[2019] UKFTT 386 (TC)

TC07201

Appeal number: TC/2016/02439

VALUE ADDED TAX – input tax – denial of right to deduct on grounds that the Appellant 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 - appeal dismissed

FIRST-TIER TRIBUNAL
TAX CHAMBER

HARD HAT LOGISTICS LIMITED **Appellants**

- and -

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

TRIBUNAL: JUDGE JENNIFER DEAN
MR MOHAMMED FAROOQ

Sitting in public at Manchester on 28 & 29 January 2019 with written closing submissions dated 30 January 2019

Mr J. Butterfield QC, Counsel for the Appellant

Mr H. Watkinson, Counsel instructed by HM Revenue and Customs, for the Respondents

DECISION

Introduction

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1. This is an appeal by Hard Hat Logistics Limited ("the Appellant") against the decision of HM Revenue and Customs ("HMRC") contained in a letter dated 10 November 2015 (as amended on 18 January 2016) to deny input tax incurred on 42 supplies of temporary labour to the Appellant in the total sum of £83,799.04.

10 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 periods 02/12, 05/12, 08/12 and 11/12 were connected with the fraudulent evasion of VAT and that the Appellant knew or, in the alternative, should have known of this fact.

15 Missing Trader Intra-Community Fraud: Legislation and Case law

3. 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 20 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).

4. Missing Trader Intra-Community Fraud ("MTIC fraud") has been described frequently by the courts and tribunals and we do not consider it necessary to set out an explanation in great detail. We respectfully adopt that of Roth J in *POWA (Jersey) Ltd* 25 *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 30 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 35 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 40 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.

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"... "

5. *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:

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

52. It follows that, where a recipient of a supply of goods is a taxable person who did not and could not know that the transaction concerned was connected with a fraud committed by the seller, Article 17 of the Sixth Directive must be interpreted as meaning that it precludes a rule of national law under which the fact that the contract of sale is void, by reason of a civil law provision which renders that contract incurably void as contrary to public policy for unlawful basis of the contract attributable to the seller, causes that taxable person to lose the right to deduct the VAT he has paid. It is irrelevant in this respect whether the fact that the contract is void is due to fraudulent evasion of VAT or to other fraud.

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'.

…

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

6. 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 [52], [59], [60], [64], [82], [84]:

"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."

…

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.

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.

…

On my interpretation of the principle in *Kittel*, there is no question of penalising the traders. If it is established that a trader should have known that by his purchase there was no reasonable explanation for the circumstances in which the transaction was undertaken other than that it was connected with fraud then such a trader was directly and knowingly involved in fraudulent evasion of VAT. The principle in *Kittel*, properly understood, is, as one would expect, compliant with the rights of traders to freedom from interference with their property enshrined in Art. I of the First Protocol of the European Convention of Human Rights. The principle in *Kittel* does no more than to remove from the scope of the right to deduct, a person who, by reason of his degree of knowledge, is properly regarded as one who has aided fraudulent evasion of VAT.

…

But that is far from saying that the surrounding circumstances cannot establish sufficient knowledge to treat the trader as a participant. As I indicated in relation to the BSG appeal, Tribunals should not unduly focus on the question whether a trader has acted with due diligence. Even if a trader has asked appropriate questions, he is not entitled to ignore the circumstances in which his transactions take place if the only reasonable explanation for them is that his transactions have been or will be connected to fraud. The danger in focussing on the question of due diligence is that it may deflect a Tribunal from asking the essential question posed in *Kittel*, namely, whether the trader should have known that by his purchase he was taking part in a transaction connected with fraudulent evasion of VAT. The circumstances may well establish that he was.

…

Such circumstantial evidence, of a type which compels me to reach a more definite conclusion than that which was reached by the Tribunal in Mobilx, will often indicate that a trader has chosen to ignore the obvious explanation as to why he was presented with the opportunity to reap a large and predictable reward over a short space of time. In *Mobilx*, Floyd J concluded that it was not open to the Tribunal to rely upon such large rewards because the issue had not been properly put to the witnesses. It is to be hoped that no such failure on the part of HMRC will occur in the future."

7. Moses J cited with approval at [83] the following guidance given by Christopher Clarke J in *Red12 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."

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

"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."

9. In *Fonecomp Limited v HMRC* [2015] STC 2254 it was submitted that the words "should have known" (per Moses LJ in *Mobilx*) meant "has any means of knowing" (at [51]) and that the Appellant could not have found out about the fraud even if it made inquiries because the fraud did not relate to the chain of transactions with which

it was concerned. Arden LJ in the Court of Appeal ([2015] EWCA Civ 39) (with whom McFarlane and Burnett LJJ agreed) said, at [51]:

> "However, in my judgment, the holding of Moses LJ does not mean that the trader has to have the means of knowing how the fraud that actually took place occurred. He has simply to know, or have the means of knowing, that fraud has occurred, or will occur, at some point in some transaction to which his transaction is connected. The participant does not need to know how the fraud was carried out in order to have this knowledge. This is apparent from [56] and [61] of *Kittel* cited above. Paragraph 61 of *Kittel* formulates the requirement of knowledge as knowledge on the part of the trader that "by his purchase he was participating in a transaction connected with fraudulent evasion of VAT". It follows that the trader does not need to know the specific details of the fraud."

10. The burden of proof in this type of case rests with HMRC; per *Mobilx* (at [81]) and *Otkritie International Investment Management Ltd & Ors v Urumov & Ors (Rev 1 – amended charts)* [2014] EWHC 191 (Comm) in which the Court stated (at [88]):

> "In my judgment, as formulated, these submissions are at the very least confused. As submitted by Mr Berry, the suggestion that the standard of proof might vary with the gravity of the misconduct alleged or even the seriousness of the consequences for the person concerned is, in my view, based upon a common misconception arising in part from an erroneous interpretation of Lord Nicholls' judgment in *Re H* [1996] AC 563: see *Re B* [2009] 1 AC 11 at para 5 per Lord Hoffmann; *Re S-B* [2010] 1 AC 678 at paras 11-13 per Baroness Hale. In a series of decisions of the House of Lords and the Supreme Court following *Re H*, it has been firmly established that:
>
> i) First, there is only one civil standard of proof and that is proof that the fact in issue more probably occurred than not: *Re B* at para 13 per Lord Hoffmann.
>
> ii) Second, the proposition that "*the more serious the allegation, the more cogent the evidence needed to prove it*" is wrong in law and must be rejected: *Re S-B* at §13 per Baroness Hale; *Re J* [2013] 1 AC 680 at para 35 per Baroness Hale.
>
> iii) Third, while inherent probabilities are relevant in considering whether it was more likely than not that an event had taken place, there is no necessary connection between seriousness and inherent probability: *Re S-B* at para 12 citing Lord Hoffmann in *Re B* at para 15:
>
> "*There is only one rule of law, namely that the occurrence of the fact in issue must be proved to have been more probable than not. Common sense, not law, requires that in deciding this question, regard should be had, to whatever extent appropriate, to inherent probabilities. If a child alleges sexual abuse by a parent, it is common sense to start with the assumption that most parents do not abuse their children. But this assumption may be swiftly dispelled by other compelling evidence of the relationship between parent and child or parent and other children. It would be absurd to suggest that the tribunal must in all cases assume that serious conduct is unlikely to have occurred. In many cases, the other evidence will show that it was all too likely. If, for example, it is clear that a child*

was assaulted by one or other of two people, it would make no sense to start one's reasoning by saying that assaulting children is a serious matter and therefore neither of them is likely to have done so. The fact is that one of them did and the question for the tribunal is simply whether it is more probable that one rather than the other was the perpetrator." (emphasis added).

See also: *Re B* at para 72 per Baroness Hale; *Re J* at paras 14-17 per Baroness Hale; *Jafari-Fini v Skillglass Ltd* [2007] EWCA Civ 261 at para 40 per Carnwath LJ, as interpreted in *Do-Buy 925 Ltd v National Westminster Bank Plc* [2010] EWHC 2862 (QB) at para 49 per Andrew Popplewell QC, sitting as a Deputy Judge of the High Court; *Donegal v Zambia* [2007] EWHC 197 (Comm) at para 276 per Andrew Smith J."

11. The standard of proof is the ordinary civil standard, on the balance of probabilities and there is no requirement to prove dishonesty, as stated in *HM Revenue and Customs v Citibank NA & Anor* [2017] EWCA Civ 1416 at [97] - [98]:

"It will by now be obvious that I agree with HMRC's submission as to the fundamental issue that is required to be resolved by this appeal. HMRC said that the question was whether the UT was wrong to conclude that an allegation that a taxpayer *knew* that its transactions were part of an orchestrated scheme to defraud HMRC required HMRC to plead and particularise, and therefore to prove, an allegation of dishonesty. I agree that that was the question raised by this appeal. I also agree that the allegation, which is a classic *Kittel* first limb contention, does not require HMRC to plead, particularise and prove dishonesty or fraud.

The main point in this case was not, as the taxpayers suggested a simple pleading question. The UT failed, I think, to identify the basic error that Judge Mosedale had made in the Citibank case, where she said, in effect, that making a first limb *Kittel* allegation required a plea of dishonesty. It does not; even if in some cases, the findings of knowledge made by the FTT could have led the FTT to uphold a plea of dishonesty had it been made. HMRC is entitled to stop short of alleging dishonesty and content itself with pleading, particularising and proving first limb *Kittel* knowledge. If, however, HMRC do expressly allege dishonesty, they will be required to comply with the normal rules of pleading and disclosure applicable to such cases. In future, it might be helpful in these cases for HMRC to say expressly in their Statements of Case whether or not they set out to prove the dishonesty of the appellant taxpayer."

12. In applying the principles set out in the authorities cited above we have approached this appeal by recognising that while we must consider the merits of the individual transactions, those transactions should not be viewed in isolation and we are entitled to look at the totality of the transactions, their characteristics, the actions and omissions of the Appellant together with the surrounding circumstances. In considering the issue of knowledge and means of knowledge of the Appellant we only had regard to information known to him during the relevant period and we attached no weight to evidence established with the benefit of hindsight.

Issues

13. HMRC must prove on the balance of probabilities that:

(a) There was a fraudulent evasion of VAT;

(b) That the Appellant's transactions which are the subject of this appeal were connected with that fraudulent evasion; and

5 (c) That the Appellant knew or should have known that its transactions were so connected.

14. The Appellant confirmed on 20 May 2017 that it does not dispute the following issues:

(a) There was a fraudulent evasion of VAT; and

10 (b) That the Appellant's transactions which are the subject of this appeal were connected with that fraudulent evasion;

(c) That the relevant transactions formed part of an orchestrated overall scheme to defraud the Revenue.

15. The only issue therefore remaining is whether the Appellant, through its Director
15 Mr Ferguson, knew or should have known that its transactions were connected to the fraudulent evasion of VAT.

