Neutral Citation: [2024] UKFTT 00874 (TC)

Case Number: TC09303

FIRST-TIER TRIBUNAL
TAX CHAMBER

at Taylor House, London EC1

Appeal reference: TC/2016/05430

VALUE ADDED TAX – input tax disallowance – Kittel – taxpayer was high street jewellers that started buying and selling large amounts of silver – it was told by HMRC that the market was tainted with fraud and informed of tell-tale signs of connection with fraudulent VAT evasion – the taxpayer undertook 10 back to back purchases and onward sales where it made a 1% margin and did not pay supplier until it had been paid by customer – it made no meaningful checks on counterparties – the transactions were, realistically, "money for nothing" – Held: there was no reasonable explanation for the circumstances of the transactions other than connection to fraudulent VAT evasion – the taxpayer therefore should have known of the connection – appeal dismissed

Heard on: 15-18 July 2024
Judgment date: 27 September 2024

Before

TRIBUNAL JUDGE ZACHARY CITRON
MS GILL HUNTER

Between

MICRORING LIMITED

Appellant

and

THE COMMISSIONERS FOR HIS MAJESTY'S REVENUE AND CUSTOMS

Respondents

Representation:

For the Appellant: Jonathan Kinnear KC, instructed by Mezzle Law

For the Respondents: Joshua Carey and Sam Way of counsel, instructed by the General Counsel and Solicitor to HM Revenue and Customs

DECISION

1. This was an appeal against HMRC's assessments denying input tax of £310,184 claimed by the appellant ("**Micro"**) in the 12/15 and 03/16 VAT quarterly accounting periods. HMRC's grounds for the input tax denial were that the purchases (the "**purchases**") on which the input tax was incurred were connected with the fraudulent evasion of VAT and Micro either knew, or should have known, this. HMRC's assessments were notified to Micro in letters of 21 September 2016 and 1 December 2016.

EVIDENCE

2. We had an electronic hearing bundle of 2,415 pages. This included witness statements of eight HMRC officers involved in investigations of Micro and its counterparties in the purchases and immediate onward sales of the goods purchased (Officers Tosta, Booth, Pounds, Douglas, McCain, Loureiro, Sharrock, and Smith): and of Mr Jitendra Ram, Micro's director at relevant times. Prior to the hearing, the Tribunal directed that Officer Smith's statement was to be admitted only to the extent that it adopted Officer Pounds' prior statements.

3. We heard oral evidence from Mr Ram, including under cross examination and in answer to questions from the Tribunal.

4. In its response to the *Fairford* directions dated 19 October 2023, Micro had said that it wished to cross examine Officers Pounds and Sharrock. However, by the time of the hearing, Officer Pounds had left HMRC and his prior statements had been adopted by Officer Smith; Officer Smith was not himself involved in the HMRC's investigations leading to the input tax denials under challenge in the appeal; nor, indeed, was Officer Pounds so involved; it was another HMRC officer, Officer Shah, who played this role. In the course of the hearing, Micro's counsel indicated that he did not wish to cross examine Officer Smith or Officer Sharrock.

THE PURCHASES

5. There were 10 purchases, each of a given weight of silver, and they, and the immediately following onward sale by Micro of the silver purchased, may be summarised as follows:

Purchase	**Amount of silver involved (in kg)**	**Seller to Micro**	**Date of payment by Micro**	**Amount paid by Micro**	**Amount paid to Micro**	**Buyer from Micro**	**Date of payment to Micro**
1	600	RTC Global Ltd	28 Oct 2015	£223,125	£225,367	Fowler Oldfield Ltd	23 Oct 2015
2	500	BA Traders Ltd	2 Nov 2015	£182,250	£184,098	Fowler Oldfield Ltd	30 Oct 2015
3	600	RTC Global Ltd	24 Nov 2015	£214,632	£216,799	Stunt & Co Ltd	9 Nov 2015
4	27.41	RTC Global Ltd	20 Nov 2015	£9,206	£9,299	Stunt & Co Ltd	20 Nov 2015
5	800	RTC Global Ltd	3 Dec 2015	£269,961	£272,691	Stunt & Co Ltd	2 Dec 2015

6	500	RTC Global Ltd	14 Dec 2015	£172,230	£173,970	Stunt & Co Ltd	11 Dec 2015
7	500	RTC Global Ltd	22 Dec 2015	£172,230	£173,970	Stunt & Co Ltd	18 Dec 2015
8	750	Sinclair Marketing Solutions	21 Jan 2015	£257,148	£259,740	Stunt & Co Ltd	21 Jan 2016
9	500	Quality Engines Direct Ltd	5 Feb 2016	£177,600	£179,514	Stunt & Co Ltd	5 Feb 2016
10	495	Quality Engines Direct Ltd	26 Feb 2016	£182,714	£184,717	Stunt & Co Ltd	26 Feb 2016

6. In its response to the *Fairford* directions, Micro accepted that the purchases and onward sales had been made, and that there were tax losses in all of the purchases except the two from Quality Engines Direct Ltd (9 and 10 in the table above), and that the sellers in those transactions fraudulently evaded VAT.

