignment had been physically examined yet Mr Draper appeared unfamiliar with the products. On 3 May 2011 Mr Draper conceded he had been mistaken. In a letter from the Appellant to HMRC dated

25 July 2011 it was stated that serial numbers had been discussed with Mr Baldwin prior to the first transaction. Mr Baldwin told the Appellant that Jacob & Co retained the numbers for an audit trail. The Appellant contended that this was confirmed at a meeting with Mr Baldwin and the Appellant on 12 January 2011.

227. In his oral evidence Officer Saxon highlighted the practical difficulties of the Appellant's explanation:

> *"Well, if the explanation given by Mr Baldwin held water -- and we are not suggesting he hasn't retained something; it's just it's never been seen -- the practical example would then be that a customer in, say, France, would be asking a retailer in France if it wasn't the customer of Mr Baldwin to then go back to his supplier who may not necessarily be Mr Fermor, but we assume it may be, and for then Mr Fermor to go to My Digi and ask to see certificates and have them produced and then My Digi then go to Mr Baldwin and ask for those certificates. Now, in a practical sense how would that work when the customer is standing in a shop waiting to be satisfied that the goods he is being shown have genuine documents behind them?*
>
> *Q. We have seen and indeed you have commented on the speed in which transactions have taken place between the parties. It would seem that it wouldn't be of great difficulty for such communication to take place at the same sort of speed that the transactions took place.*
>
> *A. … As a customer I would be expecting to see certificates and documents available with the watch that was being presented to me.*
>
> *MR GINNIFF: It is not likely to be a purchase that one goes in and just buys over the counter straight there and then is it though?*
>
> *A. I am not sure. I am just suggesting that if I was spending that sort of money, which these are expensive watches, I would expect that documents would be there, and one of the other issues that comes from this is how would My Digi know that the watch which was being requested for certificates was the same*

watch that was being presented to a customer in a retail shop in France?

Q. Because it will have the serial numbers on the lugs?

A. But My Digi didn't have those serial numbers….I'm not suggesting that Mr Baldwin did not say what he told My Digi. What I am basically saying is that My Digi ought to question it in respect of the certificates and satisfy themselves.

(Transcript 25/4/14 page 91)

228. In addition to the contradicting information above provided by the Appellant, Officer Saxon also noted that there was no explanation as to why the Appellant chose not to obtain the serial numbers from Mr Baldwin. In contrast, Officer Saxon noted, the Appellant recorded the serial numbers of electronic goods it traded showing an awareness of the significance of such information. A letter from the Appellant to HMRC dated 25 July 2011 stated that serial numbers were requested from Mr Baldwin on a number of occasions but never received. Correspondence with Jacob & Co was attached in support of this assertion dated 13 May 2011, 7 June 2011 and 26 May 2011 which Officer Saxon noted post dated HMRC's enquiries regarding serial numbers.

229. At no time did the Appellant obtain certificates of authenticity which were said to be retained by Mr Baldwin.

230. Mr Draper was asked at a meeting on 3 May 2011 about the research undertaken about the products. Mr Draper stated that he had visited a jewellers shop in Southport, although that particular branch did not deal in Jacob watches. Mr Draper was advised by the jeweller that the Blackburn store held Jacob watches but he did not visit the shop.

231. In his written evidence Mr Draper stated that HMRC had confused two visits made by him; one to the Southport Watch Shop which took place prior to any of the watch transactions and where he was told that *"he would not trade in such watches as the residual value in Jacob watches weren't as strong as Rolex etc"*. Mr Draper also made visited another jeweller in Southport in 2011.

232. In evidence-in-chief Mr Draper's stated that he:

> *"personally called in to a small retail outlet at Southport called The Old Watch Shop and…just asked him for his opinion on Jacob watches. They were not a product for him, he felt that at some point the bubble would burst with the Jacob brand…"*

(Transcript 29/4/14 page 93)

233. In cross-examination Mr Draper explained that he happened to be walking past The Watch Shop in Southport when consideration was being given to trading in watches and attempts had been made to market Jacob watches. The jeweller had never traded in such watches but Mr Draper explained that he was *"getting an expert's opinion of the state of the high value watch market across a number of brands"*

(transcript 1/5/14 page 136). The other shop in Southport was called Jacksons, which Mr Draper made a point of calling into as Mr Baldwin had stated it was one of his customers. He was told by Jackson's that the branch in Blackburn dealt in Jacob watches but he did not visit:

"You could have gone to Blackburn, could you not?

A. I could.

Q. You could have actually seen a real Jacob's watch yourself, could you not?

A. I had already seen them because this was after the first shipment.

Q. So you went to the Blackburn shop after.

A. No, I didn't go to the Blackburn shop.

Q. I am terribly, terribly sorry. You went to the Southport shop after the first shipment.

A. Correct."

(Transcript 1/5/14 page 139)

234. It was also stated that the Appellant carried out internet research on the watches however Officer Saxon noted there was no evidence to support this assertion. In oral evidence Mr Draper stated:

> *"Quite extensive internet research, because we wanted to satisfy ourselves, not having had any dealings with watches: was Jacob involved or were there any examples of Jacob watches, or indeed watches, being used in respect of MTIC fraud. We couldn't find any evidence."*

(Transcript 29/4/14 page 94)

235. Mr Jackson explained in his oral evidence that initially he had little involvement in the watch deals although he had carried out internet research by Googling the brand and Jacob & Co. Mr Jackson explained that this was his first ever involvement in due diligence checks and his understanding was that it involved checks on trading counterparties and obtaining certificates of incorporation and VAT registration. Mr Jackson explained that serial numbers were not an issue for the Appellant as they believed they were dealing with an authorised distributor. He could not explain why serial numbers were recorded by the Appellant in respect of some electronic products traded and not for watches.

236. In oral evidence Mr Marcus stated that when the Appellant was approached by Jacob &Co *"we identified that they were the authorised distributor"* (transcript 9/5/14 page 11). The research carried out by Mr Marcus involved getting a *"feel for the size of the market and…in which countries we would be able to sell the product without disrupting the…or bringing attention, too much attention, to the distributor"* (transcript 9/5/14 page 14)

237. Mr Bluffield stated in oral evidence that he researched Jacobs watches by looking into the market valuation. He also stated that he had looked online to find out more information about Jacob & Co. Mr Bluffield confirmed that he did not carry out any research on Ferenergy. He stated that he had no real involvement in the watch transactions as he was busy on other work. He believed the final transaction took place while he was away with his family.

238. At a meeting on 3 May 2011 with Officer Shorrock, Mr Draper confirmed that the only inspection of watches carried out by the Appellant related to the first transaction on 9 December 2010. The watches in subsequent transactions were not examined. Photographs were supplied by the Appellant to HMRC on 16 June 2011 which purported to relate to the first transaction. Officer Saxon noted that the protective film had been removed from the watch surface in two photographs although there was no evidence as to when and by whom this had been done. Officer Saxon further noted that despite examining the watches in the first transaction, no record of the serial numbers was made.

239. In his written evidence Mr Draper confirmed that the Appellant had removed the protective film for the initial shipment "*as part of the visual inspection of the goods.*" In oral evidence Mr Draper added that the inspection only served to confuse matters as the Appellant was then asked not to open any further consignments:

> "*because in our zeal to establish what we were shipping and ensuring that we had what we said we had bought, I was advised by one of my colleagues that one of us had left fingerprints on it and that had devalued the product.*"

(Transcript 29/4/14 page 102)

240. In cross-examination Mr Draper was questioned about the fingerprint. He agreed that it would be easy to rub off a fingerprint mark and stated he and his co-directors had discussed the issue because legal advice was sought regarding the request that further consignments not be opened by the Appellant, although Mr Draper was unable to recall when this had taken place. Mr Draper could not explain why he and his co-directors had made no mention of the fingerprint in their witness statements although he explained that the Appellant did not have the benefit of the manpower that HMRC had in preparing the case. Mr Draper could also not explain how a fingerprint came to be on the watch when the pictures exhibited by the Appellant which Mr Draper had confirmed related to the first transaction appeared to show the goods being handled in gloved hands:

> *"All I can say is it wasn't my fingerprint. I don't know how it got on there. I thought we were being careful and we specifically went out and bought white linen gloves."*

(Transcript 2/5/14 page 92)

241. Mr Marcus stated in his witness statement that:

> *"Although we were asked to not open future shipments from our customer due to the high value of the goods and the fact that finger marks were left on the first shipment. We still opened at least one of the boxes but handled the watches with gloves."*

242. In evidence-in-chief Mr Marcus added (referring to its customer Ferenergy):

> *"He'd obviously been aware that the heat sealed bags had been cut open and some of the plastic covering on the facing had been removed and he'd indicated that there were fingerprints on the watches. It didn't occur to us to wipe them down, if you will, or wear any protective gloves. We did have a conversation with Jacob and Co about how they handle watches and he indicated that he always handled watches with gloves, at which point we went out and purchased a pair of gloves."*

(Transcript 9/5/14 page 21)

243. In cross-examination Mr Marcus could not recall when the Appellant had been advised by Mr Baldwin to use gloves to handle the watches; it may have been from the outset or at the meeting in January 2011. He confirmed that Mr Fermor had complained about fingerprints on the watches after the first transaction but was unsure whether the photographs exhibited by the Appellant showing watches being handled with gloves related to the first consignment but stated that the fingerprints may well have come from the warehouseman or one of his co-directors as he had used gloves. Mr Marcus confirmed that this incident had been omitted from his witness statement and stated that at the time of writing the statement he had recalled events as accurately as possible.

244. Mr Marcus was asked why the Appellant believed that it was an agreed term of sale that the watches would not be opened or the contract would be invalidated; a factor which was not included in his witness statement nor set out in writing between the parties. Mr Marcus was unsure but believed that the condition was contained on Ferenergy's purchase orders at his request. The purchase order contained the following:

"Damaged/substandard/incomplete goods may be rejected on inspection"

Mr Marcus agreed that these were standard terms and did not specify that the contract would be invalidated if the packaging had been opened. Mr Marcus explained that he could not recall but the term could have been expressed verbally or set out in correspondence as Mr Draper sought legal advice on the issue. Mr Marcus agreed that there was no documentary evidence in support of this assertion before the Tribunal. Mr Marcus agreed that a fingerprint could be easily rubbed off and explained that he understood it was not the fingerprint which de-valued the goods but removal of the plastic covering on the face.