Undisputed Background Facts

16. Mr Ross Ferguson is the majority shareholder (98%) and sole director of the Appellant. The Appellant was incorporated on 7 September 2001 under the name
20 Slackers Entertainment Ltd, changing its name to Hard Hat Logistics Ltd on 27 February 2007. The Appellant's SIC code at Companies House remains as "other amusement and recreation activities". The Appellant was registered for VAT with effect from 1 August 2004 under the trade classification of "corporate entertaining agent".

25 17. Mr Ferguson had significant experience in the security industry; between 2002 and 2007 Mr Ferguson was chairmen of the British Security Industry Authority and at a visit to the Appellant by HMRC on 20 February 2014 Mr Ferguson advised that he was an "ACS Pacesetter", one of the top 10% compliant security businesses in the country who provide advice to other security companies to help them achieve the
30 Security Industry Authority ACS standard. He had also been the director of two security businesses, namely Security (Northwest) Limited and Security Control Limited.

18. On 22 January 2008 HMRC visited the Appellant and ascertained from Mr Ferguson and the company accountant Mr Penny that in 2006 the Appellant had
35 started providing security consultancy and security staff for the construction industry.

19. In VAT periods 02/12 – 11/12 the Appellant made 42 purchases of supplies of temporary staff. In each transaction the Appellant's supplier was either SRL or WL.

Transactions connected to fraudulent tax losses

20. Workforce Ltd ("WL") was incorporated on 22 June 2009 in the name Orion Payroll Services Ltd ("OPSL"), changing its name to Workforce Northwest Ltd on 23 November 2010. The company used the name Workforce Ltd on its invoices. OPSL did not notify HMRC of a change of name. The directors were as follows:

- From 22 June 2009 – 8 October 2010: Mr Stephen Rayment
- From 10 January 2011 – 6 March 2012: Mr Jamie Cameron.

21. Ms Gillard noted that Mr Adam Weir also appeared to have been a director until his resignation on 11 January 2011 although there are no Companies House records for his appointment.

22. WL was dissolved on 2 October 2012 following an application to strike the company off the Companies House register dated 6 March 2012.

23. OPSL was registered for VAT from 1 July 2009 under the trade classification "combined office administration service activities". OPSL was de-registered on 1 April 2011 as it informed HMRC it had ceased trading.

24. Despite the de-registration of OPSL, WL issued invoices on which VAT was charged using OPSL's previous VAT registration number. WL did not attempt to account for the VAT that it charged on the invoices.

25. Skill-Rite Ltd ("SRL") was incorporated on 12 October 2011. The director was Mr Neil Weir from the date of incorporation to 20 October 2011. From 20 November 2011 SRL's director was Mr Anthony Gallagher. Mr Neil Weir was the sole shareholder.

26. SRL applied for VAT registration in January 2012 and was refused. HMRC received a reconsideration request in June 2012 which was again rejected on 16 July 2012.

27. SRL's invoices issued between 23 March 2012 and 6 July 2012 used the VAT registration number of another company, Eastham Construction Ltd, thereby using a hijacked VRN. After 6 July 21012 no VRN was supplied on SRL's invoices but VAT continued to be charged and the invoices were noted "VAT No applied for". SRL failed to account for any VAT that it charged and was never successful in its application to be VAT registered. SRL was dissolved on 21 January 2014.

28. It is quite clear that both WL and SRL deliberately and dishonestly failed to account for tax thereby causing fraudulent tax losses; as the Appellant's direct suppliers, the transactions and the fraudulent tax losses were thereby connected to the Appellant's transactions.

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

Evidence on behalf of HMRC

29. We heard evidence from HMRC officer Mrs Gillard on behalf of HMRC. Mrs Gillard has worked within HMRC's Labour Market Investigations business team for 12 years and part of her role is checking the VAT accounts of traders falling within the labour market sector such as recruitment, construction, security and agriculture.

30. Mrs Gillard set out a number of factors relied on by HMRC in support of its case against the Appellant and we have summarised the salient parts of the evidence below.

The Appellant and Awareness of MTIC fraud

31. HMRC submit that the Appellant, through Mr Ferguson, was fully aware of the risks associated with MTIC fraud as a result of a previous denial of input tax which arose following HMRC's visit to the Appellant on 22 January 2008 at which officer Higgins noted from the company records that it appeared that the Appellant was providing labour using sub-contractors. The main sub-contractor at that time was a company called Circular Electronic Systems Ltd ("CESL"). The invoices provided by the Appellant from CESL for VAT periods 05/07 and 08/07 bore no VRN and were therefore not valid VAT invoices. The Appellant was notified on 4 February 2008 that in the absence of valid VAT invoices HMRC would disallow the Appellant's input tax claim of £9,180.86. On 25 February 2008 the Appellant's accountant wrote to HMRC accepting that the VRN had been omitted from the invoices and providing a VRN for CESL from Mr Ferguson. The VRN provided was for a different company, Circular Securities Ltd. HMRC notified the Appellant on 27 February 2008 that the VRN did not relate to CESL and therefore the Appellant's input tax claim would be denied. The Appellant did not challenge the decision to disallow input tax nor the related misdeclaration penalty.

32. Following the advice and guidance given to Mr Ferguson in 2008 the Appellant undertook due diligence checks on all of its suppliers. The checks were carried out using the VIES system until 2014. HMRC submitted that this was an important event for the Appellant as it drew to Mr Ferguson's attention the importance of checking trading partners and the consequences of failing to do so. The denial of input tax in relation to CESL brought to Mr Ferguson's attention an awareness of fraud particularly arising from the use of false VRNs.

Association and contrivance within a group of companies

33. HMRC submit that the two defaulting traders did not operate alone but rather as part of contrived trading arrangements between a group of companies, one of which was the Appellant. In support of this submission HMRC rely on the associations between WL and SRL, and WL, SRL and Bernic UK Ltd ("BUL") and the Appellant's involvement with those companies.

34. On 23 September 2011 an HMRC officer visited the Appellant's accountant and was informed that the Appellant's main sub-contractor was BUL. BUL was

incorporated on 28 June 2007. Its director was Miss Danielle Raynor and the company secretary was Mr Jason Gillam. On 21 November 2007 Mr Alan Rimmer was appointed director of BUL and was replaced by Mr John Topping from 19 June 2012.

35. BUL's invoices recorded the company's address as Salus House, Wirral; the same address at which the Appellant was based between 7 June 2008 and 14 May 2012. Mr Neil Weir is recorded as a shareholder in BUL as at 28 June 2008. From 28 June 2010 he is not recorded as having any shareholding however he is recorded as having been paid on a PAYE basis by BUL as an employee from 22 November 2010.

36. Between VAT periods 08/08 and 05/11 the majority of the Appellant's input tax claims related to supplies of sub-contracted labour from BUL. The Appellant continued to purchase supplies of labour from BUL in the VAT periods during which it also purchased labour supplies from SRL and WL.

37. BUL also purchased labour supplies from WL and SRL in VAT periods 01/11 – 10/12 in respect of which it was denied in excess of £300,000 input tax. BUL went into administration in 2013 with an estimated debt to HMRC in excess of £275,000.

38. HMRC rely on the following associations between SRL, WL, BUL and the Appellant: both BUL and the Appellant were supplied by WL and then SRL. The Appellant was also supplied by BUL. One of BUL's customers was Eastham Construction Ltd, whose VRN was fraudulently used by SRL on its early invoices to the Appellant. The workers supplied by WL largely transferred to SRL and then to the Appellant; 27 of WL's workers began working for SRL after the Appellant ceased trading with WL and 8 workers began working for the Appellant. After the Appellant ceased trading with SRL 44 of its 63 workers transferred to the Appellant, including 17 who had previously worked for WL. The Appellant stated that Mr Neil Weir was behind WL and SRL, Mr Weir was employed by BUL at the relevant time. All four companies used the same premises at Salus House.

39. Mrs Gillard highlighted that BUL provided labour services and Mr Weir, who was the main company officer in WL and SRL worked for BUL. Mrs Gillard queried why BUL would introduce Mr Weir to the Appellant when he was a competitor. As to whether the companies worked in different geographical locations, Mrs Gillard stated that no evidence to support this assertion had been presented to her.

40. HMRC submit that this arrangement lacked commerciality and was clearly contrived. The role of Mr Weir as employee of BUL whilst acting for WL and claiming to be its director is wholly implausible. HMRC submit that the Appellant's involvement in this contrived scheme is relevant to its knowledge as to the connection with fraud and the Tribunal is invited to infer that the closer a company is to the fraudsters in a scheme, the more likely that it knew of the fraud. HMRC submit that given Mr Ferguson's experience in the industry it is unlikely that he would have been chosen by fraudsters as a dupe.

41. Ms Gillard noted that a letter dated 8 September 2014 from the Appellant's agent Mr Tobin to HMRC stated that Mr Ferguson was introduced to Adam Weir as a director of BUL and was later introduced to Neil Weir from WL (who was later appointed the principal shareholder/director of SRL). Neil Weir does not appear in the Companies House or FAME records for WL and it appears he was an employee of WL. Mr Tobin advised that because WL had been recommended by a trusted colleague, Mr Ferguson met with Neil Weir and WL was able to supply temporary workers to the Appellant. In the same letter, Mr Tobin stated that Neil Weir set up SRL as director and shareholder and he told Mr Ferguson that this was because he was disillusioned with his colleagues in WL. Subsequently SRL was unable to provide insurance documents requested by the Appellant who took the decision to cease trading with SRL and increase its staff numbers internally. The letter stated:

> "Our client was made aware of Workforce and Skill-Rite Limited through a working relationship with Bernic UK Limited…he formed a trusting relationship with the directors and managers. Whilst advising at Bernic, he was introduced to Adam Weir as being a director of Bernic and it was at a later date that he was then introduced to Neil Weir (from Workforce Limited, who was later the principle shareholder/director of Skill-Rite) as a potential solution to Hard Hat Limited's staffing shortages."

42. Ms Gillard noted that there was no record on Companies House records of Adam Weir being a director of BUL or having any involvement with the company. Mr Neil Weir remained an employee of BUL throughout the relevant period as demonstrated by HMRC's PAYE records.

Commercial Checks and due diligence

43. At a meeting with Mr Ferguson and Mr Penny on 20 February 2014 Ms Gillard provided a leaflet about the use of labour providers and the continuing problems with fraud in the industry. Ms Gillard advise that it was good commercial practice to carry out checks and establish the legitimacy of suppliers. Mr Ferguson stated that due diligence was carried out on suppliers annually and that they were required to supply their VAT number and sign a document to say that their tax affairs were in order. According to Mr Ferguson the last checks had been carried out in September 2013 however Ms Gillard noted that there was no evidence provided to HMRC to support this assertion. Mr Ferguson stated that he used labour providers on referral or recommendation from other firms. He queried what he needed to do and whether he should follow all the checks on the leaflet. Ms Gillard advised that the phone check was very important and that he should pick the checks relevant to the company.