7. Micro said this in its response to the *Fairford* directions about the two purchases from Quality Engines Direct Ltd:

> [Micro] does not accept that HMRC has proved that there were tax losses in [those two purchases]. In decision TC06403, dated 21 March 2018, [Quality Engines Direct Ltd] successfully appealed HMRC's assessment. It does not appear that any assessment or denial of input tax has been raised against any entity purporting to be [Quality Engines Direct Ltd] and as a result, no tax loss has been established.

8. In his witness statement, Mr Ram maintained that Micro did make the two purchases from Quality Engines Direct Ltd. This was notwithstanding the factual finding in another Tribunal decision (*Quality Engines Direct Ltd v HMRC* [2018] UKFTT 0151 (TC), at [26, 29]), that these taxable supplies were not made.

9. In the course of the hearing, Micro clarified its position that, in line with Mr Ram's witness statement, purchases 9 and 10 *had* taken place; but it now accepted that there were tax losses in those purchases and that Quality Engines Direct Ltd had fraudulently evaded VAT.

MICRO'S BUSINESS AT THE RELEVANT TIME

10. At the time the purchases took place, Micro was a long-established high street jeweller business, operating from a shop in Kingsbury, North West London. It traded as Bhagwanji Ram & Sons. The company director and (with his brother) shareholder was Mr Ram. Mr Ram was the controlling mind of Micro.

11. According to its VAT records, Micro's "outputs" (i.e. its VATable sales, and therefore akin, approximately, to its business turnover) were just over £1 million in the 12/15 VAT quarterly period, just over £0.5 million in the subsequent VAT quarterly period (03/16), and £37,000-odd in the next period, 06/16.

MICRO'S INTERACTIONS WITH HMRC CONCERNING VAT FRAUD

12. A letter from HMRC to Micro dated 18 December 2006 indicated that HMRC had discussed with Micro on a recent visit the fact that the jewellery trade was an area that had been affected by "MTIC" (missing trader intra community) fraud; the letter referred to HMRC's knowledge of dealings by other businesses with certified diamonds moving between several parties quite quickly, and that certain purchases made by Micro seemed to follow that pattern; the letter enclosed a copy of HMRC's Notice 726 *Joint and several liability for unpaid VAT*. About a year later, on 4 October 2007, HMRC again wrote to Micro, saying that its counterparty in respect of the precious stone purchases in question, had been ascertained as a defaulting trader.

13. An HMRC internal note indicates that HMRC officers visited Micro's shop 5½ years later, on 3 May 2013, and spoke with Mr Ram's brother (the note says that Mr Ram returned to the shop as HMRC were about to leave and was given a brief explanation of the visit). The reason for the visit was that a company which (for HMRC) was a "known MTIC trader" had asked HMRC to "verify" Micro. HMRC noted that Micro's business was sale of retail jewellery to the public; that Micro accepted gold in part-exchange but did not purchase it outright; that there was a lot of Asian jewellery displayed in Micros' shop such as bangles, rings, and ear-rings. HMRC's note recorded Mr Ram's brother as then saying that Micro had decided to expand in the scrap metal business and were setting up "accounts" with other companies; they had no experience in this market and were currently "studying" it; the business model was to buy and sell on a back-to-back basis; the commodity was copper cathode, bright wires, etc. In answer to questions from HMRC as to how Micro could be sure the goods were really scrap metal etc, the note indicates that Mr Ram's brother suggested involving an "inspection company". The note records HMRC as advising that this trade sector was "tainted with fraud" and Micro should safeguard its interests as it would be exposed to "risks"; this led to a discussion about due diligence and reference to the section of Notice 726 (which HMRC handed to Mr Ram's brother) on this topic. HMRC also gave him a leaflet called *How to spot missing trader VAT fraud*. The note says that the officer told Mr Ram's brother that, although Notice 726 refers to specified goods, "it can apply to any commodity"; it also says that the officer referred Mr Ram's brother to section 6 of Notice 726, "which describes the checks they can apply".

14. A letter from HMRC to Micro dated 8 May 2013, and headed "VAT Fraud alert: Alternative Banking Platforms", opened by saying that HMRC had seen evidence of MTIC fraudsters attempting to make use of alternative banking platforms. The letter said the following, under the heading, "What to look out for":

> "As part of what you might want to do next the annexe to this letter provides a more detailed explanation of MTIC fraud together with some examples of factors HMRC has found to be indicative of MTIC fraud. This list is not exhaustive and should not be seen as a check list. You are responsible for carrying out all the due diligence necessary for your particular business".

This annexe referred to was Annexe A, about MTIC fraud.

15. The letter also said, under the next heading, "How HMRC might help", that "as part of your risk management process we invite you to validate the VAT details of any new or potential customers/suppliers. Details of how to do this are attached at Annexe B."

16. An HMRC internal note indicates that HMRC officers again visited Micro's shop on 17 September 2013, to obtain details of deals Micro had undertaken with a Czech company; they spoke with Mr Ram; there had been one scrap metal deal in the 06/13 quarter (sale by Micro to a Luxembourg company) and two such deals in the 09/13 quarter (with the Czech

company); the note said that Micro's due diligence had been confined to the buyer (not the supplier) and was "very basic": validating the VAT registration number, a VAT registration certificate, a company introduction letter, and a director's passport. HMRC told Mr Ram that in order to protect Micro's commercial interests, it had to improve its due diligence.

