[2013] UKUT 0599 (TCC)

Appeal number: FTC/90/2012

VAT – MTIC fraud – (1) whether First-tier Tribunal erred in law in applying the Kittel principle as interpreted by the court of appeal in Mobilx – whether that interpretation is open to doubt by subsequent CJEU judgments – Mahagében and Dávid; Tóth; Bonik; LVK-56 – no – (2) whether conclusions drawn by First-tier Tribunal from its findings of fact were irrational – no – appeal dismissed and application for reference to CJEU refused

UPPER TRIBUNAL
TAX AND CHANCERY CHAMBER

FONECOMP LIMITED **Appellant**

- and -

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

TRIBUNAL: MR JUSTICE SALES
JUDGE ROGER BERNER

Sitting in public at the Royal Courts of Justice, The Rolls Building, Fetter Lane, London EC4 on 29 – 30 October 2013

Michael Patchett-Joyce, instructed by Dass Solicitors, for the Appellant

Mark Cunningham QC and James Puzey, instructed by Howes Percival LLP, for the Respondents

DECISION

1. This is the appeal of Fonecomp Limited ("Fonecomp") from the decision of the First-tier Tribunal ("FTT") (Judge Hellier and Mr Nigel Collard), released on 3 February 2012, dismissing Fonecomp's appeal against the decision of HMRC to deny credit for input tax in respect of Fonecomp's purchase of mobile phones in two transactions which took place in July 2006. The amount of input tax in dispute was £183,951.30.

2. The basis for the refusal of input tax credit by HMRC was that Fonecomp's purchases were connected to the fraudulent evasion of VAT by a company called Softlink Limited ("Softlink"), and that Fonecomp knew or should have known of the connection to VAT fraud. This is therefore a further example of cases which have been described as missing trader intra-Community fraud (or MTIC) cases which have fallen to be considered on a number of occasions by the courts and tribunals. In this case the FTT found that such a connection to VAT fraud had been made out, and that Fonecomp should have known that its purchases were connected with the fraudulent evasion of VAT. On that basis, the FTT dismissed Fonecomp's appeal.

3. Following submissions of the parties following the release of the FTT's decision on the appeal, the FTT released on 25 June 2012 a further decision refusing the application of Fonecomp that a reference be made to the Court of Justice of the European Union.

The decision of the FTT: facts and conclusions

4. The facts are extensively set out in the decision of the FTT, reported at [2012] UKFTT 102 (TC), and can for the purpose of this appeal be stated quite briefly.

5. The two transactions of Fonecomp in issue were:

> (a) Deal 1: the purchase by Fonecomp of 1100 Nokia 9300i phones and 1200 Nokia 8801 phones from PDA Stuff Limited for £759,226.25, including VAT of £113,076.25, and the sale of those phones to Axess Denmark ApS ("Axess"), a company incorporated in Denmark, for £679,200. The purchase and sale invoices were dated 11 July 2006; and
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> (b) Deal 2: the purchase by Fonecomp of 900 Nokia N80 phones and 500 Nokia N91 phones from TM Global Limited (trading as Team Mobile) for £475,875, including VAT of £70,875, and the sale of those phones to Axess. The purchase and sale invoices were dated 26 July 2006.

6. The FTT found that Softlink had defaulted in its VAT payment in respect of transactions undertaken by it in August 2006, after the date of the July transactions carried out by Fonecomp. Softlink was not involved in transactions in the goods bought and sold by Fonecomp, but the FTT found that Fonecomp's purchases were

connected to Softlink's default through what has been described as a "contra-trader", a company called Klick (UK) Limited ("Klick").

7. As the FTT recorded (at [5]), contra-trader is a term used by HMRC (Mr Patchett-Joyce referred to it as "an HMRC construct") to describe a trader which (a) buys goods from a defaulter and exports them claiming, in what is termed the "dirty chain", the input VAT ("the dirty input VAT") on the purchase; and (b) in a "clean chain", imports goods and sells them to a third trader, and then offsets the dirty input VAT against the clean output VAT on the sale to the third trader. The dirty input VAT is by this means sought to be transmuted into clean input VAT in the hands of the third trader; or at any rate the third trader is sought to be so distanced from the default that he could not know of his connection to it, or HMRC discover it.

8. That is a description of a straightforward example of contra-trading. More complex examples may be found, where the goods pass through a number of intermediate traders in a chain. In this case Fonecomp, alleged to be the third trader in the description of contra-trading, did not purchase the goods from Klick. It was distanced from Klick by one or two intermediate traders in the clean chain. It was alleged by HMRC that, first, the activities of Klick provided the connection between Fonecomp's purchases and Softlink's default, and secondly that there was a wider managed scheme associated with Klick's transactions, involving 37 other traders including Fonecomp, in an organised assault on the revenue which involved reclaiming the VAT on which Softlink defaulted, amounting to some £66 million.

