



Neutral Citation: [2023] UKFTT 745 (TC)

Case Number: TC08925

**FIRST-TIER TRIBUNAL
TAX CHAMBER**

Taylor House

Appeal references: TC/2020/01789
TC/2020/04225

VALUE ADDED TAX – input tax – denial of right to deduct on ground that knew or should have known that transactions were part of fraud by others – imposition of penalty and Personal Liability Notice – whether First Appellant knew or should have known of fraud – yes – whether actions of First Appellant attributable to Second Appellant – yes – appeals dismissed

Heard on 24 to 28 October 2022
Judgment date: 1 September 2023

Before

**TRIBUNAL JUDGE GERAINT WILLIAMS
MR JOHN WOODMAN**

Between

KONSTRUCT RECRUITMENT LIMITED

First Appellant

RAJANBIR SINGH

Second Appellant

and

THE COMMISSIONERS FOR HM REVENUE AND CUSTOMS

Respondents

Representation:

For the Appellant: Nicolas Yeo of Counsel, instructed by Kangs Solicitors

For the Respondents: Laura Stephenson of Counsel, instructed by the General Counsel and Solicitor to HM Revenue and Customs

DECISION

INTRODUCTION

1. On 15 May 2020, the First Appellant, Konstruct Recruitment Limited (“Konstruct”) appealed against the decision of the Respondents (“HMRC”) dated 18 December 2019 (“Denial Decision”) to refuse Konstruct input tax in the sum of £264,124.40 incurred on the purchase of labour supplies from two companies, Combat Construction Limited (“Combat”) and Sandhar Consultancy Limited (“Sandhar”) and the imposition of a penalty in the sum of £79,237.20 under s 69C of the Value Added Tax Act 1994 (“VATA”). A Notice of Appeal was lodged on 15 May 2020.

2. The director of the Konstruct is the Second Appellant, Rajanbir Singh (“RS”). RS appeals against the decision to issue him with a Personal Liability Notice (“PLN”) under s 69D of VATA in the sum of £79,237.20. A Notice of Appeal was lodged on 3 December 2020.

3. The original decision was a denial in the sum of £266,388, that figure has been reduced by HMRC because they could not rule out that some of the supplies (to a maximum value of £13,592) could not be traced to another supplier, Dhillon Structures Limited. The two penalties were reduced from £79,916.40 for the same reason.

PRELIMINARY ISSUE

4. The appeal was made or notified more than 30 days from the date of the document notifying the decision to which the appeal relates and may therefore only be made with the permission of the Tribunal. HMRC acknowledged the problems that Konstruct had faced during the COVID-19 pandemic and accepted that Konstruct lodged its initial invalid appeal in time (Konstruct had failed to pay the tax in dispute and had not sought relief on the grounds of hardship) and then acted promptly to resubmit the appeal on receipt of the notice that its initial appeal had been rejected. Having considered the circumstances, we grant permission for Konstruct to bring a late appeal.

MTIC: LEGISLATION AND CASE LAW

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

6. The European Court of Justice (“ECJ”), in its judgment dated 6 July 2006 in the joined cases of *Axel Kittel v Belgium & Belgium v Recolta Recycling SPRL* C-439/04 & C-440/04 (“*Kittel*”) confirmed that taxable persons who “knew or should have known” that the purchases in which input tax was incurred were connected with the fraudulent evasion of VAT will not be entitled to deduct that input tax in certain circumstances:

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

...

56. In the same way, a taxable person who knew or should have known that, by his purchase, he was taking part in a transaction connected with fraudulent evasion of VAT must, for the purposes of the Sixth Directive, be regarded as a participant in that fraud, irrespective of whether or not he profited by the resale of the goods.

57. That is because in such a situation the taxable person aids the perpetrators of the fraud and becomes their accomplice.

58. In addition, such an interpretation, by making it more difficult to carry out fraudulent transactions, is apt to prevent them.

59. Therefore, it is for the referring court to refuse entitlement to the right to deduct where it is ascertained, having regard to objective factors, that the taxable person knew or should have known that, by his purchase, he was participating in a transaction connected with fraudulent evasion of VAT, and to do so even where the transaction in question meets the objective criteria which form the basis of the concepts of ‘supply of goods effected by a taxable person acting as such’ and ‘economic activity’.

...

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.”

7. The *Kittel* test was considered 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*”):

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

...

59. The test in *Kittel* is simple and should not be over-refined. It embraces not only those who know of the connection but those who “should have known”. Thus it includes those who should have known from the circumstances which surround their transactions that they were connected to fraudulent evasion. If a trader should have known that the only reasonable explanation for the transaction in which he was involved was that it was connected with fraud and if it turns out that the transaction was connected with fraudulent evasion of VAT then he should have known of that fact. He may properly be regarded as a participant for the reasons explained in *Kittel*.

60. The true principle to be derived from *Kittel* does not extend to circumstances in which a taxable person should have known that by his purchase it was more likely than not that his transaction was connected with fraudulent evasion. But a trader may be regarded as a participant where he should have known that the only reasonable explanation for the circumstances in which his purchase took place was that it was a transaction connected with such fraudulent evasion.

...

64. 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.

...

82. 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.

...

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

8. Moses LJ also gave guidance as to the sort of circumstances that might be relevant to the “should have known” question. Moses LJ commended a number of questions posed by the Tribunal at [72] and [83], including:

“(1) Why was [the Appellant], a relatively small company with comparatively little history of dealing in mobile phones, approached with offers to buy and sell very substantial quantities of such phones?”

“(2) How likely in ordinary commercial circumstances would it be for a company in [the Appellant’s] position to be requested to supply large quantities of particular types of mobile phone and to be able to find without difficulty a supplier able to provide exactly that type and quantity of phone.”

“(3) Was [the Appellant’s supplier] already making supplies direct to other EC countries? If so, he could have asked why [the Appellant’s supplier] was not making supplies direct, rather than selling to UK traders who in turn would sell to such other countries.”

“(4) Why are various people encouraging [the Appellant] to become involved in these transactions? What benefit might they be deriving by persuading [the Appellant] to do so? Why should they be inviting [the Appellant] to join in when they could do so instead and take the profit for themselves?”

9. At [79], Moses, LJ drew attention to the significance of the fact that *Mobilx*, aware that the business in which it was engaged was “rife with fraud”, nevertheless chose to ignore HMRC’s warnings that its own transactions had, upon extended verification, been shown to trace back to fraud. Moses LJ cited with approval at [83] the following guidance given by Christopher Clarke J in *Red 12 Trading v HMRC* [2009] EWHC 2563: at [109] – [111]:

“109. Examining individual transactions on their merits does not, however, require them to be regarded in isolation without regard to their attendant circumstances and context. Nor does it require the tribunal to ignore compelling similarities between one transaction and another or preclude the drawing of inferences, where appropriate, from a pattern of transactions of which the individual transaction in question forms part, as to its true nature e.g. that it is part of a fraudulent scheme. The character of an individual transaction may be discerned from material other than the bare facts of the transaction itself, including circumstantial and “similar fact” evidence. That is

not to alter its character by reference to earlier or later transactions but to discern it.

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

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

10. HMRC do not have to prove that the Appellant knew or should have known either the details of the fraud or the identities of the fraudulent defaulters *Megtian Ltd (In Administration) v The Commissioners for Her Majesty’s Revenue & Customs* [2010] EWHC 18 (Ch) at [37-38].

11. 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]:

“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.”

12. 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]:

“97. 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.

98. 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.”

13. 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 Konstruct through its director, RS, together with the surrounding circumstances. In considering the issue of knowledge and means of knowledge of Konstruct through its director, RS, 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.

LEGAL BASIS FOR THE PENALTY AND PLN

14. VATA relevantly provides as follows:

69C Transactions connected with VAT fraud

(1) A person (T) is liable to a penalty where-

(a) T has entered into a transaction involving the making of a supply by or to T ("the transaction"), and

(b) conditions A to C are satisfied.

(2) Condition A is that the transaction was connected with the fraudulent evasion of VAT by another person (whether occurring before or after T entered into the transaction).

(3) Condition B is that T knew or should have known that the transaction was connected with the fraudulent evasion of VAT by another person.

(4) Condition C is that HMRC have issued a decision ("the denial decision") in relation to the supply which-

(a) prevents T from exercising or relying on a VAT right in relation to the supply,

(b) is based on the facts which satisfy conditions A and B in relation to the transaction, and

(c) applies a relevant principle of EU case law (whether or not circumstances that are the same as the circumstances in which any relevant case was decided by the European Court of Justice).

(5) In this section "VAT right" includes the right to deduct input tax, the right to apply a zero rate to international supplies and any other right connected with VAT in relation to a supply.

(6) The relevant principles of EU case law for the purposes of this section are the principles established by the European Court of Justice in the following cases-

(a) joined Cases C-439/04 and C-440/04 *Axel Kittel v Belgian State; Belgium v Recolta Recycling* (denial of right to deduct input tax), and

(b) Case C-273/11 *Mecsek-Gabona Kft v Nemzeti Adó- és Vámhivatal Dél-dunántúli Regionális Adó Főigazgatósága* (denial of right to zero rate), as developed or extended by that Court in any other cases relating to the denial or refusal of a VAT right in order to prevent abuses of the VAT system which were decided before the coming into force of section 42 of TCTA 2018.

(7) The penalty payable under this section is 30% of the potential lost VAT.

(8) The potential lost VAT is-

(a) the additional VAT which becomes payable by T as a result of the denial decision,

(b) the VAT which is not repaid to T as a result of that decision, or

(c) in a case where as a result of that decision VAT is not repaid to T and additional VAT becomes payable by T, the aggregate of the VAT that is not repaid and the additional VAT.

(9) Where T is liable to a penalty under this section the Commissioners may assess the amount of the penalty and notify it to T accordingly.

(10) No assessment of a penalty under this section may be made more than two years after the denial decision is issued.

(11) The assessment of a penalty under this section may be made immediately after the denial decision is made (and notice of the assessment may be given to T in the same document as the notice of the decision).

(12) Where by reason of actions involved in making a claim to exercise or rely on a VAT right in relation to a supply T-

(a) is liable to a penalty for an inaccuracy under paragraph 1 of Schedule 24 to the Finance Act 2007 for which T has been assessed (and the assessment has not been successfully appealed against by T or withdrawn), or

(b) is convicted of an offence (whether under this Act or otherwise), those actions do not give rise to liability to a penalty under this section.”

15. Section 69D provides:

“69D Penalties under section 69C: officers' liability

(1) Where-

(a) a company is liable to a penalty under section 69C, and

(b) the actions of the company which give rise to that liability were attributable to an officer of the company ("the officer"),

the officer is liable to pay such portion of the penalty (which may be equal to or less than 100%) as HMRC may specify in a notice given to the officer (a "decision notice").

(2) Before giving the officer a decision notice HMRC must-

(a) inform the officer that they are considering doing so, and

(b) afford the officer the opportunity to make representations about whether a decision notice should be given or the portion that should be specified.

(3) A decision notice-

(a) may not be given before the amount of the penalty due from the company has been assessed (but it may be given immediately after that has happened), and

(b) may not be given more than two years after the denial decision relevant to that penalty was issued.

(5) HMRC may not recover more than 100% of the penalty through issuing decision notices in relation to two or more persons.

(6) A person is not liable to pay an amount by virtue of this section if the actions of the company concerned are attributable to the person by reference to conduct for which the person has been convicted of an offence.

In this subsection "conduct" includes omissions.

(7) In this section "company" means a body corporate or unincorporated association but does not include a partnership, a local authority or a local authority association.

(8) In its application to a body corporate other than a limited liability partnership "officer" means-

(a) a director (including a shadow director within the meaning of section 251 of the Companies Act 2006),

(b) a manager, or

(c) a secretary.

(9) In its application to a limited liability partnership "officer" means a member.

(10) In its application in any other case, "officer" means-

(a) a director,

(b) a manager,

(c) a secretary, or

(d) any other person managing or purporting to manage any of the company's affairs.

CONSTRUCTION INDUSTRY SCHEME

16. The Construction Industry Scheme ("CIS") is a statutory scheme contained in the Finance Act 2004. The Court of Appeal reviewed the operation of the scheme in *J P Whitter (Waterwell Engineers) Limited v HMRC* [2016] EWCA Civ 1160, where Henderson LJ summarised the purpose of the scheme:

"(3) The overall structure and purpose of the legislation has remained the same since the inception of the statutory scheme some 45 years ago. In a passage which has often been cited with approval in later cases, Ferris J described the background to the legislation, and the advantages to a sub-contractor of being registered for gross payment, in *Shaw v Vicky Construction Ltd* [2002] EWHC 2659 (Ch), [2002] STC 1544, ("Vicky") at [2] to [5]:

“2. Vicky is engaged in the construction industry. In the course of its business it does work in that field as a sub-contractor engaged by another company (the contractor).

3. In the absence of the statutory provision with which this appeal is concerned Vicky would be entitled, like any other sub-contractor, to be paid the contract price in accordance with its contract with the contractor without any deduction in respect of its own tax liability. However it became notorious that many sub-contractors engaged in the construction industry “disappeared” without settling their tax liabilities, with a consequential loss of revenue to the exchequer.

4. In order to remedy this abuse Parliament has enacted legislation, which goes back to the early 1970s, under which a contractor is obliged, except in the case of a sub-contractor who holds a relevant certificate, to deduct and pay over to the Revenue a proportion of all payments made to the sub-contractor in respect of the labour content of any sub-contract. The amount so deducted and paid over is, in due course, allowed as a credit against the sub-contractor's liability to the Revenue.

5. The need to make and pay over such deductions can be an irritation to the contractor obliged to carry out this exercise. It also adversely affects the cash flow of the sub-contractor. Accordingly it is advantageous to a sub-contractor to have a statutory certificate rendering such a deduction unnecessary. The provision of such a certificate tends to make the sub-contractor holding the certificate a more attractive party for the contractor to deal with and, by enabling the sub-contractor to receive the contract price without deduction, improves the sub-contractor's cash flow.”