44. Mr Ferguson stated that he was an Approved Contractor Scheme ("ACS") Pacesetter for the SIA and was one of the top 10% compliant security businesses in the country, providing advice and assistance to other companies to bring them up to SIA ACS standard. Mr Ferguson told Ms Gillard that SIA Licensing Authority regulations had been followed and checks are carried out to ensure all staff hold the appropriate licence. SRL provided a list of operatives used by the Appellant on a weekly basis which allowed the Appellant to check they were SIA registered. Due

diligence was carried out on any guard or worker which was monitored and recorded in a spreadsheet provided to HMRC. Ms Gillard was advised that the SIA conduct regular checks and she noted that the level of due diligence in this area appeared to be much higher than the checks carried out on suppliers and customers.

5 45. In June 2014 Mr Penny the accountant advised HMRC that his firm had provided the Appellant with a link to HMRC's VAT registration checker tool in 2010/11 which was used by the company at that time. The Appellant had recently used the VIES software to re-verify VAT numbers. The agent stated that suppliers were only instructed after due diligence checks had been carried out including 10 recommendations, checking the company's existence and meeting with management. Ms Gillard noted that if such checks had been carried out the Appellant would have discovered that the VRNs being used by both WL and SRL were not valid.

46. On 8 July 2014 Ms Gillard wrote to the Appellant and Mr Penny regarding invalid invoices issued by SRL and WL in the 02/12 – 12/12 period. Ms Gillard 15 requested a full explanation of the due diligence checks undertaken by the Appellant. On 8 September 2014 Ms Gillard was advised by Mr Tobin that due to a flood at the Appellant's main office caused by storms in April 2012 a large number of documents were destroyed including due diligence and correspondence. Ms Gillard noted that the Appellant indicated in a letter dated 30 March 2015 that email and electronic 20 documentation was intact, but other than two emails requesting SRL's insurance documents no other evidence of due diligence was provided.

47. Mr Tobin explained that the Appellant was made aware of WL and SRL through its relationship with BUL and Mr Ferguson's trusting relationship with the directors and managers of that company. Mr Tobin provided copies of contracts with both SRL 25 and WL and advised that the Appellant should be able to provide limited details of the workers supplied by SRL as their names would be found on rotas. Mr Tobin said that SRL failed to provide insurance documentation which led the Appellant to cease trading with the company; email correspondence from the Appellant's administration manager was enclosed to show the request to SRL on 20 April 2012. Ms Gillard noted 30 that despite the Appellant requesting the insurance documents by the end of that week and SRL's failure to provide them, the Appellant continued to use SRL until September 2012. Furthermore, despite the change to invoices where the VRN had been removed, the Appellant continued to trade with SRL and pay VAT. Ms Gillard also noted that she was advised that Mr Ferguson had visited the offices used by Neil 35 Weir and SRL at Livingston Street, however it later emerged that the Appellant was already trading from an office in the same building.

48. In January 2015 Ms Gillard requested further information to support the Appellant's due diligence procedures and correspondence ensued between the parties. On 22 July 2015 Ms Gillard was provided with information on SIA checks, details of 40 VAT invoice checks and controls and worker schedules related to invoices. Mr Tobin reiterated that certain records had been destroyed in the flood and asked that this be taken into consideration.

49. Ms Gillard issued a decision letter on 10 November 2015. By letter dated 9 December 2015 Mr Tobin requested reconsideration of the decision and stated that due diligence carried out on SRL included meetings with the director, company checks, the VAT number being checked on HMRC's website, past knowledge of the director, personal recommendation and other checks. Ms Gillard noted that no documentary evidence was provided in support of these checks. On 18 December 2015 Ms Gillard wrote to the Appellant advising that she remained of the opinion that there was insufficient evidence to support the input tax claimed in relation to WL and SRL. Mrs Gillard accepted the Appellant's assertion that many documents had been destroyed in the flood but explained that the Appellant had never specified what documents had existed and what was contained in the files which were damaged or destroyed in the flood. Mrs Gillard added that the checklist produced by Ms Wileman prescribes a list of checks; if those checks had been carried out the Appellant should have been aware that the suppliers were not legitimate; for example, one of the checks was for a VAT certificate but a VAT certificate could not have been obtained for a company that was not VAT registered. Furthermore, the Appellant had failed to explain what documents were missing, there was no attempt to explain how the records worked or what would have existed, only general statements that there were meetings, a build-up in the relationship and director checks carried out.

50. Ms Gillard considered the evidence of Mrs Enid Wileman who undertook the Appellant's due diligence as part of her financial administration duties. The VIES check is a real time VAT number validation tool provided by the European Commission website. Both Mr Ferguson and Ms Wileman state that the VIES VAT checking system was used to check companies following advice from HMRC in 2008. Ms Wileman stated that she carried out these checks on SRL and WL before placing operatives on site. Ms Gillard notes that if these checks had been carried out in relation to validating the VRNs then the information provided by the European Commission VIES system would have shown the name and address of the VRN's rightful owner and therefore would have shown that the VRNs provided by SRL and WL were not proper to those companies. Mrs Gillard clarified that as far as she was aware from a colleague in Customs and Indirect Tax Policy, since January 2010 VIES has provided for UK businesses the name and address associated with a valid VRN number; prior to 2010 VIES provided only a check on the number. Mrs Gillard stated that the document which confirmed this information could not be disclosed under EU law which regulates public access to European Parliament Council and Commission documents. Mrs Gillard was unable to confirm whether or not there was any delay in the region of 3 months between VIES being updated if a company was deregistered. Mrs Gillard agreed that a VRN check would be carried out at the start of a trading relationship and repeated if any changes were brought to a trader's attention such as a change of company name, although she highlighted HMRC's guidance which stated "Verify VAT registration details with HMRC before you use them and make regular checks for VAT registration numbers afterwards."

51. Ms Gillard accepted that if the Appellant's trading relationship with WL commenced as far back as February 2011 it was possible that a VRN check at that

time would have shown a valid number. However she added that the VRN would have related to Orion Payroll Services Ltd although the address remained the same.

52. Mrs Gillard accepted that the SIA may be rigorous about its membership criteria and exercises considerable scrutiny over member businesses. However she explained that the organisation is different to HMRC and she was not aware of the level of checks that are carried out other than reports are done on an annual basis. She added that the information provided by Mr Tobin of the Appellant's accountants which related to SIA checks was due diligence in relation to the workers, their badge status and right to work in the UK rather than due diligence on suppliers. Mrs Gillard did not accept that the SIA checks in relation to workers indicated that the same level of due diligence was carried out by the Appellant on its suppliers. Mrs Gillard took into account the overview given but concluded that it was not sufficient to show that the Appellant had checked the credibility and legitimacy of its suppliers.

53. Mrs Gillard noted that SRL's insurance document was requested by the Appellant before the SIA audit. She accepted that the request for the document indicated a degree of scrutiny by the Appellant and that the failure by SRL to provide the document led to the termination of the trading relationship, although Mrs Gillard noted that it was only six months later when termination was considered by the Appellant.

54. Mrs Gillard accepted in cross examination that the Appellant had increased its due diligence from almost nothing in 2008 prior to HMRC's visit to the use of a due diligence checklist which is now carried out. She confirmed that there was no evidence that in 2008 the Appellant had been provided with written advice such as a leaflet about the types of checks to carry out on VAT numbers, there was only a reference to verbal guidance being given by HMRC officer Higgins. There was also no evidence that officer Higgins had discussed the risks of hijacked VAT numbers or given a warning about de-registered VAT numbers to the Appellant. Mrs Gillard confirmed that the Appellant's accountants, The Priory Partnership, had asked on a number of occasions HMRC's view on the due diligence that the Appellant should undertake. Mrs Gillard's response had been to refer the Appellant to the labour provider leaflet as HMRC will prescribe the checks a trader should undertake but the leaflet indicates a number of generic checks specifically aimed at the labour provider sector.

55. Ms Gillard concluded that if the checks were carried out, the results were disregarded as both would have shown that the VRNs belonged to companies other than WL and SRL.

Nature of trading, turnover and payments

56. At the meeting with Mr Ferguson and Mr Penny from the Appellant's accountants Priory Partnership on 22 January 2008 officer Higgins noted that since the change in business activity outputs had risen from an average £17,000 per quarter as a provider of business entertainment to £120,000 per quarter as a security labour

provider. Officer Higgins found the sudden change in turnover in a high-risk area for VAT to be grounds for concern.

57. The Appellant's turnover and profits from September 2008 – 2013 were as follows:

Period end	**Turnover (£)**	**Profit (£)**
30/09/13	2,249,686	248,038
30/09/12	1,968,377	322,099
30/09/11	1,147,433	117,672
30/09/10	964,412	12,751
30/09/09	1,174,049	36,820

5

58. VAT periods 02/12 – 11/12 in which the relevant transactions took place saw the Appellant's quarterly outputs at record levels increasing from £252,687 (05/11), £265,785 (08/11) and £335,893 (11/11) to £384,971 (02/12), £476,157 (05/12), £498,706 (08/12) and £893,097 (11/12).

10 59. In oral evidence Mrs Gillard accepted that there may be a commercial reason for the Appellant's suppliers agreeing to forego premium payments in order to make contacts. However she added that the very nature of business is to make profit and the fact that the suppliers in this case stood to make no profit lacked commerciality and led her to conclude that the businesses were not viable. Mrs Gillard did not accept that 15 the payments to the suppliers represented an introductory offer on favourable terms as there was no room to meet any costs other than the workers' wages which she did not accept was normal commercial practice. She accepted that the preferential payments made to WL and SRL as compared to the Appellant's other suppliers may have been due to the favourable terms but stated that this was not information that had been 20 given.

60. Ms Gillard highlighted the difference in the transactions with SRL and WL as compared to those with other suppliers of labour. The invoices of SRL and WL both use the description: "for the supply of temporary labour/security guards as requested." The invoices from other suppliers contain the client name or site, number of hours and 25 dates of labour supplied. Ms Gillard highlighted by way of example an invoice from Safe Hands Management Solution dated 14 October 2013 which attached a table containing site names, guard names, the date, number of shifts and subtotal amounts. Mrs Gillard accepted that different companies do invoice differently but stated that there is usually a certain standard of information that would be expected on an invoice 30 and it was the responsibility of the Appellant to ensure it had adequate documents and an audit trail to support the invoices.

61. In other transactions the invoices appeared to show that the supplier determined the price, however in the transactions which form the subject of this appeal the Appellant appeared to set the price and inform the supplier; emails between 12 December 2011 and 10 September 2012 issued by the Appellant to WL and SRL show wages lists for the week. Mrs Gillard explained that she had not been provided with any calculation method nor had the Appellant ever asserted during the enquiry that the emails were steps to allow the calculation of wages. The value paid to the supplier only covers the wage with no mark up. Ms Gillard noted there appeared to be no charge by the suppliers for the provision of labour as the wages shown on the weekly emails add up to the net invoice amount and therefore the suppliers' only profit was the VAT which was not paid to HMRC.