9. The FTT made detailed findings of fact in relation to Softlink, Klick and the alleged wider "Klick" scheme. It concluded:

> (a) Softlink had a liability to pay VAT in respect of 194 deals it had undertaken between 15 and 25 August 2006, that it did not pay that VAT and that at the time it entered into the transactions it had not intended to pay that VAT. Softlink fraudulently evaded, and at the time of the deals had intended to evade, the £66 million of VAT on its sales to Klick between those dates (FTT, [164]).
>
> (b) Klick's activities in June, July and August 2006 were part of a planned scheme which encompassed Softlink's default. The object of that scheme was to fuel chains of supply in June and July 2006 with input tax credits which could eventually be claimed by exporters, and to match those credits with a later fraudulent VAT default by Softlink leaving a small VAT reclaim at the end of the quarter. All Klick's sales in June and July 2006 were by this arrangement connected to Softlink's later fraudulent default. Softlink's default was planned as part of the same operation as Klick's activities in those months (FTT, [166] – [167]).
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> (c) Fonecomp's acquisition of the phones in Deal 1 in July 2006 was connected with Klick's acquisition and disposal of them in the senses: (i) that they were the same phones and were sold and acquired in transactions close in time, (ii) that the input and output VAT were offset, and (iii) that the acquisition aided Klick's sales (FTT, [203]).

(d) Fonecomp's acquisition of the phones in Deal 2 in July 2006 was in the same sense connected with Klick's acquisition and disposal of them (FTT, [205]).

(e) Accordingly, for each Deal, the FTT found that Fonecomp's purchase was connected with Klick's fraudulent arrangements in relation to, and hence was connected with, the fraudulent evasion of VAT by Softlink (FTT, [206] – [210]).

10. The FTT concluded that Fonecomp's participation as an exporter in the scheme involving Klick and Softlink did not mean that it necessarily knew that it was part of the scheme (FTT, [219]). It nonetheless found that, since Fonecomp knew when it made its purchases all the facts from which it should have concluded that the deals assisted or were connected to VAT fraud, it should have known that its purchases were connected with fraud at the time it made them (FTT, [228]).

11. The FTT summarised its reasons for reaching that conclusion at [222] – [229]. At [222] it referred to its findings in relation to the following matters as indicating that the parties to Fonecomp's transactions were not concerned with precisely what phones they were buying and selling, and hence proceeded in a manner which was at variance from what one would expect in a normal commercial transaction:

(a) the lack of specification, particularly on purchase orders from Axess;

(b) the lack of proper inspection of the phones despite their value;

(c) the purchase and sales of phones designed for the US market and sold with "Central European spec"; and

(d) the lack of defined clear contractual terms (time of payment, title etc.).

12. The FTT found that the only explanation of these factors was that what Fonecomp's customer (and possibly Fonecomp and its supplier) wanted was that there would be a sale and export (that is, *any* sale and export), and was indifferent to precisely what was said to be exported because the recipient already knew precisely what it was getting because the chain had been pre-arranged (FTT, [223]).

13. At [224], the FTT focused further on the European and US specifications of the phones that were the subject of the transactions. It referred back to its findings at [136] to [144], where it concluded that the nature of both the types of phones was such that there was no likely explanation other than that they had been imported into the UK in order to be exported. The FTT further concluded, at [225], that the only reasonable explanation of these features was that the Deals were part of a scheme for the import, onsale and later export of the phones, and that the only explanation for such a scheme was that the transactions in the phones were part of, and aided, a VAT fraud.

14. Earlier in its judgment, the FTT had found that Fonecomp knew the mechanics of VAT fraud, it knew that its suppliers were back-to-back trading and it knew there

could be VAT fraud affecting the chains of supply to it. In those circumstances, the FTT concluded that Fonecomp should have known that the factors referred to by the FTT, which it found (at [228]) were known to Fonecomp at the time it made its purchases, led ineluctably to the conclusion that the Deals assisted or were connected to such a fraud (FTT, [226]).