245. Mr Jackson's written evidence explained:

> *"The initial deal was arranged by myself and Brant Marcus…When the watches arrived by secure courier to our offices in Warrington, we immediately opened up the package, and using white jewellery gloves bought specifically to handle such products unwrapped each timepiece individually and took pictures of each. We then securely wrapped them back up and arranged for shipment to our customer."*

246. In oral evidence Mr Jackson added that gloves were used so that the watches weren't scratched or marked. Many of the cellophane sleeves on the front and back

were removed and would not stick back on and he believed this had led to Ferenergy requesting that the following shipments were not opened. When it was put to Mr Jackson that he had not mentioned fingerprints in his witness statement nor in evidence-in-chief Mr Jackson explained that it had not stuck in his mind when he write the statement but denied fabricating the evidence to explain why the goods were not inspected thoroughly. It was put to Mr Jackson that if the packages were not opened, they could contain anything to which he responded that there was a certain element of trust when dealing with a distributor.

247. On the issue of wearing gloves Mr Bluffield recalled in oral evidence that the Appellant was told by Mr Baldwin in a telephone call to use them to handle the watches to ensure that no fingerprints were left.

Visit by HMRC on 23 March 2011

248. HMRC officers Kent and Marsh visited the Appellant on 23 March 2011 at the request of Mr Draper earlier that day. The purpose of the visit was said to be to witness a consignment of watches arrive at the Appellant's premises. What took place at the meeting was a contentious issue between the parties.

249. Officer Marsh completed a visit note which formed part of the exhibits in this case. The report states that the officers were not given the opportunity to examine the watches. Officer Marsh described a sealed outer box which contained two packages wrapped in bubble wrap. She recalled the directors expressing concern that they had expected three watches and therefore three packages but it was then explained that one of the packages contained two watches. Officer Marsh's visit note recorded:

> *"The packages appeared to be two plastic type round boxes that were sealed in transparent bags. The boxes were dark in colour and were opaque. I could not actually confirm that these boxes contained watches…a vague bulbous shape could be made out but as the packages could not be opened or taken out of their plastic bags that was all that could be confirmed. The directors stated that they could not open the bags or boxes as it would invalidate their contract with the buyer."*

250. In oral evidence Officer Marsh stated:

> *"There was one box, an outer box, that contained two packages inside, two boxes, plastic boxes, and they were wrapped in bubble wrap. But they were encased in like a plastic bag and then they were wrapped in bubble wrap.*
>
> *…Q. When the boxes were opened was there general bubble wrap in the box?*
>
> *A. Yes.*
>
> *Q. And you are saying within that bubble wrap ---*
>
> *A. Yes.*
>
> *Q. --- there were two packages.*

A. Yes.

Q. Now trying to cut through the layers of the packages, was there bubble wrap round those packages?

A. Yes, I would say that they were wrapped. Because that is what I have said: "The outer box contained two packages wrapped in bubble wrap."

Q. Was the bubble wrap round some plastic boxes, are you saying?

A. The plastic boxes, yes. The plastic boxes were in a plastic bag in ---

Q. How do you know that if the bubble wrap was round them?

A. The bubble wrap was opened.

…Q. Then you are saying the next layer would be a plastic bag.

A. The next, yes, there is a plastic bag, a sealed plastic bag.

Q. Then the next layer that is vacuum packed is you get down to a box, you are saying… And you are saying that box was dark in colour.

A. Yes.

Q. How big was that box?

A. A small box, like that.

Q. And were they both small boxes?

A. That's what I recall, yes….

Q. Did you ever say, "I can't even tell if these are watches"?

A. No.

Q. Do you accept that you had been asked to witness the delivery of watches as Mr Draper was doing that because he wanted to satisfy you they were taking a delivery of goods of watches? You realised that is why you were there?

A. Yes, that was the reason why I was there, yes.

Q. And yet you never asked or said, "I am sorry, but I can't tell if those are watches"?

A. No.

Q. Why was that?

A. Primarily because Mr Draper had asked us to pose as customers and I didn't feel that ... I felt that that precluded us from sort of asking too many questions."

(transcript 25/4/14 page 124 - 130)

251. Officer Kent's written evidence explained that he accompanied Officer Marsh on the visit as Officer Shorrock was unavailable. Officer Kent had no prior knowledge or dealings with the Appellant. Officer Kent agreed the contents of the visit report prepared by Officer Marsh and endorsed the notes as follows:

> *"Contents agreed – we both made the observation that the "business premises" consisting of a warehouse with small office at the front were totally bereft of any day to day goods in/out activity apart from the watch delivery."*

252. Officer Kent described how two packages were opened which contained items *"encased in opaque bubble wrap"*. He had been unable to confirm that the goods contained therein were watches as the items were not removed from the bubble wrap. Officer Kent's written evidence disputed the Appellant's claim that he had acknowledged that the packages contained watches.

253. In oral evidence Officer Kent stated:

> *"I don't recall anybody, not myself anyway, taking hold of it or anything like that. We did ask, I did ask to confirm what was in there if the packaging could be peeled back, or whatever, so that we could confirm what we were looking at but we were told that to do that, even to tamper with the packaging, would invalidate the transaction...As I say, I didn't pay a great deal of attention to how it was packaged, if you like. I was more interested in what it contained….From where I was looking from, I couldn't say yes or no as to whether they – the actual form of what was in those plastic wrappings, other than the fact that they were plastic wrappings and there was something inside them"*

(Transcript 25/4/14 page 140, 154, 159)

254. All four of the directors disputed the evidence of officers Kent and Marsh. Mr Draper stated that there were initial concerns that a watch was missing and it was only on further examination witnesses by the officers that the directors were satisfied as to the contents.

255. Mr Draper's evidence was that HMRC was invited to witness the Appellant's procedures as a result of the continued delay in relation to its February repayment claim. In his witness statement Mr Draper described the goods as follows:

> *"The couriers handed over 1 box that was sealed with security packing tape. This was removed and the contents checked. Inside the box were 2 items that were "vacuum packed" in clear film. On initial observation we did not immediately identify the highest value item, £141k Tourbillion and my first*

thought was that this may have been the concern for HMRC and for us all. Were we involved in shipping "fresh air"? On closer examination we identified the consignment in full and it is fair to say there was a sigh of relief. I can confirm that this was witnesses by all parties including SM and her colleague which is contrary to what is implied by Richard Saxon in his witness statement…"

256. In oral evidence Mr Draper reiterated the point:

"With respect to the officers, I am dumbfounded by ... I was dumbfounded when I read their witness statements, and they have stood by what they have submitted and I can't comment on that. What I can comment on is the fact that at no point certainly was I and the other directors, well, you can ask them, but I am pretty sure I am speaking on their behalf, none of the directors were advised that they couldn't see any watches. I just, I am staggered by that, and, if they couldn't, why didn't they tell somebody?"

257. During his oral evidence Mr Draper produced packaging said to be that which the watches were wrapped in. The evidence had not been formally served and was not put to officers Marsh or Kent during their evidence. Mr Draper stated that he had come across the packaging when clearing out boxes in his kitchen two or three weeks earlier

258. Mr Marcus also stated in his written evidence that:

"HMRC witnessed the watches as we opened all the packaging as we first thought there was one missing against the manifest...we took comfort in the fact that HMRC had witnessed the watches and the paper trail for this shipment."

259. In oral evidence Mr Marcus added that Mr Jackson had identified that a watch was missing which caused initial concern. As a result the bubble wrap and packaging was opened to the heat sealed bags whereupon it was identified that two watches were back to back. The HMRC officers witnessed this but made no comment.

260. Mr Bluffield confirmed in his written evidence that he:

"was there and saw everything that everyone else saw which was a complete consignment. There was initially some concern as the packages did not clearly show all the goods so we had to examine the goods fully to satisfy ourselves that we were not shipping "fresh air"."

261. In cross-examination Mr Bluffield stated:

"Q. How far away was Officer Kent from you when he was looking at the watches?

A. About 15 feet behind a closed door.

Q. So you left the inspection, did you, and went and sat behind ... you opened the door, sat down, or whatever, and closed it. Is that what you are saying?

A. Yes, I have already said that earlier.

Q. Have a look at your witness statement again, please, at page 124, paragraph 8. …In fact you spend seven lines talking about the VAT officer's badge and you spend about two and a half lines on the vital bit of this case, which is the inspection itself:

"I have been told that HMRC claim not to have seen the goods. This is not the case."

Pausing there, you are now making your case plain that the officers are lying. …Your evidence today is different from that, is it not? Do you agree?

A. Slightly.

Q. So you are now saying you were not present throughout the inspection. So if that is true, Mr Bluffield, why did you not put it in your witness statement?

A. Um ... possibly because the witness statement was written some time after the events. Having to think back on my exact movements is, probably for anybody several years after an event, it is quite difficult to do. What I probably meant was I was there present when they have arrived, when the watches arrived. I saw parts of the consignment. I was not privy to the whole consignment. I was not stood in side by side to your officers, but I was certainly present and witnessed the delivery coming in and going again."

(Transcript 8/5/14 page 30)

262. Mr Jackson's evidence in respect of officers Marsh and Kent was:

> *"HMRC then witnessed us opening up the newly delivered consignment of watches. They witnessed us unwrap the timepieces as we checked against our paperwork that the correct number and models were present. They acknowledged this and then witnessed us repackage them…"*

263. In oral evidence Mr Jackson clarified that initially Mr Draper and Mr Marcus took the officers to see the packages while he and Mr Bluffield remained at their desks. Mr Draper then took Mr Jackson to see them while Mr Bluffield was still at his desk. He stated that Officer Kent had confirmed seeing the watches, although clarified

that this had not been a verbal acknowledgement but Mr Jackson said he *"could see by his face"* (transcript 7/5/14 page 14).