62. Ms Gillard noted that despite changing suppliers from WL to SRL in March 2012, the Appellant's administration manager continued to email the same person, Barbara, with the lists of workers and wages due for the week.

63. Furthermore, the payments to WL and SRL indicate preferential terms in comparison to other suppliers. WL was generally paid 3 days after the invoice date and SRL was paid up to 4 days before the invoice date. By comparison, other suppliers' invoices indicated payment terms of 14 days. Mrs Gillard explained that it is not usual commercial practice for companies to be paid before an invoice is raised; most companies aiming to make a profit would operate in a different way and she reiterated the fact that WL and SRL were operating with no room for profit.

64. Ms Gillard highlighted the crossovers of workers employed by WL and SRL in the emails provided by the Appellant's agent and payments made to workers. 27 of WL's 40 workers began working for SRL after the Appellant stopped trading with WL. A further 8 of WL's 40 workers began working for the Appellant meaning that 87.5% of WL's workers transferred to SRL or the Appellant after the Appellant ceased trading with WL. After the Appellant ceased trading with SRL 44 of SRL's 63 workers (70%) transferred to the Appellant including 17 workers who had previously worked for WL.

65. Ms Gillard concluded that the checks described as carried out by the Appellant could not have provided adequate assurance that the transactions were not connected to fraud. The documents checked confirm, at the highest, that the companies existed but no evidence has been provided by the Appellant to demonstrate that robust commercial checks were undertaken to establish the veracity of the Appellant's suppliers. Taken together with the associations between SRL, WL and BUL via Mr Weir, the shared premises, preferential business terms and lack of commerciality in the transactions Ms Gillard concluded that the transactions were contrived and that the Appellant must have been aware or should have known that the transactions were connected to the fraudulent evasion of VAT.

<u>Evidence on behalf of the Appellant</u>

66. We were provided with two witness statements from Mr Ferguson who also gave evidence. We were also provided with a witness statement from Ms Enid Wileman,

who was not available to give evidence, and Mr Stuart Penny, the Appellant's accountant, whose evidence was agreed.

Awareness of fraud

67. Mr Ferguson explained that he had been involved in the security industry at a senior managerial level for over 20 years. Between 2002 and 2007 he was chairman of the British Security Industry. He started the Appellant in 2004 with himself as the only member of staff. He now employs over 70 staff and 40 agency operatives. The Appellant provides a range of award winning, accredited and certified security, cleaning, waste management and cleaning services to the construction and infrastructure sectors nationally.

68. Between 1994 and 2005 Mr Ferguson was employed by 3 well-respected security companies which together with his longstanding role as chairman of the BSIA enabled him to make valuable contacts in the industry.

69. In 2006 Mr Ferguson secured self-employed consultancy positions with BUL and SES Security. One of the directors at BUL was an old friend, Mr John Lynch, who offered Mr Ferguson office space at Salus House were he rented an office from 2008 – 2011 and traded as the Appellant.

70. The Appellant began to expand when it won the five Cheshire Care Homes contract in 2007. In February 2008 Mr Ferguson employed Ms Enid Wileman to undertake payroll and financial administration duties, one task being due diligence for VAT purposes on suppliers following advice given by HMRC to the Appellant in 2008.

71. Mr Ferguson explained that VAT checks were carried out using VIES until the Appellant switched to HMRC's checking service in 2014.

72. BUL was a security services provider to different sectors than those the Appellant usually worked with. Mr Ferguson conculted with BUL on attaining ACS status from the SIA and he was not involved in BUL's commercial operations. Mr Ferguson worked with one of the directors Mr Adam Weir who introduced Mr Ferguson to his brother Mr Neil Weir as director of WL. Mr Adam Weir and the team at BUL vouched for Neil Weir who offered to supply the Appellant with labour at a heavily discounted rate in exchange for introductions to other security providers. Mr Ferguson agreed to the discounted rate but stated he would not make introductions until he was satisfied that WL was a reputable and credible supplier.

73. Mr Ferguson agreed to pay the national minimum wage for the first 6 months in anticipation of the invoices to help WL with cashflow. The Appellant would send the hours worked by each operative and WL would send an invoice in return.

Due diligence

74. Mr Ferguson stated that the Appellant carried out all the due diligence checks it was required to and followed all of the guidance from HMRC and professional advice available as the time of the transactions. Mr Ferguson explained that the Appellant was also heavily regulated by the SIA who made continual spot checks on the company and operatives and who did not raise any concerns about the Appellant's working practices or those of the suppliers. He confirmed that as an ACS he was provided with various documents by the SIA setting out best practice which he had read. Mr Ferguson accepted that he had a certain amount of knowledge and understanding of the regulations of the day but that did not necessarily mean he would be the last person to be chosen to dupe in a VAT fraud. Mr Ferguson contended that he had been duped by the Weir brothers but it was only with the benefit of hindsight that he realised this. He stated:

> "Q. So in reflecting upon this episode, what's your conclusion as to how these two men managed to dupe you into entering these transactions?
>
> A. How they duped me? We thought we'd done due diligence checks. Enid Wileman, who is the lady that is responsible for this part of it, would have brought – provided me with advice at a point if she saw something that she saw as being wrong and obviously I would have had to act on that.
>
> Q. But you're the man who has sat down face to face with these fraudsters; yes?
>
> A. they were never classed as fraudsters when I first met them. It was only during the relationship that we started to realise there was something not quite right with them.
>
> Q. So during the relationship you realised that there was something not quite right, and when was that?
>
> A. Towards, I would say that that was in 2012.
>
> Q. Was it when WL asked for prepayment of the VAT and Enid Wileman says that she was horrified and raised the matter with you?
>
> A. And that I was in August, I believe, 2011, and within 30 days we had terminated the relationship with Workforce.
>
> Q. And taken up with Skill-Rite, which is run by the same man?
>
> A. But we had been provided with a VAT number via the checker that we use to the day that said valid, so we believed we were acting responsibly…
>
> …
>
> Q. So why did you tell them where to go when they asked for prepayment of the VAT element?
>
> A. Because they hadn't provided enough documentation, as in i.e. the insurance for me to, sort of, even trust them, and this is why the relationships, obviously, were terminated. This is all over the space of about 12 months.

Q. That was Skill-Rite who hadn't provided you with insurance, wasn't it?...But we're talking about Workforce Ltd, who ask you for prepayment of the VAT element of an invoice. Can't be to do with cash flow, can't be because of insurance for that company, so why did you tell them where to go?

5 A. I told – as I say, I've just mentioned about the cash flow element. We make sure that the guards get paid. If that means that at some stage we've had to pay them a day or two in advance, then – to keep the clients happy, that's what we had to do. Confidence is the - - it was more important to me than profitability. That's how my reputation and credibility have grown in the industry.

10 Q. So, in that case, what was the problem with prepaying the VAT element of an invoice if you wanted to ensure that the men were paid and stayed on site?

A. I didn't think it was the right thing to do at the time.

Q. Why not?

A. Well, why would you pay the VAT - - the VAT element without an invoice?
15 Why would you pay it early?

Q. Why did you think you were being asked?

A. It doesn't matter. I didn't ask - - I didn't respond to the request, I denied it.

Q. But why? Why is it not the right thing to do?...what was the discussion between you and Enid Wileman about why this was such a bad thing that
20 they've requested?

A. Because it was out of the normal, it was out of the normal trading relationship. It wasn't the way that business should be conducted.

Q. Because it indicated to you that they were using the VAT to fund the business, didn't it?

25 A. To fund their business."

(29/01/19 page 10 - 14)

75. In 2011 Mr Ferguson became aware of a conflict between the directors at WL and Ms Wileman had raised concerns. Mr Neil Weir told Mr Ferguson that he was leaving WL having become disillusioned and would be starting a new labour supply
30 company. When Mr Neil Weir started SRL he approached the Appellant for business offering preferential rates. Mr Ferguson explained that SRL had recruited the majority of the existing WL work force including site operatives and admin staff which led him to the decision to discontinue his business with WL and begin a new relationship with SRL. From March 2012 the Appellant moved all of the business that had previously
35 been with WL to SRL. Ms Wileman carried out the due diligence checks including the online VIES VRN checker. However, SRL continued to fail to provide its insurance documents which were repeatedly requested and in August 2012 Mr

Ferguson instructed Ms Wileman to withhold the VAT payment to SRL. In September 2012 the Appellant ceased trading with SRL.

76. Mr Ferguson stated that there was nothing about the working practices of either company that would lead a reasonable person not connected to them to suspect that fraudulent practices were taking place. He stated that although the request by WL for payment of the VAT element would be the "first inkling" that he did not want to be involved in the relationship and it was Mr Weir who set up SRL, certain guarantees were given, one being the VRN check. As to his relationship with Adam Weir, Mr Ferguson stated:

> "In 2006 when I joined – became a consultant at Bernic, obviously I had very occasional dealings with Adam Weir. I knew he was a decent businessman on the outset of it and decided that I could work with him, not trust him but work with him. Obviously I put my own due diligence in place to make sure I thought we were protected, but I'm not a scholar in VAT fraud and didn't understand how you could defraud the VAT until obviously this was all revealed to me at a later date…. We thought we'd done our due diligence in the fact that we'd checked the VAT number that would allow us to say we had done our due diligence. So that exonerates us from any further fault.
>
> Q. That was your thinking, was it, I've checked the VAT number, therefore that's my due diligence and therefore that exonerates me from any fault?
>
> A. No, that was one of several checks that were taking place. Obviously trade references, check the premises, meet the directors were also done at the same time.
>
> Q. So Workforce Ltd, you think: 'They've asked me something extraordinary about prepaying the VAT, I don't like this at all, I'm not going to do it, I'm going to terminate my relationship with that company but I'm going to continue trading with Mr Weir in a different corporate guise because he's got a VAT number.
>
> A. Neil Weir was the front man for Skill - - for Workforce but then he said he was setting up Skill-Rite. Now, I had a little bit confident in Neil than I did over Adam. Again, it's just coincidence they happened to be brother, I saw them as two businessmen doing business and I decided to go with Adam - - sorry, Neil after Adam.
>
> Q. But Adam Weir wasn't involved in Workforce Ltd, was he? He wasn't a director?
>
> A. Well, as I've just alluded to, I met him in 2006 and he was named as a director of - - of Bernic Security, who were then a client of mine, and at a later date in your documentation the Companies House director is Danielle Raynor, I think her name was, who is his wife or girlfriend, so that's why he wasn't there but I never met Danielle.
>
> Q. we're talking about Adam Weir, Mr Ferguson. Adam Weir was not part of Workforce Ltd, was he, as far as you knew? It was Neil?