17. Under s 63 of the Finance Act 2004, a company must apply under the CIS scheme for registration for gross payment. If it does not meet the requirements set out in s 64, it will be registered for payment under deduction.

18. 44. The Income Tax (Construction Industry Scheme) Regulations 2005/2045, Regulation 6, provide so far as is relevant:

“(1) A contractor must verify with the Commissioners for Her Majesty's Revenue and Customs whether a person to whom he is proposing to make-

(a) a contract payment, or

(b) a payment which would be a contract payment but for section 60(4) of the Act (contract payments: exceptions)

...

(3) A contractor may not verify under paragraph (1) unless the contractor has a contract with the sub-contractor or has formally accepted a tender for work under a contract.”

19. 45. Following verification, HMRC informs a company whether its subcontractor is registered for CIS, and at what rate it should be paid:

a. Gross Payment Status (“GPS”), i.e. with 0% deductions;

b. At a deduction rate of 20% for CIS registered subcontractors; or

c. At a deduction rate of 30% for unregistered subcontractors.

ISSUES TO BE DETERMINED

20. The burden of proof is on HMRC, the relevant standard of proof being the balance of probabilities. In *HMRC v Citibank NA, E Buyer UK Limited* [2017] EWCA 1416 (Civ) the

Court of Appeal held that satisfying the burden of proof in respect of the allegation that a taxpayer knew or should have known that its transactions were connected with the fraudulent evasion of VAT does not require HMRC to prove that the taxpayer (or those acting on its behalf) was dishonest or fraudulent. HMRC had made no pleading of dishonesty or fraud against either Konstruct or RS. HMRC must prove that:

- (1) There was a fraudulent evasion of VAT;
- (2) That Konstruct's transactions which are the subject of this appeal were connected with that fraudulent evasion;
- (3) That Konstruct knew or should have know that its transactions were so connected;
- (4) The s 69C penalty was properly issued to Konstruct; and
- (5) The actions of Konstruct which give rise to the penalty are attributable to RS under s 69D.

21. The representative for Konstruct confirmed on 7 January 2022 in its response to *Fairford* directions that:

- (1) Konstruct accepted the accuracy of each of the transaction chains for which HMRC have denied input tax;
- (2) That there is a tax loss at the start of each of the transaction chains;
- (3) The tax loss at the start of each of the transaction chains is attributable to the fraudulent evasion of VAT; and
- (4) That each of the transaction chains were part of an overall scheme to defraud HMRC.

22. The remaining issues in dispute are:

- (1) Did Konstruct, through its director, RS, know or should have known that each of its transactions were connected to the fraudulent evasion of VAT?
- (2) If so, were the actions of Konstruct, which give rise to the s 69C penalty, attributable to RS under s 69D?

EVIDENCE

23. We were provided with an extensive pdf hearing bundle containing the appeal documents, relevant correspondence, transaction details and visit notes and the following witness statements:

- (1) Officer Gary Treece provided two witness statements dated 2 September 2020 and 30 March 2021 regarding Konstruct's supplier Sandhar;
- (2) Officer Gavin Stock's witness statement dated 23 September 2020 regarding the trading activities of Akshay Contracts Limited;
- (3) Officer Gareth Marklew's witness statement dated 20 October 2020 regarding the VAT position of Darkstone Contractors Limited;
- (4) Officer Ranjit Kaur's witness statement dated 5 November 2021 regarding Konstruct's supplier Combat;
- (5) Officer James Huffadine provided two witness statements dated 31 March 2021 and 24 November 2021 setting out the chronology of HMRC's contact with Konstruct and RS; and
- (6) Rajanbir Singh dated 1 October 2021.

24. We heard evidence from two witnesses. For HMRC, we heard evidence from Officer James Huffadine (“JH”). JH’s evidence, as confirmed in cross-examination, was “to speak to the chronology of events” based upon his “perusal of the papers” as his involvement began at the tail-end of the investigation when he issued the “*Kittel*” decision and notice of assessment. It was further confirmed in cross-examination that JH had never worked in the CIS team and his knowledge of CIS and Gross Payment Status (“GPS”) was minimal such that it was virtually non-existent. Accordingly, the usefulness of his evidence was limited to the relevant correspondence and documents exhibited to his witness statements.

25. Rajanbir Singh (“RS”) gave evidence on behalf of Konstruct.

FACTS

Background facts

26. Konstruct was incorporated at 44 Hammond Road Southall UB2 4EG on 20 March 2013 under Company Registration Number 08453023. The nature of its business, as listed in its Companies House records, is: “*construction of commercial buildings*” and “*construction of domestic buildings*” and not supply of labour.

27. On 29 July 2013, Konstruct registered for VAT by submitting a VAT 1 Form in which it was stated:

- (a) the business activities were “*General labour supplies to construction companies*”
- (b) the business activity description was “*Labour recruitment*”
- (c) the estimated annual turnover was £150,000
- (d) the question “*Does the business supply a provision of labour?*” was answered by selecting “*N/A*”.

28. It was registered for VAT backdated to 26 July 2013 under VRN 1717 5632 14.

29. Its current principal place of business (“PPOB”) is Rourke House, Watermans Business Park, The Causeway, Staines upon Thames, TW18 3BA. The PPOB given at the time of the VAT registration was Knyvett House, The Causeway, Staines, Middlesex TW18 3BA. HMRC were informed of the change of the PPOB on 23 October 2017. It has had the following registered offices:

- (1) 44 Hammond Road, Southall UB2 4EG (20 March 2013 to 15 July 2013);
- (2) Knyvett House, The Causeway, Staines, Middlesex TW18 3BA (15 July 2013 to 18 October 2017);
- (3) Rourke House, Watermans Business Park, The Causeway, Staines upon Thames, TW18 3BA (18 October 2017 to 10 June 2020); and
- (4) 284 Aberdeen Avenue, Slough Trading Estate, Slough SL1 4HG (10 June 2020 to present).

30. The current director and sole shareholder of Konstruct is RS who was appointed on 27 December 2013. Prior to his appointment, Mr Mandeep Singh (“MS”) was the director and sole shareholder having been appointed at registration and having resigned on 27 December 2013. On 29 December 2013, RS purchased Konstruct from SM by way of a Share Purchase Agreement for £10,000.

31. RS had not had any role in Konstruct before his purchase and was not involved in Konstruct’s VAT registration on 29 July 2013.

32. Following the purchase of Konstruct, RS took over Konstruct’s rental of a serviced Regus office at Knyvett House, the associated landline telephone number, the mobile number ending 6065 and Konstruct’s bank account with Barclays.

TRANSACTIONS CONNECTED TO FRAUDULENT TAX LOSSES

33. The Denial Decision denied Konstruct credit for input tax incurred on the transactions with Combat and Sandhar during the relevant periods. The fact of each of the transactions having occurred, that they were connected to fraudulent tax loss and that the fraudulent defaulter was in each case the immediate supplier to Konstruct is not disputed. We do not therefore recite the details of the transactions. We have referred to background information in respect of Combat and Sandhar that is relevant to the due diligence undertaken by Konstruct in respect of the two suppliers.

Period	Supplier	Defaulter	Input tax denied
12/17	Combat	Akshay	£36,766 (reduced by £2,263.80)
03/18	Combat	Akshay	£61,313
09/18	Sandhar	Darkstone	£51,116
12/18	Sandhar	Darkstone	£29,195
03/19	Sandhar	KSR	£64,197
06/19	Sandhar	KSR	£23,801

Combat

34. Combat was incorporated on 16 September 2016 (CRN 10378578). The nature of business declared on its Companies House records was “*construction of commercial buildings*” and “*construction of roads and motorways*”.

35. Combat’s registered addresses were:

- (1) Office 6, Sansome Lodge, Sansome Walk, Worcester WR1 1LH between 10 April 2018 and 13 August 2019;
- (2) Apartment 3, Moseley Road, Hallow, Worcester WR2 6NH between 16 November 2016 and 10 April 2018;
- (3) 25 Pollard Court, 25 Basin Road, Worcester WR5 3GB between 16 September 2016 and 16 November 2016;
- (4) Alpha Tower, Suffolk Street, Queensway, Birmingham B11TT from 17 November 2016 to present.

36. The director at incorporation was Mr Daniel Singh Sekhon (“DS”). On 10 March 2019 DS’s directorship was terminated and a new director was appointed, Mr Gurmeet Singh Sidhu.

37. Combat applied to be registered for VAT on 20 December 2016. Its registration took effect from 24 November 2016 (VRN 257 4234 01).

38. On the VAT1, the PPOB was given as Apartment 3, Oakleigh Court, Moseley Road, Hallow, Worcester, WR2 6NH. At the time of VAT application this was also the registered address for the business. The business moved its PPOB to Sansome Lodge, however no formal notification was ever made to HMRC to this effect. The trade class was described as “*material supply and groundworks contractor*”. The estimated annual turnover was £500,000.

39. Combat was deregistered for VAT from 1 July 2018 on the basis that it had not submitted VAT returns since the period 03/18 and had not replied to correspondence from HMRC. A petition was made by HMRC to wind the company up in February 2020. Combat is currently in liquidation.

40. HMRC records confirmed that Combat had received net payments of £446,103 but had only declared a total of £128,605 in receipts to HMRC. Combat had not submitted its monthly report of PAYE payments, or a report identifying the subcontractors it has paid and detailing payments and deductions, as required of businesses operating within the CIS system. A net figure of £317,498 was unaccounted for and of this sum £267,655 was one large payment from Konstruct.

Sandhar

41. Sandhar was incorporated on 5 March 2012 (CRN 07975725). The nature of the business is shown on Companies House as “*other specialised construction activities not elsewhere classified*”.

42. Mr Shevdinder Singh Sandhar was listed as the sole director of Sandhar at incorporation and resigned as director on 10 March 2017. On 6 February 2017 Mr Sukhvinder Singh Sandhu was appointed as a director. He resigned on 7 August 2019. On 14 May 2018 Mr Hardeep Dosanjh (“HD”) was appointed as a director and remains the sole director.

43. Sandhar had the following registered addresses:

- (1) 36 Clifton Road, Slough, Berkshire, SL1 1SP from incorporation to 8 March 2017;
- (2) PO Box WV6 0BZ, 7 Beech Close, Wolverhampton, West Midlands WV10 6TS from 17 May 2018 to 19 May 2018;
- (3) PO Box WV2 1EL, The Workspace, All Saints Road, Wolverhampton, WV2 1EL from 19 May 2018 to 19 May 2018;
- (4) The Workspace, All Saints Road, Wolverhampton, WV2 1EL from 19 May 2018 to present date.

44. On 31 July 2012, Sandhar submitted an application to register for VAT. It was registered for VAT with effect from 5 March 2012 (VRN 139 2039 19). The VAT1 declared its trade classification was “*Management consultancy activities other than financial management*” and provided a further description of its business activity as “*I intended to provide an advisoral [sic] role in sales and marketing services to companies. I am also starting out in providing kitchen splashbacks on a part time basis*”. The PPOB was given as 36 Clifton Road, Slough, Berkshire, SL1 1SP, which is the home address for Shevdinder Singh Sandhar. The estimated annual turnover was £80,000.

45. Sandhar came to HMRC’s attention in July 2017 due to its labour supply chain links to Global Trading Contractors Ltd, Combat Construction Ltd and VM Contracts Ltd. In August 2017, HMRC became aware that Sandhar appeared to be trading at a loss. It received large payments as a subcontractor but did not appear to have a sufficient workforce to serve that work.

46. On 25 March 2019, HMRC sent a request via email to Sandhar for the sales invoices relating to payments received totalling £310,478.00 made 6 October 2018 to Sandhar from Konstruct.

47. On 14 May 2019, Sandhar supplied HMRC with copies of 45 sales invoices issued to Konstruct between 1 October 2018 and 4 March 2019. The invoices contained little detail of

what supplies had been made and do not contain any details of the sub-contractors that supplied the labour. Sandhar did not supply copies of its bank account statements as requested.

48. On 20 June 2019, Sandhar was informed its GPS would be removed.

49. On 13 March 2020, HMRC issued a VAT pre-assessment letter with accompanying schedule of calculations to Sandhar. The proposed assessments covered two VAT periods (05/19 and 11/19) where CIS data showed the company had received payments totalling £742,766. The company had submitted a nil return for period 05/19 and had failed to submit a return in period 11/19.

50. Sandhar was deregistered for VAT with effect from 22 September 2020.

Contact with HMRC

Initial contact with HMRC

51. Following receipt of Konstruct's VAT registration, HMRC wrote on 19 August 2013 requiring it to provide further information. On 28 August 2013, Konstruct provided the following further information:

- (a) The main business activity was general labour supplies to construction companies;
- (b) The supply was labour only;
- (c) The services included providing workers to customers;
- (d) Konstruct intended to supply 8-20 workers;
- (e) Konstruct did not source its customers;
- (f) Konstruct received payment directly from its customer.

52. Question 3a asking whether Konstruct used sub-contracted labour and to provide it with workers was left unanswered, the question about the names and addresses of any sub-contractors was answered "N/A". The form was signed by MS and dated 28 August 2013. The remainder of the form is completed in different handwriting. In evidence RS confirmed that he did not recognise the handwriting and confirmed that it was not his. The information supplied included Form 64-8 dated 28 August 2013 authorising HMRC to exchange and disclose information with Konstruct's accountant, A & Co Accountants ("A&Co").

53. On 8 October 2013, HMRC advised Konstruct that the application for registration was approved with effect from 26 July 2013.

54. In 2014 and 2015 there was contact with Konstruct by HMRC in which employer and contractor records were reviewed. No concerns were raised by HMRC in that respect.