Appeal

15. The primary ground of appeal, as presented by Mr Patchett-Joyce, was that the FTT erred in its analysis of the operation of the legal regime in EU law and case law of the Court of Justice covering the right of a person who purchases goods (and pays VAT on the purchase) and then sells them on in the course of his trade, to claim back the VAT paid as input tax. In Mr Patchett-Joyce's submission, the FTT should have found that Fonecomp was entitled to claim the VAT it had paid in relation to the Deals as input tax, and that its entitlement in that regard was *acte clair* in Fonecomp's favour. In the alternative, if not *acte clair* in Fonecomp's favour, Mr Patchett-Joyce submitted that the position was unclear so that a reference should be made to the Court of Justice under Article 267 TFEU.

16. As a further, distinct ground of appeal, Mr Patchett-Joyce submitted that the FTT had erred in law in its assessment regarding Fonecomp's state of mind in relation to its purchase transactions and its conclusion that Fonecomp should have appreciated that those transactions were connected with VAT fraud, and that certain of its conclusions on these matters were irrational.

Alleged error in interpreting the Sixth VAT Directive

17. We propose to deal with this quite shortly. Although the argument was elaborated at some length by Mr Patchett-Joyce, by reference to a significant number of authorities, we consider that the relevant European case law has been thoroughly analysed by the Court of Appeal in *Mobilx Ltd v Revenue and Customs Commissioners* [2010] EWCA Civ 517; [2010] STC 1436 and there is nothing that can usefully be added to its judgment in that case. In truth, the arguments rehearsed by Mr Patchett-Joyce before us go over ground which has been well-travelled domestically and in the Court of Justice and there is no material doubt about the legal principles to be applied. We consider that the FTT identified the legal principles correctly and directed itself appropriately as to the law when deciding the case before it. We also consider that there is no sound basis on which it would be appropriate to make a reference to the Court of Justice for the purposes of deciding the outcome of this appeal.

18. The facts in this case took place at a time when the VAT regime was governed by the Sixth VAT Directive. (That Directive has now been superseded by a new VAT Directive, but no material change has been made by that Directive.)

19. The Court of Justice laid down the relevant approach to be adopted where there is an allegation that a trader who is claiming input VAT has in some way been involved in or connected with VAT fraud carried out by another person in the leading

judgment given in Joined Cases C-439/04 and C-440/04 *Axel Kittel* [2006] ECR-I 6177. At paras. [56] and [61] the Court said this:

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

20. The test which is set out in these paragraphs has been restated and affirmed by the Court of Justice in a number of judgments since *Kittel*: see Joined Cases C-80/11 and C-142/11 *Mahagében and Dávid* [2012] STC 1934, paras. [45]-[50]; Case C-324/11 *Tóth* [2013] STC 185, paras. [38]-[39]; Case C-285/11 *Bonik* [2013] STC 773, paras. [35]-[43]; Case C-643/11 *LVK-56*, unrep, judgment of 31 January 2013, paras. [58]-[64]. It is the test that the FTT correctly sought to apply to the facts as found by it in the present case. There is in our view no doubt that this test represents a correct interpretation of the applicable EU law.

21. It should be observed that at some points in *Mahagében and Dávid* and in *Tóth* the Court of Justice referred to connection to VAT fraud committed by a trader "at an earlier stage in the transaction" (para. [45] in *Mahagében and Dávid*) or "acting earlier in the chain of supply" (paras. [49], [50] and [52] in *Mahagében and Dávid* and paras. [38] and [39] in *Tóth*); but elsewhere in *Mahagében and Dávid*, at para. [47], the Court indicated that the principle would apply where it was known or should have been known by the trader claiming to deduct input tax that the transaction in relation to which input tax was claimed "was connected with fraud committed by the supplier, or that another transaction forming part of the chain of supply prior to or subsequent to that transaction carried out by the taxable person was vitiated by VAT fraud". This wider interpretation of the *Kittel* principle, by reference to connection to VAT fraud occurring in the relevant supply chain prior to or subsequent to the transaction in relation to which input tax is claimed, has been confirmed by the Court in the formulation of the principle adopted in *Bonik* at paras. [40] and [43] (deduction of input tax may be refused where the taxable person knew or should have known that the transaction in relation to which input tax was claimed "was committed by the supplier or another trader acting upstream or downstream in the chain of supply") and in *LVK-56* at para. [60]. This approach makes obvious sense, in view of the way in which the order of transactions involving VAT can be readily adjusted to allow for claims to deduct input VAT to be made by different entities using different accounting periods for VAT purposes. Within this jurisdiction, the Court of Appeal in *Mobilx* has authoritatively interpreted the *Kittel* principle as involving this wider approach: "If the circumstances of [the relevant] purchase are such that a person knows or should know that his purchase is or will be connected with fraudulent evasion, it cannot matter a jot that that evasion precedes or follows that purchase" ([62]).