A. He was part of Workforce. He was part of Workforce.

Q. What was he doing at Workforce?

A. He claimed to be the director or the shareholder, I can't quite remember."

(Transcript 29/01/19 at page 16 – 17)

5 77. Mr Ferguson stated that he was not aware of tax evasion, criminality or aggressive avoidance within the labour market; he had not previously been made aware of this and had never received advice from HMRC or any professional advisor to exercise additional care or diligence when using the services of those in the industry. Mr Ferguson denied that he made a "sudden shift in business activities" 10 given his lengthy experience in the industry at a senior level nor was Mr Ferguson told that he was operating in a high risk area for VAT. Mr Ferguson was referred to a document he had produced issued by the SIA against which his business was assessed in 2011 which stated "the company follows HMRC guidance regarding due diligence record-keeping for the use of labour providers." Mr Ferguson also confirmed that he 15 would have received the assessor's guide part of the same document which stated:

> "HMRC have identified increasing problems in the security industry with fraud and unpaid taxes through the use of labour providers. It is good commercial practice for all businesses to carry out checks to establish the credibility and legitimacy of their suppliers. Approved contractors must seek to avoid 20 involvement in supply chains where VAT and/or other taxes will go unpaid."

78. Mr Ferguson stated that he would have received this document in May or June 2012 although he was aware of the criteria against which he was to be judges before the audit in June 2012 and he believed he had followed due diligence on labour providers. He recalled that a leaflet had been given to him relating to HMRC's 25 guidance on due diligence, perhaps in 2011. Mr Ferguson agreed that the incident with CESL in 2008 was, to some extent, tax evasion in the labour supplier market by his supplier although he never thought of it in that way. He maintained that he had not been provided with guidance relating to aggressive avoidance, tax evasion or criminality; there had simply been an administration error which led to the Appellant 30 paying VAT twice. As the business grew they became more aware of how to protect the company from VAT fraud and to some extent that was the reason for the due diligence checks although he added:

> "…do you not always want to just be a better citizen every year and prove how you interact with your business community and with your co-workers.
>
> 35 Q. Mr Ferguson, why did you think Hard Hat was doing due diligence checks on its suppliers?
>
> A. Because that was the compliance of the day.
>
> Q. What, it was just doing it for the sake of it? Come on, why were you doing these checks?

A. Well, to be honest with you, when you're a busy guy like I was back in 2008, trying to create a business and going out to see clients, that was all it was, it was just compliance. It's just like doing your tax return, you don't really think about too much more after that point of view…"

(Transcript 29/01/19 page 30 – 31)

79. In relation to the invalid invoices from CESL Mr Ferguson stated that they were naively paid in full in good faith; no checks were made at the time as to the legitimacy or otherwise of the supplier to charge VAT; after advice was received from HMRC in relation to due diligence the Appellant immediately implemented the use of VIES or HMRC's VAT checking service. He drew the distinction between the invalid invoices which contained no VRN and the present transactions which used false VRNs. The advice to the Appellant as Mr Ferguson understood it was that no VAT should be paid without a proper VAT invoice, the invoice should contain the VRN which should be checked as valid by the Appellant. No advice was provided regarding de-registered or hijacked VRNs.

80. Mr Ferguson stated in cross-examination that he had been duped in 2008 by CESL but in a different type of strategy by a supplier who did not have a VAT number and when the Appellant asked for one, someone else's VRN was given. As a result Mr ferguson was aware from 2008 that there were unscrupulous traders in the industry that charged VAT on invoices but he tended to stay away from as many of those traders as he could. He explained that Mr Francis Enuani, the company secretary of CESL who came to work for him after the incident had, Mr Ferguson believed, also been duped.

81. Mr Ferguson added that during the Appellant's 2012 SIA audit the company was judged to be properly following HMRC's advice relating to the use of labour providers.

82. Mr Ferguson stated that the Appellant undertook individual risk assessments of both WL and SRL by way of VRN checks, background knowledge of both companies and the individual directors and recommendation from BUL. Additional checks were carried out to verify the integrity of the companies such as assessing their knowledge of industry standards and compliance, cross-referencing of invoices with operative time records. In 2012 the Appellant was advised that there had been a flood at its storage space which had destroyed over 30 lever arch files of documents and clients' files.

83. Mr Ferguson clarified that he did not recall the due diligence checklist produced by the Appellant being used as far back as 2011; the document was produced to show the continuous improvement and the type of checks that were carried out in 2013. The checks listed in the document were not carried out on WL or SRL; those were limited to the VRN check either using VIES or HMRC's checker. He stated the Appellant may have also looked at an invoice to check they were paying the correct company, although he did not have a clear recollection. Mr Ferguson conceded in cross-examination that he could not be sure whether VRNs were checked using VIES or

HMRC's checker; he agreed that both his and Ms Wileman's witness statements confirmed that VIES was used but highlighted that Mr Penny his accountant believed HMRC's VAT checker was used. He stated that he could not be sure which system was used but he would stand by his witness statement which he believed was 75% accurate on that point. He added that he personally did not carry out the VAT number checks and did not know what the result would have been other than Ms Wileman would have told him if there were any exceptional circumstances. He confirmed that he did not know what information a VIES check produced at the relevant time and that if the name of the company and address associated with the VAT number were not those provided by his supplier he would have asked further questions:

> "A. Yes, but, as I say, even if it did come up with the VAT number and the address for Workforce, it was the correct VAT number for Workforce.
>
> Q. Workforce weren't using their own VAT number. There was no correct VAT number for Workforce, though, was there?
>
> A. Skill-Rite hijacked their VAT number. Workforce - - Workforce used their own VAT number because they de-registered in April or May, according to the records, the FAME records that you show.
>
> Q. That was in the name of a previous company name, wasn't it: Orion Payroll Services Ltd?
>
> A. Yes, but that was still the same entity that was a name change but it was still the same company.
>
> Q. But if you'd seen that, you'd have had to make those checks on Companies House, wouldn't you?
>
> A. We'd have had to make those checks on Companies House, yes, but obviously when the VAT number came back valid without any further detail, we didn't need to do anything further, we thought."

(Transcript 29/01/19 page 41)

84. Mr Ferguson accepted with hindsight that if the Appellant had carried out all of the checks on the checklist, he would not have traded with either WL or SRL which is why the checklist was brought in. Mr Ferguson was not aware what machinery may have been destroyed in the flood in addition to documents but stated he had looked for electronic copies of documents such as rotas.

85. Mr Ferguson noted that HMRC had not specified what checks he should carry out in addition to those taken and that the Appellant is a victim of fraud; this is demonstrated by the fact that WL used a legitimate but then de-registered VRN in its invoices with the intention of defrauding the Appellant. Similarly, SRL's use of a hijacked VRN led to the Appellant being a victim of its fraud as the Appellant stood to gain nothing from the fraudulent transactions.

86. Mr Ferguson confirmed that Adam Weir was introduced to him as director of BUL which he accepted at face value. He was not aware that Neil Weir was an employee of BUL. Mr Ferguson accepted that at HMRC's visit in September 2011 the notes recorded that the Appellant had approximately 10 employees, used subcontractors as necessary; the main one being BUL which was VAT registered and the rest were recorded as mainly unregistered individuals and that there was no mention of Workforce being a trading partners as at May 2011. The first invoice with WL is dated 3 June 2011 which Mr Ferguson believed was about the time the trading started. Mr Ferguson agreed that the invoice was dated two months after WL's de-registration. He explained that the reason it was faxed from BUL was because there was a shared office with only one secretary used by all companies. Mr Ferguson explained that when he set up the Appellant he had an agreement in place with BUL to have a non-competition clause. He went on to explain that he agreed to use WL at a discounted rate but would not make introductions to WL until he was satisfied that it was a reputable and credible supplier; when no introductions were made the relationship terminated. Mr Ferguson stated that WL did not give him the assurances he needed to ensure WL was bona fide; once they started trading he could see that WL were not what they seemed to be or reputable enough:

> Q. What was it at the start of the trading relationship that made them credible enough to trade with?
>
> A. You like to give people a chance in life. So we looked at them and understood what they were trying to do and believed that we could align with them but obviously they just were - - they weren't professional - - as professional as hard Hat and the vision that I had of becoming a successful operator in the region."

(Transcript 29/01/19 page 48)

87. Mr Ferguson stated that company checks were carried out on WL prior to trading which were followed up with Companies House checks. He agreed that the checks would have shown that the actual company name was Workforce Northwest Ltd and that Ms Wileman would have raised that. As to whether there is a contradiction between what a company says and what its records show, Mr Ferguson stated that he assessed the risk and addressed it. He added that WL was low risk when checks were made in May 2011 as the VAT number was correct and there were trade references from Adam Weir and the other directors at BUL which gave the green light. Mr Ferguson accepted that the director of WL was Mr Cameron, not Neil Weir but stated that Ms Wileman would have brought it to his attention if she had a concern but because they had "a relationship internally in the building, she'd have raised no concern about it" (transcript 29/01/19 page 62). Mr Ferguson stated that he moved out of the shared building in January 2011 and did not trade with WL until May; during the time he shared the building, he was not present as he was on the road, had an office in London, a young child and was working on the Olympics. He was therefore lucky if he was in the office one day a week to meet anyone. At the time he was not as anxious as he is now about knowing who had the legal authority in a trading partner

as he was learning how to become a successful operator of the day; at the time he did not identify the repercussions from a day to day point of view.

88. Mr Ferguson explained that although the arrangement between the Appellant and BUL was lucrative, it could not continue as BUL became ACS and the relationship terminated in 2010. He stated that the fact that the Appellant and BUL continued trading in the same VAT periods in which he was supplied by WL was a transitional time in which work was completed but no new work was given. That transitional period continued until September 2012. He later stated that trade with BUL did not continue as they charged a higher price and Mr Ferguson wanted better commercially which WL could provide as a start-up company, it was not BUL's decision and they introduced the Appellant to WL as Mr Ferguson had given BUL ACS and "set them on the path". As to Adam Weir's involvement as director of BUL and a part of WL, Mr Ferguson explained that people can have various directorships in different companies in the same industry supplying different parts of the sector. The relationship between BUL and WL was not a matter he got involved in. The risks were assessed and calculated and gave Mr Ferguson no cause for concern when trade with WL commenced. He took everything in good faith, he received the service he needed, received an invoice and got paid.

89. In relation to SRL Mr Ferguson stated that Companies House checks were made in early 2012 prior to the commencement of trade in March 2012. Mr Weir was a director of SRL for 8 days, ending on 20 October 2011 but Mr Ferguson was not aware of that fact and stated that Ms Wileman must have missed it. Mr Ferguson stated that he asked Ms Wileman to look on Companies House to see if there were any concerns. He had never spoken to Mr Gallagher who was the sole director at the time the companies started trading. In addition to Companies House checks there were also meetings with directors. Mr Ferguson stated that although the Companies House checks may have been carried out they may not have been actioned. He agreed that when the companies started trading he had not received the insurance document which he viewed as critical but he traded with SRL because he needed a workforce to meet his clients' needs and "better with people that you know than the devil you don't." Mr Ferguson stated that he wanted to continue commercially attractive trade in relation to the pricing even though it would seem too good to be true.