12 February 2015 visit

55. On 12 February 2015, two HMRC Officers, Mrs C Cruse and Mr J Tilsar, visited Konstruct at Knyvett House. RS was present. HMRC's "Note of Meeting" recorded the following. RS explained that Konstruct works with concrete, building frames for schools/hospitals/universities. Konstruct is labour supply only. No materials are provided by Konstruct.

56. RS confirmed he is the sole director and responsible for the running of the business. He stated that Konstruct was working nationwide including in Southampton, London and Leicester. RS confirmed his accountant was Mr Arfat of A&Co who had acted under Konstruct's previous ownership. Konstruct's main contractors were MJ Gallaher ("MJG"), Allingtons, Dune Group and William and Grant amongst others.

57. RS confirmed that he purchased Konstruct for £10,000 from MS who was not a relation. RS said that he had previous experience of the constructions industry whilst working for a company called GCL. During his day to day work he goes out on sites, meets potential clients and discusses rates of pay. He attends the office once a week to deal with invoices and sends the paperwork to his accountant.

58. As at 12 February 2015, Konstruct was only using First Choice Employment Ltd (“FC”) as its labour supplier, this was the existing labour supplier when RS purchased the business from MS. His contact at FC is a Mr Laxman. The rates paid to FC were £9 or £10, the rates paid by Konstruct’s customers vary from £11, £12 and £15 depending on the company. Konstruct’s average profit per man is £1 or £2 per hour. FC invoiced Konstruct every three or four months and Konstruct paid FC once payment was received from the main contractors i.e. Konstruct’s customer.

59. On that day approximately 10 to 14 workers were being used, working for J Carney Construction in Deephams Street, London. He was unable to recall exactly where this was but had visited the site two weeks ago and used a TomTom to navigate. The TomTom was not available for HMRC to look at. He thought the site was in Cheshunt and the invoices would show the address.

60. RS was asked about discrepancies between money going in and money going out of Konstruct as recorded on HMRC systems. RS explained that Konstruct employed payroll workers and that these employees sometimes worked on site or would pick up and drop off other workers. Konstruct owned its own vehicles which were kept by its drivers during the week and dropped off at weekends. RS said that in addition to using FC to supply workers, Konstruct had five employees (including himself) on the payroll. Three of these are “gangermen” and his wife, Paulina Wlodarczyk, works in the office. He and his wife are paid by bank transfer whilst the other three employees are paid in cash. The PAYE staff are paid monthly and they work part time; 30 hours over 3 days each week. He said he pays himself approximately £1,000 per month.

61. Konstruct’s monthly CIS returns are dealt with by Mr Arfat. Mr Arfat prepared the VAT returns based upon the information contained in the invoices. RS was asked if he had had received correspondence from HMRC regarding FC’s payment status. RS stated that he had not and Officer Tilsar advised him that FC’s GPS had been removed and that future payments to FC should be made net of 20% deduction. RS confirmed he understood. It was pointed out to RS that the last invoice from FC was dated 3 October 2014, RS confirmed that FC were paid in arrears.

62. RS confirmed that Konstruct only had one bank account, the Barclays account ending 0694. Officer Tilsar asked if they could borrow the records to complete their review back at the office and RS confirmed that he had no objection. A receipt for the documents was given and Officer Cruse checked that the mobile number that HMRC held for RS was correct and the number was confirmed as the mobile number ending 6065. RS confirmed that he would prefer that HMRC write to him as he could not always answer the phone when he was working on site.

20 April 2017 letter

63. On 20 April 2017, HMRC sent a VAT deregistration veto letter to Konstruct informing it that its supplier, Flawless Decorators Ltd (“Flawless”) had been deregistered for VAT. The letter provided a link to HMRC’s publication “Use of Labour Providers – Advice on Due diligence” (“Leaflet”). The letter stated:

“This guidance has equal relevance wherever a user is situated in the supply chain.

I strongly recommend that your staff with responsibilities for engaging and administering labour read this leaflet. Relevant staff should do some or all of the proposed due diligence checks as and when deemed necessary. This will help to minimise the risk of you being connected with any possible subsequent failures.”

64. RS confirmed that Konstruct always had staff in the office mainly checking the post. During 2017 the staff would probably have been a bookkeeper, Priya Gill, and RS’s wife. In the event that the office was unmanned, Regus would notify Konstruct that it had received post, Regus held such post in a folder kept for Konstruct.

24 August 2017 letter

65. On 24 August 2017, HMRC wrote to Konstruct informing it that tax losses had been identified in its supply chain with its sole supplier at that time, VG Painting and Decorating Ltd (a.k.a. VG Contracts Ltd) (“VG Contracts”). The letter repeated the link to the Leaflet and the strong recommendation per the 20 April 2017 letter above.

9 October 2017 letter

66. On 9 October 2017, a VAT deregistration veto letter was sent to Konstruct confirming that its supplier, VG Contracts, had been deregistered for VAT. That letter similarly contained the link to the Leaflet and the strong recommendation per the 20 April 2017 letter above.

19 October 2017 visit

67. On 19 October 2017, Officer Tilsar visited Konstruct at Rourke House, Staines. The visit had been arranged to investigate a discrepancy of over £8,500 between Konstruct’s employer payment summary and its CIS returns. RS confirmed that the office had recently relocated and the records requested were on hand. RS said he was rarely in the office but Priya Gill attended a few days each week to deal with invoicing. RS said that Konstruct still undertook concreting jobs and was currently working on 10 to 13 sites nationwide. The charge out rate to main contractors for labour was now £13 to £15 per hour. He said there were now hardly any cash payments. Konstruct now owned 13 vehicles which were driven by employees. RS confirmed that Konstruct’s current labour provider was VG Contracts. The supervisor and contact was “Billy” from Birmingham. RS had never met the director of VG Contracts but thought he was called “Gon” and they had spoken once on the phone when he was asked to deal with “Billy” regarding labour provision. He said that he spoke to “Billy” once or twice a week by phone to discuss labour requirements. Officer Tilsar asked for “Billy’s” telephone number but RS could not locate it and said it must be stored within another mobile telephone. Officer Tilsar asked RS whether he had ever met “Billy”, he said there was a meeting at a site at Fitzjohns two to three months ago.

68. RS said that “Billy” agreed the prices which ranged from between £10.70 and £12.00 per hour. Current jobs were at Dorchester (for “Woodmace”), Southampton (“for Southern Concrete”), Capital Quarter Cardiff (for “Midwest Formwork”) and Fitzjohns in London (for “Woodmace”). In response to Officer Tilsar enquiring how the invoicing and payment system worked, RS said that the main contractors “signed off” the timesheets and sent them to Konstruct. Officer Tilsar asked whether any timesheets were held within Konstruct’s records and RS replied that this was not the case. RS said the Konstruct received via the post invoices from “Billy” at VG Contracts each fortnight, “Billy” was notified separately of the figures from the various sites. Konstruct made payment to VG Contracts by BACS payment seven to ten days later. Officer Tilsar examined the purchase invoices contained within the VG Contracting folder and remarked upon a box entry stating: “Authorised by Victor”. RS said he presumed that was someone within VG Contract’s office. Officer Tilsar pointed out to RS that there did

not appear to be any due diligence documents and RS said he would have to check this with Mr Arfat.

69. Officer Tilsar asked about Flawless who had been Konstruct's supplier before VG Contracts. RS said that he dealt with a director, Mr Vandeeep Singh, in respect of pricing although they had never met. The "gangerman's" name was "Karma". Officer Tilsar queried why Flawless stopped working for Konstruct and RS said that Flawless gave one weeks' notice and stopped supplying Konstruct with labour.

70. Officer Tilsar said at the end of the meeting that he would write to RS shortly.

23 October 2017 letter

71. On 23 October 2017, Officer Payne wrote to Konstruct at the Rourke House address to confirm arrangements for a "Check of records" visit to be held on 2 November 2017 at the Rourke House address. The letter set out what records HMRC would want to see during the visit. The letter dated 9 October 2017 notifying Konstruct of the deregistration of VG Contracts was enclosed as Officer Payne noted that it had previously been sent to the Knyvett House address.

9 November 2017 visit

72. On 9 November 2017, HMRC Officers Payne and Lindsay Coe visited Konstruct at Rourke House, Staines for the purpose of investigating VAT issues. The visit report recorded that the premises were a Regus owned serviced office and was a single room office with Wi-Fi and a printer/photocopier. During the meeting, RS was given a tax loss letter in respect of its supplier Decon Ltd ("Decon") and Flawless. During the meeting RS made brief notes on a post-it of suggested changes made by Officer Payne to Konstruct's procedures for record keeping and requests for further information. RS confirmed that in the early days of his purchase of Konstruct he only employed "a few workers" but he now employed 40 to 50 workers. RS listed ten current sites on which Konstruct was currently contracted to work. Konstruct's customers were:

- (a) Woodmace Ltd;
- (b) Woodmace Concrete Ltd;
- (c) Midwest Formwork Ltd;
- (d) Southern Concrete Ltd;
- (e) PL Civils Eastern Ltd;
- (f) Blanchard Wells Ltd; and
- (g) Toureen Contractors Ltd.

73. The bookkeeping is done by his wife. Priya Gill works part-time in the office and prepares invoices using timesheets or a 'statement', both of which were obtained from the customer. Once the invoices were completed the timesheets are discarded. He was unable to locate any current timesheets and was advised by Officer Payne that he should keep the timesheets to assist HMRC understand who the workers are, the exact nature of the supply chains and whether HMRC have received accurate declarations and payments for the workers involved.

74. RS confirmed the nature of the work to be mainly concrete pouring and related work although some activities are general labouring. He explained that he sometimes got involved on site and helped with concreting but the majority of his time was spent managing the work and the workers. He said payments received were always by BACS and credit was offered depending in the contractor, usually seven-day terms but 14 and 30 days were also offered.

Konstruct pays the workers between £7.50 to £9 per hour depending on the requirements. Konstruct was paid between £13 and £14 per hour by his customers, this was negotiated and agreed with each contractor.

75. He confirmed that Konstruct was still trading with VG Contracts despite receiving the letter confirming their VAT deregistration. He said that recent invoices from VG Contracts did not have VAT on them and were for around £15,000 to £20,000. When Officer Payne pointed out that this should have made him wonder why they were no longer registered despite trade being at normally “high” levels RS said he had not thought about that. RS said he had a decision to make regarding his continued use of VG Contracts as it was not easy to find replacement workers for existing contracts. Officer Payne suggested that taking workers on to Konstruct’s own books (PAYE) or using net status sub-contractors were the safest options in terms of tax risk but the decision was a commercial one that only he could make.

76. Due diligence was discussed. Officer Payne explained about missing trader fraud and how it affected the construction trade sector. Officer Payne explained the due diligence checks that needed to be done to ensure that RS is fully aware of the supply chain and credibility of the business he is dealing with and that checks should be carried out before a business starts to use a sub-contractor. The checks need to be meaningful and acted upon should negative indicators appear. The Officers observed that due diligence checks did not appear to have been carried on VG Contracts and there were minimal due diligence checks on Konstruct’s suppliers Flawless and Decon.

77. RS was referred to the Leaflet, was given a copy, and advised to read it and use it as a guide for implementing a due diligence structure. RS said that he carries out CIS verifications but had not realised that VRN checks needed to be undertaken. Officer Payne explained the process for checking VRNS and that it is important that VRN validations checks are carried out before trading begins to prevent involvement in supply chain frauds as VRNs can be applied for using bought or hijacked information. RS was advised that there is no definitive list of checks and Konstruct should make as many checks as possible to satisfy itself that it is engaging with a legitimate business. Officer Payne suggested a number of ideas for potential checks:

- (a) Meeting the director, to ensure that they are the actual director (seek a copy of their passport), see if they have a history in the trade and seem to know what’s required for the intended contract;
- (b) Visit the premises, again to get a feel for the sub-contractor’s business. If hundreds of workers and machinery are being provided do the premises reflect this
- (c) Ask the director whether they will provide their own workers or will be further sub-contracting;
- (d) Ask the director if they are carrying out due diligence on their own sub-contractors; and
- (e) Third party information requests such as trade references and credit checks.

78. RS was reminded that the Leaflet was a good place to start in assisting Konstruct to devise its own system of checks and was informed that Konstruct could lose its entitlement to claim input tax if losses were identified in Konstruct’s supply chain and they knew or should have known a fraud was taking place. Officer Payne explained to RS that Konstruct has moved straight on to use one subcontractor after the other and all have defaulted on their tax obligations.

79. Officer Payne advised RS that he would write to him after the visit confirming the matters discussed and requesting evidence of improved due diligence procedures and details regarding

any new worker/sub-contractor arrangements that had been put in place. RS agreed that he would write within a few weeks of the visit to confirm all the changes he has made.

80. Under the heading of “Conclusion/Recommendations” Officer Payne noted that RS “*appeared surprised by the revelations of tax losses and appeared keen to comply and took suggestions re DD on board. It appears that out of commercial necessity and convenience he had continued to use VG Contracts to supply workers for all contracts other than the MJG one (MMH) but he advised he will review his procedures and write to confirm changes.*”

14 November 2017 letter

81. On 14 November 2017, Officer Payne wrote to Konstruct to confirm the matters discussed at the meeting on 9 November 2017. The letter stated the following:

“Tax losses identified in your supply chains: Decon Ltd, Flawless Decorators Ltd, VG Painting & Decorating Ltd (also known as VG Contracts Ltd)

A tax loss letter dated 24 August 2017 was issued to you at your Knyvett House premises advising that HMRC had identified tax losses within the supply chains involving your current sub-contractor, VG Painting & Decorating Ltd. During our meeting you confirmed that you had received that letter and I explained the meaning and potential implications of HMRC’s identification of tax losses in your supply chains.

I also advised that HMRC had identified tax losses in your supply chains involving your sub-contractors Flawless Decorators Ltd and Decon Ltd. I have enclosed a separate letter advising you accordingly and you should take the time to read and understand the content of that letter.

...

Retention of timesheets

You advised me that you dispose of all timesheets showing details of workers and hours worked once you have completed the relevant sales invoices.