22. Thus, in the present case, the FTT applied the correct approach under EU law by inquiring whether the Deals in question were connected with VAT fraud occurring before or after the Deals.

23. Mr Patchett-Joyce took us to the French language version of various of these judgments, in order to suggest that the formulation of the *Kittel* principle in French (whether the transaction in relation to which input VAT was claimed "était impliquée dans" a VAT fraud) was materially different from that used by the Court of Justice in the English language version of its judgments (whether the transaction in relation to which input VAT was claimed was "connected with" a VAT fraud). We reject this suggestion. The Court has regularly for some years treated these phrases as correct and accurate translations, and it is clear that it perceives there to be no material difference between them. The English phrase, "connected with", has been deliberately adopted by the Court and provides a clear and reliable guide for a court operating in English as to the proper interpretation of EU law. Again, in this jurisdiction, the Court of Appeal in *Mobilx* has authoritatively interpreted the judgment in *Kittel* in this way (see, in particular, [3], [4], [16]-[18], [20] and [59]-[60]).

24. Mr Patchett-Joyce also submitted that the principle laid down by the Court of Justice is only referable to VAT fraud which occurs in the *same* chain of supply of goods or services, and does not extend to cover VAT fraud which occurs in another chain of supply, as happens in a "contra-trading" case such as the present. We do not accept this submission either. The authoritative statement of the principle given by the Court at paras. [56] and [61] of its judgment in *Kittel* is not qualified in this way, and such an arbitrary and excessively narrow focus would not accord with the usual purposive approach to interpretation of EU legislation. Since it is readily possible to conceive of situations in which contra-trading occurs, whereby transactions in the so-called clean chain of supply can provide material assistance for VAT fraud in the so-called dirty chain of supply (as the FTT found had happened in this case), there is no basis at all for reading down and limiting the *Kittel* principle in the manner contended for by Mr Patchett-Joyce. The rationale and explanation given by the Court in *Kittel* for the principle it stated in that case apply with equal force in a contra-trading situation as in relation to a simpler type of case involving a single chain of supply. It should be borne in mind that the primary mechanism to control the application of the principle which disallows a trader from claiming input VAT is that the national authorities have to establish that he knew or should have known that his transaction was connected with the fraudulent evasion of VAT, and that mechanism is equally available to protect a trader in both a simple chain of supply case and in a contra-trading case. The applicability of the *Kittel* principle in a contra-trading case was very fully explained by Lewison J in *Revenue and Customs Commissioners v Livewire Telecom Ltd* [2009] EWHC 15 (Ch); [2009] STC 643.

25. The Court of Appeal in *Mobilx* gave detailed consideration to the proper interpretation of the judgment in *Kittel*. The Court of Appeal held that it was not arguable that the principles of fiscal neutrality, legal certainty, free movement of goods and proportionality were infringed by the Court of Justice in laying down the principle in *Kittel*, on the Court of Appeal's reading of that principle and its judgment: see [66]. The principles of proportionality and legal certainty are respected in the

balance struck by the Court of Justice between the interests of the tax authorities and the interests of the taxpayer in its formulation of the *Kittel* principle. Since the contrary was not arguable, there were no grounds for a reference to be made to the Court of Justice.

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

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

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

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

from or re-formulation or modification of the *Kittel* principle, as interpreted by the Court of Appeal in *Mobilx*.

30. We therefore conclude that the position regarding the proper scope of the *Kittel* principle is *acte clair* against Fonecomp. Accordingly, this aspect of Fonecomp's appeal is dismissed and we dismiss its request for a reference to be made to the Court of Justice.

31. Mr Patchett-Joyce sought to support Fonecomp's request for a reference by pointing us to certain guidance issued by the French tax authorities and suggesting that this showed that there was a serious difference in approach to application of the *Kittel* principle between Member States, which should be resolved by means of a ruling by the Court of Justice on a reference under Article 267. We were unpersuaded by this. There was no proper evidence of French law or the approach of the French tax authorities on the basis of which we could assess the true position in France. Moreover, we consider that the legal analysis set out above indicates that there is no significant uncertainty about the proper interpretation of relevant EU law which might require to be resolved by the Court of Justice in order for this appeal to be determined.

32. The application of the *Kittel* principle to the facts of a particular case is a matter for the relevant national court: see, e.g., *Bonik*, para. [45]; *LVK-56*, para. [64]. We therefore now turn to consider whether there has been any error by the FTT in its application of the principle to the facts of the case.

Were the conclusions reached by the FTT irrational?