264. On 23 March 2011 the Appellant was notified that its February 2011 repayment claim would be released on a *"without prejudice"* basis. The Appellant took comfort from the fact that it believed it had satisfied HMRC regarding its watch trades and further transactions were carried out. In oral evidence Mr Draper explained that he believed *"without prejudice"* was a general caveat used by HMRC and did not believe it reflected any undue concern.

Officer Shorrock's visit on 21 March 2011

265. It was the Appellant's case that its trade in watches was predicated on 2 bases:

i) That the goods were sourced directly from the authorised distributor Jacob & Co; and

ii) That HMRC approved the trading.

266. Officer Shorrock's visit report of 21 March 2011 noted:

"AS concentrated on Due Diligence produced in respect of Ferenergy…AS stated that the due diligence gave cause for concern or at the very least further enquiry by My Digi. I stated the reasons why I did not feel that the due diligence provided them with any assurances…

Mr Draper seemed to have the impression that HMRC had given the green light to My Digi's trading activities because the previous precred had been released and the company had been granted monthly returns. AS explained that this was not the case. Repayment returns were frequently verified dependent upon size, frequency and risk. HMRC did not provide the green light for transactions. Who the company traded with and the types of trade it undertook were for the company to determine…"

267. Mr Draper did not recall Officer Shorrock specifically stating that HMRC did not give the Appellant a green light in its trading, although he did recall the officer saying that it was not for HMRC to tell the Appellant who to trade with. Subsequently Mr Draper stated:

"Q. So, none of the four of you were saying something along the lines of, "Well, that Andy Shorrock, he seemed to be saying to me that we don't have a green light to do these transactions"? Not one of the four of you came out with anything like that?

A. We were aware that there were outstanding queries.

…

JUDGE BLEWITT: So, at the point that you were waiting for the email you

knew that there were concerns?

A. Yes.

JUDGE BLEWITT: So, at that point do I understand that you and your fellow directors understood there was essentially something wrong or you weren't, to use the phrase, getting the green light at that point?

A. We knew we had to satisfy HMRC with further queries, yes, we did. We knew that."

(Transcript 2 May 2014 page 16)

268. In cross-examination Mr Jackson initially stated that Officer Shorrock did not tell the Appellant at the meeting that it did not have the green light to trade. He subsequently stated that he did not hear this being said and added that he was not present for the entirety of the meeting, or could not recall if he had been there 100% of the time as he may have gone to the bathroom.

269. Mr Marcus' evidence was that he could not recall Officer Shorrock telling the Appellant that HMRC did not give the green light to transactions but he recalled Mr Draper suggesting to him after the meeting that *"everything was okay"* (transcript 12/5/14 page 30). Mr Marcus stated that if Officer Shorrock had advised the Appellant that there was no green light, he either wasn't listening or was not present. Mr Marcus subsequently stated in cross-examination that he was *"fairly confident"* (transcript 12/5/14 page 48) that Officer Shorrock did not indicate that the transactions were not approved as "*otherwise it would have been discussed there and then*" (transcript 12/5/14 page 49).

270. Mr Bluffield's evidence on the issue of what the Appellant was told by Officer Shorrock was that he could not recall what was said:

"Q. Well, that would fit in with him saying that, "We don't green light trading". Do you agree?

A. Partially.

Q. What do you mean, "partially"? Either you do or you don't agree.

A. Well, I remember the talk of a type of green light moving forward. I can't remember the type of -- the way the conversation went. I think I remember it talking about the size and frequency, but I don't know what that meant. I don't know if that was something that was done, if there were any green lights given after that. I don't know, I can't remember, looking, what, three years back."

(Transcript 8/5/11 page 136)

271. At the visit on 21 March 2011 Officer Shorrock had highlighted that Ferenergy was registered to trade carbon credits – commodities commonly found in MTIC frauds. Officer Shorrock's record of a telephone call with Mr Draper on 25 March 2011 noted that Mr Draper said he had googled carbon credit fraud after it had been suggested by Officer Shorrock. In cross-examination Mr Draper accepted that prior to the first transaction with Ferenergy he had not been aware that the company's business had been carbon trading and that he only became aware of this fact at the meeting with Officer Shorrock on 21 March 2011.

272. In oral evidence Officer Shorrock confirmed that he had not informed the Appellant prior to the relevant transactions that watches had previously been used in MTIC fraud. Officer Shorrock also accepted that he had not given the Appellant an explanation of contra-trading during the meeting. Officer Shorrock noted that although the Appellant took steps such as visiting Ferenergy:

> *"My Digi were taking these steps but they were taking them retrospectively, so they were happening after the deals had actually occurred…"*

(Transcript 29/4/14 page 21)

273. In oral evidence Officer Saxon noted that the Appellant had continue to trade following the visit on 21 March 2011 despite the concerns he had raised.

274. Mr Draper stated that Officer Shorrock touched on three areas of the company's watch trade at the meeting, none of which caused him concern:

(a) Funds received from outside France via Malmo-based bank;

(b) Shipments to fright forwarders and not direct to customer; and

(c) Some goods shipped at buyer's risk.

275. A letter was received by the Appellant from Officer Shorrock on 1 April 2011. Mr Draper took the view that the letter was deliberately compiled in a manner which implied that more advice and concerns had been aired by Officer Shorrock at the visit than had been the case.

276. Mr Draper confirmed that he asked himself if the deal was too good to be true. His witness statement explained that he discussed the following issues with his co-directors:

> *"Were we physically exporting the goods under our control?*
>
> *Yes*
>
> *Were we physically shipping goods and not fresh air?*
>
> *Yes – although not all consignments visually checked we reserved the right to do so at will*
>
> *Were we involved in money laundering?*
>
> *No – full audit trail of who paid what and from where*

Was a margin of around 4% too good to be true?

No – a fairly thin margin but no credit risk and only VAT exposure to fund"

Insurance

277. On 22 March 2011 the Appellant provided evidence of goods in transit insurance cover to HMRC. This consisted of an "Evidence of Insurance" note dated 17 March 2011 issued by a German insurance broker called MIRA to the Appellant and which named the Malca-Amit group of companies as the Assured Policyholder underwritten at Lloyds in "valuable cargo of all kinds" to a value of USD $800,000,000.

278. On 23 March 2011 the Appellant provided to HMRC insurance cover from Arista Insurance effective from 14 December 2010 naming My Digi Ltd and My Digi Retail Ltd as jointly insured policy holders underwritten at Lloyds covering property damage and capital equipment, loss due to business interruption and employer liability cover.

279. On the same date the Appellant also supplied a Marine Cargo insurance policy dated 14 December 2010 from CAN Insurance Company effective for a 12 month period showing My Digi Ltd and My Digi Retail Ltd as joint policyholders for stock transit of £250,000 per conveyance throughout the EU and at rest at a place of business to the value of £50,000. Officer Saxon noted that the business activity under cover was named as *"Importers, Exporters and Distributors of New & Refurbished Consumer Electronics"* and the subject matter insured was *"New and Refurbished Consumer Electronics."* Officer Saxon concluded that the insurance by Malca-Amit commenced on 17 March 2011 and the cover by CNA covered *"consumer electronics"* which does not appear to cover the watches. Furthermore the CAN insurance was dated 14 December 2010 and therefore did not cover the first transaction on the sales invoice dated 9 December 2010 valued at £64,380.

280. In oral evidence Officer Saxon explained:

"Q. Let me just go to that. Thank you. So it is CNA, effective ….. An insured value of £50,000 for new and refurbished consumer electronics. Yes?

A. Yes.

Q. Not watches.

A. Watches aren't mentioned, no, and I did pose the question in my evidence: were watches covered?, and I think in the directors' evidence they actually confirmed that watches weren't included in the insurance policy.

Q. If we go to your paragraph 212 again, the policy itself is dated 14 December, yes?

A. Yes.

Q. So if the watches were shipped on 9 December, at that time they were not covered.

A. If they were shipped on 9th, yes.

Q. The February deal, what is the position there?

A. I understand that the same policy was in force in February as well. The change appeared to be when, from March, Malca Amit provided insurance cover, but that appears to have only commenced, according to paragraph 213 of my evidence, on 17 March 2011. I have no evidence prior to that date of any other policy which would cover watches. So that would include February as well."

Q. Turning to the Malca Amit insurance, who was the policyholder in respect of the Malca Amit policy?

A. Malca Amit.

Q. So if MDL suffered a loss, they would depend upon the cooperation of Malca Amit if they wanted to secure any compensation.

A. Yes.

Q. Had you seen any documentary material where MDL has advised Malca Amit of the nature and price of the watches it was despatching to France?

A. I have not seen that, no."

(Transcript 28/4/14 page 69 – 70)

281. In his written evidence Mr Draper stated that the Appellant *"always endeavoured to ensure that it had the right level and type of insurance cover for its business."* He confirmed that watches were not covered by the insurance for general stock and that the Appellant had difficulty obtaining goods-in-transit insurance for the watches due to the individual values and high risk nature of the goods. A quote was provided by NMU but the price was not *"workable as nearly all of our margin would have been taken up in insurance."* As a result it was agreed with the customer that until suitable insurance was obtained any shipments were at the customer's risk and this was noted on the invoices.

282. In cross-examination Mr Draper accepted that the transaction in December was not covered by insurance by the Appellant. He stated it may have been insured by Ferenergy although he could provide no explanation as to how Ferenergy would arrange insurance on goods when they did not know the location of them or which company was transporting them. Mr Draper also agreed that the February transaction was also not insured. In respect of the March deal, the evidence was:

"Q. The March deals, you had no insurance cover either, did you?

A. Yes, we did. Our Malca Amit ---

Q. No, they have their policy which will cover them in case of loss; but you are not privy to that insurance contract. You cannot claim on that insurance policy, can you?

A. My understanding was that we could. I wouldn't have entered into the arrangement if we couldn't.

Q. You are not a stupid man, Mr Draper.

A. Clearly I must be if I paid ---

Q. Do you think that paying nothing you can ... nothing or very, very little, you can claim the benefit of an insurance policy that somebody else has?

A. I think I must be a stupid man because, I forget the quote, something in the order of .8 per cent which we felt was reasonable and it covered us from us signing over for the goods, for the goods being signed over by the ultimate customer or freight forwarder.