MR RAM'S EVIDENCE

Business background

17. Mr Ram's witness statement described his business background as follows: he studied jewellery at art college; in the 1970s he worked in a workshop making edible gold foils; the company he worked for was a large gold bullion dealer; Mr Ram said this gave him an understanding of the wholesale bullion market.

18. In oral evidence, Mr Ram said that he and his brother ran the Micro business together; that they opened the shop in Kingsbury in mid 1980s; that they did manufacturing at the back of the shop; that they imported jewellery and on-sold to well-known high street retail chains.

Commerciality of the purchases and onward sales

19. As to the commerciality of the purchases and onward sales, Mr Ram's witness statement made the point that silver is tested, and the price is determined on its purity at the specific time of sale. Mr Ram said that the prices at which Micro bought silver in the purchases reflected the market price at the time.

20. In cross examination, Mr Ram said that someone at Fowler Oldfield Ltd tested the silver for quality; they also "refined" the silver. He accepted that he never saw the goods; they were transferred from Micro's suppler to its customer, directly, he said. When asked what the point was of Micro's being in the supply chain, Mr Ram replied that Micro had an "account" at Fowler Oldfield Ltd (whereas the companies selling to Micro did not). When asked why a company wishing to sell silver would not just open its own such "account", Mr Ram said that Fowler Oldfield Ltd would not open accounts for just "anyone".

21. In re-examination, Mr Ram clarified the following points in his evidence:

(1) Micro had advertised online, saying that it was interested in buying precious metals; this was the source of "enquiries" from companies wishing to sell to it;

(2) the "account" at Fowler Oldfield Ltd was opened because it was needed to deal in large quantities of precious metal; Mr Ram said he had "heard of" Fowler Oldfield Ltd earlier in his career; he understood that Fowler Oldfield Ltd undertook refining of precious metals; once the silver was refined (to a certain degree of purity; for example, 99.9%), Fowler Oldfield Ltd advised on weight; and this determined the transaction price, applying the market price at the time; 1% was subtracted to deduce the price to be paid by Micro to the company it purchased from, to give Micro a 1% margin on the purchase and related onward sale; Mr Ram described 1% as the "going rate" for the margin on such transactions;

(3) Micro did not pay the company it purchased from, until it received payment for the onward sale of the same goods; this protected it from loss caused by the onward sale falling through for any reason.

22. HMRC's counsel objected to the evidence summarised at [21(2)] above being "admitted" because the point about Oldfield Fowler Ltd having "accounts", and being a "refiner" of silver, had not been mentioned in Mr Ram's witness statement (and it was therefore contrary to the procedural rules of the Tribunal (and principles of evidence more broadly) for this evidence to come up for the first time in re-examination). We do not agree. These points had surfaced in answers to questions put to Mr Ram by HMRC's counsel in

cross examination. Obvious questions and clarifications related to these points had, to our minds, been left "hanging" in the course of cross examination, without the natural follow-up questions which would allow the Tribunal to understand what Mr Ram was trying to say. The re-examination questions assisted the Tribunal in this respect. There was no unfairness to HMRC: it is a hazard of cross examination that the witness says things, in answer to the questions, that the questioner was not expecting, and which may be "new" information; if that information requires common-sensical further questioning (to understand what the witness was intending to say), then that, clearly, must be done. To leave things in a state of muddle, because the witness answers the question in a way the questioner wasn't expecting and introduces "new" information, would clearly be contrary to both fairness and justice, and would do disservice to the Tribunal in its fact-finding role. (In any case, the point about Micro having "accounts" in other companies was not new – it had come up in HMRC's note of the meeting with Micro on 3 May 2016). The Tribunal ruled on this point in the course of the hearing and gave HMRC a fair opportunity to ask further questions arising upon the re-examination, if they wished. (HMRC raised similar objections to the evidence summarised at [21(1) and (3)] above, and [18] above, but the former was, quite clearly, simply clarification or repetition of evidence given in Mr Ram's witness statement; and the latter, being general background information, is to our mind self-evidently fair and just to "admit", and certainly cannot be said to raise any material point of concern or "prejudice" for HMRC).

23. What we *make of* the evidence that emerged in Mr Ram's oral evidence, and what *weight* we put on it, is of course a different question, and one to which we return in the "Discussion" section below.

VAT fraud and checks on suppliers

24. Referring to HMRC's letter of 8 May 2013, and its Annexe A about MTIC fraud, Mr Ram's witness statement said that Micro had "no idea what HMRC was talking about"; referring to the reference in the Annexe to MTIC fraud typically involving 'high value low volume' commodities such as mobile phone and computer chips imported VAT-free from EU member states, Mr Ram said that Micro thought this letter was confined to the trades mentioned in the letter. Mr Ram also quoted from Annexe B to the letter (the process for validating VAT details of new or potential customers or suppliers) and said that Micro followed that process: Mr Ram referred to Micro having followed Officer Shah's "instructions".