90. Mr Ferguson agreed that his gross profits almost doubled when trade commenced with WL because he was doing great business.

91. In relation to pricing Mr Ferguson stated that the price was not determined by the Appellant. The price was agreed in advance with the suppliers and the Appellant simply calculated the hours/units and sent through the figures for each week. Mr Ferguson stated that this was standard practice within the industry. He added that although no profit was made by WL or SRL a mark up was due to be added and he denied that the VAT was the profit. In cross-examination Mr Ferguson explained that he saw the situation as cost neutral to WL.

92. Mr Stuart Penny is a director of Priory Practice Ltd, the agent of the Appellant since 2001. Mr Penny's witness statement confirmed that in or around 2010 he

showed Ms Wileman and Mr Ferguson the web link to HMRC's VAT site which gave access to the VRN checker. The links are no longer valid but at the time when a VRN was entered a 'yes' or 'no' was provided to indicate the validity. Mr Penny states that there were discussions at the time as to how to improve due diligence and it was agreed that a VRN check would be added to the standard due diligence carried out by the Appellant before being replaced at a later date with VIES.

93. Ms Enid Wileman has held the position of office manager at the Appellant company since February 2008. Prior to this Ms Wileman held a similar position at another security company in Liverpool between 1999 and 2008 where her responsibilities included payroll, invoicing, banking and credit control. Ms Wileman's responsibilities at the Appellant mirrored that at her previous employment with some additional responsibilities such as fleet vehicle management and due diligence checks for HMRC and the SIA.

94. The due diligence carried out on temporary labourers includes requesting identification documents, proof of address, proof of entitlement to work in the UK and all SIA checks.

95. The due diligence carried out on the labour supplier follows a checklist. Ms Wileman stated that the following checks are carried out and documents obtained in relation to every supplier:

- Due diligence checklist (3 page document consisting of 37 questions);
- Supplier signs and returns the Appellant's purchase policy document;
- Registration is checked with Companies House and Certificate of Incorporation obtained;
- VIES VRN check and copy kept for file;
- VAT certificate obtained from HMRC;
- Proof of address by way of bank statement or utility bill;
- Certificate of insurance and copy of policy.

96. Ms Wileman stated that she always used VIES to check the VAT status of a company. She was responsible for all due diligence checks and would report any concerns to Mr Ferguson. Once checked, Ms Wileman would not repeat the check. Both WL and SRL were VAT registered.

97. In relation to WL Ms Wileman stated that she carried out all due diligence prior to placing operatives on site in Scotland in May 2011. Ms Wileman could not recall due to the passage of time the specific checks carried out on WL and she could not recall when the business relationship began as the records are not complete. Ms

Wileman assumes that the VRN check she carried out took place prior to WL's de-registration.

98. The relationship with WL became unworkable as Ms Wileman became aware of a delay between the Appellant paying invoices and the operatives on site being paid which caused upset amongst the operatives. Ms Wileman was told by WL that the delay was due to administrative issues but she noted that at one stage WL asked to be paid the VAT in advance of invoices. Ms Wileman was "stunned" and refused. She reported her concerns to Mr Ferguson.

99. All due diligence checks were carried out on SRL with the only item missing being the insurance document which Ms Wileman continued to chase. Ms Wileman stated that by May 2012, despite the Appellant's best efforts to keep the relationship going, it became apparent that things were not going to be much better under SRL. Ms Wileman discussed the situation with Mr Ferguson who agreed to source another supplier.

100. Ms Wileman was responsible for paying the suppliers. The rate agreed with WL and SRL was national minimum wage multiplied by the number of hours works minus breaks which was the rate Mr Ferguson had negotiated with the suppliers.

101. Ms Wileman confirmed that the due diligence checks carried out on both WL and SRL would have been amongst the documents destroyed in the flood.

Submissions

HMRC's submissions

102. On behalf of HMRC Mr Watkinson summarised HMRC's case as follows:

- The Appellant's transactions were connected with fraudulent VAT losses occasioned by its two suppliers WL and SRL;
- Those transactions formed part of a set of contrived transactions between a group of companies that did not operate at arm's length. Each of those companies operate as labour providers and were therefore competitors;
- The contrived nature of those transactions in which the Appellant dealt directly with fraudulent companies provides a strong inference that the Appellant had actual knowledge that its impugned transactions were connected with the fraudulent evasion of VAT. HMRC rely on the cumulative circumstantial evidence for the inference that it was; and
- In the alternative, the Appellant should have known that its transactions were connected with the fraudulent evasion of VAT by another taxable person because the relevant transactions permitted of no other reasonable explanation.

103. HMRC highlighted that Mr Ferguson, at the relevant time, had more than 15 years of experience in the security industry. Between 2002 and 2007 he was chairman of the British Security Industry Authority. Mr Ferguson had also held directorships going back to 2008. At a visit by HMRC on 20 February 2014 Mr Ferguson advised that he was an ACS Pacesetter; one of the top 10% compliant security businesses in the country who provided advice to other security companies to bring them up to the Security Industry Authority ACS standard. In those circumstances HMRC contend that Mr Ferguson was an unlikely candidate to be selected as a dupe by someone seeking to perpetrate a VAT fraud.

104. Despite Mr Ferguson's claim to have been duped by the Weir brothers into dealing with WL and SRL he could not provide any explanation as to how it happened. Furthermore, if Mr Ferguson was duped he cannot have learned any lessons from events in 2008 when the Appellant was also denied the right to deduct input tax.

105. HMRC submit that the evidence shows that the Appellant became involved with WL and SRL because they offered to supply labour at prices that the Appellant knew were too good to be true. The Appellant either carried out no proper checks on WL or SRL because it knew that such checks would serve no purpose, or carried them out and ignored the glaring indicators of fraud presented by both companies preferring instead to achieve greater profits by the arrangements.

106. At a visit on 22 January 2008 the Appellant's main subcontractor was noted as being CESL. The invoices provided by the Appellant from CESL for VAT periods 05/07 and 08/07 bore no VRN and were therefore not valid VAT invoices. Officer Higgins noted that it was clear that the Appellant had not carried out any due diligence checks on CESL and could not provide valid VAT invoices for the supplies. As a result, the Appellant's input tax claim of £9,180.86 was disallowed. A VRN was subsequently provided by Mr Ferguson via his accountant to HMRC however it transpired that the number provided related to a different company to that named on the invoices. The decision to disallow the input tax remained and was not appealed. One of the directors of CESL, Mr Francis Enuani, was later employed by the Appellant. Mr Ferguson stated that he was duped by CESL and the incident made him aware that there were unscrupulous traders in his industry as a result of which he followed the advice and guidance given to him in 2008 and began to undertake due diligence checks on its suppliers. HMRC submit that these events demonstrate that Mr Ferguson became aware from at least 2008 that there was a risk of VAT fraud in the industry which was carried out by charging VAT when a company was not registered or by using another company's VRN. On Mr Ferguson's own account these events prompted a change in the Appellant's approach to due diligence in relation to VAT aspects of its suppliers and the validity or otherwise of their VRNs. HMRC submit that it would have made any reasonable businessman astute to check that a VRN provided was proper to the entity which supplied it. By 2011 Mr Ferguson was aware of HMRC's guidelines regarding due diligence and record keeping in the industry because it was a criterion against which the Appellant would be judged when it was assessed for the ACS.

107. HMRC submit that the arrangements between BUL, WL, SRL and the Appellant were obviously contrived. The circumstances of the arrangements are not remotely explicable in terms of their very close geographical proximity.

108. BUL and the Appellant had a lucrative trading history. Mr Ferguson contended that this came to an end in May 2010 however BUL continued to supply the Appellant. On Mr Ferguson's account, Adam Weir, a director of BUL, put forward his brother Neil Weir and WL as a replacement. However, HMRC note that this would amount to BUL doing itself out of substantial business with the apparent consent of the actual director Mr Lynch.

109. Furthermore, if Mr Ferguson's account were true, BUL and the Appellant were in direct competition and BUL's promotion of its own supplier would leave it without the labour WL provided to it. On the face of it WL, SRL, BUL and the Appellant were in competition with one another as ultimately they all supplied SIA licensed security guards. The arrangement between WL and BUL was obviously lacking in commerciality as it involved Adam Weir a "director" of BUL and Neil Weir, an employee of WL, setting up a business to supply BUL itself. Any reasonable businessman would question how this could possibly operate in practice; Mr Ferguson's evidence was that "he didn't need to get involved" as the arrangements between BUL and WL were "not relevant to me".

110. WL then appears to have used BUL's office and used BUL's fax machine to send its first invoice to the Appellant, despite claiming it had another address on its transaction documents. SRL then operated from BUL's premises.

111. Both BUL and the Appellant were supplied by WL and SRL. The Appellant was also supplied by BUL. One of BUL's customers was Eastham Construction Ltd whose VRN was fraudulently used by SRL. The workers from WL largely transferred to SRL and then to the Appellant. These arrangements support HMRC's submission that there was a contrived plan that BUL and the Appellant would use WL and then SRL to supply labour at implausibly low prices and WL and SRL would make money by keeping the VAT paid by BUL and the Appellant who would then seek to reclaim as their input tax.

112. Mr Ferguson's evidence as to the due diligence checks carried out and the reason for them was vague. There is no documentary evidence that accurately records what checks were carried out on WL or SRL, when they were carried out and the conclusions drawn. Mr Ferguson stated at one point in evidence that the due diligence checks in 2011/12 were limited to a VRN check, seeing an invoice and a paying-in slip.

113. Mr Ferguson's evidence indicated that due diligence was not about checking the credibility of his suppliers but rather he was only interested in getting the labour, getting an invoice and being paid. The fact that he started trading with WL before he was satisfied that it was a credible company was shown by the evidence that he intended to make a judgement on the company after trading when deciding whether to make introductions.

114. Had due diligence been carried out the Appellant would have found out that WL's name was in fact Workforce Northwest Ltd, its registered office was in Essex yet an address in Heswall was contained on the invoices and business cards, the SIC was not the provision of security guards and Neil Weir was not recorded at Companies House as a director nor as having any involvement with WL. If the Appellant had carried out Companies House checks it would have been obvious that something was wrong. Mr Ferguson's contention that meeting people was more important than documents is untenable.

115. If a VIES check had been carried out in April 2011 it would have shown a different company name to address to those provided by WL. HMRC submit that the evidence of officer Gillard and VIES itself should be preferred to that of the Appellant; namely that VIES provided a company name and VRN check. Mr Ferguson did not carry out the check and cannot say what any check showed. Ms Wileman, as the person who carried out the check, was not present to give evidence on the issue.