Q. But Malca Amit -- sorry to interrupt you -- are not an insurance company, are they? They are a firm which moves goods around.

A. Specialist courier.

Q. Thank you, courier. They are a courier not an insurance policy. Is there any document you can point to which is a contact between you and Malca Amit to underwrite any loss to your products? I am not talking about emails; I am talking about a contract which sets that out?

A. I will need to find the contract. I haven't got it in front of me."

(Transcript 2/5/14 page 43)

Negotiation, profits margins and patterns

283. The Appellant produced evidence of negotiation in the form of emails provided to HMRC on 21 March 2011 showing stock enquiries and price negotiations.

284. In his written evidence Mr Jackson stated that he was responsible for negotiating on margin with Jacob & Co which led to an extra 0.5% margin after the first deal.

285. Officer Saxon undertook a profit analysis within the watch transaction chains connected to the Appellant covering watch deals undertaken from 9 December 2010 to 29 March 2011. In period 03/11 Officer Saxon noted that 58 watches were sold on four separate invoices between 16 March 2011 and 29 March 2011. The individual cost price excluding VAT varied depending on the model between £5,750, £6,497.50, £12,497.50, £29,050 and £135,00. In all deals save for three the mark up on cost was

4.71%. The remaining three deals had a mark up of 10.47% (the same model sold together in a single deal). Officer Saxon concluded that 10.47% was a transposition error in the price charged on the sales invoice. According to the sales invoice the three watches sold for £13,806 each. Two of the same model sold 13 days later for £13,086 each and in that deal the mark up was 4.71%. In both deals the same cost price of £12,497.50 was paid.

286. In period 02/11 29 watches were sold on three invoices between 16 February 2011 and 21 February 2011. Again the individual cost price varied depending on model and the mark up on 24 of the watches was 4.71% and 4.69% on the remaining five.

287. In period 10/10 ten watches were sold on a single invoice dated 9 December 2010. Again the individual cost price varied depending on model and the mark up on six of the watches was 4% and 4.02% on the remaining four.

288. Officer Saxon highlighted that the mark ups were in essence identical despite the variation in cost price and there was no evidence of competitive and open market price negotiation between the Appellants and its supplier or customer. Officer Saxon also noted that a consistent profit achievement and profit division was made between the participants of the transaction chains irrespective of model traded or value of the watch and that all four parties in the chains achieved an aggregate profit which was a fixed percentage of the price paid for the goods by the UK acquirer.

Distribution Agreement

289. Officer Saxon obtained a copy of a document entitled *"Exclusive Wholesale Distribution Agreement"* between Jacob & Co Watches Inc (the US manufacturer) and Jacob & Co (UK) from the FCA which in turn obtained the document in the course of a criminal investigation "Operation Tabernula". As a result of the criminal investigation two directors of Jacob & Co (UK) (together with others) have been charged with insider dealing (Mr Baldwin) and money laundering (Mr Baldwin and Mr Hind).

290. The agreement is dated 21 September 2006 and was extant for a 5 year period. It is unsigned by Mr Hind and states:

> *"Distributor shall only sell Products to Authorized Retailers in the Territory"*

291. *"Authorized Retailer"* is defined as *"a retail store selling to ultimate consumers in the territory who has been approved by Manufacturer as an approved seller of products." "Territory"* is defined as the UK, Ireland and the Channel Islands. Officer Saxon noted that the Appellant is not an authorised retailer.

292. It was the case for the Appellant that it understood that it was involved in circumventing the distribution agreement. Mr Marcus accepted in cross-examination that he had not read the distribution agreement before and agreed that Jacob & Co were breaching the agreement by selling to the Appellant.

293. In oral evidence Mr Draper agreed also that Jacob & Co was deceiving Jacob & Co Watches Inc (USA) by attempting to breach the distribution agreement but stated

that *"that's the nature of business in the commercial world"* (Transcript 1/5/14 page 90) and he did not agree that such practice was dishonest.

294. In cross-examination Mr Draper was questioned about the Appellant's view that the purported circumvention of the distribution agreement went some way to explain the transactions:

"Q. So, you were not an authorised retailer were you?

A. No.

Q. So, by Jacob selling to you, they were breaching the fundamental term of their agreement, namely that they should sell only to authorised retailers. So, if this is a way of trying to get around the terms of a distribution agreement, it was completely ineffectual. Do you agree?

A. Yes, looking at this document

…

Q. But they didn't need you did they? They are breaching the agreement anyway by selling to you -- let me finish. So, why not just sell the product straight to Edward Fermor?

A. I think, to use your term, this was window dressing in terms of their agreement, but I don't know what was in the mind of Richard Baldwin at the time.

Q. Well, it is pretty rubbish window dressing isn't it because if Jacob USA were provided with information by Jacob UK that they had sold to My Digi Ltd, Jacob USA would know straightaway that My Digi was not an authorised retailer and therefore Jacob (UK) had broken their agreement. So, it is not going to camouflage the problem for Jacob (UK) is it?

A. Jacob (UK) may have felt that he didn't realise that we weren't an authorised reseller.

…

Q. It is a simple point here which again, with respect, I suggest you are trying

to obfuscate, but if Jacob (UK) are going to break their agreement, they may as well just export straight to Ferenergy mightn't they?

A. It seems as though they could have done, yes.

…

Q. Let's try and keep our eye on the ball for a moment, here, Mr Draper. There are some simple facts here. Jacob (UK) are going to break their distribution agreement and they can do it in two ways. They can either sell outside the territory, because if you look at definition (b), "territory" means, the UK, which is Great Britain, Scotland, Ireland, the Channel Islands, so that is one way they can breach their agreement by selling outside the UK. Another way they can breach the agreement is by selling to an authorised retailer. If they choose to breach (b), territory, they can save themselves your profit can't they?

A. Yes.

Q. So, looking at the facts now do you accept that these deals had nothing to do with breaking a distribution agreement?

A. Notwithstanding that that was our heartfelt belief at the time of our transactions, in the light of the evidence presented, there must be another reason why they did it, yes.

…

I agree that in respect of Jacob & Co the sale to us was nothing to do with the circumvention -- circumventing a distribution agreement."

(Transcript 1/5/14 page 99 – 105)

Skype

295. Mr Cook, a forensic investigator employed by the FCA, had conduct of the financial enquiries in relation to Operation Tabernula. Mr Cook's unchallenged evidence was that during the course of searches of premises associated with Mr Hind and Mr Baldwin on 23 March 2010 and 7 April 2011 respectively various digital devices were seized. Forensic review of the seized items of Mr Baldwin recovered a

number of Skype messages which were produced within a report by the FCA. Tables within the report showed chats and messages recorded in the Skype data extracted from computers and mobile phones of Mr Baldwin. The report focussed on communication between three characters:

A) watchtrader;

B) frogmanbob; and

C) inspain2011.

296. It was agreed by the parties that watchtrader was Mr Baldwin. The identities of frogmanbob, inspain2011 and other characters referred to including "The Big Man" and "The European" remain unknown although many of the witnesses speculated. Officer Saxon for instance believed "The European" was Mr Fermor. In oral evidence Officer Saxon explained:

"If you look at the round of the nature of the conversations, it would appear that Frogmanbob and Inspain2011 are taking the position of a fixer, if you like, the arranger of the deals, the go-between, so in the context of that the fact that they haven't used names which may potentially reveal any identity may well be the reason why they've used those screen names…but I've no evidence to say that was the…"

(Transcript 25/4/14 page 41)

297. By way of example the data extracted showed the following communication between Mr Baldwin and Frogmanbob:

Date/Time	**Author**	**Message**
29/11/2010 16:30	Frogmanbob	Brant.marcus@mydigi.co.uk
29/11/2010 16:30	Frogmanbob	Mob fone…07980******
29/11/2010 16:30	Frogmanbob	ok?
29/11/2010 16:31	Watchtrader	Cool
30/11/2010 11:00	Frogmanbob	morning
30/11/2010 11:03	Frogmanbob	The big fella said you want to start Thursday…have you sent your intro into the customer yet?
30/11/2010	Frogmanbob	I just spoke to the customer and he said he hasn't received

13:37		anything from you mate
30/11/2010 17:33	Watchtrader	Hi
30/11/2010 17:34	Watchtrader	What do I exactly need to send to him?

It was the case for HMRC that not only does the Skype evidence demonstrate the contrived nature of the transactions but that it can also be properly inferred that someone from the Appellant was communicating with a third party regarding the deals and was thereby a knowing participant in the fraud.

298. In oral evidence Officer Saxon agreed that the Appellant was referred to in the third person in the Skype conversations and there is no evidence that the Appellant was a direct party to any of the conversations. He stated:

"There are some messages which suggest that there may be contact between Inspain and Digi and Frogmanbob and Digi based on the comments that have been made"

(Transcript 25/4/14 page 64)

299. Officer Saxon was unable to explain why the records appear to contain entries which were repeated in identical terms but in different months.

300. In cross-examination Mr Draper speculated that Frogmanbob was Mr Stout. The reasoning behind this was that there were emails contained within the Skype data which indicated that Frogmanbob received information from the Appellant, for example regarding a payment instruction Frogmanbob is recorded as messaging Watchtrader "*he said he just sent it"*. The evidence was:

"Q….how did Mr Stout find out that MDL had just sent it?

A. It is quite possible that he rang somebody at My Digi.

Q. And why would anybody at My Digi be telling Mr Stout about the movement of money between My Digi and Jacob (UK)?

A. Because Philip Stout was the individual who made the introduction and it may have been a case of Mr Stout wanting to know if we had paid, because he may be due commission, or I would expect him to be due commission from Jacob (UK).

Q.… So you think this may all be about a commission?

A. That particular conversation, yes. If I was Mr Stout, I would want to know when my contact was being paid so I can get my cut of whatever the commission or introductory commission was, yes. And as I have said, and I have no reason to lie about this, there were ... as Stout was the main contact at Anovo, we did speak to him regularly.

Q. You see, I asked you with great particularity right at the start of the cross-examination, after Mr Stout made the introduction, was he in any way involved in the later transactions ---You said, "No, he wasn't." Now we are getting, "Well actually he was involved all the way through, phoning up. No doubt he had a commission waiting and he wanted information." You are now painting a totally different picture from what your evidence was to start with.