33. Mr Patchett-Joyce made clear that Fonecomp did not seek to argue that the FTT acted irrationally in making any of its findings of fact. Nonetheless, it was submitted that the FTT was not entitled to draw the conclusions it did from the facts it had found, on the basis that it was irrational to draw those conclusions.

Connection to fraud

34. We start with Mr Patchett-Joyce's submissions in respect of connection. These necessarily proceeded on the basis that his arguments on the basis in law of the connection test in the context of the contra-trading construct had not succeeded.

35. As we described earlier, the FTT found that each of Fonecomp's transactions, Deal 1 and Deal 2, were connected with the acquisition and disposal of the phones in each case by Klick, the contra-trader. At [203] it summarised its reasons as follows:

> (a) the phones were the same phones and had been sold and acquired in transactions close in time;
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> (b) the input and output VAT had been offset; and
>
> (c) the acquisition by Fonecomp aided Klick's sales.

36. As regards (a) Mr Patchett-Joyce argued that it was an inherent feature of any distribution system that, in the course of the distribution process, the same phones

would pass throughout the course of that process. On that footing, he argued, the test of connection would always be satisfied. That, he submitted, could not be correct in law, because the result would be that *all* transactions in a distribution process would become tainted by the fraud of one taxable person in that chain. This analysis, submitted Mr Patchett-Joyce, had been consistently rejected by the ECJ, for example in Joined cases C-354/03, C-355/03 and C-484/03 *Optigen Ltd* [2006] ECR I-500; [2006] STC 419.

37. We do not consider that *Optigen*, or any other authority of the Court of Justice assists Mr Patchett-Joyce in this respect. The remarks of the Court in *Optigen*, following on from the opinion of the Advocate-General, were not concerned with the question of connection. They were concerned with whether the *character* of a particular transaction in a chain could be altered by earlier or subsequent events (*Optigen*, judgment, at para [47]). The context of those remarks was whether the nature of a supply as a supply by a taxable person and an economic activity could be determined by, amongst other things, the fraudulent nature of another transaction in the chain. Those remarks do not address the question of connection; but they assume that a trader's transactions, although having to be considered on their own merits, can properly be regarded as part of a chain of supply.

38. Mr Patchett-Joyce criticised the FTT's reliance on the transactions being close in time. He argued that this must be wrong in law, as a party such as Fonecomp would know only that it was purchasing from its own immediate supplier, and would not therefore know how close in time that transaction was to an earlier transaction. This argument is also, in our view, misplaced. The question of connection to a particular VAT fraud is concerned with the linkage with that fraud on the facts, and is not itself concerned with the knowledge of the trader in question. The assessment whether a particular transaction is connected with VAT fraud depends on objective factors which, in contrast to questions relating to knowledge or means of knowledge of the trader, may well be outside the knowledge of the trader.

39. We also reject the argument of Mr Patchett-Joyce that reference to transactions being close in time would be the antithesis of legal certainty, as it would not be clear how close in time transactions would have to be for a connection to be established, or not established. We could see the force of Mr Patchett-Joyce's submission were the FTT to have found that closeness in time was the defining factor in establishing connection. But it did not do so. In referring to the timing of the transactions, it was merely making the point that such timing is one of the objective factors that may be taken into account by the tribunal in considering the question of connection, alongside other factors.

40. As regards (b) and (c), Mr Patchett-Joyce reminded us that Fonecomp did not itself deal with the contra-trader, Klick. There were one or two intervening traders between Klick and Fonecomp. Thus, argued Mr Patchett-Joyce in relation to (b), taking Deal 2 as an example, the output tax of Klick was offset as input tax by TM Global, and not by Fonecomp. He submitted that the offsetting of input tax against output tax was intrinsic to the concept of VAT, and could not therefore be an objective factor which established the appropriate level of connection.

41. With respect to Mr Patchett-Joyce, we consider his submission misses the point. The FTT was not basing its conclusion on connection on the mere machinery of offset in isolation from the overall circumstances of the case. It looked instead to the role played by that offsetting in the transactions before it. It found, first, that Fonecomp's acquisitions of the phones were connected to Klick's purchase and sale of them. That was a necessary step in the analysis of connection, but it was not sufficient. The FTT had to go on to find, as it summarised at [206], that Klick's transactions were connected to Softlink's default. It found that all Klick's sales and purchases in July 2006 were executed with the object of fuelling chains of supply with the relevant input tax credits and of matching those credits in aggregate with the planned VAT default by Softlink. That, the FTT found, was an arrangement connecting Klick's supplies to its purchases from Softlink and Softlink's default. This conclusion cannot be impugned.