25. Mr Ram's witness statement said that, in respect of the purchases, Micro sought confirmation of the supplier's VAT registration number, obtained a copy of its certificate of incorporation, obtained identification from its directors, and carried out "VIES" checks (VAT number verification provided by the European Commission), and Companies House checks. Mr Ram also said that Micro asked its suppliers to fill in a "trade application" form that asked for "trade references". We had no evidence of any such references actually being taken.

26. Mr Ram said in his witness statement that Micro had no reason to believe that the information and documents given to it by the companies from which the purchases were made was "insufficient to verify [each of those companies'] VAT registration number that was issued to them by HMRC".

NOTICE 726

27. Notice 726 was a 19-page document issued by HMRC, entitled *Joint and several liability for unpaid VAT*. The introduction said that the notice explained how you could be made jointly and severally liable for the unpaid VAT of another VAT-registered business when you buy and/or sell specified goods. The goods specified included electronic equipment made or adapted for use by individuals for the purposes of leisure, amusement or

entertainment and any other equipment made or adapted for use in connection with any such electronic equipment. It explained that the rules it described were introduced to tackle VAT fraud, a "virulent" form of which was MTIC fraud. It then said:

> "MTIC fraud is a systematic criminal attack on the VAT system detected in many EU member States. In its simplest form, the fraud involves a fraudster obtaining a VAT registration number in the UK for the purposes of purchasing goods free from VAT in another EU member State, selling them at a VAT inclusive purchase price in the UK and then not paying the output tax due to HMRC. The goods are then sold through a number of UK businesses and finally sold outside the UK free from VAT. The final UK business claims a VAT repayment from HMRC that, if paid, crystallises the loss at the start of the UK supply chain.
>
> This type of fraud relies heavily on the ability of fraudulent businesses to sell goods or services to other businesses that are complicit in the fraud, prepared to turn a blind eye, or not sufficiently circumspect about their trading connections. Such action fuels the growth of the fraud. These rules remove the attraction of financial gain."

28. In section 4, the notice said it contained examples of reasonable steps you can take to establish the integrity of your customers, suppliers and supplies, to help you avoid being unwittingly caught up in a supply chain where VAT goes unpaid. It then said:

> "It is good commercial practice for businesses to carry out checks to establish the credibility and legitimacy of their customers, suppliers and supplies. These checks will need to be more extensive in business sectors that are commercially risky or vulnerable to fraud and other criminality.
>
> Such checks will also assist you to avoid being involved in supply chains linked to the theft of VAT and the possibility of becoming jointly and severally liable for VAT unpaid elsewhere in your supply chain.
>
> HMRC does not expect you to go beyond what is reasonable. However, HMRC would expect you to make a judgement on the integrity of your supply chain and the suppliers, customers and goods within it.
>
> Factors you may wish to consider include:
>
> • The type and level of checks you carry out to establish the integrity of the supply chain and the action you take as a consequence of those checks;
>
> • The nature of the supply;
>
> • Payment arrangements and conditions; and
>
> • Details of the movement of goods involved.
>
> You can find examples of checks at section 6."

29. Extracts from section 6 of the notice are set out in the appendix to this decision.

HMRC'S EVIDENCE ABOUT FOWLER OLDFIELD LTD

30. HMRC's evidence had the following information about Fowler Oldfield Ltd and its business: its trading address was in Bradford; from 2013, it was in the business of trading in precious metals; a director told VAT officers in 2014 that silver was melted, manufactured and refined on its premises; HMRC suspected that it was involved in supply chains connected with fraudulent VAT evasion; *Kittel* assessments were raised in 2016; in September 2016 its premises in Bradford were raided by police on suspicion of money laundering; it was placed in liquidation in October 2016.

RELEVANT LAW

Kittel

31. The European court (the "**CJEU**"), in its judgment dated 6 July 2006 in *Axel Kittel v Belgium State, Belgium State v Recolta Recycling SPRL* C- 439/04 & C-440/04, held that taxable persons who "knew or should have known" that the supplies in which input tax was incurred were connected with the fraudulent evasion of VAT would not be entitled to claim a credit in respect of that input tax. In particular, at [51] and [56], the CJEU, whilst reiterating that "traders who take every precaution which could reasonably be required of them to ensure that their transactions are not connected with fraud, be it fraudulent evasion of VAT or other fraud" should not lose their right to a credit for the input tax in relation to supplies associated with fraud, stated that "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 [VAT directive], be regarded as a participant in that fraud, irrespective of whether or not he profited by the resale of the goods."

32. The rationale for the above approach was set out at [57] and [58], where the CJEU noted the following:

> [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.

33. At [59] the CJEU concluded that *"*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'."

34. At [61] the CJEU reiterated that, *"*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."

Agreed brief summary of *Kittel*

35. The parties agreed that, in relation to *Kittel* denials of input tax deduction, the test for the Tribunal to apply is:

(1) was there a VAT loss?

(2) if so, was it occasioned by fraud?

(3) if so, were the purchases connected with such a fraudulent VAT loss?

(4) if so, did Micro know, or should it have known, of such a connection?