A. It is certainly not intentional to paint a different picture.

…

Q. But there is a more fundamental problem to this explanation. You have already accepted that this whole set up has nothing to do with a distribution agreement. It is a VAT fraud. So it is going to be nothing to do with Mr Stout, if Frogmanbob is Mr Stout, getting commission on a breach of a distribution agreement because you have finally accepted it is a VAT fraud not a distribution agreement. Do you follow me?

A. I do.

Q. So do you agree that your explanation actually does not make any sense?

A. No, no. Sorry, you see, I haven't got the forensic mind that you have, Mr Taylor, because I'm not a trained legal technician or anything, so I have to say I am a bit confused as to the point you are making."

(Transcript 2/5/14 page 52)

301. Similar Skype messages indicated that the Appellant had also communicated (directly or indirectly) with Inspain2011 regarding the transactions, for instance on 28

March 2011 Inspain2011 Skyped Watchtrader (Mr Baldwin): *"Purchase order from Digi should come to you this morning as they have had the order from their client."* Mr Draper's explanation was that the Appellant had been used *"as puppets by a number of individuals"* (transcript 2/5/14 page 67) and he could provide no further explanation as to why the Appellant would have told someone who was not a party to the transaction that a purchase order would be sent to Mr Baldwin, their supplier, in the morning. Mr Draper reiterated that he believed that information may have been imparted to Mr Stout by Mr Bluffield who was in contact with Mr Stout on an almost daily basis.

302. In cross-examination Mr Marcus accepted that the messages indicated that someone from the Appellant had communicated with Frogmanbob regarding the transactions. He assumed that Frogmanbob was Mr Stout:

> *"Q. But there is no commercial reason for that to be the case, is there?*
>
> *A. It depends who frogman is, doesn't it?*
>
> *Q. He is not in MDL. That is the point. But this is MDL's business. It is not Phil Stout's business, is it?*
>
> *A. No, but you have just said he had no – whoever that person is, I assume it's Phil Stout. If he has a vested interest in this, then surely there is a commercial reason for him, commercial being as in he gets cash at some point, so he's got a reason to want to – I can't find any logical reason for it, except it has to be him and obviously he is communicating with MDL."*

(Transcript 12/5/14 page 56)

303. Mr Marcus believed that someone may have given information to Mr Stout innocently although he emphasised as his co-directors had that the information did not come from him. Mr Marcus queried the accuracy of the Skype data stating that it contained too many repeated entries to be reliable.

304. Mr Jackson's oral evidence was that Mr Stout had no involvement once the watch trading commenced as far as he was aware. However he subsequently stated that Mr Bluffield spoke to Mr Stout about watches:

> *"Q. …Now, again I asked you carefully this morning whether Phil Stout played any part, had any connection with the dealing after the first connection in October 2010 and you said he did not.*
>
> *A. He did not.*

Q. So, we have Stout speaking via Skype to Baldwin saying, "I've just spoken to MDL".

A. Mm hmm.

Q. So, there is somebody in MDL who Stout is speaking to?

A. Yes, Andy.

Q. And it is about watches

A. Yes.

Q. Do you think watchtrader, Baldwin, is going to be interested in electronic goods?

A. No, Andy is speaking to Phil Stout on a daily basis about electronics, refurbished electronics which we were buying from Anovo. If in a conversation Phil Stout has asked Andrew if he's done a watch deal or, "Are we doing a watch deal?" and Andy has told him some information -- I don't know what Andrew's told him -- that could possibly be it.

Q. Well, you see, that is exactly why I asked the question, do you think Stout was connected once -- the 27 October was dealt with?" You said, "No he wasn't."

A. It depends what you mean by "connected".”

(Transcript 7/5/14 page 117)

305. Mr Jackson denied that Mr Stout had asked for a commission from the Appellant. When it was put to him that Mr Draper had given evidence to the contrary Mr Jackson stated he was unaware of Mr Stout having asked for a commission payment.

306. In oral evidence Mr Brant stated that he had assumed that Mr Stout was taking a commission from Jacob & Co; Mr Stout had approached him and asked for a commission from the Appellant but Mr Marcus has refused as the margin was tight. Mr Brant confirmed that Mr Stout had had no direct involvement in the transactions although “*he may have on occasion asked me where we were up to, bearing in mind he was the one who introduced us to Jacob and Co”* (transcript 9/5/14 page 12).

307. Mr Bluffield explained in oral evidence that he communicated with Mr Stout approximately twice a day regarding refurbished stock and sourcing televisions. He stated:

"... I spoke to Phil Stout on a daily basis so he had obviously asked us about the watches, you know, I might have said something, he might have asked me: how is the watch trade going? It is dubious but I can't remember completely, but I used to see him quite regularly to go and look at more goods before I bought them. Um, it might have been a passing comment. I can't recall fully."

(Transcript 8/5/14 page 24)

308. Mr Bluffield's evidence was that he may have commented on the Appellant's trading to Mr Stout but:

"A. Yes, but one handing out information, that is quite a loose term, is it not?

Q. Yes, and you have already explained.

A. So I have said that it might have been a comment, he might have asked me

---

Q. Okay.

A. --- I have not given anything, nature of prices, anything like that….

…

JUDGE BLEWITT: I have just got a couple of questions, Mr Bluffield, just to clarify. My understanding is really you did not have any involvement with the watch deals. You said earlier you were tasked with the electronics side of the business.

A. Yes.

JUDGE BLEWITT: And really that was your experience. Is that fair?

A. Yes.

JUDGE BLEWITT: So you did not really have any involvement in the small details, the dates paperwork was generated necessarily, confirming orders on the phone, knowing what type of watches they were, that sort of thing. You just did not know that level of detail -----

A. No.

JUDGE BLEWITT: ….. would that be fair?

A. Yes."

(Transcript 8/5/11 page 156 -7, 191)

Submissions

309. We were grateful to both Mr Taylor and Mr Ginniff who provided detailed written submissions in addition to their oral closing submissions. What follows is intended as a summary of the points raised and we should make clear that due to the voluminous nature of the submissions we do not intend to simply repeat the contents verbatim however all points were considered.

310. On behalf of HMRC Mr Taylor highlighted the following:

(a) The Appellant's reliance on the meeting with Officer Simpson on 2 February 2011 is misconceived; it took place after the first transaction in December 2010 and therefore is irrelevant to the Appellant's state of mind at the relevant time. It is further submitted that the Tribunal must assess the events of that meeting; HMRC contend that the officer expressed no view as to the appropriateness of the Appellant's watch trading nor did she review the due diligence file presented by the Appellant;

(b) The majority of Officer Shorrock's visit note pertaining to his visit on 21 March 2011 was accepted by the directors as accurate. Officer Shorrock stated that he had not given the Appellant the "green light" to trade. The directors did not dispute that this was the case but rather each stated they had not heard officer Shorrock express this. If, as the Appellant contends, its trading was predicated upon HMRC's approval it follows (if officer Shorrock's evidence is accepted) that the predicate was not met from 21 March 2011 and therefore the appeal in respect of deals after that date (32 to 34) is without merit;

(c) The invitation to HMRC officers to attend the delivery of watches on 23 March 2011 should be viewed in the context of Officer Shorrock's visit on 21 March 2011. HMRC contend that it was a last ditch attempt by the Appellant to get HMRC to support its VAT reclaim;

(d) There is a stark contrast between the evidence of HMRC and that of the Appellant in respect of the meeting on 23 March 2011. The Tribunal must determine the credibility and honesty of the witnesses in assessing the evidence; either the HMRC officers have conspired to lie or the directors have. Mr Taylor highlighted the fact that officer Kent had had no previous involvement with the Appellant and was wholly unconnected to the verification. Furthermore, HMRC have consistently treated the Appellant fairly which should be contrasted with the evasive evidence given by the directors;

(e) The Appellant also placed great reliance on the fact it believed the transactions arose from Jacob & Co seeking to circumvent its distribution agreement with Jacobs & Co Watches Inc (USA) yet it is clear from the agreement that Jacobs & Co was breaching the agreement by selling to the Appellant which was not an authorised retailer. In those circumstances Jacobs & Co could have sold directly to Ferenergy;

(f) There was no clause in the Appellant's contract to specify that the watches should come directly from the manufacturer;

(g) The evidence of the Appellants regarding visits to Jacob & Co and Ferenergy was inconsistent;

(h) HMRC contend that the evidence regarding a fingerprint was fabricated as an explanation as to why the packages were not opened;

(i) Mr Draper's projection was unbelievable and indicates the huge financial gains which may have accrued for the Appellants if trading continued;

(j) The evidence of the directors as to how contact was made with Ferenergy was vague and inconsistent;

(k) The transactions were, on any view, too good to be true;

(l) The evidence shows little variation in margins achieved which reflects the unrealistic nature of the transactions;

(m) The Appellant accepted that there was no insurance in place for the December 2010 and February 2011 transactions which valued £65,964 and £387,300 respectively which is a further unrealistic feature of the transactions;

(n) The evidence as to why the Appellant did not retain serial numbers was inconsistent and did not bear scrutiny;

(o) HMRC contend that the directors tailored their purported understanding of carousel fraud to suit their case;

(p) The due diligence was at best substandard. HMRC submit that the due diligence undertaken was no more than "window dressing";

(q) The Skype messages indicate that someone from within the Appellant was communicating with a stranger to the transactions who was a participator in and orchestrator of the fraud. The unwillingness on the part of all four directors to admit this reflects badly upon their credibility.