42. Furthermore, the FTT had earlier in its decision referred to what the Chancellor (Sir Andrew Morritt C.) had said in *Blue Sphere Global Ltd v Revenue and Customs Commissioners* [2009] STC 2239, at [44], in rejecting in that case similar arguments put by Mr Patchett-Joyce:

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

That disposed of Mr Patchett-Joyce's argument in *Blue Sphere*, and it equally disposes of it in this case.

43. Mr Patchett-Joyce also criticised the FTT's reliance on Fonecomp's acquisition having aided Klick's sales. He argued that it was TM Global's acquisition from Klick, in the case of each Deal, that aided Klick's sales. In so far as Mr Patchett-Joyce again sought to rely on *Optigen* in this respect, we reject his submission for the reasons we gave earlier: we are here concerned with the issue of connection, and not with the nature of Fonecomp's transactions or Fonecomp's state of mind. We ought, however, having regard to the way in which the FTT approached this question, to express our own view on the way in which, in a contra-trading case, connection to the fraudulent evasion of VAT might be established.

44. The FTT considered the legal test of connection in some detail (at [22] to [26]). It identified, by reference to what Lewison J had said in *Livewire Telecom Ltd* [2009] STC 643 at [107], what it considered to be an anomaly, namely that "since the whole

VAT system works on the basis of constant offsetting of input tax and output tax the implication … is that every taxable person could be connected with every other taxable person". The FTT sought to eliminate this supposed anomaly by concluding, at [33], that having regard to the fact that a taxable person who knew or should have known of the fraud is regarded as a participant in the fraud for the purposes of the VAT regime, on the footing that in such a situation the taxable person aids the perpetrators of the fraud and becomes their accomplice (*Kittel*, at [56] – [57]), the connection must be something that assists the fraud.

45. With respect to the FTT, we do not consider that the test of connection involves such a requirement. In our view, the test in a contra-trading case is that set out by the Chancellor in *Blue Sphere*, whose judgment was upheld by the Court of Appeal in *Mobilx* and others without any adverse comment on this aspect. We do not consider that this gives rise to any anomaly of the nature identified by the FTT. We respectfully agree with the Chancellor in *Blue Sphere* when he said, at [46], that the control mechanism, which ensures that not all persons in the chains, whether dirty or clean, although connected, should be refused the deduction of input tax, lies in the need for either direct participation in the fraud or sufficient knowledge of it. There is no need, in assessing whether connection with fraud has been made out, for the purchase to be found to have assisted the fraud.

46. Applying that test, which we note was one of the tests which the FTT regarded as satisfied (FTT, [208]), we do not consider that there can be any doubt that, on the facts found by the FTT, the FTT was entitled to conclude that Fonecomp's purchases were connected with the fraudulent evasion of VAT by Softlink. There was no error of law by the FTT in that respect.

Means of knowledge

47. Mr Patchett-Joyce submitted that, on the basis of the factors referred to by the FTT at [222], no reasonable tribunal could have concluded that Fonecomp should have known of the connection to fraud. We do not accept that submission. We explain below our conclusion on the arguments of Mr Patchett-Joyce in relation to each factor.

(a) Specification

48. The FTT made findings, at [107] – [113], concerning the specification of the phones in the documentation in respect of Fonecomp's own transactions. It found that, although Fonecomp itself had issued purchase orders in each case with "an amount of detailed specification", the documentation for the purchase by Axess was less extensive. Axess simply ordered a number of a particular type of phone. It was only when Fonecomp sent Axess its pro forma invoice that the detailed specification could be seen. By the time of issue of the pro forma invoice, Axess must have placed its order (FTT, [115]).

49. The FTT concluded, at [116], that Fonecomp's suppliers and Axess in both deals were not particularly interested in the detailed specification of the phones, and that Fonecomp knew this.

50. Mr Patchett-Joyce submitted that, given the FTT's finding that Fonecomp's own specification was detailed, its findings as to the deficiencies in the paperwork of other traders were not relevant to the state of knowledge of Fonecomp. We disagree. The FTT was examining the state of knowledge of Fonecomp, and it was relevant what Fonecomp knew of the way in which its supplier and customer were conducting the trades with Fonecomp. The FTT were entitled, on the evidence, to conclude that Fonecomp knew that its supplier and customer had little concern with the detailed specification of the goods being traded.