36. The parties were also in agreement, by the end of the hearing, that the only issue for determination by the Tribunal in this appeal was (4) above.

Mobilx

37. The issues to which *Kittel* gave rise were addressed in the UK context by the Court of Appeal in *Mobilx Limited (in Liquidation) v HMRC* [2010] EWCA Civ 517. At [52], Moses LJ said as follows in relation to the "should have known" part of the *Kittel* test:

> *"*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."

38. At [53] to [60] Moses LJ addressed the extent of knowledge required. He observed that it would offend the principle of legal certainty to deny input tax credit on the grounds that the relevant taxpayer knew or should have known that it was *more likely than not* that the supplies in question were connected with fraud. Instead, such denial could be made only if the relevant taxpayer knew or should have known that the supplies in question *were* connected with fraud:

> "[56] … A trader who knows or could have known no more than that there was a risk of fraud will find it difficult to gauge the extent of the risk; nor will he be able to foresee whether the circumstances are such that it will be asserted against him that the risk of fraud was so great that he should not have entered into the transaction. In short, he will not be in a position to know before he enters into the transaction that, if he does so, he will not be entitled to deduct input VAT. The principle of legal certainty will be infringed.
>
> [56] It must be remembered that the approach of the court in *Kittel* was to enlarge the category of participants. A trader who should have known that he was running the risk that by his purchase he might be taking part in a transaction connected with fraudulent evasion of VAT, cannot be regarded as a participant in that fraud. The highest it could be put is that he was running the risk that he might be a participant. That is not the approach of the court in *Kittel*, nor is it the language it used. In those circumstances, I am of the view that it must be established that the trader knew or should have known that by his purchase he *was* taking part in such a transaction …"

39. At [59-60] Moses LJ observed that:

> "[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."

40. At [61] Moses LJ said the following about legal certainty:

> "A trader who decides to participate in a transaction connected to fraudulent evasion, despite knowledge of that connection, is making an informed choice; he knows where he stands and knows before he enters into the transaction that if found out, he will not be entitled to deduct input tax. The extension of that principle to a taxable person who has the means of

> knowledge but chooses not to deploy it, similarly, does not infringe that principle. If he has the means of knowledge available and chooses not to deploy it he knows that, if found out, he will not be entitled to deduct. If he chooses to ignore obvious inferences from the facts and circumstances in which he has been trading, he will not be entitled to deduct."

41. At [64] Moses LJ reiterated that, "[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".

42. At [74-75] Moses LJ referred to a tribunal's "undue focus" on whether a company director had "exercised due diligence or done 'enough to protect himself'". Moses LJ then stated: "That is not the only question. The ultimate question is not whether the trader exercised due diligence but rather whether he should have known that the only reasonable explanation for the circumstances in which his transaction took place was that it was connected to fraudulent evasion of VAT."

43. At [81] and [82] Moses LJ noted that the burden of proof in such cases is on HMRC but made it clear that that "is far from saying that the surrounding circumstances cannot establish sufficient knowledge to treat the trader as a participant …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.*"*

Other authorities on* Kittel *principles

'Should have known' test - Davis & Dann

44. In considering the "should have known" test, the Court of Appeal (Arden LJ) in *Davis & Dann Ltd & Anor v HMRC* [2016] EWCA Civ 142 said that the tribunal must guard against over compartmentalisation of the factors, rather than the consideration of the totality of the evidence. The court said the Tribunal is not restricted from relying on any circumstance which is capable of being probative of knowledge to the no other reasonable explanation standard. It was not correct to argue that, simply because there was no allegation that X was a party to a scheme to defraud, no circumstance surrounding X could be a circumstance, which, when added together with other circumstances, should have led HMRC to conclude there was a connection with fraud. Arden J then cited the last sentence of [52] of *Mobilx* (concerning a trader who fails to deploy means of knowledge available to him) and observed that a taxpayer may have knowledge to the "only reasonable explanation" standard if he fails to make inquiries.

45. In *AC (Wholesale) Ltd v HMRC* [2017] UKUT 191 (TCC) the Upper Tribunal decided that the 'should have known' test did not require HMRC to eliminate all other possible reasonable explanations in order to establish, as required by *Mobilx*, that the only reasonable explanation for the transactions was that they were connected to fraud. It added (at [30]):

> "Of course, we accept (as, we understand, does HMRC) that where the appellant asserts that there is an explanation (or several explanations) for the circumstances of a transaction other than a connection with fraud then it may be necessary for HMRC to show that the only reasonable explanation was fraud. As is clear from *Davis & Dann*, the FTT's task in such a

case is to have regard to all the circumstances, both individually and cumulatively, and then decide whether HMRC have proved that the appellant should have known of the connection with fraud. In assessing the overall picture, the FTT may consider whether the only reasonable conclusion was that the purchases were connected with fraud. Whether the circumstances of the transactions can reasonably be regarded as having an explanation other than a connection with fraud or the existence of such a connection is the only reasonable explanation is a question of fact and evaluation that must be decided on the evidence in the particular case. It does not make the elimination of all possible explanations the test which remains, simply, did the person claiming the right to deduct input tax know that, by his purchase, he was participating in a transaction connected with fraudulent evasion of VAT or should he have known of such a connection."