You should retain all copies of timesheets unless advised otherwise. These form part of your business records and will assist HMRC with understanding the supply chain, knowing the details of the individuals actually carrying out the work and whether tax has been appropriately declared.

Please supply me with any remaining copies of existing timesheets should any have been retained by your book-keeper, Priya Gill.

Written confirmation of new due diligence procedures and any new sub-contractors used

I should thank you again for your assistance with my enquiries and for taking on board suggestions relating to your due diligence procedures. At the end of the meeting you agreed to write to me with details of changes you have implemented as a result of our discussions and to confirm the details of any new sub-contractors used.

Please confirm these details in writing to me by Friday 1st December 2017 at the latest

I will continue to monitor your use of sub-contractors via referral to the HMRC CIS database and advise you of any concerns accordingly.”

1 December 2017 letter

82. On 1 December 2017, RS wrote to Officer Payne and stated:

“We have implemented the followings before taking any labour supply sub-contractors:

- 1) Company Certificate of Incorporation
- 2) Proof of Company Corporation Tax Reference
- 3) Proof of PAYE Registration Reference
- 4) Proof of VAT Registration
- 5) Meeting with Director
- 6) Director passport copy
- 7) Visiting principle place of work
- 8) Verifying for CIS Tax treatment before 1st payment
- 9) Verifying VAT Registration number with HMRC on the telephone number 03000538254 before 1st payment
- 10) Requesting procedure to take employees and how they get paid.”

12 December 2017 letter

83. On 12 December 2017, Officer Payne wrote to Konstruct to remind RS that he had agreed at the meeting on 9 November 2017 that he would retain and send copies of timesheets to HMRC, provide written confirmation of new diligence procedures introduced and written confirmation of new sub-contractors used. Officer Payne provided a further reminder regarding potential input tax denial via use of the *Kittel* principle and requested that the information be sent by no later than 5 January 2018.

5 January 2018 e-mail

84. On 5 January 2018, Officer Payne e-mailed Mr Arfat requesting:

- (a) Copies of all timesheets retained;
- (b) Examples of the due diligence documents referred to in RS’s letter dated 1 December 2017 including any examples of where the new system has been used to carry out checks on a potential sub-contractor; and
- (c) Konstruct’s plans relating to the engagement of workers required to fulfil its contracts should it stop using VG Contracts which may include the names of sub-contractors it is intending to use or details of plans it had to employ workers on a PAYE basis.

24 January 2018 Arfat e-mail

85. On 24 January 2018, Mr Arfat replied by e-mail. He apologised for the delay in responding which he said was due to being unwell with blocked sinuses. He explained that RS’s mother was unwell meaning that RS had only recently returned to the UK, he had a lot of work to do and that he was also suffering from a viral infection. Mr Arfat requested that the meeting planned for 30 January 2018 be cancelled. He asked for a postal address to send timesheets and the due diligence information.

24 January 2018 HMRC e-mail

86. On 24 January 2018, Officer Payne replied pointing out that the meeting had been planned since 11 December 2017, rearrangement would be inconvenient and the matters relating to CIS and VAT declarations were now pressing, particularly given the information requested at the November visit had still not been provided. He explained that the documents could be sent by email or to the postal address at the bottom of his emails.

25 January 2018 Arfat e-mail

87. On 25 January 2018, Mr Arfat replied stating:

“Further to your email of 5th January 2018, we will post the followings to your address tomorrow:

- 1) Timesheets
- 2) Example of due diligence documents.

Our client do [sic] not use VG Contracts Ltd anymore.

Konstruk Recruitment Ltd has employed a lot of employees on PAYE basis.

Can we collect the documents on Tuesday 2nd February 2018 or after.”

29 January 2018 HMRC e-mail

88. On 29 January 2018, Officer Payne e-mailed Mr Arfat to request bank statements and invoices from Konstruk’s sub-contractors. The e-mail stated:

“I’ve tried to call both you and your client today. I indicated in my e-mail that I will now be visiting Konstruk recruitment on Monday 12th February at 12.30 ... You advised me that you have posted timesheets out and a due diligence example. Please ensure this is not simply the blank due diligence checklist which I have already received and is an example of actual due diligence which has been carried out on a sub-contractor or sub-contractors.”

7 February 2018 HMRC e-mail

89. On 7 February 2018, Officer Payne confirmed that he had received via e-mail the Combat invoices dated 7 November 2017 to 22 January 2018 and copies of Konstruk’s bank statements.

12 February 2018 visit

90. On 12 February 2018, Officers Payne and Wallis visited Konstruk at Rourke House, Staines. The visit report included the following. Under the heading “Reason for visit” it stated:

“Konstruk have been making net CIS deductions in relation to a handful of self-employed sub-contractors in addition to payments of PAYE via the RTI system. Extensive analysis of the workers stated on the timesheets however reveals large discrepancies involving either partial PAYE declarations being made or no records at all found for around 20 workers named on the timesheets. Further information is being requested to facilitate more definitive results.”

91. At the visit RS said that Konstruk no longer obtained labour supplies from VG Contracts and had taken on 10 to 15 of VG Contracts’ workers by putting them on Konstruk’s payroll. Officer Payne asked RS why he had not informed HMRC that Konstruk had started to use Combat as a sub-contractor despite HMRC’s request that they be informed of new supplies of sub-contracted labour. RS said that he had been in Pakistan and had not had the chance to inform HMRC. RS said he had previously been contacted by Combat’s director, DS, who had offered to supply Konstruk with workers. RS explained that he had met DS at a construction site in Cardiff and had explained to him that HMRC had advised him that VG Contracts were

connected to tax losses in Konstruct's supply chains and that DS had agreed to supply Konstruct with workers. By the end of the day DS had e-mailed RS a "due diligence pack". Officer Payne questioned whether RS had carried out independent checks such as credit checks, requested trade references or carried out an internet search for any mention of Combat. RS said he needed a workforce as soon as possible and had not had time to carry out any of the extra checks.

92. RS said that Combat provided him with 30 to 40 workers. RS was shown the Combat invoices provided to HMRC by Mr Arfat and spelling errors were pointed out: "Construct" rather than "Konstruct". RS said he'd spotted the name error and told DS to correct this, although the "Ltd" part of the Konstruct's name was still missing from the invoices. RS confirmed that the invoices were posted to him by DS. RS was asked about the location of the construction sites which use workers supplied to Konstruct by Combat as the invoices stated a different location to those worked on by MJG: Birmingham, Walton and Rugby. RS said work on the Birmingham site had ended and Walton and Rugby were the only sites being worked on by Konstruct for MJG. RS said there were up to 20 other sites which Konstruct provides labour for and it currently had contracts to provide labour for MJG, Woodmace Ltd and Mid-West Formwork Ltd. RS said that Konstruct currently had 50 to 60 workers on its payroll.

93. RS was asked if more thorough due diligence checks had been carried out for Combat and RS said he had obtained the "normal pack" as he had needed a new workforce quickly after he had stopped using VG Contracts. Officer Payne referred RS to previous correspondence and their first meeting and reminded him that the existing due diligence checks were inadequate and of the potential for HMRC to apply the *Kittel* principle and deny input tax. It was explained that Konstruct's due diligence checks had not improved despite education, advice, and tax loss letters and reminded RS that all of his GPS subcontractors to date were involved in chains connected to tax losses:

- (a) VG Contractors: defaulter 07/17- 10/17
- (b) Flawless: defaulter 12/16-06/17
- (c) Decon: defaulter 05/15-02/17
- (d) FC: defaulter 11/13-03/15

94. RS was advised that Combat had not paid their VAT or CIS to HMRC from when Konstruct started to trade with them in January 2018 and HMRC were considering denying the input tax for those supplies. RS said that in light of what had been discussed he would try to take some of Combat's workers onto Konstruct's payroll and he would discuss that with DS next Wednesday. Officer Payne asked if DS would appreciate his workers being "poached" but RS did not think it would be a problem.

16 February 2018 e-mails

95. On 16 February 2018, Mr Arfat e-mailed HMRC stating "*Employee details are attached as requested from the director.*" The attached document was a list of the details of 14 workers under the heading of "Konstruct Recruitment Limited Employee Details – Personal".

96. HMRC's e-mailed reply of the same date stated:

"Thank you for the information provided however this falls well short of the details requested and would be provided by Mr Singh at our recent meeting earlier this week...Mr Singh made notes of my request at the end of the meeting. For clarity, the details he agreed to provide are as follows:-

- VG Contracts Ltd: Mr Singh agreed to provide me with the names and NINOs of the workers he took on to his own payroll from VG

- Combat construction Ltd: Mr Singh agreed to provide me with an update regarding his use of the sub-contractor Combat Construction Ltd. I made it clear that Combat have defaulted on their tax obligations to HMRC and Mr Singh advised he would stop using them and ask the workers to work for him on the payroll of Konstruct Recruitment Ltd. The email makes no mention of this matter. I take this omission to mean that he is continuing to use Combat Construction Ltd as his sub-contractor.

The list of employees I have been provided with gives no detail as to the source of the workers (i.e. who they worked for previously) or when they started with Konstruct (although it looks like they have start dates of either the 30/10/17 or 06/11/17 – which is prior to my visit on the 09/11/17). Please provide the omitted information by Monday 19th February at the latest. This information should be to hand and Mr Singh was left in no doubt as to the importance of providing it to HMRC during Monday's meeting."

97. RS on the same date e-mailed Officer Payne stating:

"... the details of men we have sent you I believe these were men which we have taken from vg contractors on to our company direct Onwards from 16.11.17. And all combat construction men I have spoken to them and all of them will submit their documents on Monday whoever will start work for Konstruct so we will send you all their information by end of Monday or latest Tuesday."

20 February 2018 correspondence

98. On 20 February 2018, Officer Payne wrote to Konstruct and confirmed the matters discussed at the meeting on 12 February 2018.

99. On the same date, Mr Arfat e-mailed Officer Payne to explain that the workers listed in the document attached to his e-mail dated 16 February 2018 were "*workers taken from VG Contracts*". He then stated: "*Followings are taken from Combat Construction Ltd*" and provided a list of a further 13 names and National Insurance Numbers. Mr Arfat concluded the e-mail stating: "*The Director has confirmed that the company is no longer using any labour supplies subcontractors.*"

100. Officer Payne replied to query whether (1) the further 13 workers taken from Combat were on Konstruct's payroll and (2) whether there were any employment contracts in place.

3 March 2018 Arfat e-mail

101. On 3 March 2018, Mr Arfat replied stating "(1) Yes (2) No written agreement and taken as new employees". He restated: "*Director confirmed that the company is not using labour supply sub-contractors. Company will employe workers directly.*" He advised that he would be away until 20 March 2018.

5 March 2018 HMRC e-mail

102. On 5 March 2018, Officer Payne e-mailed Mr Arfat (copied to RS) stating:

"In your absence I presume that the Mr Singh will be able to help with enquiries relating to Konstruct, being the sole Director of the company. It would be helpful if either yourself or Mr Singh (who will know the names of all of the employees) could provide me with a full list of your current employees together with their NINOs.

Rajanbir, Please provide me with a list of names within the next 10 days (Mr Arfat is way [sic] until the 20th March 2018). This should not be a problem as have advised in recent meetings that you manage the allocation of workers to the different sites and will therefore know their names."

20 April 2018 HMRC letter

103. On 20 April 2018, Officer Priest wrote to Konstruct and Mr Arfat to request that business records be sent by 8 May 2018 to enable HMRC to review Konstruct's CIS, PAYE and VAT declarations.

8 May 2018 A&Co e-mail

104. On 8 May 2018, an unnamed representative from A & Co accountants e-mailed Officer Priest stating:

“Just to let you know that we will not be able to provide you with the required records.

We were planning to prepare and send the records to you but unfortunately Mr. Arfat had an accident last week and is unable to reply to your letter. Mr. Arfat will be on holidays from 11th May to 25th May.

Could you please give us further time to prepare and send the records to you. We will aim to send all the records by beginning of May.”

9 May 2018 HMRC e-mail

105. On 9 May 2018, Officer Priest replied to A & Co stating:

“My letter was issued 20 April 2018 and therefore provided ample time to prepare and send the requested information. Therefore, I am unable to offer an extension of time to provide the documentation requested.

A large proportion of the information should already be held by the Director, or yourselves as the companies [sic] accountant, therefore no preparation should be necessary. In order for me to progress with my enquiries, I would suggest that you provide what documents you have available now and forward the remainder within 30 days.

I have today issued an Information Notice to the company. This gives 30 days from today's date for the requested records to be submitted.

...

You will be aware that this company has been under enquiry for the past 10 months ... During the period of review, Mr Singh has been made fully aware of the seriousness of the matter.”

9 May 2018 Sch 36 letter

106. On 9 May 2018, Officer Priest issued a Schedule 36 Information Notice letter to Konstruct with a deadline of 9 June 2018 for production of company records to check Konstruct's PAYE, CIS and VAT position.

8 June 2018 Arfat e-mail

107. On 8 June 2018, Mr Arfat e-mailed Officer Priest stating:

“Following information are attached as requested:

- 1) Wage Summary
- 2) Wage Slips
- 3) Employee details summary
- 4) Example of employee details
- 5) CIS Returns Copy
- 6) VAT Returns Copy

7) VAT Returns working

8) Bank Statements

Some are missing as I am out of the country since 11th May 2018 for family rason [sic] and planning to come back in couple of weeks.

Could you please advise for any further information required by you.”