(b) Inspection

51. After considering the evidence, including that of Mr Sharif, the sales administrator of Fonecomp, the FTT concluded, at [120], that Fonecomp had not required reliable assurance from its freight forwarders that the goods received and sent out were of the specification that had been agreed. The likely explanation, in the assessment of the FTT, was that Fonecomp knew that it would be paid whatever the precise specification was, and that this explained its apparent indifference in that respect. That in turn suggested that Fonecomp knew that what mattered was that there was a sale, rather than a sale of specific goods, and that the purchaser already knew what it was getting.

52. Mr Patchett-Joyce submitted that this too was irrelevant to what the FTT had to find in respect of Fonecomp's knowledge. He argued that it had been no part of HMRC's case that phones of an incorrect quantity, type or specification had been concerned in the transactions, and in any event the FTT had found that the freight forwarder had sent Fonecomp a fax setting out the number of phones received and despatched.

53. Those arguments are once more misconceived. The FTT was making no finding as to the quantity, type or specification of the phones. Its finding went to the objective factor of Fonecomp's own lack of enquiry, beyond the fax detailing only quantity, of its freight forwarder as to details of the phones it was purchasing and selling. The FTT was entitled, on the basis of its findings concerning inspection to make the findings and draw the conclusions that it did.

(c) Nature of the phones dealt in

54. We referred earlier, when summarising the FTT's decision, to its findings at [137] – [144] concerning the European and US specification of the phones traded in Fonecomp's transactions, and to the conclusion it reached that the nature of both the types of phones was such that there was no likely explanation other than that they had been imported into the UK in order to be exported.

55. Mr Patchett-Joyce criticised this conclusion on the basis that the FTT found, at [141], that it was "the normal course for Fonecomp to deal in 2 pin phones, and that the two pin phones in these deals were not unusual but part of Fonecomp's normal trade" and that this was a significant part of Fonecomp's business (FTT, [73]).

56. That criticism, however, takes what the FTT said out of context. The FTT's comments in this respect followed what it had said at [140], namely that the importation of two pin phones into the UK followed by the changing of the chargers to three pin UK chargers could be an explanation for finding the occasional batch of two pin phones in the UK. But the FTT did not accept that explanation for the level of trade in issue. It concluded that the level of Fonecomp's trade showed that the consignments in question were not small ones, intended for conversion to the UK market, but were of phones in the UK whose only destination must have been outside the UK.

57. As regards the reference in the FTT's decision at [143] to the Nokia 8801 phones involved in Deal 1, Mr Patchett-Joyce accepted that the FTT had corrected an inadvertent slip in its decision by later amending that paragraph (in the course of a short ruling granting permission to appeal) to make clear that the FTT considered that Fonecomp knew that those phones were designed for the American market. In that respect too, the FTT found that there was no likely explanation other than that they had been imported into the UK in order to be exported. That this was indeed the finding which the FTT meant to express in [143] is also clear from the FTT's alternative finding, at [144], which was predicated on a different view of the facts ("If Fonecomp did not know that these phones were designed for the American market then …") from that in [143] (*sc.* "If, as we believe, Fonecomp did know that the 8801 phones were designed for the American market …").

58. In our judgment the FTT was entitled to conclude that all these factors were known to Fonecomp at the time it entered into its purchases, and that it should have known that these factors, along with the others referred to by the FTT, led to the conclusion that its purchases were connected to VAT fraud.

Terms of trade

59. The FTT made findings, at [121] – [127], on the contractual documentation in respect of Fonecomp's trades, both with respect to Fonecomp itself and also its suppliers.

60. At [128] the FTT commented that it found certain aspects of this evidence "worrying". It went on to explain why at [130] – [134]:

> (a) Lack of payment terms in the invoices from Fonecomp's suppliers made little commercial sense.
>
> (b) Even if the supplier was relying on the term in Fonecomp's purchase order that payment would be made on inspection, payment had not been made in accordance with that term.

(c) While Fonecomp imposed a retention of title clause on its customer, it made no provision in its contract with its supplier for transfer of title. Even if reliance could be placed on an implied term, in a transaction involving large sums, provision that title would at the latest pass when payment was made would have been expected to have been considered.

(d) In the context where Fonecomp knew its suppliers were engaged in back-to-back trading, so that its suppliers would obtain title only on release of the goods by their own suppliers or on their making payment, it was possible, even after Fonecomp had paid, that it would not obtain title or possession of the goods.

(e) There was lack of clarity in relation to arrangements for allocation and shipping on hold. The position of releases of goods shipped on hold was unclear. Fonecomp, and it seemed its suppliers, were at risk that goods which had passed to another freight forwarder were beyond their control.

(f) Fonecomp placed a lot of trust in freight forwarders in relation to which it had done no due diligence.