THE PARTIES' CASES IN BRIEF

HMRC

46. HMRC argued that the purchases were part of an overall scheme to defraud the revenue, since:

(1) Micro made consistent mark-ups of the sales of the purchased goods, of 1% or just slightly more; HMRC submitted that this was uncommercial;

(2) HMRC submitted that, in commercial circumstances, transactions like the purchases and onward sales would have required security and a clear understand of ownership of the goods; that was absent here; HMRC submitted that this was further evidence of "uncommerciality";

(3) Micro was not involved in the transport of the goods, or their insurance;

(4) there was no negotiation between Micro and the companies it purchased from – this, too, was uncommercial, HMRC submitted;

(5) Micro has no experience in trading in metals;

(6) Micro did not perform any meaningful due diligence on its counterparties ;

(7) The purchases and onward sales of the goods were back to back transactions;

(8) Micro did not take into account the "warnings" it had received from HMRC about the scrap metal market being rife with fraud.

47. HMRC argued in the alternative that Micro should have known that the purchases were connected with fraudulent VAT evasion.

48. HMRC submitted that there were "vast gaps" in the evidence called by Micro as to the nature of its business and the knowledge of those involved in the purchases and onward sales of the goods; HMRC sought "adverse inferences" from these "failures".

Micro

49. Micro's skeleton argument for the hearing was on the basis that HMRC had failed to discharge the burden of proof. Intertwined with this argument were submissions critical of HMRC for not producing, as part of their evidence, certain material provided to them by Micro in the course of HMRC's investigations, such as sales invoices, banking evidence of movement of funds, and Micro's "due diligence" material. Micro (rightly) accepted that, in accordance with the case management directions leading up to the hearing, it was for HMRC to provide the documents *on which they chose to rely* (and for Micro to do this same); but Micro submitted that it was difficult to see how HMRC could discharge the burden of proof, without producing invoices, bank statements, and "due diligence" material that had been provided to them by Micro.

50. In closing submissions, Micro submitted that there was documentary evidence to support Mr Ram's oral evidence about Fowler Oldfield Ltd being a "refiner" of silver. Micro's counsel drew attention to the fact that invoices and other such documents in relation to purchases 9 and 10 (from Quality Engines Direct Ltd) *were* included in the evidence HMRC provided to the Tribunal; and to the fact that

(1) for purchase 10,

(a) the invoice raised by Quality Engines Direct Ltd to Micro dated 16 February 2016 for 495 kg of silver scrap bars, deducted an amount of £1,980 as a "refine charge" (the invoice total, including VAT, was £182,714.40);

(b) an invoice dated 25 Feb 2016 raised by Micro to Stunt & Co Ltd also made reference to a £1,980 "refine charge" (the invoice total here, including VAT, was £184,717.20);

(c) an email from Daniel Rawson at Fowler Oldfield Ltd headed "Re: stock inquire for March 2016" stated: "Your metal has been processed and your sale of 495 kg from your account completed. Please invoice Stunt: …"; it then included the items and calculation that were shown on Micro's invoice to Stunt & Co Ltd of 25 February 2016;

(2) evidence provided by HMRC to the Tribunal included two invoices raised by Micro to Fowler Oldfield Ltd:

(a) one, for purchase 1, dated 23 October 2015 for 600 kg "scrap silver"; and

(b) another, for purchase 2, dated 30 October 2015 for 500 kg where the description column is more detailed, as follows: "delivered silver scrape 538.45 kg; Assay of 92.40%; 500 kg at 10.18 fix; Return Rate 93.75; = 9.543 troy oz; = £306.83 kg x 500 kg" (the invoice total is £184,098).

51. Micro submitted that the evidence just cited corroborated Mr Ram's oral evidence that Micro had an "account" at Fowler Oldfield Ltd and that Fowler Oldfield Ltd performed the service of "refining" the silver that was the subject matter of the purchases.

52. Micro submitted, based on Mr Ram's oral evidence, that the commercial reason for Micro's being in the chain of supply was that Micro had an "account" at Fowler Oldfield Ltd (whereas the companies selling to it, in the purchases, did not).

53. Both Mr Ram's witness statement, and Micro's skeleton argument for the hearing, complained of prejudice to Micro due to the inability to cross examine Officer Shah, who was responsible for the input tax denials that were the subject matter of the appeal. During the hearing, Micro's counsel did not pursue this point, and rightly so: the appeal was not about the conduct of the investigation by HMRC, or the opinions of a particular HMRC officer, but about whether the input tax denial was correct in law and, in particular (given the honing of the issues via the *Fairford* directions and the process of the hearing), Micro's state of knowledge at the relevant time, and the evidence of that; and Micro had been at liberty to put forward evidence (as indeed it did) on that matter.