18 July 2018 HMRC letter

108. On 18 July 201, Officer Sanderson, CIS Technical Senior Officer, issued a decision to cancel Konstruct’s GPS following her conclusion that there had been a failure to comply with the GPS scheme conditions specifically Konstruct’s failure to pay deductions in accordance with Regulation 7 Income Tax (CIS) Regulations and a failure to make deductions in accordance with s61 FA 2004. Officer Sanderson wrote:

“The company’s income as a subcontractor from 6/4/17 to 5/5/18 is a total of £3.2m yet payments reported to workers and other labour supply companies only amounts to £2.2m. As a business solely engaged in the provision of labour, the difference is too great to represent solely profit margin. It is therefore a reasonable conclusion to draw that you have made payments to workers or other businesses to supply labour for your contracts with clients, but have failed to report them. With a trading practice of a mix of employees, self-employed workers & other labour providers, I conclude that this practice has continued but you have failed to operate CIS on payments to unknown businesses, and failed to report those payments on your CIS returns.”

Konstruct were informed that they had 30 days in which to request a review of the revocation and a right of appeal to the Tribunal.

28 August 2018 Arfat letter

109. On 28 August 2018, A&Co wrote to Officer Sanderson to explain that her letter had not been received and Konstruct had only just discovered that their GPS had been removed when they received a net payment from a contractor. A&Co did not understand the decision to remove Konstruct’s GPS and details of Officer Sanderson’s calculations were requested. The request was treated by HMRC as an appeal against the decision despite it being made late. Information was requested from Konstruct to demonstrate the reason for the excess of sub-contractor income and provide relevant documents to Officer Payne. A deadline of 26 October 2018 was agreed for the provision of documents, Konstruct were reminded of the deadline by HMRC on 25 October 2018.

September and November 2018 correspondence

110. During September and November 2018, a series of e-mail exchanges took place between Officer Payne and RS and business records were provided including payment and sales invoices, VAT summaries, bank statements and worker’s timesheets and wage records. On 14 November 2018, Officer Payne sent a tax loss letter to RS (copied to A&Co) which itemised all the transactions that Konstruct had with Combat that had been traced to fraudulent tax losses earlier in the supply chain. The letter gave information about how a customer could reduce its exposure to fraud through robust due diligence procedures. Officer Payne sent a further tax loss letter dated 15 November 2018 to RS (copied to A&Co) which itemised all the transactions that Konstruct had with Sandhar that had been traced to fraudulent tax losses earlier in the supply chain. The letter noted that Konstruct had obtained the supplies which had led to tax losses from Sandhar despite Konstruct having agreed to inform HMRC when it engaged a new sub-contractor, indicated that it would be undertaking more robust due diligence and indicated that it would only use workers that it employed directly. The same advice was given in respect of carrying out robust due diligence to reduce exposure to fraud.

111. On 19 February 2019, Officer Sanderson wrote to Konstruct noting that the records sent to Officer Payne did not provide any evidence that the discrepancy between income and CIS payments did not represent payments to unknown CIS contractors (either individuals or companies). Konstruct was advised that HMRC's decision remained unchanged and it could ask for the decision to be reviewed or appeal to the Tribunal but Konstruct did not do so.

112. On 8 August 2019, Konstruct applied for GPS via the CIS helpline and on 9 August it was granted GPS status again.

113. On 16 October 2019, Konstruct provided its due diligence documentation in respect of Combat and Sandhar. The due diligence documents for Combat were comprised of:

- a. Verification of CIS status from HMRC website dated 4 December 2017;
- b. Photograph of passport of DS (due to expire 6 September 2017);
- c. Certificate of incorporation on 16 September 2016;
- d. Companies House website print showing company number and address;
- e. Certificate of registration for VAT dated 24 November 2016;
- f. Certificate of Employers' Liability Insurance covering the period 25 August 2017 to 24 August 2018; and
- g. Certificate of Business insurance issued on 25 August 2017

114. On 17 December 2019, Konstruct sent additional invoices from Sandhar for the period October 2018 to March 2019. On 18 December 2019, Officer Huffadine, in reliance on the *Kittel* principle, issued a letter denying Konstruct entitlement to the right to deduct input tax claimed for transactions with Combat and Sandhar totalling £266,388. Konstruct requested a review of the decision, on 20 March 2020 HMRC confirmed that the decision was upheld. On 15 May 2020, Konstruct lodged an appeal at the Tribunal against the decision dated 20 March 2020.

115. On 15 May 2020, Officer Huffadine informed Konstruct that it was being assessed to a penalty under s 69C VATA. On 16 June 2020, Officer Huffadine issued a PLN under s 69C VATA to RS. RS requested a review of the decision, on 23 November 2020 HMRC confirmed that the decision was upheld. On 3 December 2020, RS lodged an appeal against the decision dated 23 November 2020.

Evidence on behalf of Konstruct

116. RS came to the UK in 2010 or 2011 on a student visa and studied for a Diploma in Business Management at Citec College for one year. His student visa allowed him to work 20 hours per week. After leaving college, RS obtained a Security Industry Authority qualification and worked as a self-employed security advisor/door supervisor until some time in late 2011/early 2012. Whilst he was self-employed, he did additional part-time general labouring work (restricted to 20 hours per week) on various construction sites in the South of England. He struggled to find suitable employment and jumped from job to job in construction or other work and that position remained until December 2013. In December 2013, RS received a UK residence permit which lifted his working restrictions. At some point in 2013, whilst working as a concrete pourer he became acquainted with MS who was also working as a concrete pourer.

117. RS heard via word of mouth that MS wanted to sell Konstruct and approached him with a view to buying Konstruct. MS was looking to sell Konstruct because of the stress of working in the construction industry. RS said that he knew of Konstruct as it already had contracts with MJG. He could not recall that he that he had seen any evidence of Konstruct being profitable

but he saw it as a sound commercial opportunity because of its reputation in the construction industry and its contract with MJG.

118. RS was aware that Konstruct's nature of business, as listed in its Companies House records was "*construction of commercial buildings*" and "*construction of domestic buildings*" and not supply of labour. RS did not see anything odd about the discrepancy between the stated nature of the business and the supply of labour as any form of construction would be required to be done by a labour workforce.

119. RS stated in his written evidence that that he was fully aware of the risk of VAT fraud in the construction industry and sought to avoid it, upon becoming director of Konstruct, whilst he was aware of the high-risk nature of the industry, Konstruct did not experience any issues in this regard. Konstruct was the subject of an HMRC inspection in 2015 and no concerns were raised by HMRC at that time. In his oral evidence, RS stated that in 2015 he was not aware of the high rate of tax fraud in the construction industry as he had not received any tax loss letters from HMRC. He only became aware of tax fraud in the industry in 2017 when notified by HMRC at meetings. He was provided with a copy of the Leaflet at the 9 November 2017 meeting.

120. RS explained that whilst he was not aware of tax fraud in the industry, Konstruct carried out the basic due diligence checks that were required before engaging sub-contractors. The documents supplied would be used to check the sub-contractors were registered for VAT and CIS before making the first payment. Other standard documents supplied by the sub-contractor may include Certificate of Incorporation, Certificate of Insurance, Bank Giro Credit form and a letter of introduction. RS stated in cross-examination that the due diligence information would be provided by the sub-contractor as a "due diligence pack".

121. RS confirmed that he was responsible for Konstruct's due diligence and made the decisions about who to obtain labour from.

122. At that time, those basic checks were all that were needed to be done to before trading with a sub-contractor. RS stated that as soon as he was advised by HMRC of any concerns about a sub-contractor, Konstruct would cease trading with the sub-contractor. Whenever HMRC suggested any improvements to Konstruct's due diligence processes the advice was implemented. He followed HMRC's advice to employ workers rather than sub-contract their labour but this was very hard to sustain.

123. Konstruct has sourced labour in the same way throughout its existence save for 2018. Konstruct engaged staff in four ways. The first is that Konstruct provides labour from its own directly employed staff. It currently has 10 PAYE employees. The number of permanent staff over the years has varied. In 2018/19, Konstruct variously had 120 employees at one time or another during the year. The advantage of direct employees is that they are always available and committed to working for Konstruct throughout the year. The disadvantage is that Konstruct has to pay the employees and find them work for the whole year. As there is no guaranteed demand from customers, Konstruct cannot take on employees to meet peak demand as having surplus employees on the Konstruct's books is not commercially viable. Konstruct do not employ specialist staff (e.g. drivers for large construction equipment) as full-time employees as there is no guaranteed demand for their skills.

124. The second is that Konstruct maintains a "pool" of self-employed workers who work as a sole trader or as a "one man band" but agree to work for Konstruct on a particular project. CIS allows Konstruct to deduct their NIC and income tax at source and account for it to HMRC under the CIS returns. The advantage is that the "pool" is used to cover a specific job without any continuing obligation to pay them when the specific job is completed. Konstruct would

always use its own employees first and then the “pool” of workers. If a particular job requires a large number of workers at short notice, Konstruct sources labour externally.

125. The third is a list of available workers that Konstruct maintains. Konstruct would also contact their existing network of staff and self-employed workers to find out if they have any friends or contacts that they would recommend. Where such a referral is made, Konstruct would offer the worker a trial period to find out if the quality of work matches the required standard and, if so, provide them with further work. RS confirmed that obviously there are times when it is impossible to find enough people to meet demand.

126. The fourth is that Konstruct uses other companies to supply labour by way of sub-contracting. RS stated that Konstruct would sub-contract work when it was unable to use its own workforce (employees or self-employed workforce). Supplying sub-contracted labour requires Konstruct to pay the rate demanded by the sub-contractor which, in principle, would always be a higher rate as it requires paying a “cut” to the sub-contractor. Konstruct would not be told what the profit margin was. The construction industry could not function without sub-contractor middlemen as they are motivated by their “cut” to source and provide labour. He stated that occasionally, using sub-contracted labour is cost effective as it saves Konstruct the expense of transport and expenses. He confirmed that you might pay say £12.50 per hour to employees/self-employed workers compared to £14 for sub-contracted labour.

127. RS was never told by sub-contractors where they sourced their labour from as that information was confidential and he confirmed that he never asked. He would not expect them to say in the same way that he would not tell his customers (nor would they ask) where he sourced his labour. He explained that if that information were known there is a risk that the customer would bypass Konstruct and go direct to the sub-contractor and negotiate a lower hourly rate as they could cut out Konstruct’s margin.

128. When negotiating hourly rates, RS relied upon his knowledge of the current going rate. If he was asked to supply concreters, he would set the hourly rate at the current going rate, say £15.50. The customer might negotiate him down to £15.25 or £15 but there is little room for flexibility on hourly rates as RS knew roughly how much he would have to pay his employed workers. The jobs that Konstruct were working on would usually have a standard day rate or an agreed piece work price (e.g. an agreed price for pouring a concrete slab). Consequently, when RS needed to obtain labour from sub-contractors, he knew the maximum figure that he could pay to make the supply commercially viable. Generally he would need to make a profit of £1.50 per hour per worker, the lowest profit margin he would agree is £1 per hour per worker. Sometimes the profit would be as high as £3 per hour per worker. Agreeing the price was just like any other commercial negotiation: if the supplier was asking for too high a price, he would not use their labour. Sometimes he would have to go back to his customer to inform them that market price is higher than they have offered. RS stated that most of the time this was no problem as Konstruct needed a workforce and the supplier had workers looking for a job. Once the rate was agreed it was generally put in an e-mail or text to remind the parties what had been agreed. In response to cross-examination RS confirmed that negotiations on price were conducted via telephone, WhatsApp, text or e-mail. He stated he could not remember if any negotiations were conducted via e-mail and that he had provided all relevant documents which should be in the hearing bundle.

Decon

129. At the beginning of 2015 and whilst still using FC as its labour supplier, RS was cold-called by Mr Naresh Kumar (“NK”), a director of Decon, to offer his company’s services as a labour supplier. At that time Konstruct was not looking to change suppliers and did not have sufficient work to engage multiple labour suppliers. RS advised NK that he would retain his

details should Konstruct's future needs change. In April 2015, following Konstruct's termination of their relationship with FC, RS contacted NK by telephone to find out if he could fulfil Konstruct's labour requirements. RS stated that during the call he made due diligence enquiries and NK provided the following documents: (1) Certificate of Incorporation dated 24 March 2015; (2) VAT Certificate of Registration dated 9 April 2015; (3) Introductory Letter; (4) Copy Bank Giro Credit and (5) Certificate of Insurance. In cross-examination, RS confirmed that this was the first time he had set up a new supply of labour for Konstruct and whilst he had carried out due diligence enquiries, he was not aware of tax fraud in the labour supply market. He further confirmed that a basic due diligence check was all that was needed in those days to engage sub-contractors. The VAT number was used to verify the UTR, whether payments could be made net or gross and to verify the VAT number. He confirmed that the other information was always needed before beginning trading with a new company or to make the first payment. Decon's VAT Certificate of Registration dated 9 April 2015 stated under the heading of trade classification "*construction of commercial buildings*". RS confirmed he knew that Decon was a labour supplier but he did not question this as his understanding was that all construction work was done by a workforce which satisfied the trade classification of "*construction of commercial buildings*".

130. RS agreed that it appeared that Decon had requested confirmation of its own UTR and that it had been incorporated only a month before he was cold-called. He could not remember if he had seen Decon's complete certificate of insurance or just the page contained in the bundle headed "Certificate of Employers' Liability Insurance with a stated commencement date of 10 April 2010. He did not query any of the information supplied. He could not remember if it was a few days or weeks after the initial discussion when he contacted NK and agreed that Decon would supply labour to Konstruct at sites in Newhaven, Bristol and Bournemouth. RS confirmed that he had not met NK but had met with someone from Decon whose name he could not recall at a site in Stratford, London opposite Westfield and at a MJG near the M3 motorway. RS accepted that he did not have any assurances that Decon could meet Konstruct's needs and provide good quality labour but he stated that he was reassured from speaking to NK as he was knowledgeable about the construction industry and current national construction projects. RS stated that he could quickly gauge the quality of the worker once they started working. RS confirmed that the client would run the induction process and supervise the worker. Decon supplied Konstruct with labour for 18 to 24 months. RS explained that towards the end of that period the quality of the labour supplied deteriorated and the relationship with Decon broke down and Konstruct made plans to change supplier.