311. On behalf of the Appellant Mr Ginniff submitted that the Tribunal should consider the following features:

(a) That Mr Stout and Anovo were never investigated despite the directors requesting that HMRC investigate;

(b) The Skype messaging was available to HMRC from May 2013 (and not provided to the Appellant until March 2014) yet Officer Saxon could not explain why parts of the communications are repeated verbatim on separate occasions which must cast doubt on the reliability of the evidence;

(c) The projections of Mr Draper were queried by HMRC on the basis of figures obtained from a publicly available Orbis report yet the report may not have shown the whole story of trading by Jacobs Inc (USA);

(d) There were discrepancies between the evidence of officers Marsh and Kent regarding events on 23 March 2011. Furthermore Officer Kent failed to mention in his witness statement that he had asked to see the products in the packages;

(e) There was no evidence of any direct communication between the directors and any of the companies involved in the VAT fraud other than Jacobs & Co and Ferenergy. Had the Appellant been a willing and knowing participant of the fraud it would be expected that they would be a party to the Skype conversations;

(f) The directors took reassurance from the fact that they were purchasing from an authorised distributor;

(g) Mr Baldwin did not provide the Appellant with a copy of the distribution agreement and therefore the Tribunal should consider what was known by the directors at the time, not what has subsequently come to light now that the agreement has been produced;

(h) Officer Saxon accepted that a considerable amount of information was collected by the Appellant in respect of due diligence. The ability to critically review that information depends on the extent and knowledge of the reader and Mr Draper was satisfied by the checks undertaken and visits made;

(i) The evidence of the directors regarding visits to Mr Baldwin and Mr Fermor was sufficiently detailed and consistent;

(j) The deals were structured in a manner which provided commercial protection to the Appellant and ensured control of the goods to guard against the directors' understanding of carousel fraud;

(k) The question of how a complaint might be tracked back to Jacobs & Co would not have been a difficult task given the limited types and numbers of Jacob watches;

(l) The continued efforts of the directors to secure insurance indicates their commercial approach to the transactions;

(m) The Appellant was reassured by Officer Simpson's visit on 2 February 2011 when the records were inspected and Officer Simpson concluded that "trader appears to take all due diligence checks on customers";

(n) Furthermore, following Officer Simpson's visit the Appellant's 12/10 repayment was authorised adding further reassurance to the Appellant;

(o) The Appellant disputes that Officer Shorrock expressed as much concern as he stated during the meeting on 21 March 2011. The visit note records several items but answers were only recorded in respect of three matters – the three that Mr Draper stated were raised.

The Decision

Findings of fact on whether the Appellant knew, or should have known, that its transactions were connected to fraud.

312. We considered the law, oral and written evidence and submissions of both parties carefully in reaching our conclusions.

313. We found assistance in *Mobilx* at [72] where Moses LJ referred to a number of important questions which in our view are applicable irrespective of the goods traded:

"(1) Why was…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 [the Appellant'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 [the supplier] already making supplies direct to other EC countries? If so, he could have asked why [the supplier] 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 [the Appellant] to become involved in these transactions? What benefit might they be deriving by persuading [the Appellant] to do so? Why should they be inviting [the Appellant] to join in when they could do so instead and take the profit for themselves?"

The witnesses' credibility

314.We should begin by commenting on the witnesses called to give evidence. Officer Saxon and Officer Shorrock both impressed as credible witnesses who gave their evidence in a straightforward manner. We found Officer Kent and Officer Marsh were honest witnesses who had neither the knowledge nor imagination to have conspired against the Appellant for reasons which we will expand upon in due course. We were satisfied that there was no substantial challenge to the evidence of the HMRC officers such that their evidence was undermined.

315.In stark contrast we found the evidence of all four directors particularly unconvincing and regularly contradictory. We found Mr Draper was an evasive, at times flippant and a deliberately misleading witness. We were left wholly unconvinced about the honesty or reliability of his evidence. Mr Marcus was an equally evasive witness and we found his evidence unpersuasive. We were wholly satisfied that both Mr Draper and Mr Marcus were aware that the transactions in this appeal were connected to the fraudulent evasion of VAT. Mr Jackson and Mr Bluffield appeared to have limited knowledge of the relevant transactions and as a result their evidence was vague and inconsistent. We were left in no doubt that both should have known that the transactions were connected to a fraudulent tax loss; however we were forced to conclude that both men also had actual knowledge on the basis of our conclusion that the evidence regarding the visit of Officer Kent and Officer Marsh was untruthful. Having reached that conclusion we rejected the Appellant's argument that it had been duped by other fraudsters.

Awareness of MTIC fraud

316. We were satisfied that the Appellant through its directors were aware of the nature and prevalence of MTIC fraud. In particular we noted that HMRC had issued a number of letters to Diverse of which Mr Marcus was a director warning of and advising about MTIC fraud. Similar correspondence had also been issued to Celltec of which Mr Marcus had also been a director. Mr Draper had also been involved in Celltec and although he disputed that he was a director we were satisfied that the statements of the administrators' proposals indicated a high degree of involvement in

the running of the company, irrespective of whether the title "financial director" was formally applied. Furthermore all four directors were clearly intelligent men and we concluded that the efforts made to minimise their awareness of VAT fraud was deliberate and unreliable.

317.We also rejected the contention that the Appellant could not be expected to know that watches could be used in MTIC fraud if HMRC were unaware. Aside from the fact that HMRC's state of knowledge is irrelevant to the issues we have to determine in this case, we were satisfied that publicly available information, including that given to the Appellant by HMRC, made clear that such fraud was prevalent in a number of industries. It is the responsibility of any reasonable and legitimate trader to question the nature of the transactions in assessing whether there is a connection to fraud. In this case the deals which fell into the Appellant's lap were quite clearly too good to be true; with no prior experience in such trade the Appellant just happened upon a supplier and customer. The evidence regarding attempts to find other customers was vague and unpersuasive. We were satisfied that no real efforts were made and that any reasonable trader would have queried why and how the opportunity to trade watches arose and how it was that trading partners were found with such apparent ease.

318. We considered *Mobilx* at [72] where Moses LJ referred to a number of important questions:

The directors and Mr Stout

319.We found the evidence regarding the Appellant's link to Mr Stout was vague. Furthermore the manner in which the Appellant was introduced to watch trading was such that in our view any reasonable trader seeking to minimise exposure to tax fraud would have made far more enquiries. Anovo provided My Digi Retail Ltd with reconditioned consumer electronics. Mr Stout had also been known to Mr Bluffield and Mr Marcus from Diverse which dealt in software products and consumer electronics. There was no clear explanation as to why Mr Stout suddenly wanted to involve the Appellant in watch trading nor was there any evidence that the directors questioned this. The directors gave evidence that Mr Stout may have been receiving a commission on the transactions however we found this evidence vague, inconsistent and speculative and for those reasons we did not accept it.

320.There was no convincing evidence as to why the Appellant believed Mr Stout to be a legitimate trader or what checks were undertaken by the directors to satisfy themselves in this regard. In our view, the fact that Anovo was a subsidiary of a French listed company told the Appellant nothing in terms of Mr Stout's veracity. Mr Draper's oral evidence that he was impressed with Anovo appeared to be based on nothing more than the company looking very well organised and we concluded that this lacked credibility. The Appellant was content to take Mr Stout's explanations as face value and made no independent enquiries of its own. We could only conclude that these were not the actions of a reasonable businessman seeking to avoid involvement in fraud.

Trading model

321.The evidence regarding the Appellant's first trade was vague and inconsistent. At a meeting with Officer Shorrock on 21 March 2011 it was said that the Appellant met Ferenergy through Anovo. Mr Draper's evidence in cross-examination that the

Appellant received an unsolicited email from Ferenergy contradicted this as did his statement to Officer Shorrock on 3 May 2011 that Mr Fermor was known to Mr Marcus as the pair had exchanged business cards at a Cebit fair. Mr Marcus' evidence failed to clarify the issue as he could not recall having met Mr Fermor. Given that this was the sole customer in the Appellant's watch trade and bearing in mind the value of the transactions which made up the majority of the Appellant's turnover we found it surprising to say the least that none of the directors could provide a clear explanation as to how contact with Ferenergy was made. We would have expected any reasonable trader to have recorded or at least recollect the enquiries made of a potential customer or have given consideration to the coincidence (as accepted by Mr Draper) of a customer emailing out of blue regarding the very goods that the Appellant had just decided to trade. The Appellant's failure to do so and the inconsistency of the evidence led us to conclude that this indicated knowledge on the part of the Appellant that the deals were contrived.

322.Given that the Appellant stressed the importance to it that the goods were sourced from the manufacturer we were surprised to find that this was not a documented condition of the trading between the Appellant and its supplier. Of itself this would not be sufficient to indicate knowledge on the part of the Appellant but when viewed in the round we were satisfied that the only reasonable explanation for the absence of the term and lack of enquiries to establish the source of the goods was that the Appellant was aware that the deals were contrived.

Funding and projection of trade

323.It was reiterated on a number of occasions that the directors had invested family savings into the business. We did not find that this assisted us in determining the issue of knowledge one way or another.

324.Whilst we noted that the document containing Mr Draper's projection of trade which was provided to Officer Shorrock on 21 March 2011 was not discussed in detail at that meeting, the document clearly set out a *"31 week summary"* showing an increase in turnover from £1,057,592 in March 2011 to £3,518,325 in September 2011. The document also sets out the gross margin, margin of sales, base overheads, net profit and cumulated profit.

325.We noted the limitation of Officer Saxon's evidence in using an Orbis report on Jacob & Co Watches Inc (USA) against which to compare the Appellant's figures which, on the basis of that information, appeared to exceed the manufacturer's annual turnover in 2010. The point is that Officer Saxon was not conducting the trade and his analysis, limited or not, highlighted the fact that the Appellant had not obtained data to justify the figures contained in the projection.

326.The absence of any substance to the document became even more apparent in cross-examination and we found Mr Draper's evidence that the figures were purely an arithmetical progression to demonstrate that the levels of repayment to the Appellant could significantly increase provided no explanation as to how the projection was calculated. In those circumstances we concluded that Mr Draper's projection of future trade was no more than window dressing designed to lend credence to the legitimacy of the watch trading and support the Appellant's outstanding and future repayment claims. It became abundantly clear in the cross-examination of Mr Draper that the figures had no substance and we did not accept that he had added the caveat when

producing the document to officer Shorrock as he stated in evidence that it was based on assumptions of margins and overheads.

Due Diligence

327.When we considered the information known to the Appellant about Ferenergy and Jacob & Co in the lead up to and during the period with which we are concerned, we concluded that the due diligence obtained did little to verify the legitimacy or otherwise of the companies.