116. The low prices charged by WL are not comparable to an introductory offer by established companies such as Sky; WL had no assets to enable it to make such offers and survive let alone make a profit. Mr Ferguson's own evidence was that it became clear that something was not right with WL and HMRC highlight the request by WL that the VAT element of an invoice be paid in advance which Mr Ferguson eventually accepted was an indication that WL was using the VAT to fund its business. The only explanation for WL making such a request was that it felt comfortable enough in the relationship with the Appellant to make such a request.

117. Despite the many issues with WL, Mr Fergsuon, almost overnight, went on to trade with SRL which was run by the same person. Had checks been undertaken the Appellant would have known that Neil Weir had resigned as a director of SRL 8 days after his appointment and the registered address on SRL's invoices did not match that on Companies House. On Mr Ferguson's own admission, the Appellant continued to trade with SRL for approximately 5 months despite the critical insurance document not being provided. A VIES check would have revealed that the VRN belonged to another company.

118. Mr Watkinson submits that Mr Ferguson's admission that had it carried out the due diligence checks contained on the checklist produced by Ms Wileman it would not have traded with either company; this is tantamount to an acceptance that the Appellant should have known that its transactions with WL and SRL were connected to fraud. The only reasonable explanation for the lack of due diligence was that the Appellant had actual knowledge.

119. During the relevant periods the Appellant's profit grew significantly. HMRC submit that the profit from these transactions in which labour was supplied at cost and the suppliers made no profit is obviously too good to be true. Despite Mr Ferguson's evidence that the industry is competitive the Appellant made easy profits from WL and SRL. The circumstantial evidence indicates that the Appellant chose to ignore the

obvious explanation as to why it was presented with the opportunity to reap a large reward over a short space of time.

120. The contractual arrangements with WL and SRL differed from the other trading partners of the Appellant. Invoices from other suppliers show a breakdown of hours worked, at which site and the type of services in comparison with the vague invoices from WL and SRL. The Appellant's other suppliers set the rate of payment whereas the Appellant provided WL and SRL with the wages and has provided no timesheets from WL or SRL to support the hours worked and rates paid. WL and SRL were also paid either before the invoice was issued or within 3 – 4 days of the invoice whereas the other suppliers were not paid as quickly or within the specified 7 days as shown in an invoice from Safe Hands Management Solution.

121. HMRC submit that all of these factors indicate knowledge on the Appellant's part. In the alternative the same factors demonstrate that the Appellant should have known that its transactions were connected to the fraudulent evasion of VAT because the cumulative circumstances permitted no other reasonable explanation.

Appellant's submissions

122. On behalf of the Appellant, Mr Butterfield warned against the risk of ex post facto reasoning and reaching a decision with the benefit of hindsight. Alternative explanations have been provided by the Appellant which are entirely plausible and the Tribunal is invited to accept them as legitimate explanations which were provided both at the time and since.

123. That the Appellant received supplies for which it paid under invoices which were issued is not in dispute; the right to deduct therefore remains intact. The invoices specified the services provided, the amount to be charged, the VAT calculation and the entity requesting payment. HMRC accepted that the bare bones of the invoices could be supplemented by background documentation, an example of which was provided to HMRC. The fact that there is no complete set of documentation is a red herring.

124. HMRC are attempting, by their reliance on knowledge and means of knowledge in the alternative, to ride two horses at once. In reality HMRC are arguing actual knowledge. However, on the issue of means of knowledge the Appellant relies on the fact that it was not known to the SIA, the external auditors or HMRC at the time that the relevant transactions were linked to the fraudulent evasion of VAT. All three bodies visited the Appellant at or around the relevant period and did not see the fraud which it is now submitted the Appellant should have seen. HMRC visited on 23 September 2011, the relevant trading or initial checks began in or around May or June of that year.

125. The test is whether the only reasonable explanation for the transaction was that it was connected to the fraudulent evasion of VAT; not that there was a risk or that it might be. HMRC have failed to satisfy this test. It is submitted that the Appellant did

its best to implement HMRC requirements to the limited extent that HMRC set out what was required.

126. The lack of profits made by the suppliers arose from a negotiated agreement akin to an 'introductory offer'; the enticements do not indicate fraud but represent a focus on the bigger picture which is a practice common in mainstream business. In those circumstances the arrangements were not 'too good to be true'. The Appellant took responsibility for collating information about number of workers so that the process of paying the individuals was performed efficiently. The Appellant did not set the amounts and therefore the criticisms levelled at the conduct of the Appellant lacks a proper interpretation of commercial realities and are unjustified.

127. Due diligence was carried out conscientiously. The nature of the industry is that it is heavily supervised which means the Appellant must be compliance driven. It was also clear that the Appellant's awareness and procedures grew organically over time. Due diligence was carried out at the outset of the Appellant's trading relationships. This was a specific part of Ms Wileman's remit; Mr Ferguson cannot be expected to have been aware of every last detail and he was entitled to delegate the task. Ms Wileman's deficiency in either performing the task, understanding the results or failing to notify Mr Ferguson is not a matter the Appellant can be held to account for; the knowledge relied on by HMRC is that of Mr Ferguson, not Ms Wileman. Mr Butterfield queried why, if the Appellant had actual knowledge, it would ask for SRL's insurance documents and cease trade when the document was not supplied.

128. In relation to the events in 2008 it is submitted that it did not alert the Appellant to fraud as the mechanism of the fraud committed by CESL was different in that no VRN existed. Further, there is no evidence of discussions or warnings being given in relation to de-registered or hijacked VRNs. The Appellant improved the due diligence after 2008 despite HMRC's refusal to give guidance as to the checks that should be carried out.

129. The email from the Appellant's accountant setting out tactics does not mean that the Appellant had no genuine desire to be guided by HMRC. Whilst it demonstrates an element of cynicism on the accountant's part, this should be confined to its context.

130. When the Appellant commenced trading with WL there was a valid VRN. VIES at that time provided no greater information other than whether the number was valid. There is therefore no criticism to be levelled at the Appellant as to the deficiency of the systems. Even if a check did provide further information the address was the same; the only inconsistency was that the number related to Orion, not WL. HMRC accepted that a change of company name did not mandate a different VRN. As to SRL the Appellant ceased trade.

131. It is submitted that Mr Ferguson presented as an industrious man committed to doing the right thing and raising standards. He is senior and experienced in the industry which HMRC is attempting to use against him. The Appellant's profits continued to increase over a number of years with the transactions in this appeal only forming part of that rise over the years. Mr Ferguson accepted that the request by WL

for payment of the VAT element in advance was inappropriate – which is why it was rejected by Mr Ferguson. However it does not necessarily indicate fraud; it is not inconsistent with seeking a temporary ease of cashflow problems which is a reality in business. The fact that the request was rejected indicates that Mr Ferguson was not knowingly part of a fraud.

132. The documents from the SIA were not received by Mr Ferguson as he was the subject of an ACS visit and the document was for the assessor. The document was obtained for the purpose of these proceedings and therefore Mr Ferguson did not have the warnings set out in the documents in his possession at the relevant time.

133. Mr Ferguson explained that he was assessing WL's credibility in terms of making a recommendation, not that he believed they lacked the credibility to be given a chance. He could only make this assessment when he had experienced WL's performance. The shortcomings turned out to be "the backroom staff".

134. HMRC have failed to take into account that the Appellant lost documents due to flood damage.

Discussion and Decision

135. 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. The issue for us to determine is whether the Appellant, through Mr Ferguson, knew or should have known that the relevant transactions were connected to fraud.

136. We found Mr Ferguson was a wholly unconvincing witness. His evidence was vague, implausible and, at times, contradictory.

137. Mr Ferguson had a significant experience and knowledge of the industry having been chairman of the British SIA and subsequently an ACS Pacesetter who assisted security companies to achieve SIA ACS standards. He had, at the time of the relevant transactions, also been the director of two security businesses. We were satisfied that Mr Ferguson had a good understanding of the industry and with that, the risks inherent in it. Following a visit by HMRC in January 2008 the Appellant had a claim to input tax denied as a result of paying VAT on invoices which omitted a VRN. The Appellant tried to rectify the issue by providing a VRN which it transpired was for a different company.

138. Although there was no record of written information being provided to Mr Ferguson nor could we be satisfied that the subject of hijacked VRNs and de-registered companies was specifically discussed with Mr Ferguson, we were satisfied that as a result of this incident that at the very least by 2008 the Appellant had an awareness of the importance of checking the veracity of companies and the VAT registration numbers provided to it. We were reinforced in our view by the fact that the Appellant began carrying out due diligence, albeit to a limited extent, on its suppliers following the incident. The SIA 'Guidance to Assessing Bodies' document

produced by the Appellant stated that the Appellant "follows HMRC Guidance regarding due diligence, record keeping for the use of labour providers". We accepted Mr Ferguson's clarification in answer to questions from the Tribunal that he did not have the assessor's document in his possession which referred in detail to fraud in the industry but Mr Ferguson clarified that he did have the document which made reference to HMRC's Guidance regarding due diligence. He also stated that the assessment criteria had not really changed for a number of years. We therefore found that Mr Ferguson was aware of the importance of due diligence and that HMRC had published guidance.It is against that awareness that we must consider the transactions in this appeal.

139. We rejected Mr Ferguson's contention that he was a victim of fraud by the Weir brothers, a fraud which was distinct from that carried out by CESL. We will say more about the Weir brothers in due course, but in respect of the denial of input tax arising from CESL, we took the view that even if Mr Ferguson had not been aware of the different ways in which VAT fraud can be committed, the incident with CESL must have made him aware of the dangers of not receiving VAT numbers from suppliers, the importance of checking that any VRN provided matched the supplier and the fact – which Mr Ferguson acknowledged in evidence - that there were dishonest traders willing to supply incorrect VRNs for fraudulent purposes. In our view, armed with this knowledge, it was the responsibility of Mr Ferguson to educate himself as to how to protect the Appellant from fraud and we rejected Mr Ferguson's attempts to shift his responsibility by blaming HMRC for lack of guidance.

140. There is a clear contrivance between WL and SRL. We considered how BUL and the Appellant fitted in to the association. At a visit by HMRC in 2011 BUL was the Appellant's main supplier. We found Mr Ferguson's evidence that he had known one of the directors, Mr Lynch, for a number of years and had a relationship of trust with him was unconvincing. Mr Ferguson offered no evidence as to how he knew Mr Lynch, how the relationship had built or the reasons why he trusted Mr Lynch sufficiently to trade with BUL. We also noted that Mr Lynch was not recorded as a director or company secretary. Even if the director, Miss Raynor, was the girlfriend or wife of Mr Adam Weir, as stated by Mr Ferguson, we found it implausible that a reasonable businessman seeking to protect himself from fraud would enter into trade with a company without full knowledge of the company officers and never having met or spoken to the directors Miss Raynor or Mr Rimmer who ultimately had control of the company. Moreover, we were satisfied that Mr Ferguson had no relationship of any substance with Mr Adam Weir; in cross-examination Mr Ferguson stated:

> "…obviously I had very occasional dealings with Adam Weir. I knew he was a decent businessman on the outset of it and decided that I could work with him, not trust him but work with him…"

141. Had the Appellant made any checks on BUL, Mr Ferguson would have been aware that Adam Weir, who was introduced to him as a director of BUL, was not a director which would have led any reasonable person to query the role of Adam Weir and the subsequent introduction by Adam Weir to his brother, who would have been, if a company officer of WL, a competitor of BUL in supplying the Appellant. In fact,

Neil Weir was a shareholder in BUL although from 28 June 2010 and therefore at the time of the relevant transactions he was not recorded as having a shareholding but rather as an employee. Furthermore, Neil Weir was not recorded in the Companies House records for WL and appeared to be an employee.