Flawless

131. During 2016, RS began receiving calls from Mr Vendeep Singh ("VS"), a director of Flawless. VS advised RS that Flawless was able to supply labour to Konstruct and was available immediately. At the time, Konstruct was being supplied with labour by Decon, RS advised DS that Flawless' services were not required at that time. RS explained that whilst Konstruct was not at its busiest in 2016 there were jobs that Konstruct required labour for. RS telephoned VS to discuss working together and ran through what documentation he required in terms of due diligence. VS supplied RS with a "Due Diligence Pack" containing the following documents: (1) Certificate of Incorporation; (2) VAT Registration Certificate; (3) Introductory Letter; and (4) Company letterhead.

132. RS accepted that Flawless' VAT Registration Certificate dated 19 April 2016 stated that its trade classification was "*painting*" but explained that this did not raise any concerns in his mind as it was his understanding that you could register a company at Companies House for any trade and after a couple of weeks change the nature of the business. RS confirmed that as long as the company was CIS registered and had a VAT number nothing further needed to be

asked. He confirmed Flawless' VAT and GPS status with HMRC and began trading with Flawless. He stated that he was not aware that HMRC made further enquiries when a VAT registration application stated that the business would be the supply of labour. The Introductory Letter in the Due Diligence Pack stated that "*Flawless Decorators started off specialising in commercial decorating but now have found themselves specialising in civil engineering due to the Directors knowledge and passion for the sector.*" RS accepted that no mention was made of labour supply but explained that civil engineering is related to construction and that construction has many different names. RS could not recall receiving HMRC's letter dated 20 April 2017 that was headed in bold type "*Warning*" which stated that Flawless had been deregistered for VAT from 19 April 2017. HMRC's letter strongly suggested that Konstruct's staff should read the Leaflet and a link to the Leaflet was provided. His recollection was that the letter was copied to his accountant. He confirmed that Konstruct always had staff in the office mainly checking the post. During 2017 the staff would probably have been Gill and RS's wife. In the event that the office was unmanned, Regus would notify Konstruct that it had received post and keep the post in a folder kept for each company. RS confirmed that he remained the only person at Konstruct who engaged labour providers.

133. RS was referred to HMRC's Visit Note dated 9 November 2017 which recorded that RS was given a copy of the Leaflet and that he confirmed that VRN checks were not being done although he carried out CIS verifications. RS stated that he did not agree with the visit note and believed that Konstruct was checking VRN numbers either by calling HMRC or by Mr Arfat checking online. His recollection is that he was advised to check VRNs by telephoning HMRC as online checks were not 100% accurate. He accepted that his recollection of that advice was not recorded in the Visit Note.

VG Contracts

134. In or around mid-2017 RS received a cold-call by someone whose name began with "Gon..." who was the director of VG Contracts. "Gon" informed RS of VG's ability to supply labour and that if Konstruct required labour then RS should contact his colleague, "Billy". RS confirmed that he did not know the full name of either "Gon" or "Billy". By way of explanation, he stated that he was just called "Raj". In or around July 2017, Konstruct needed labour and RS telephoned "Billy" to inform him of Konstruct's labour requirements and the documents that he required from Billy in terms of due diligence. In cross-examination RS stated that he could not remember why he did not mention to HMRC at the November 2017 meeting that "Billy" was his contact at VG Contracts and not "Gon". The documents provided were: (1) HMRC Gross payment status document; (2) Certificate of Incorporation; (3) Letter from VG confirming company details; and (4) HMRC letter confirming online VAT Enrolment. The documents were not provided to HMRC as RS could not find them and they were not held by his accountant. In cross-examination, he confirmed that Mr Arfat would use the due diligence documents to verify online the company's CIS and VAT status. RS stated he could not recall if the documents were requested by HMRC during the November 2017 meeting.

135. VG Contracts' certificate of incorporation confirmed the date of incorporation as 26 January 2017. RS accepted that VG Contracts had only been operating for a couple of months but explained that having spoken to "Gon" he was satisfied that VG Contracts could fulfil Konstruct's labour demands as it had people who can pour slabs and can travel nationwide. RS confirmed that he had never met "Gon" nor had he requested any identification from him. RS stated that the fact that VG Painting and Decorating Ltd trading as VG Contractors were operating in the construction sector did not raise any questions in his mind. Having checked VG Contracts' VAT and GPS status with HMRC and after considering the due diligence documents supplied by VG Contracts, he was satisfied despite not having met "Gon", having only met "Billy" at a construction site and not knowing their full names.

136. RS thought that he had read HMRC's letter dated 24 August 2017 which stated that VG Contracts was a supplier in a transaction chain where at least one participant had failed to meet its VAT liability, his recollection was that it took a couple of days or weeks for the letter to arrive. RS believed that he had spoken to "Billy" about the letter and that "Billy" had said he would come back to him. RS explained that the letter did not tell Konstruct not to trade with VG Contracts and that out of commercial necessity it was not possible to stop trading with VG Contracts immediately as Konstruct, as well as the client it was supplying, would lose their contract and reputation and could be liable to penalties. In cross-examination, RS confirmed that the letter did not prompt him to ask VG Contracts for further due diligence information as such requests were not made in the construction industry as any information additional to VRN and CIS registration was confidential and would not be provided.

137. Konstruct only worked with VG Contracts for a couple of months as RS received notification from HMRC dated 9 October 2017 that VG Contracts had been deregistered for VAT and Konstruct advised not to continue to trade with them. RS could not recall if he had clicked on the link in the letter to the Leaflet. RS confirmed that at the time of the meeting with HMRC on 19 October 2017 he was still trading with VG.

138. RS accepted that at the 9 November 2017 meeting with HMRC he had confirmed that he was still trading with VG Contracts and knew that VG Contracts had been deregistered. In cross-examination, he confirmed that he understood what the VAT registration threshold was and accepted that Konstruct's trades with VG Contracts would on their own have been over the VAT threshold. He explained he had still not made a decision on 9 November 2017 about continuing to trade with VG Contracts as he could not stop overnight as Konstruct needed to fulfil the contract and there would be so many surcharges, trouble on the site and the site potentially closed down if he had to find a new labour supplier. In cross-examination he confirmed that he understood that a pattern had emerged where Konstruct had moved straight from one sub-contractor to another following a cold-call from a company that said it could supply Konstruct's labour needs and that all the sub-contractors had defaulted on their tax obligations. RS explained that he was upset by all that had happened and he had tried his best to satisfy himself that he was dealing with a legitimate company and to comply with his tax obligations.

139. RS believed that he had been provided with the Leaflet at the 9 November 2017 meeting and that he had read it after the meeting. He recalled being given suggestions as to possible due diligence checks to carry out when engaging a sub-contractor and stated that he had taken steps to implement the suggested ideas. The suggested ideas are at [77] above. In cross-examination, RS confirmed that they were all questions that he would feel able to ask but could not recall if he had said to HMRC at that meeting that it was not possible for reasons of confidentiality to ask a director if they were providing their own or sub-contracted labour. He confirmed that he had read the letter from HMRC dated 14 November 2017 that summarised the due diligence ideas suggested at the meeting. RS recalled that during the meeting he was advised to keep a written record of his discussions with potential sub-contractors but he could not remember having done that. RS stated that after having read the Leaflet, Konstruct changed many things going forward and the ten points implemented were set out in Konstruct's letter to HMRC at [8282] above. In cross-examination, RS confirmed that he had requested "right to work" documentation from both Combat and Sandhar and that evidence should be in the hearing bundle. No such documents were in the hearing bundle.

140. He further confirmed that the letter dated 1 December 2017 at [82] above had been written by his accountant. RS confirmed that the contents of the letter were correct and he had agreed to inform HMRC about any new sub-contractors that Konstruct was using.

Combat

141. RS was cold-called by DS, director of Combat, in mid-to-late 2017. RS written evidence was that he conducted his due diligence in the same way that he had done previously with labour suppliers. He also decided to meet DS in Cardiff at one of the sites that Konstruct was working on as he wanted to get a “feel” for the director and question him, in light of previous issues with labour suppliers and HMRC, directly about his knowledge of fraud in the industry and what he was doing to combat the same. Following the meeting and the due diligence documentation provided, RS was satisfied that he was engaging with a legitimate business and honest director stating: “*he appeared to be an upstanding British gentleman*”.

142. The first invoice from Combat to Construct [sic] under invoice reference “con/001” and “Contract: Feltham” was dated “Weekending 26/11/21017” was for “Concrete Operatives” supplied for 1,159 hours at an agreed hourly rate of £12 per hour. RS confirmed that it was very rare for construction work to be done on a Sunday. The next invoice, invoice reference “con/002” and “Contract: FJA” also dated “weekending 26/11/2017” was for “concrete Operatives” supplied for 3,220 hours at an agreed hourly rate of £12 per hour. Invoice “Con/003” and “Contract: Southampton” was also dated “weekending 26/11/2017” and was for “Concrete Operatives” supplied for 180 hours at an agreed rate of £12 per hour. Invoice “con/004” and “Contract: Cardiff” was also dated “weekending 26/11/2017” and was for “Concrete Operatives” supplied for 730 hours at an agreed rate of £12 per hour. Invoice “Con/005” and “Contract: Porton” was also dated “weekending 26/11/2017” and was for “Concrete Operatives” supplied for 1,284 hours at an agreed hourly rate of £12. In cross-examination, RS explained that the invoices might be for two weeks or one week and there would have been 20 men on site. He accepted that Konstruct had “*gone in pretty big*” using untested labour for thousands of hours but explained that Konstruct needed the labour urgently as it had to fulfil a contract.

143. RS confirmed that he had received Combat’s due diligence documentation from DS at some point before trading began. In cross-examination, RS stated that he had not notified HMRC in Konstruct’s letter dated 1 December 2017 that he was already being supplied labour by Combat as he understood that by Konstruct verifying Combat on the CIS database and checking the VRN by telephone would automatically notify HMRC.

144. RS confirmed that prior to HMRC’s request, timesheets were not retained. He explained that once the worker had been paid there was no dispute about pay. He accepted that the invoices just stated the site and either the total hours and the hourly rate or the total square metreage of poured concrete and agreed rate but the timesheets enabled him to check the days and hours worked and pay the workers. He did not accept that the absence of any disputes about the quality of the work done or workers not being paid fully or the correct amount confirmed that the trading was part of an orchestrated scheme.

Sandhar

145. In or about June/July 2018, RS was cold-called by HD, a director of Sandhar who was exploring whether Konstruct could provide any work to Sandhar. RS confirmed that he was approached in exactly the same way as all the other cold-calls. In cross-examination, RS confirmed that he had not thought about doing his own research to find labour as Konstruct needed labour and he had carried out more due diligence on Sandhar. RS was provided with a due diligence pack by HD. In cross-examination, RS could not recall if the due diligence information was provided by post or e-mail or whether it was provided in advance of the meeting or at the meeting with HD. RS attended upon HD at his office and, having seen that Sandhar was being operated in a professional manner and occupied well equipped offices, decided to engage Sandhar as RS saw no risk to Konstruct or HMRC. At that time, Konstruct

had numerous employees engaged in day work trade and RS decided to only engage Sandhar on fixed price work.

146. The due diligence information provided was: Certificate of Incorporation dated 5 March 2012, CIS confirmation letter from HMRC to Sandhar dated 5 June 2017, VAT certificate dated 25 May 2018 confirming effective date of registration 5 March 2012 with business activity description as “*Management consultancy activities other than financial management*”, copy VAT return submitted by Sandhar in respect of The Workspace showing VAT as zero, photocopy of HD’s British passport, VIES VAT number validation dated 23 July 2018 timed at 16.57, CIS Verification result dated 20 July 2018, Certificate of Insurance dated 18 July 2018 stating trade as “*Groundwork*”, e-mail reference request dated 17 July 2018 provided by Sebastian Mann at Crown Recycling Limited to Sandhar and written reference from Planacre Limited dated 17 July 2018. RS confirmed that this was the first time that Konstruct had obtained trade references. In cross-examination, he explained that he did not query why a recycling company was involved in construction as the company name could have been any name and they could have been involved in the construction industry but doing recycling. He further confirmed that he did not ask to see any of Crown Recycling’s previous work but he had telephoned both Crown Recycling and Planacre to ask about Sandhar. In cross-examination he was unable to recall which company he telephoned to ask about Sandhar’s services but he had spoken to a man who said that Sandhar was “reliable”. In his written evidence, RS stated that he was now aware that Sandhar was using sub-contracted labour which did not come as a surprise to him. In cross-examination, he stated that he had asked if Sandhar was using its own employees or sub-contractors and HD had confirmed that Sandhar was using sub-contractors but was making checks. RS accepted that this evidence was not in his witness statement which had been prepared to the best of his ability and what he could remember.

147. Konstruct’s CIS payments and turnover for the years 2017 to 2019 [RS confirmed that the tax period referred to financial years] were as follows:

Tax Period	CIS Total Payments Made	Turnover
17		£1,998,444.00
17-18	£1,669,794.00	£3,103,748.00
18-19	£900,227.00	£2,260,843.00

Submissions

HMRC’s submissions

148. Ms Stephenson’s submissions on behalf of HMRC are summarised as follows.

149. Konstruct’s transactions took place as part of an orchestrated fraud, this is an important factor in determining whether Konstruct knew or should have known that its transactions were connected with the fraudulent evasion of VAT, *Mobilx* at [82]-[83]. The transactions were the product of orchestration by fraudsters as part of an overall scheme to defraud HMRC as opposed to transactions which occurred in an ordinary commercial market, *HMRC v Pacific Computers Limited* [2016] UKUT 350 (TCC) (“*Pacific*”) at [13], [76] and [80]-[81]. The same questions apply equally to this appeal: (a) is the Tribunal satisfied there is a high level of orchestration; (b) how was it managed so well; and (c) would the orchestrator of a fraud involve an unknowing party and, if so, why?