61. The FTT considered, at [135], whether these factors could be explained by Fonecomp simply having been careless. It considered, however, that it was more likely that Fonecomp knew, or must have known, that it was participating in a transaction whose sole purpose was the movement of a particular consignment of goods along a chain and to a non-UK counterparty in circumstances where until payment was made and flowed back along the chain the transaction could be unwound. What mattered to the parties to the transaction was not precisely what was supplied, but simply that something – anything – passed down the chain.

62. Mr Patchett-Joyce argued that the lack of specificity in the contractual documents of other parties should not be held against Fonecomp. We reject that argument for the reasons we have given earlier: what is important is what Fonecomp knew concerning the contractual documentation of its supplier and customer and what, having regard to that knowledge, it should have known of the connection of its own purchases with fraud.

63. Mr Patchett-Joyce sought to argue that any deficiencies in contractual terms identified by the FTT could be excused on the basis that commercial dealings were based on trust, and not distrust. In essence, Mr Patchett-Joyce was seeking to put forward an alternative explanation for those deficiencies. But even if such an explanation could have been accepted by the FTT, it was not, and that does not form any sort of foundation for an argument that the FTT's conclusions in this respect were perverse or unlawful. Nor can the argument be assisted by reference to the responsibility of a freight forwarder in cases where "ship on hold" was a term of the contract of carriage. This seems to us to be an attempt to argue the factual case again; but it does not detract from the finding of the FTT, based on Mr Sharif's evidence, that there was a lack of clarity as regards allocation and shipping on hold.

64. Finally, Mr Patchett-Joyce criticised the reliance by the FTT on the absence of due diligence on the freight forwarders, pointing out that, at [86], the FTT had found that Fonecomp had used the freight forwarders for some time. He posed the question: what better due diligence is there than a satisfactory previous course of dealing? He submitted also that there was no evidence that Paul's Freight was of "uncertain credit" as referred to by the FTT at [135].

65. As to that last point, we do not read that as a finding of fact by the FTT in relation to Paul's Freight; it seems to us that it is no more than making the point that there had been no credit check by Fonecomp. In any event, the absence of due diligence in this respect was not referred to by the FTT, at [222] et seq, as one of the factors on which it based its critical conclusions.

Shipping destination

66. At [145] the FTT analysed the explanation given in evidence by Mr Sharif for the facts that Axess had a Danish address, but the phones were shipped to another company, Pro-log, in France. Mr Patchett-Joyce argued that the arrangements made eminently good sense, and that in any event the intention of Fonecomp's customer would not be known to it and was irrelevant to the FTT's determination.

67. We agree that an undisclosed intention of a customer would not be an objective factor on which the FTT could have based its conclusion regarding the state of knowledge of Fonecomp. But the evidence of Mr Sharif went to the intentions of Fonecomp, which was that Fonecomp itself insisted on delivering the goods to Pro-log and not to Copenhagen. The FTT heard the evidence of Mr Sharif seeking to explain this, and did not accept it. Rather than conclude, as Mr Sharif had said, that France had been chosen as a neutral jurisdiction, the FTT found that Fonecomp must have known that Axess wanted the goods shipped to France, and that this was part of a further back-to-back deal. Alternatively, Fonecomp knew that what mattered was the export of goods, and that for that purpose France was as good as anywhere.

Our conclusion on the challenges to the FTT's conclusions

68. As we have explained, we find that the FTT was entitled on the evidence to reach the conclusions it reached. The consistent theme of the FTT in its decision was that the facts known to Fonecomp at the time it carried out its own purchases were such that Fonecomp ought reasonably to have concluded that what mattered was not the actual supply of particular goods, but that something, or indeed anything, passed through the chain of transactions, which would indicate a connection between Fonecomp's purchases and VAT fraud. That was a conclusion we find that the FTT was entitled to reach.

69. Taking all the objective factors known to Fonecomp into account, the FTT was entitled to conclude that the transactions could not be explained by reference to ordinary commercial trading, but that the only reasonable explanation was that Fonecomp's purchases were connected with VAT fraud. Accordingly, the FTT was

entitled to find, as it did at [228], that Fonecomp should have known that its purchases were connected with fraudulent evasion of VAT at the time it made them.

Decision

70. For the reasons given above, we dismiss the appeal.

71. We also dismiss Fonecomp's request for a reference to be made to the Court of Justice under Article 267 TFEU.

MR JUSTICE SALES

UPPER TRIBUNAL JUDGE ROGER BERNER

RELEASE DATE: 5 December 2013