328.We disregarded information which was obtained by the French and Dutch Authorities and of which the Appellant could not have been aware. However there was a plethora of available information which the Appellant either chose not to obtain or failed to give adequate consideration to.

329.We found Mr Draper's evidence regarding visits to shops to research the Jacob brand lacked credibility. The evidence was vague and even if we accepted that Mr Draper had visited jewellers as he stated, there seemed little he could have or did glean from speaking to one jeweller who had never traded in Jacob watches and another who did not stock them at the branch visited. The evidence of the remaining directors regarding research carried out on the products and the Appellant's trading partners was vague and unconvincing. In our view, that so little research was conducted and the Appellant was willing into transactions of significant value with effectively no knowledge of the product lacked commercial reality.

330.Ferenergy was a relatively new company which registered for VAT in May 2009 and its business activities were energy and commodities trading. In addition to the fact that none of the directors seemed sure how contact was first made with Ferenergy, we could not see how the documents obtained for the purpose of due diligence could have satisfied the Appellant of the veracity of the company to any degree. The copy of Mr Fermor's passport and Europa VAT validation (which post dated the first deal) told the Appellant little of value about the company and its officials. The introduction letter which stated that the company had *"twenty years of combined Distribution and Export experience within the electronics, metals and commodities industries"* is not only inaccurate as to the age of the company but fails to mention watches. The two documents in French had not been translated and it was clear from the Appellant's evidence that their content was not understood. The Creditsafe report which was dated 9 December 2010 gave a rating of 3: *"Caution- credit at your discretion"* which, irrespective of whether credit was to be given provides an indication as to the credit worthiness and financial standing of the company which could not have failed to cause concern to any reasonable trader.

331.The evidence regarding the trade references provided by Ferenergy was particularly poor; Mr Draper, who by his own admission had been responsible for due diligence, agreed it was a coincidence that Mr Stout was named as a trade reference and stated this "cosy" coincidence was discussed with his co-directors yet none of the co-directors could recall this and there was no evidence that the issue prompted any further enquiries or consideration by the Appellant. Mr Draper relied upon Mr Marcus' enquiries with the second reference provided although he ultimately accepted that he was unaware as to what enquiry had been made and the outcome. Mr Marcus could not recall speaking to the firm of accountants/management consultants and there was no documentary evidence to support the contention that he had in fact done

so. As it transpired the evidence from Mr Marcus did not assist the Appellant; he accepted in cross-examination that so long as there was a reference who could confirm the existence of that was sufficient. On Mr Marcus' own evidence this was not a robust system. Our view was that it could provide no comfort to the Appellant is assessing the legitimacy of its intended trading partner.

332. The evidence about visits to Ferenergy from the directors was also wholly unconvincing. A visit had taken place to France in April 2011. En route Mr Draper had telephoned Officer Shorrock to ask what information should be sought from Mr Fermor and when the Appellant could expect HMRC to conclude its verification of the 03/11 repayment claim. In our view the visit, which post dated all of the Appellant's transactions, was designed to appease HMRC and was no more than a belated attempt by the Appellant to demonstrate the type of caution that any reasonable trader would have applied prior to the transactions.

333. In his second witness statement dated 10 January 2014 Mr Draper mentioned for the first time another meeting with Mr Fermor which was purported to have taken place on 12 January 2011 following the meeting with Mr Baldwin of Jacob & Co. Mr Draper stated that he, Mr Marcus and Mr Jackson had travelled to London by train for the meeting. Mr Jackson recalled the meeting took place a week or two before visiting Mr Baldwin. Mr Marcus could not recall who was present save that Mr Bluffield was not and the visit took place on the same day as the meeting with Mr Baldwin. However Mr Bluffield stated that he had been at the visit to Jacob & Co to see Mr Baldwin, the four directors travelled in Mr Marcus' car but he had never met anyone from Ferenergy.

334. Aside from the fact that this took place after the first transaction had already been carried out and we queried how, in such circumstances, this visit could have assisted the Appellant in satisfying itself as to the veracity of Ferenergy, the evidence from the four directors was contradictory and we rejected it as untruthful.

335. The due diligence on Jacob & Co was equally poor and we concluded that any reasonable trader would not have been satisfied by the information obtained by the Appellant in determining the legitimacy of the company or the transactions in question. By way of example the Appellant took Mr Baldwin's assertions at face value without making any independent checks, such as the information regarding the source of the goods from the manufacturer and the reason for selling to the Appellant to circumvent a distribution agreement.

336. Furthermore the evidence of Mr Draper that he was satisfied by the visit to Jacob & Co as it had Jacob products in the office and Mr Baldwin *"came across as a very credible individual"* lacked any substance and it was in our view wholly implausible that four (or three depending on the differing accounts of the visit) intelligent men such as the directors of the Appellant would make such an assessment on the basis of so little. The Appellant had in its possession a Creditsafe report which showed that the company had traded at a loss and which would have given any reasonable trader cause for concern. Yet the Appellant made no further enquiries as to the company's financial standing and Mr Draper accepted in cross-examination that trade references were not required.

337. We found the Appellant's reliance on officer Simpson's visit on 2 February 2011 misconceived. It was clear from the officer's evidence that she had done no more than

accept the Appellant's word that due diligence was carried out. We were wholly satisfied that the purpose of officer Simpson's visit was not to check the Appellant's due diligence procedures or documents and she had not approved the Appellant's trade in watches.

Inspections, serial numbers and certification

338.Having found Officer Shorrock to be a reliable witness we were satisfied that his note in which he recorded Mr Draper as saying that the watches didn't have serial numbers only model numbers was accurate. We considered Mr Draper's evidence that he had simply been mistaken, however we found that surprising given that the comment was made more than 3 months after the Appellant's first transaction by which point a level of familiarity with goods being traded would be expected. In our view it was indicative of the fact that the product traded by the Appellant was irrelevant as it knew that the deals were contrived. Particularly in circumstances where the Appellant on its own admission recorded some of the serial numbers of electronic products traded which clearly showed that it was aware of the importance of retaining such information.

339.We also rejected as implausible the Appellant's evidence that it was told by Mr Baldwin that he retained the serial numbers. In our view any reasonable trader would have ensured, particularly given the value of the goods, that serial numbers were recorded to guard against fraud or for the simple reason that should its customer find fault, damage or in any way query the consignment it had the ability to trace the goods. The letter from the Appellant dated 25 July 2011 which responded to HMRC's query about serial numbers by stating that they had been requested from Mr Baldwin was but not received, in our view, an attempt by the Appellant to strengthen its case. The evidence produced by the Appellant in support of this assertion in the form of letters post dated the transactions and HMRC's enquiries on the issue. We concluded that any reasonable person would either have recorded the information himself or sought it from the supplier at the earliest opportunity. We inferred from the Appellant's failure to do so that in reality the serial numbers did not matter as it was fully aware of the contrived nature of the deals. Similarly the Appellant's failure to obtain certificates of authenticity for the same reason for goods of such high value was unreasonable and implausible.

340.The evidence regarding the fingerprints left on the first consignment of watches was deeply contentious. We considered all of the evidence carefully and in doing so concluded that the evidence had been concocted by the Appellant to explain why the goods were not inspected. The principal reason for so finding was that the evidence of the directors was inconsistent and deeply unpersuasive. Mr Draper's evidence was that the fingerprints had been left on the first consignment despite the fact that gloves were specifically purchased to handle the goods and as a result the customer complained that the product had been de-valued. Mr Marcus stated that goods were examined after the first consignment following fingerprints being left but gloves were used in the subsequent deals. He also stated that it was not the fingerprint but the removal of plastic covering on the watch face that had de-valued the goods and that it was an agreed term of sale that the Appellant would not open the consignments. Mr Jackson stated that gloves were specifically purchased to handle the first consignment but made no reference to the customer complaining that the goods were de-valued as a result of the fingerprint; rather that there had been a request that further consignments

were not opened after the Appellant removed the plastic covering on the face. Mr Bluffield provided no detailed evidence on the issue.

341.In addition to the inconsistencies and the fact that only Mr Marcus had made reference to the fingerprints in his written evidence, we found the evidence nonsensical. We rejected the contention that fingerprints had de-valued the product; as noted by counsel for HMRC and agreed by the directors, fingerprints are easily removed. Furthermore we queried how fingerprints could have been left when the Appellants made much of having specifically purchased gloves in order to handle the gloves. Mr Marcus' evidence that it was a term of sale that the consignments not be opened was not borne out by the documentation and there Appellant could produce no documentary evidence in support. Having found Mr Marcus to be an unreliable witness we rejected this evidence.

HMRC visit 23 March 2011

342.The evidence regarding the fingerprint overlaps to a degree with that of the visit by officers Kent and Marsh on 23 March 2011. The accounts given by the Appellant on one hand and the officers on the other were markedly different and we took care to consider where we were satisfied that the truth lay.

343.We found the officers' evidence credible and we were strengthened in our view by the fact that a visit note had been prepared following the visit which we were satisfied provided the most accurate and contemporaneous record of events. The officers were clear in the evidence and remained adamant throughout robust cross-examination that they could not see the watches through the packaging. A further feature of the evidence that we found significant in reaching our conclusion was that of Officer Kent. He told us that he had asked if the packaging could be removed so that he could see the goods but was told by the Appellant that to tamper with the packaging would invalidate the transaction. Officer Kent was wholly unconnected to the Appellant and verification of its returns; he had been asked to accompany Officer Marsh as officer Shorrock was unavailable. In those circumstances we concluded that officer Kent would have had no knowledge at the time that the Appellant contended that it was told not to remove the packaging; a matter Mr Draper said he took legal advice on and Mr Marcus stated was a term of the sale. Thereafter we rejected as wholly implausible that officer Kent was part of a conspiracy against the Appellant which would have involved liaising and conspiring with officers Shorrock and Saxon to familiarise himself with the Appellant's case and tailor his evidence to rebut it.