142. We found all of these features highly unusual and we found it implausible that none of this was known to Mr Ferguson given that the Appellant was based at the same address as BUL until at least January 2011. We noted Mr Ferguson's evidence in relation to the shared premises that he was rarely at the office due to being on the road and having a young family. We found Mr Ferguson's evidence contradictory; he asserted that he relied on recommendations and trusted relations yet the recommendations and trust came from persons about whom Mr Ferguson knew little or nothing. He stated he had no knowledge of the roles of the various individuals within BUL, WL or SRL yet proceeded to trade with them; we found this wholly implausible and we queried why if Mr Ferguson had no knowledge of the roles of the various individuals and no relationship of any substance with them he proceeded to trade. We concluded that these were not the actions of a reasonable businessman seeking to protect himself from fraud and we were satisfied that it supports an inference of knowledge on Mr Ferguson's part.

143. We did not accept that Mr Ferguson was a victim of fraud or that he had been duped by the Weir brothers. It was clear from the evidence that Mr Ferguson made no attempts to check the veracity of Adam or Neil Weir as individuals or businessmen. Far from the "trusting relationship" referred to in Mr Tobin's letter dated 8 September 2014, on the evidence before us there was no basis for Mr Ferguson to trust the Weir brothers. We rejected his explanation that he commenced trade because "you like to give people a chance in life" as wholly implausible. Mr Ferguson's assertion that he had carried out due diligence and thought he was protected was not borne out by the evidence and his contention that there was nothing in the business practices of WL or SRL to give cause for concern was wholly contradicted by Mr Ferguson's acceptance that during the relationship he decided "something was not right" and WL's request for payment of the VAT element in advance indicated that the VAT was being used to fund the business. We did not accept that this was only clear to Mr Ferguson with the benefit of hindsight; in our view it would have been blindingly obvious to any businessman with his experience. Taken together with Mr Ferguson's willingness to take up trade with SRL which was, in reality, the same entity as WL run by the same person with the same administrative staff and workers, we concluded that the only reasonable explanation for Mr Ferguson's involvement was that he knew that the transactions were contrived.

144. The Appellant's due diligence was woefully inadequate. We found Mr Ferguson's reliance on following SIA regulations misconceived; the evidence showed that the SIA checks predominantly related to workers, their employment status and record keeping rather than suppliers. Mr Butterfield invited us to infer that the Appellant's adherence to SIA regulations and status within the SIA reflected the Appellant's general attitude to due diligence. We rejected this submission; in our view it demonstrated that Mr Ferguson was aware of the importance of making checks to

safeguard his business which was at odds with his evidence that he believed he was doing all he could in terms of due diligence.

145. The evidence relating to the Appellant's VRN checks was unclear and contradictory. Mr Penny's evidence was that he had given the Appellant the link to HMRC's VRN checker in 2010/11. This contradicted the evidence of Ms Wileman who stated that she was responsible for carrying out the checks and used VIES. We did not find that Mr Penny's evidence assisted us in reaching our decision; he may have provided the web link to the Appellant but he could not provide any evidence as to what was actually done and whether the link was used. We attached no weight to the evidence of Ms Wileman as she did not attend the hearing and her evidence could not be tested.

146. Mr Ferguson's evidence on the point was vague and unconvincing. Having stated in his witness statement that VIES was used, Mr Ferguson's evidence changed in cross-examination. Ultimately Mr Ferguson accepted he could not be sure which system was used, as he had not carried out the checks.

147. We attached no weight to the due diligence checklist produced by Ms Wileman which Mr Ferguson clarified was not used at the time of the relevant transactions. The evidence as to what checks were actually carried out was vague. Mr Ferguson referred to trade references, checking premises and meeting directors. The difficulty with this evidence is, as we have set out above, that the only recommendations specified by Mr Ferguson came from BUL with whom the Appellant, WL and SRL shared premises and whose personnel were closely associated with WL and SRL. We found Mr Ferguson's evidence unpersuasive and we rejected his attempts to minimise his responsibility by reiterating that he delegated the task of due diligence to Ms Wileman; it was clear from the evidence that it was Mr Ferguson who met the Weir brothers and decided to trade with WL and SRL. We accepted that documents belonging to the Appellant were destroyed in a flood in 2012 however as the Appellant has never clearly specified what checks were carried out and what documentary evidence of those checks was lost we did not find that this assisted us.

148. In our view the due diligence purported to be carried out by the Appellant was superficial and could not have provided the Appellant with any reassurance as to the veracity of WL or SRL. In relation to WL we were satisfied that any VRN check was carried out on or around the end of May/beginning of June 2011 as at a visit by HMRC on 23 September 2011 there was no record of WL as a trading partner in the VAT quarters checked, namely 08/08 to 05/11. The first invoice was dated 3 June 2011. At that point OPSL, the company whose VRN was used on the invoices had been de-registered and therefore any check would have flagged this up. If a check was made prior to OPSL's deregistration on 1 April 2011 then a valid number may have been shown. There was an issue as to whether the check would have revealed that the VRN related to OPSL rather than WL. The emails from VIES dated 2 December 2014 and 19 April 2017 respectively stated:

> "Indeed, in 2011 the name of the company was not displayed during VAT validation."

"…during the period you are referring, the VIES on the web response on an EU VAT validation request did return information of the requested VAT number's Name and address, assuming of course the number was valid…"

149. We did not find that the emails provided clarification given the different responses. We also found that Mr Ferguson could provide no assistance as he was unable to say what checks were carried out or what they showed as he had not been responsible for the task. We accepted the oral evidence of Ms Gillard that since 2010 VIES provided the name and address associated with a valid VRN. In those circumstances we were satisfied on the balance of probabilities that had a VIES check been carried out the Appellant would have known that the VRN related to a different company. We considered the submission that delays in updating the information of up to three months could have meant that the Appellant was advised that the VRN was valid when in fact it was not. However, the information from VIES referred to delays in updating national databases in "certain Member States". Given the general and unspecific nature of this information we could not be not satisfied that it applied to the UK and we rejected the submission as speculation unsupported by evidence.

150. In relation to SRL which was never registered for VAT and which used a hijacked VRN we were satisfied that had a VIES check been carried out the Appellant would have known that there was no valid VRN. The Appellant's request for SRL's insurance document was ignored yet despite Mr Ferguson's evidence that this document was "critical" the Appellant continued to trade with SRL without it for approximately 5 months. Added to that, despite WL's request for the VAT element to be paid in advance and Mr Ferguson's admission that this request was clearly not normal commercial practice, he nevertheless went on to trade with SRL which was run by the same person, with the same key staff and many of WL's workers.

151.Whether the Appellant carried out the VRN checks and ignored the results or failed to carry out the checks at all, we concluded that this supported knowledge, and means of knowledge, on the Appellant's part that the transactions were contrived and willingly entered into trade with WL and SRL. We noted Mr Ferguson's evidence that the reason for carrying out due diligence was "compliance of the day" and we were satisfied that this reflected the Appellant's true attitude to due diligence; rather than seeking to protect itself from fraud, the Appellant's due diligence lacked any meaningful substance and there was no evidence of the Appellant conducting the type of efficient checks we would have expected of any legitimate trader seeking to avoid connection to fraud. We found that there was no evidence to support Mr Ferguson's claim that he assessed and addressed risks; to the contrary we were satisfied that he did nothing at all to identify the risks that were clear from the information available and the only reasonable explanation for trading with companies about which he knew so little was that Mr Ferguson was aware that the transactions were contrived.

152. We were satisfied that the significant profits reaped by the Appellant over a short period as a result of the low prices charged by WL and SRL was "too good to be true" when viewed against the ease with which the profits were made and the obvious lack of any profit and viability in business to WL or SRL. We did not accept that the Appellant being supplied at minimum cost is analogous to an "introductory offer"; the

low prices charged by WL and SRL were clearly unsustainable. The Appellant's contention that WL and SRL hoped to secure contacts as a result of the low price was unsupported by evidence we would expect to see such as emails between the parties making reference to any such agreement or future plans to implement it. Moreover, even if we were to accept that this was the case when the Appellant started trading with WL, we found it wholly implausible that after the Appellant ceased trading with WL as a result of the request for the payment of VAT which was clearly needed to fund the business, SRL would offer the same unsustainable rates in the hope of Mr Ferguson providing contacts for SRL where he failed to do so for WL. Furthermore, we inferred from Mr Ferguson's failure to query why he would be offered such low prices again by the same person trading as a different company where no contacts had previously been provided that the only reasonable explanation was that either Mr Ferguson knew that the transactions were connected to fraud or he turned a blind eye to it.

153. Having concluded that Mr Ferguson had actual knowledge that the transactions were connected to fraud, we took the view that whether or not the price was determined by the Appellant and sent to WL and SRL to invoice added little as the companies were, in our view, all part of a group contrived to facilitate VAT fraud. In isolation, we were not satisfied that the vague nature of the invoices or preferential payment terms indicated knowledge or means of knowledge. However, when viewed against the totality of the evidence we were satisfied that these were additional features of the trade which lacked commerciality and reinforced our view that the Appellant knew that the transactions were contrived such that the details on the invoices were irrelevant and the payment terms were preferential as compared with the Appellant's other trading partners.

Conclusion

154. We concluded, on the balance of probabilities, that in respect of the period under appeal that the actions, inactions and the circumstances of the Appellant's transactions as a whole indicated that Mr Ferguson had actual knowledge that the transactions were connected to fraud. We found that some reasons carried more weight than others and we did not base our decision solely on one reason but rather the cumulative effect of our findings viewed in totality. The same factors from which we inferred the Appellant's actual knowledge, would in our view also support a finding of means of knowledge. We noted Mr Butterfield's submission regarding HMRC pleading its case in the alternative; HMRC are entitled to plead their case in this way and we have therefore considered within our decision whether the Appellant knew, or should have known, that the transactions were connected to fraud. We have based our decision on the totality of the evidence and we were careful not to judge the evidence with the benefit of hindsight. We have set out our findings on the various features of the transactions highlighted by HMRC in support of its case. In reaching this conclusion we have considered the trade with WL and SRL and the surrounding circumstances together with all of the evidence.

155. The appeal is dismissed.

156. 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 DEAN
TRIBUNAL JUDGE

RELEASE DATE: 13 JUNE 2019