[2020] UKUT 176 (TCC)

Appeal number: UT/2019/0109 (V)

VALUE ADDED TAX – missing trader fraud – whether FTT decision adequately reasoned – whether FTT followed the correct approach to deciding whether taxpayer had the necessary "means of knowledge" – whether decision vitiated by error as to a fundamental fact – appeal allowed

UPPER TRIBUNAL
(TAX AND CHANCERY CHAMBER)

THE COMMISSIONERS FOR HER MAJESTY'S REVENUE & CUSTOMS	**Appellants**
-and-	
BEIGEBELL LIMITED	**Respondent**

TRIBUNAL **JUDGE JONATHAN RICHARDS**
JUDGE JONATHAN CANNAN

Sitting in public by way of video hearing treated as taking place in London on 19 May 2020

James Puzey, instructed by the General Counsel and Solicitor for HM Revenue & Customs for the Appellants

Tim Brown, instructed by Appleton Richardson & Co, for the Respondent

DECISION

Introduction

1. The Appellants, to whom we will refer to as "HMRC", appeal with the permission of the Upper Tribunal against a decision (the "Decision") of the First-tier Tribunal (Tax Chamber) (the "FTT") released on 29 May 2019.

2. In the section that follows we explain the Decision in more detail. However, by way of broad introduction, it concerned what HMRC considered to be a "missing trader" or "MTIC" VAT fraud. The Respondent ("Beigebell") carried on a business that included the supply of promotional merchandise, such as stickers, bags, T shirts, note books and mouse mats to companies. In its VAT period 10/15, it made six purchases of memory cards from a single supplier, Online Distribution Limited ("ODL") and sold them in five transactions to Hi View Trading SL ("HVT"), a company incorporated in Spain. HMRC formed the view that Beigebell's purchase of the memory cards was connected with fraudulent evasion of VAT and that Beigebell either knew, or should have known, of that connection. HMRC therefore refused to allow Beigebell credit for input tax arising on its purchases from ODL. Beigebell appealed to the FTT and, in the Decision, the FTT allowed that appeal.

The Decision

3. References in this section to numbers in square brackets are to paragraphs of the Decision unless we say otherwise.

4. After a brief introduction, the FTT set out details of the transactions that Beigebell had undertaken, including the transaction chains of which they formed part. At [10] to [18], the FTT directed itself on the applicable law as to the circumstances in which a taxpayer could be denied credit for input tax incurred on transactions that were connected with fraudulent evasion of VAT. Neither party suggests that, in this section, the FTT misdirected itself as to the applicable law.

5. In response to "Fairford" directions made by the FTT requiring Beigebell to confirm which aspects of HMRC's case it was disputing, Beigebell had confirmed that it accepted that there was a tax loss in each of its transaction chains. Moreover, Beigebell accepted that the tax loss was occasioned by fraudulent evasion of VAT except that it put HMRC to proof that Shark Partners Ltd, a defaulting trader in some of the transaction chains, was engaged in fraudulent conduct. Accordingly, at [145], the FTT identified the two key issues it had to determine as:

> (1) Was Shark Partners Ltd a fraudulent defaulter or merely an incompetent defaulter, and
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> (2) Did Beigebell know or should have it known that the transaction[s] it was entering into were part of a scheme to defraud HMRC.

6. Both parties accept that this was a correct summary of the issues before the FTT. Moreover, both parties agree that the second issue broke down into two separate sub-issues namely (i) whether Beigebell knew that its transactions were connected with

fraudulent evasion of VAT (i.e. whether it had "actual knowledge") and (ii) whether it should have known that its transactions were so connected (i.e. whether it had "means of knowledge"). HMRC's case was that Beigebell had actual knowledge but that, even if it did not, in the alternative it had means of knowledge.