344.We considered the evidence of the Appellant on the issue. The oral evidence of Mr Bluffield was vague and inconsistent with his written evidence; his witness statement confirmed that everyone present saw the watches yet in cross-examination he admitted he had not been present throughout the inspection and was vague as to what he actually saw and when he had been present. Similarly Mr Jackson's evidence changed from stating that the officers acknowledged the correct number and models of watches to stating that he could tell by the officers' faces that they had seen the goods. We rejected this as wholly unconvincing. We found Mr Draper's evidence undermined by his sudden production at the hearing of the packaging said to be that of the type which contained the goods and which he had happened to find while clearing out his kitchen. Aside from the fact that the evidence was not put to the HMRC witnesses who were therefore deprived of the opportunity to comment, we queried why it had not been adduced earlier. We rejected as untruthful Mr Draper's

evidence that he was unaware he could have served the evidence sooner; he was professionally represented and had served a second witness statement on 10 January 2014. Mr Marcus' evidence seemed to us at odds with that of Mr Jackson and Mr Bluffield. He stated that Mr Jackson had initially identified that a watch might be missing yet Mr Jackson himself made no mention of this and in cross-examination stated that he had initially been in the office with Mr Bluffield when the officers were taken by Mr Draper and Mr Marcus to view the consignment. Mr Bluffield also stated in cross-examination that when the officers viewed the consignment he was "*about 15 feet behind a closed door.*"

345. Taking all of these factors into account we preferred the evidence of officers Kent and Marsh and rejected the Appellant's evidence as deliberately untruthful.

Officer Shorrock's visit on 21 March 2011

346. The significance of this visit was that the Appellant contended that its trading was predicated on the basis that the goods were sourced from an authorised distributor and HMRC approved the trading. Officer Shorrock was clear in his evidence that no such approval had been given to the Appellant at his visit on 21 March 2011 but yet the Appellant conducted further trades.

347. For reasons already given we found officer Shorrock's evidence honest and reliable and we accepted his account, supported by his visit note that the Appellant was told in clear terms that its trading was not approved and that HMRC had a number of concerns regarding the circumstances of the transactions.

348. The evidence of Mr Draper on the issue was evasive but ultimately he accepted that he was aware from the meeting that HMRC had concerns about the watch trading. Mr Jackson was also evasive on the matter, initially stating that officer Shorrock had not stated that the Appellant did not have the green light to trade but subsequently stating that this may have been said and he could not recall if he was present for the duration of the meeting. Mr Marcus' evidence was vague and at odds with that of Mr Draper; he stated that Mr Draper had told him after the meeting that everything was fine and added that if officer Shorrock had advised against the trading he either was not present or was not listening. Mr Bluffield could also not recall what was said. The unpersuasive evidence of the directors taken together with our finding as to officer Shorrock's credibility led us to conclude that the Appellant was fully aware following the meeting on 21 March 2011 that not only did HMRC not approve its watch trading but that it had numerous concerns about it. We were therefore satisfied that the Appellant had entered into the transactions which post-dated the meeting in full knowledge that the concerns of HMRC extended beyond the three Mr Draper acknowledged in evidence. Furthermore we concluded that any legitimate trader seeking to protect itself from exposure to or involvement in fraud would not have continued trading in such circumstances and we inferred from this that the Appellant's willingness to do so indicated that it was aware of the contrived nature of the deals or that it was prepared to turn a blind eye.

Insurance

349. We found Mr Draper's evidence regarding insurance lacked credibility. The Appellant was trading in goods worth significant sums yet none of the goods were properly covered. Mr Draper accepted that this was the case for the transactions in

December and February 2011 and although the Appellant argued that it put the responsibility of insurance onto its customer there was no evidence obtained by the Appellant to show that this had been done or any evidence that the Appellant had queried how Ferenergy would insure goods either prior to ownership or the location of which it did not know. He tried to persuade us that the Malca Amit insurance covered the March deals but it was clear that the Appellant was not privy to that contract of insurance. We did not accept that Mr Draper, who was clearly an intelligent man with significant experience of financial matters, believed that the Appellant was covered. Given the value of the goods we found this indicative of the fact that the Appellant knew the deals were contrived as no reasonable businessman would take such a huge financial risk as to export goods without insurance.

Negotiation, profit margins and patterns

350.We found the evidence as to how negotiations were conducted by Mr Jackson was vague. Taken together with the analysis by Officer Saxon which indicated little or no variation in mark ups irrespective of the cost price we concluded that this lacked commercial reality. In considering the picture as a whole we accepted that the only reasonable explanation for the three deals which achieved a mark up of 10.47% was a transposition error on the sales invoice of £13,806 as opposed to £13,086 which if correct would have given a mark up in line with those for all other deals. Viewed with the consistent profits made by other traders in the chain we were wholly satisfied that this showed the contrived nature of the deals. As to the Appellant's knowledge we found that the lack of persuasive evidence or documentation regarding negotiation when considered with the pattern of mark ups must have been a fact of which the Appellant knew or certainly should have known.

Distribution Agreement

351. The Appellant relied to a large degree on their contention that the watch trading opportunity came about as a result of Mr Baldwin's desire to circumvent his distribution agreement with Jacob & Co Watches Inc (USA). It was notable that the Appellant had never obtained a copy of the agreement which was ultimately obtained by Officer Saxon.

352. On any view the Appellant's case made little sense and was such that no reasonable businessman could have honestly held such a view. Accepting the Appellant's case for a moment, it simply does not withstand scrutiny. Mr Stout introduced the Jacob & Co deals to the Appellant stating that there were willing EU customers to whom Jacob & Co were prevented from selling as a result of the agreement. However there were two ways in which Jacob & Co could breach the agreement; by selling outside of the territory (UK, Ireland and the Channel Islands) or by not selling to an authorised retailer (such as the Appellant). Given that Mr Stout (on the Appellant's case) was aware of European customers willing to trade, it made more commercial sense in terms of profit for Jacob & Co to breach the agreement by selling to Europe directly and missing out the Appellant. The sale to the Appellant in no way disguised the purported breach as it was not an authorised retailer.

353. We concluded that the purpose of the transactions was to facilitate VAT fraud and not to circumvent the distribution agreement and that the latter fact must have been known to the Appellant; we could not see how any reasonable person could have concluded otherwise. Further, if the reason for the transactions was not to circumvent

the agreement, the only reasonable explanation that follows, taking into account the nature and features of the deals, is that either the Appellant knew they were connected to fraud or should have known.

Skype

354. We approached the evidence of Skype messaging with caution as there was no explanation as to why parts of the extracts with which we were provided appeared twice in different months in identical terms. By way of example:

Date/Time	**Author**	**Message**
13/2/11 23:09	watchtrader	Next order value pls
13/2/11 23:42	watchtrader	Posted file invoice INV0000031.PDF to members of this conversation
14/2/11 00:02	watchtrader	Ok
14/2/11 00:02	inspain2011	Sorry 5 mins mate
14/2/11 00:16	inspain2011	Am here mate
14/2/11 04:31	watchtrader	Meeting went well today
14/2/11 19:54	inspain2011	Mate, Digi has received the money from the European, so should be paying you, if poss can you put a call in to ask when they are paying you please

As compared with:

Date/Time	**Author**	**Message**
16/3/11 15:26	watchtrader	Next order value pls
16/3/11 15:59	watchtrader	Posted file invoice INV0000031.PDF to members of this conversation
16/3/11 16:18	watchtrader	Ok
16/3/11 16:18	inspain2011	Sorry 5 mins mate
16/3/11 16:33	inspain2011	Am here mate
16/3/11 20:48	watchtrader	Meeting went well today
17/3/11 12:11	inspain2011	Mate, Digi has received the money from the European, so should be paying you, if poss can you put a call in to ask when they are paying you please

355. However there had been no challenge to the reliability of the evidence prior to the hearing and no expert evidence was adduced by the Appellant which undermined the following facts which we found were clear from the data:

(i) Conversations regarding the watch transactions were evidenced; and

(ii) There was no challenge to the content of those conversations.

356. There was no dispute that the reference to "Digi" referred to the Appellant and that "watchtrader" was Mr Baldwin. For the purposes of this appeal HMRC did not need prove the identities of characters such as Forgmanbob and Inspain 2011 nor did we need to satisfy ourselves as to their identities or roles.

357. Each of the four directors denied any participation in or knowledge of the conversations. It was suggested by his co-directors that Mr Bluffield may have imparted information to Mr Stout during the course of conversations with him and that Mr Stout may have been one of the characters involved. The difficulty for the Appellant is as follows: Mr Bluffield, who described himself as a junior partner, not only denied giving Mr Stout information to the level evidence in the Skype data, for instance *"Digi want to do another up to £250k this week if you can put a package together please…"* (21/3/11 at 10:31) but he went so far as to indicate that his involvement in the watch deals was such that he did not know that level of detail about the deals. Mr Jackson confirmed this in his oral evidence when he explained that Mr Bluffield was mainly involved in the EBay electronic side of the business and knew little about the watch transactions. It is clear from the data that someone from within the Appellant gave detailed information about the watch trades either directly or indirectly to those involved in the Skype conversations. We could find no alternative reasonable explanation (and none was proffered) as to why the Appellant would pass such information on to a third party who was unconnected to the transactions other than the Appellant knew the deals were contrived and actively participated in the scheme.

Conclusion

358. We were satisfied HMRC had established fraudulent tax losses and that there was an orchestrated scheme for the fraudulent evasion of VAT connected with the transactions which form the subject of this appeal. In doing so we rejected the Appellant's submission that the issue of timing in respect of the contra-trading transactions meant that the necessary connection had not been established.

359. We concluded that in respect of the periods under appeal the Appellants knew that the transactions were connected with the fraudulent evasion of VAT. We reached this conclusion not only as a result of our finding that the evidence of the directors was untruthful but also after consideration of the nature and features of the transactions. Even if we had not found the Appellant's evidence unreliable we were satisfied that we would have reached the same conclusion on actual knowledge by inferences drawn from the evidence. We were also satisfied that the factors set out above would least support a finding of means of knowledge.

360. The appeal is dismissed.

Costs

361. We direct that the Appellant is to pay HMRC costs of, incidental to and consequent upon the appeal, to be the subject of detailed assessment if not agreed.

362. 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.

JENNIFER BLEWITT
TRIBUNAL JUDGE

RELEASE DATE: 27 April 2015