150. Konstruct was repeatedly notified by HMRC of the presence of fraud in the market in which it was trading. In April 2017, Konstruct was sent a copy of the Leaflet and advised in the accompanying letter “*I strongly recommend that your staff with responsibilities for engaging and administering labour read this leaflet. Relevant staff should do some or all of the proposed due diligence checks as and when deemed necessary. This will help to minimise the*

risk of you being connected with any possible subsequent failures.” The Leaflet was given to Konstruct on at least three further occasions in 2017. It was informed by letter dated 9 October 2017 that its supplier, VG Contracts, had been deregistered for VAT.

151. Konstruct was informed on a number of occasions that its suppliers were involved in chains connect to fraudulent tax loss:

- (a) 24 August 2017: tax losses in Konstruct’s supply chain with its sole supplier at that time, VG Contracts;
- (b) 9 November 2017: tax losses in respect of its suppliers Decon and Flawless;
- (c) 12 February 2018: Konstruct was notified by HMRC that Combat had not yet paid VAT or CIS to HMRC, it was reiterated by email of 16 February 2018 that Combat had defaulted on its obligations;
- (d) 14 November 2018: tax losses in respect of its supplier Combat; and
- (e) 15 November 2018: tax losses in respect of its supplier Sandhar.

152. Konstruct’s attitude toward trading after being put on notice of these issues by HMRC is telling. Konstruct was still receiving supplies from VG Contracts despite being aware that its VRN had been removed and did not question why it had been removed or how it continued to trade previous levels. Konstruct agreed on 9 November 2017 (confirmed by HMRC in subsequent letter) to inform HMRC of any new suppliers of labour. Despite correspondence in the intervening period, Konstruct did not inform HMRC it was trading with its new supplier Combat until February 2018 and only advised HMRC of the position after repeated requests for supplier invoices. Konstruct continued to use Combat despite warnings in early February by HMRC about tax losses. On 2 March 2018, Konstruct gave an assurance that it would not use labour sub-contractors but only its own employees but instead began using Sandhar from July 2018. Again, it did not inform HMRC it had started using a new supplier and continued to use Sandhar until March 2019 despite being put on notice that Sandhar was linked to tax losses.

153. Konstruct had knowledge not only of fraud in the market generally but also specific tax losses in its own supply chains. Despite frequent and detailed warnings and advice from HMRC, Konstruct knew it was trading with suppliers linked to tax losses and had no interest in ceasing to trade. It was only when HMRC made trading sufficiently inconvenient did Konstruct move on to the next supplier involved in the scheme to defraud HMRC.

154. Konstruct can have been in no doubt about the options available to it in respect of due diligence: it received a physical copy of the Leaflet on no less than four occasions and was also referred to the link to the Leaflet and the HMRC officers repeatedly explained the guidance and the importance of due diligence.

155. The due diligence checks carried out in respect of Combat and Sandhar were inadequate. HMRC officers had emphasised the need for the due diligence checks to be meaningful and should be carried out before starting to use a sub-contractor and any warning signs acted upon. Konstruct’s checks on Combat appear to have been carried out months after trading began. On 1 December 2017, Konstruct informed HMRC that it had devised a new series of due diligence checks which included a visit to the supplier’s premises, meeting with the director, and requesting “the procedure to take employees and how they get paid”. On 12 February 2018, HMRC were informed that Konstruct had not in fact carried out any of these measures before engaging with Combat. No third-party checks were carried out by Konstruct. No site visits, meetings with directors or enquiries about the provenance of the workforce were carried out

with any supplier. It is unclear how Konstruct could be satisfied that the workers it was supplying were working legally, for proper pay, in safe conditions.

156. Any company in Konstruct's position that was aware it had received supplies from five companies in a row linked to tax losses, would reasonably be expected to take steps to independently verify the *bona fides* of its next supplier, before trading began, and satisfy itself that it was using a safe and legal workforce. Konstruct did not do this. It obtained paperwork which did little more than demonstrate the existence of the companies and the fact of their VAT and CIS registration, which was in any event necessary to execute a VAT or CIS fraud of the type it had been warned about.

157. Konstruct did not ask questions about the inconsistency between the trade descriptions in both Sandhar and Combat's VAT certificates, and the work they were apparently carrying out. Konstruct deliberately closed its eyes to the risks, both in respect of loss to HMRC and the status of the workers it supplied.

158. No contracts existed between Konstruct and any of its suppliers. This was particularly risky as RS did not know the full names of the people running Konstruct's suppliers. There was no protection in place should either party fail to meet their obligations. Konstruct did not even keep timesheets of the labour provided until asked to do so by HMRC. It is unclear how it was able to keep track of what had been provided for accounting purposes or how any dispute over the quantity or quality of labour supplied would be resolved. The situation existed because the trading was not an ordinary commercial arrangement, there was no need for Konstruct to secure its position because it knew it was operating with a scheme to defraud HMRC.

159. No evidence has been provided to the Tribunal of any negotiations between Konstruct or its suppliers. If this had been a commercial transaction some evidence of negotiations would exist.

160. The labour purchased by Konstruct was "sent" directly from its supplier to its customer without Konstruct offering any service. It is unclear why the main its contractors would not have gone straight to the source. The Tribunal is entitled to ask: "What did the Appellant bring to the table?" HMRC submit that there is no obvious reason for the First Appellant to be in the chain of transactions at all. Konstruct has asserted that it made between £1.00 to £2.25 mark up per hour, per worker for its supplies. It is unclear how much it believed its supplier, or its' supplier's supplier, was making in respect of mark-up. HMRC submit there must be a limit to how many companies, each adding no value to the transactions, can take such a mark-up before the minimum wage owed to the worker is consumed. Konstruct never questioned the mechanics of this arrangement or whether it was made possible because a company at the bottom of the chain was paying no tax.

161. Konstruct had no difficulty in sourcing supplies of labour and met its suppliers by chance. When one company was deregistered or linked to tax losses, it was quickly replaced by another. It would be extraordinarily bad luck if the First Appellant, through sheer coincidence, happened to purchase its supply of labour from four successive traders all of whom were responsible for tax loss. This was plainly not a coincidence; it was a result of Konstruct's knowing involvement in a scheme to defraud HMRC. All Konstruct's suppliers were relatively newly incorporated business with no obvious experience in the sector. Each is now out of business having been deregistered. The suppliers were little more than "straw man" companies. This too would have put the Appellant on notice that its transactions were connected with fraud.

162. RS was the sole director and responsible for running the business. His evidence was that that he rarely attended the office and worked on sites as a concrete pourer. It is unclear how he was able to properly run a labour supply company with a turnover of £500,000 to £1 million per quarter, responsible for hundreds of workers a year.

163. RS had no experience in labour supply before purchasing Konstruct. RS was on occasion unable or unwilling to respond to HMRC's e-mails containing basic enquiries about Konstruct's business, or delayed weeks or months in doing so. HMRC submit that these circumstances are consistent with someone who is required to put little time into running the business, and does not need rely on experience, because the trading is being conducted in an artificial environment, as part of an orchestrated scheme.

164. Every GPS sub-contractor that Konstruct has ever engaged leads back to a fraudulent defaulter. HMRC submit the overwhelming evidence is that Konstruct deliberately closed its eyes to the nature of its suppliers and failed to make enquiries which would have assisted it in deciding whether to trade. This has the effect that it either knew its transactions were connected with fraud or, in the alternative, should have known from the surrounding circumstances that the only reasonable explanation for its inclusion was because it was connected with the fraudulent evasion of VAT.

165. For all the reasons set out above, HMRC submit that Konstruct knew or should have known that the transactions were connected with VAT fraud and the s 69C penalty was correctly issued. In respect of s.69D, RS was the sole director of Konstruct and throughout his communications with HMRC accepted responsibility for running Konstruct. He provided instructions to Mr Arfat to communicate with HMRC. He has at no point in the investigation or these proceedings suggested that any other person was responsible for arranging and managing the purchase and sale of labour through Konstruct. The actions of RS are fully attributable to Konstruct. If the Tribunal is satisfied that the s 69C penalty was properly issued then the s 69D personal liability notice was also correctly issued.

Konstruct and RS's submissions

166. Mr Yeo's submissions on behalf of Konstruct and RS are summarised as follows.

167. In overview, Konstruct's and RS's cases are that the appeals should be allowed upon a straightforward application of the clear tests laid down in *Kittel* and *Mobilx*. On the *Kittel* appeal, HMRC has failed to prove that the Konstruct knew or should have known that any of its transactions were connected to a fraudulent tax loss. The Tribunal must, therefore, distinguish between cases where the trader knew his transaction was probably connected to a fraud and cases where the trader actually knew his transaction was connected to a fraud. Only in the latter case will a trader lose his right to deduct, *Hira Company Ltd v HMRC* [2011] UKFTT 450 (TC).

168. In the case of *Mahagében and Dávid v Hungary* C-80/11 and C-142/11, in which HMRC intervened, the ECJ affirmed the test of *Kittel* but emphasised that a trader can be expected to make only reasonable checks and the tax authority cannot expect a trader to go further and act as a fraud investigator, at [59]-[65]. In determining whether Konstruct should have known that a transaction was connected to fraud it is not sufficient for HMRC to simply point to failures to conduct particular checks. For a failure to perform a particular check to amount to a means of knowing that the transaction was connected to a fraud, it must be established that these failures, together with other matters, would have made a reasonable trader realise that the only reasonable explanation for the transaction was that it was connected to fraud. A failure to conduct a check which would not have revealed the connection with the fraud does not result in the trader losing his right to deduct (*HMRC v Livewire Telecom Ltd and Olympia Technology Ltd* [2009] EWHC 15 (Ch) at [88]). (cf *Mobilx* at [74]: not to unduly focus upon whether the Appellant "had exercised due diligence or done enough to protect himself").

169. On the PLN Appeal, it follows that HMRC has not proved that the tax loss was attributable to the conduct of RS. It is for HMRC to establish, if the point is relied upon, that that Konstruct's knowledge of fraud within the sector establishes that it knew these transactions

were connected with fraud. Likewise, HMRC rely upon RS's role it will have to establish that there is some disconnect between his skills and experience and Konstruct's business.

170. The Tribunal must, therefore, distinguish between cases where the trader knew his transaction was probably connected to a fraud and cases where the trader actually knew his transaction was connected to a fraud. Only in the latter case will a trader lose his right to deduct, *Hira Company Ltd v HMRC* [2011] UKFTT 450 (TC)

171. Konstruct was aware of the risk of VAT fraud within the construction industry and actively sought to avoid it. At all times, Konstruct engaged in legitimate business in the construction industry. RS has described the sorts of services that Konstruct provided to its customers. This appeal must be viewed through the prism of the realities of the construction sector: the fluctuations in demand, the urgency to complete projects and the importance of never letting a customer down.

172. HMRC seeks to prove that Konstruct knew that its transactions were connected with the fraudulent evasion of VAT by proving that it was a part of an overall scheme to defraud HMRC. In turn, it seeks to prove that Konstruct's transactions took place as part of a highly orchestrated fraud and relies upon *Pacific*. It is submitted that this appeal is very far from being one in which the transactions were highly orchestrated in the sense under consideration in *Pacific*. The *modus operandi* of those knowingly involved in the scheme of cold calling and waiting for Konstruct to need labour is all that is required. It is better for the dishonest participants if Konstruct is not informed of their intention. There is no need for Konstruct to be a knowing participant. Its role is merely to buy labour which undoubtedly it needed, and to pay them the VAT which was stolen by the defaulting companies. Konstruct would risk its entire direct labour force business if it got involved in a fraud.

173. HMRC suggests that due diligence did not improve despite the education, advice and tax loss letters provided. On the contrary, it is submitted that, properly understood, the evidence points to Konstruct having conducted the sort of due diligence that one would expect from a business engaged in legitimate trade and actively engaging with HMRC as to steps it can take to avoid being caught up in VAT fraud. For example:

- (1) HMRC did not prescribe what Konstruct should do, save that during the 3rd compliance visit it required Konstruct to provide it with its proposals. Konstruct duly provided the supplier due diligence letter as agreed. This was an extension upon the due diligence deployed previously and drew no adverse comment at the time.
- (2) Contrary to HMRC's case, Konstruct materially complied with these steps prior to engaging with both Konstruct and Sandhar. The due diligence it did for Combat went further than that what it had done previously. The due diligence it did for Sandhar went further than that it had done for Combat, and it included trade references.
- (3) HMRC submits that no site visits, meetings with directors took place. On the contrary, Konstruct met DS at a site. It visited HD at his principal place of business.
- (4) HMRC submits that the trade descriptions of Combat and Sandhar, declared on their VAT certificate, were inconsistent with their activity in construction and that Konstruct did nothing as a result. Neither description is startlingly inconsistent with the supply of staff to the construction industry. In each case, any concern would readily be assuaged by evidence confirming the business's ability to provide staff in the requisite numbers.

174. The Tribunal should be led by the core questions of whether any shortcoming in checks establishes an inference that Konstruct knew the company to be participating in a transaction connected with fraudulent evasion of VAT, alternatively would this have made a reasonable

trader realise that the only reasonable explanation for the transaction was that it was connected to fraud. Furthermore, it should not allow HMRC to transfer its own investigative duty to Konstruct (at a time when it had itself recently visited Sandhar and had verified its VAT number without adverse comment). There is a practical limit to what might be meaningful. If you ask whether the contractor meets its VAT obligations, a dishonest contractor is bound to produce something that confirms this to be the case. Only HMRC could actually ascertain whether the trader has met its tax obligations. This is why the ECJ in *Mahageben* says “*the tax authority cannot ... require the taxable person wishing to exercise the right to deduct VAT, first, ... that he has satisfied his obligations as regards declaration and payment of VAT, in order to be satisfied that there are no irregularities or fraud at the level of the traders operating at an earlier stage of the transaction or, second, to be in possession of documents in that regard*”. Only HMRC has the powers to divine the true answer.