DISCUSSION

Evidence and burden of proof

54. We do not accept the argument that HMRC failed to discharge the burden of proof in this appeal. Even if we confine our inquiry to evidence produced by HMRC themselves (as if, notionally, we were considering an application to debar HMRC, at a point in the proceedings when HMRC had provided their evidence, but Micro had not provided its), it seems to us that this clearly supported a *prima facie* case that Micro knew or should have known that the

purchases were connected with fraudulent VAT evasion. In our view, the key evidence put forward by HMRC in this regard was

(1) evidence of HMRC's meetings, and correspondence, with Micro prior to the purchases, at which Micro was made aware that the scrap metal market was tainted with VAT fraud; and in which suggestions were made as to tell-tale signs of transactions connected to fraudulent VAT evasion;

(2) evidence of the timing and pricing of the purchases and related onward sales, which were back to back, with a small margin;

(3) an acknowledgement on HMRC's part (see paragraph 66 of HMRC's amended statement of case) that Micro did certain checks on its counterparties in the purchases (verifying their VAT numbers, confirming their basic details via Companies House filings and copies of director's passports), together with an assertion on HMRC's part that nothing more than this was done.

55. If (as we think is more appropriate) we widen the inquiry (as to whether HMRC discharged the burden of proof) to *all* the evidence that was before the Tribunal, including that put forward by Micro – most importantly, to include Mr Ram's evidence – then it is all the more clear to us that this is not a case where there has been a failure to discharge the "burden of proof": we have sufficient evidence to determine this appeal fairly and justly; and, as will become evident in the sub-section that follows on *Micro's state of knowledge*, this is not a case where the evidence is so finely balanced that we have to fall back on the "burden of proof" in order to decide which party prevails.

56. The answer to Micro's complaint that HMRC did not produce all the materials that Micro sent to them during the investigation, is a simple one: it was for Micro, a party that was legally represented throughout, to produce those materials to the Tribunal, if it wished to rely on them.

Micro's state of knowledge

57. The only issue for determination by the Tribunal is whether Micro knew, or should have known, of the connection of the purchases to fraudulent VAT evasion. We find it efficient, in this case, to start with the question of whether Micro 'should have known'. In that regard, the guidance of the higher courts is to consider whether connection with fraudulent VAT evasion was the only reasonable explanation for the circumstances in which the purchases took place.

The circumstances in which the purchases took place

58. In this sections we make findings about the relevant circumstances in which the purchases took place.

59. We find that:

(1) each purchase was immediately followed by an onward sale of the same goods;

(2) Micro did not, and was not expected to, pay for the purchase until it had received funds for the onward sale;

(3) the goods (considerable quantities of silver) never physically moved as part of the purchase and onward sale;

(4) the price for the onward sale was calculated using a market price for silver refined to a certain quality (in some case this was adjusted for a small "refine fee"); the price for the purchase was the same as for the onward sale, with 1% (or very close thereto)

subtracted; Micro therefore made a consistent 1% margin on the purchases and onward sales;

(5) because of the above, Micro took no meaningful economic risk in the transactions.

60. There was no overlap, in realistic business terms, between (1) the purchases (and onward sales) and (2) Micro's principal business as a high street jewellers: the counterparties involved were entirely different, and the purchases/onward sales did not call on Mr Ram's expertise and experience as a trained jeweller and someone who ran a retail jewellers shop. The purchases/onward sales were a different line of business, in which Micro had started to get involved two or three years before the purchases occurred. The fact that Micro occasionally found itself with scrap silver to sell (as a result of its retail jewellery business), or that Mr Ram was somewhat aware of the wholesale silver trade, does not, in our view, affect this finding.

61. Mr Ram's evidence (given orally at the hearing) was that the reason for Micro's presence in the supply chain was that Micro had an "account" at Fowler Oldfield Ltd, whereas the companies selling to it did not; and that Fowler Oldfield Ltd was responsible for "refining" the silver. We found it odd that this point was not made in Mr Ram's witness statement; however, we are persuaded by the combination of Mr Ram's oral testimony, and the corroborating documentary evidence pointed to by Micro's counsel, that, on the balance of probabilities, Fowler Oldfield Ltd was responsible for refining the silver in the transactions; and that Micro did have an "account" with Fowler Oldfield in the sense that Micro could avail itself of Fowler Oldfield's service of transacting in silver for "clients" of its who did not themselves (physically) hold the silver (on the basis that Fowler Oldfield Ltd was holding it, and marking changes of ownership by adjusting "accounts"). We are not persuaded, however, that this arrangement between Micro and Fowler Oldfield Ltd had anything to do with Micro's longstanding business as a high street jewellers, or Mr Ram's long experience in the jewellery trade. Rather, it was an aspect of Micro's "getting into" the buying and selling of large amounts of precious metal from around 2013, that Micro entered into these arrangements with Fowler Oldfield Ltd (and, indeed, this was how Micro's need to open "accounts" was explained to HMRC according to their note of their meeting with Micro on 3 May 2013).

62. In our view, having an "account" with Fowler Oldfield Ltd was not something "special" to Micro that explains why it earned a 1% margin for buying and immediately on-selling silver; this explains why it was an afterthought in Mr Ram's evidence, rather than a centrepiece to explain the commercial rationale of Micro's role. In our view, the evidence provides no good answer to the question of why Micro was in the supply chain, or indeed what it did to justify its (admittedly small) margin of 1%. We find that Micro's 1% margin was, in realistic business terms, "money for nothing".

63. Micro had been informed by HMRC, about two years before the purchases occurred, that the scrap metal market was "tainted" with VAT fraud; and Micro had been given HMRC literature which explained how to spot transactions connected with VAT fraud. HMRC had advised Micro to take care not to be caught in transactions connected with VAT fraud, to protect Micro's own commercial interests. We do not accept that part of Mr Ram's evidence which suggests that HMRC's advice was that all Micro needed to do was confirm the company's VAT registration number, or that HMRC's advice was that the risk was confined to electronic goods or the like: Micro was told that the risks applied to all commodities, and that the checks to be made had to be substantive and meaningful.

64. We find that Micro did not heed HMRC's advice in its dealings with the companies which sold to it in the purchases: the suppliers were found by "advertising on the internet", Mr Ram said in evidence; we do not understand exactly what this entailed, but we infer that they were companies that Mr Ram, and Micro, were coming across for the first time, and of which they had no background knowledge; and yet the only checks Micro carried out were to confirm their VAT registration numbers, that they were registered at Companies House, and the identity of their managing director. Micro did not make meaningful enquiries to assure itself that these companies were not involved in VAT fraud.

Conclusions as to Micro's state of knowledge

65. In summary, the purchases and onward sales were, from Micro's perspective, small-margin, "money for nothing" transactions, buying from companies of which Micro knew nothing of substance, in a business area divorced from Micro's principal business as a high street jewellers; the transactions therefore bore a number of the tell-tale signs of connections with VAT fraud, of which Micro had been recently informed in its dealings with HMRC. In our view, there was no reasonable explanation for these circumstances other than that the purchases were connected with VAT fraud. It follows that Micro should have known this – and consequently, that this appeal falls to be dismissed.

66. For completeness, however, we state our view that, on the balance of probabilities, Micro did not actually know of the purchases' connection with fraudulent VAT evasion. This seems to us a classic case of having, in *Mobilx* terms, the means at one's disposal of knowing of that connection, but, in Micro's case, choosing not to deploy those means. A reasonable business in Micro's position and in the circumstances would have made the obvious inference of connection to VAT fraud – but, on the evidence before us, it seems Micro never did.

DISPOSITION

67. Following our conclusion set out at [65] above, the appeal must be dismissed.

RIGHT TO APPLY FOR PERMISSION TO APPEAL

68. 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.

ZACHARY CITRON
TRIBUNAL JUDGE

Release date: 27th SEPTEMBER 2024

6. Dealing with other businesses - How to ensure the integrity of your supply chain

6.1 What checks can I undertake to help ensure the integrity of my supply chain

The following are examples of indicators that could alert you to the risk that VAT would go unpaid:

1) Legitimacy of customers or suppliers. For example:

- what is your customer's/supplier's history in the trade?
- has a buyer and seller contacted you within a short space of time with offers to buy/sell goods of same specifications and quantity?
- has your supplier referred you to a customer who is willing to buy goods of the same quantity and specifications being offered by the supplier?
- does your supplier offer deals that carry no commercial risk for you — e.g., no requirement to pay for goods until payment received from customer?
- do deals with your customer/supplier involve consistent or pre-determined profit margins, irrespective of the date, quantities or specifications of the specified goods traded?
- does your supplier (or another business in the transaction chain) require you to make 3rd party payments or payments to an offshore bank account?
- are the goods adequately insured?
- are they high value deals offered with no formal contractual arrangements?
- are they high value deals offered by a newly established supplier with minimal trading history, low credit rating etc?
- can a brand new business obtain specified goods cheaper than a long established one?
- has HMRC specifically notified you that previous deals involving your supplier had been traced to a VAT loss and/or had

involved carousel movements of goods?

- has HMRC specifically notified you that HMRC date stamps have been present on goods offered for sale by your supplier, or that there is evidence of HMRC date stamps being removed from packaging. This would strongly suggest that the goods had been subject to carousel movement, which should alert you to a significant risk that the transactions entered into with that supplier may be connected with the non-payment of VAT;

- has HMRC specifically notified you that other MTIC VAT fraud characteristics (such as third party payments) have occurred in transaction chains involving your supplier?

2) Commercial viability of the transaction. For example:

- Is there a market for this type of goods — such as superseded or outdated mobile phone models or non-UK specific models?

- What research have you done to test whether these goods are available as described and in the quantities being offered?

- Is it commercially viable for the price of the goods to increase within the short duration of the supply chain?

- Have normal commercial practices been adopted in negotiating prices?

- Is there a commercial reason for any third party payments?

- Are normal commercial arrangements in place for the financing of the goods?

3) Viability of the goods as described by your supplier.

For example:

- Do the goods exist?

- Have they been previously supplied to you?

- Are they in good condition and not damaged?

- Do the quantities of the goods concerned appear credible?

- Do the goods have UK specifications yet are to be exported?

- Is your supplier unwilling to provide IMEI or other serial numbers?

- What recourse is there if the goods are not as described?

HMRC recommends that sufficient checks be carried out in each of the above categories to ensure that you are not caught in a fraudulent supply chain.