175. Konstruct deals with contracts and negotiation in RS’s witness statement. It is to be remembered that the negotiation requires only a single price: either an hourly rate or a quantity of laid concrete. It is either acceptable or not. Little more is required. RS’s evidence is that it was not the practice to have contracts and, accordingly, a reasonable trader would not have insisted that there be a contract.

176. HMRC sought to prove that the absence of contracts was an objective factor supporting its case and that the failure to keep timesheets until it was suggested they be retained was in some way malign. This overarching submission is belied by the evidence that it was the practice of the industry not to have a contract. Timesheets are generated on site and come from the customer (who can keep track of who is on site by checking in workers). Sub-contractors also provide timesheets. The fact that they were not retained back in 2017, is nothing to the point (it pre-dates the transactions in question). When timesheets were requested to be kept, they were kept, and provided to HMRC. There is no complaint as to absence of timesheets during the periods under consideration.

177. HMRC posits the question: What did Konstruct bring to the table? The answer is a work force ready to pour concrete for an established customer base that was looking for a dependable contractor ready to lay concrete slabs. If the head contractor could readily find such staff in the required numbers without more, there would be no need for subcontractors at all.

178. The Tribunal will have to assess RS for itself. He is both a hands-on concrete pourer and a manager of men. There is nothing incongruent between what the Tribunal knows of RS and his role within Konstruct. His evidence needs to be viewed through the prism of these facts:

- (1) English is not his native language and his knowledge of English is driven by his experience in the construction industry;
- (2) he is not a professional witness;
- (3) the day-to-day activities of running a sizeable business within the concrete industry;
- (4) is a far cry from the giving of evidence before a Tribunal;
- (5) the events are relatively mundane and of considerable antiquity;
- (6) he stated in his evidence (without contradiction) that he had not appreciated the importance of retaining a written record of his discussions with DS and HD;
- (7) When he didn’t know the answer or could not remember the events, he would say so.
- (8) If the answer did not assist his case, he gave it nonetheless.

(9) When the answer he gave did not directly address the question, it was more consistent with an uncertainty as to what he was being asked, rather than any lack of honesty in his response.

179. On a proper assessment of the evidence, HMRC has failed to establish that Konstruct knew that these transactions were connected with the fraudulent evasion of VAT nor that it knew that the only reasonable explanation for the circumstances in which its purchase took place was that it was a transaction connected with the fraudulent evasion of VAT. It follows that both the Kittel Appeal and the PLN Appeal should be allowed.

DISCUSSION

180. We were satisfied that HMRC have established fraudulent tax losses and that there was an overall scheme for the fraudulent evasion of VAT connected with transactions which are the subject of this appeal. The issues for us to determine are whether Konstruct, through its sole director, RS, knew or should have known that the relevant transactions were connected to fraud and, if so, were the actions of Konstruct, which give rise to the s 69C penalty, attributable to RS?

181. We found that RS was an unconvincing and unreliable witness. His evidence was at times vague, implausible and contradictory.

182. Having carefully considered all of the circumstances of this appeal, we have come to the conclusion for the reasons set out below that, at the very least RS, and therefore Konstruct, should have known that the transactions the subject of the Denial Decision were connected to the fraudulent evasion of VAT. There was no specific factor or single piece of evidence that led us to our conclusion, rather, it was the overall circumstances surrounding the transactions entered into by Konstruct. The transactions which were undertaken by Konstruct all bore features that, in our view, would concern a legitimate businessman or trader.

Overall scheme to defraud HMRC

183. HMRC relied upon the fact that Konstruct's transactions took place as part of an orchestrated fraud as an important factor in determining whether Konstruct knew or should have know that its transactions were connected with the fraudulent evasion of VAT. Ms Stephenson further submitted that the Tribunal is entitled to conclude that the more heavily orchestrated and efficient a fraudulent scheme is, the more likely it is that each party knew about its role. We do not accept that this was a heavily orchestrated fraud and agree with Mr Yeo that none of the factors present in *Pacific* that led to that conclusion (circularity of goods or funds, no uniformity or markups and centrality of control) are present in this appeal. However, we are satisfied that this was an orchestrated fraud. We do not accept as credible RS's evidence that it was a mere coincidence that on each occasion in the period prior to Konstruct changing/losing its labour supplier, RS was cold-called by a complete stranger offering to supply Konstruct with labour, Konstruct confirmed it did not need a supplier of labour at that time and, when Konstruct needed a new source of labour, the cold-caller was able to immediately supply all of Konstruct's labour needs. It was no part of Konstruct's evidence that it had attempted to source labour from any other supplier despite the extensive list of contacts in the construction industry that RS maintained nor that there was any period when Konstruct was unable to satisfy its labour requirement: on each occasion the cold-caller's company was used to supply Konstruct's exact labour needs. We do not accept that Konstruct was an innocent victim of fraudsters or just "unlucky": on each occasion when engaging a labour supplier the identical *modus operandi* was followed, Konstruct's labour needs were immediately met in full and Konstruct was always inserted into the exact same position in the transaction chain.

Knowledge of VAT Fraud

184. We are satisfied that Konstruct had knowledge not only of tax fraud in the construction labour supply market but of specific tax losses in its own supply chains.

185. Konstruct was informed on no less than five occasions that its suppliers were involved in chains connected to fraudulent tax loss: 20 April 2017 (Flawless), 24 August 2017 (VG Contracts), 9 November 2017 (Decon and Flawless), 12 February 2018 (Combat had not yet paid VAT or CIS to HMRC), 16 February 2018 (Combat had defaulted on its obligation), 14 November 2018 (tax losses in respect of Combat) and 15 November 2018 (losses in respect of Sandhar). HMRC's visit note dated 9 November 2017 records that RS was handed a copy of the Leaflet and advised to read it and use it as a guide and that missing trader fraud and how it was affecting the construction trade sector was explained to him. The note recorded that RS appeared to appreciate the advice and he acknowledged that he needed to improve his due diligence. That evidence was unchallenged and RS confirmed in his oral evidence that he was the only person at Konstruct to engage labour. His written and oral evidence regarding his knowledge of tax fraud in the construction sector was contradictory; however, we are satisfied that shortly after 20 April 2017, Konstruct had knowledge of VAT fraud in the construction labour supply market generally and specifically in Konstruct's supply chain. RS confirmed that Konstruct always had staff in the office checking post and, in the event that the office was unmanned, Konstruct would be notified by Regus that it had received post. We are satisfied that, despite RS's knowledge of VAT fraud, no meaningful improvement to Konstruct's due diligence was ever undertaken. We agree with HMRC's submission that the reality is that Konstruct knew it was trading with suppliers linked to tax losses and demonstrated no interest whatsoever in ceasing to do so. It was only when HMRC made trading sufficiently inconvenient for Konstruct that it then moved on to the next labour supplier.

Due diligence

186. We are satisfied that no meaningful due diligence checks were carried out by Konstruct despite having been repeatedly provided with physical copies of the Leaflet, links to the Leaflet and advice provided by HMRC both in person and in correspondence. In spite of the warnings and repeated advice, the due diligence that Konstruct relied upon was, on each occasion, provided to Konstruct by the sub-contractor as a standard "*due diligence pack*". The due diligence documents and information were always accepted at face value and no further verification or independent checks on the sub-contractors or their previous clients were carried out by Konstruct. None of the negative indicators in the "*due diligence pack*" were ever followed-up by Konstruct.

187. The due diligence that was carried out by RS was limited to verifying the suppliers' VRN and CIS status and visiting either a serviced office or meeting someone at a construction site where Konstruct were working. We found this approach to be highly unusual particularly in light of the repeated warnings and advice from HMRC. The verification of the suppliers VRN and CIS status did no more than confirm that the supplier company existed and was registered for VAT and CIS, both of which were pre-requisites for the fraud to work. Whilst Konstruct attached great weight to checking the VRN and CIS status, RS's evidence on this point was contradictory and vague: he could not recall if he or Mr Arfat carried out the checks and whether the checks were done via telephone calls or online.

188. The due diligence that RS conducted on the individuals that he traded with, "Gon", "Billy" and DS was based on perception rather than any objective criteria: his "feel" that an individual was a legitimate and honest businessman or an "*upstanding British gentleman*" followed a discussion about construction or the impression created by an occupied well-equipped office.

189. We consider it of note that when Konstruct was made aware of VG Contract's VAT deregistration and its failure to comply with its tax obligations, Konstruct did not immediately stop trading with VG Contracts but continued to trade as a matter of "commercial necessity" being more concerned with protecting Konstruct's reputation as a "reliable labour provider" rather than tarnishing its reputation as a company involved in tax fraud.

190. Mr Yeo relied upon *Mahageben* (at [59]) which confirmed that a trader is only required to make reasonable checks and is not expected to go further and act as a fraud investigator. We accept that as a correct statement of the position but in our view, Konstruct did not carry out any reasonable checks. The evidence was that the due diligence information was provided *after* Konstruct had already made the decision to begin trading with both Combat and Sandhar. The trade descriptions of Combat and Sandhar declared on their VAT certificate were wholly inconsistent with their activity in construction. We do not accept as plausible RS's explanation that he attached no relevance to the declared descriptions as "construction has so many different names" that it could encompass financial management and painting and decorating. We agree with HMRC's submission that, as confirmed by the evidence, Konstruct deliberately closed its eyes to the risks and did not ask any questions about the inconsistency between the sub-contractors' trade descriptions and the labour supply work that they were engaged in.

Contracts

191. There was no evidence before the Tribunal of any contracts in place between Konstruct and its sub-contractors. RS could not provide any explanation or describe what the procedure would be in the event of any dispute or inaccuracy in the calculated hours or rates of pay, he simply stated that it never happened. We find that his evidence in this regard as highly implausible. We accept that it may be the norm in the construction labour industry not to have formal written contracts; however, we do not accept that there would not be some form of confirmatory message (however brief) by e-mail, text, WhatsApp or a manuscript notebook entry recording the agreement. RS's evidence was that when VG Contracts withdrew their labour his immediate concern was the imposition of penalties by the main contractor, a liability that apparently solely fell on Konstruct but, on his evidence, a liability that could not be passed on to his suppliers. We find that Konstruct's willingness to assume sole liability for potential penalties for "breach of contract" is further evidence of the transactions not being atypical commercial arrangements or agreements.

No evidence of negotiation with suppliers

192. RS's evidence was that negotiations took place via WhatsApp, e-mail, telephone conversations and text messages. No WhatsApp messages, e-mails, notes of telephone conversations or text message were in evidence before the Tribunal. We agree, as Mr Yeo submitted, that negotiations would have been limited as it was a matter of Konstruct either agreeing an hourly rate for labour or price per m² for poured slabs. However, in our judgment, if the transactions had been commercial transactions, we consider that some evidence (electronic or otherwise) of the negotiations would exist particularly as RS was very rarely in the office as he was either working on construction sites or travelling.

Position within the chain of transactions

193. Konstruct's position in the transaction chain in respect of the transactions the subject of the Denial Decision was on each occasion always directly below the main contractor. On each occasion the labour was supplied direct by Konstruct's supplier to the main contractor without Konstruct adding any value to the transactions. Whilst RS asserted that Konstruct made between £1 to £2.25 per hour mark-up we agree with HMRC that there must be a limit to how many companies, each adding no value to the transactions, can take such a mark-up before the minimum wage payable to the worker is consumed. We consider it of note that Konstruct never

questioned the mechanics of the arrangements nor how it could work if all the parties in the chain were paying the correct amount of tax. We agree with Mr Yeo that during the period in dispute Konstruct took workers onto its own books from VG Contracts and Combat and from the point of view of this appeal, it is impossible to commit VAT fraud. We disagree with Mr Yeo's subsequent submission that it then follows that this undermines HMRC's case that each time Konstruct changed labour suppliers it moved on to a tax loss connected sub-contractor. We accept that not all of Konstruct's transactions were connected to tax fraud, we do not find it inconceivable that Konstruct was involved both in genuine and fraudulent transactions.

Nature of the suppliers

194. Konstruct was always able to source supplies of labour from suppliers with whom it had had no previous contact for the exact quantity of labour required and at the precise time required for Konstruct to satisfy its existing obligations. We do not accept as plausible RS evidence that it was coincidence or plain bad luck that Konstruct happened to purchase a supply of labour from six successive traders all of whom were responsible for tax loss and who were predominantly newly incorporated businesses with no obvious experience in the supply of labour to the construction industry.

RS's role

195. RS was the sole director and shareholder and was responsible for running Konstruct. RS had no previous experience in the labour supply business before purchasing Konstruct, his experience was as a labourer pouring concrete. In his evidence, RS confirmed that he was solely responsible for the sourcing and supplying of labour. His evidence was that he rarely attended the office and continued to work on construction sites as a concrete pourer whilst simultaneously running a labour supply business with a turnover of £500,000 to £1 million per quarter with responsibility for hundreds of workers. We do not accept that evidence as plausible and agree with HMRC's submission that these circumstances are consistent with someone with no previous labour supply experience who is required to put very little time into running a labour supply business because the trading is being conducted in an artificial environment as part of an orchestrated scheme.

196. For all the reasons set out above, we are satisfied that RS and therefore Konstruct should have known the transactions were connected to fraud and that it is more likely than not that he actually knew of that connection.

Company penalty and PLN

197. For all the reasons set out above, we are satisfied that RS and therefore Konstruct should have known the transactions were connected to fraud and we are satisfied that the s 69C penalty was correctly issued. In respect of the PLN, RS confirmed that he was the sole director of Konstruct, responsible for running the business and solely responsible for sourcing the supply of labour. We are satisfied that the actions of Konstruct are fully attributable to RS and the PLN correctly issued.

DECISION

198. For the reasons above, the appeals are dismissed.

RIGHT TO APPLY FOR PERMISSION TO APPEAL

199. 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.

**GERAINT WILLIAMS
TRIBUNAL JUDGE**

Release date: 1st SEPTEMBER 2023