7. In a section headed "The Facts" that ran from paragraph [19] to [144], the FTT made findings of primary fact. Paragraphs [21] to [52] set out findings in relation to Shark Partners Ltd and another company, SD 2013 Ltd, that appeared in Beigebell's transaction chains. Overall it concluded that Shark Partners Ltd was a fraudulent defaulter but that is not material for the purposes of this decision.

8. The FTT prefaced its findings of fact by concluding, at [20], that all witnesses who appeared before it were reliable and honest. In paragraphs [53] to [144], in a section headed "Mr Orton and Beigebell", the FTT made findings of primary fact covering, very broadly, the background of Mr Orton and Mr Griffiths, Beigebell's two founders, and how the purchases and sales of memory cards were put together. There was no real dispute as to most of the primary facts which the FTT was invited to find. To put some of the later discussion of the Decision into context, and without intending to summarise all the findings of fact that the FTT made, we would highlight the following findings of fact that appear in this section.

9. The first disputed transaction to be arranged, referred to as "Deal 5" in the Decision, came about as a result of the friendship of Mr Orton and Mr Griffiths with a Mr Ritesh "Ricky" Patel. On 18 August 2015, Mr Patel called Mr Orton to explain that he had reached agreement to sell 1,000 SanDisk 512GB SD cards to HVT but that he could not fulfil that order due to a restriction from the manufacturer on selling outside of the UK. Mr Patel did not want his deal to fall apart as it was part of a much bigger order and asked if Beigebell would effectively step into the transaction in his place by buying the SD cards from ODL, Mr Patel's supplier, and selling them to HVT, Mr Patel's customer. ([63]).

10. Mr Orton had previously worked for a company that sold IT security hardware and software. In that role, he had gained knowledge of how "the sales channel works in the IT industry" ([54] and [55]). What Mr Patel was saying seemed plausible to him as he understood that the "channel model" in operation did not permit "distributors" to sell directly to "end-users". He did not, however, test whether ODL was a "distributor" or HVT was an "end-user" ([183]).

11. Beigebell had never traded in SD cards before and Mr Orton and Mr Griffiths were hesitant at first. However, Mr Patel, who they both knew well and trusted, reassured them that the transaction was straightforward. Having received those reassurances, they decided that they would go ahead as, while Beigebell would not make a large profit on the deal, its turnover would increase as a result of it which they thought might help with tenders that Beigebell made in the future ([64] to [66]).

12. Beigebell set about making arrangements for the purchase and sale of the memory cards. During this process, on 24 August 2015, ODL sent Mr Orton an unsolicited indication of the price that they would charge for different memory cards (1,000 x

256GB SD cards). On 25 August 2015, HVT made an unsolicited request for pricing on an identical quantity of 256 GB SD cards. The FTT concluded that "with the benefit of hindsight, this was clearly more than simple coincidence" ([79] to [81]). The purchase and sale of 1,000 256 GB SD cards ultimately became "Deal 1".

13. While putting Deals 1 and 5 together, Mr Orton was in regular telephone contact with a Mr Jones (at ODL) and a Mr Saenz (at HVT). During those discussions, it became clear to Mr Orton that ODL and HVT knew each other because Mr Jones said that, in his experience with orders from HVT, HVT would probably pay for the 256GB cards first and the 512GB cards later. Mr Orton did not regard it as suspicious that Beigebell was being interposed into a transaction between two parties who appeared to know each other well. On the contrary, he was reassured as he thought it would enable Beigebell's transactions with them to proceed more smoothly. He believed that it was quite possible that the "channel model" prevented ODL selling direct to HVT and did not ask any further questions ([84]).

14. Deal 2 came about after HVT emailed Mr Orton, on 3 September 2015 to ask if he could source 3,000 to 4,000 Samsung 250GB SSDs. Mr Orton forwarded that email to ODL who confirmed that they could deliver 1,000 which ultimately became the subject of Deal 2. During those discussions, ODL also offered to sell further SD products which it turned out that HVT were interested in buying. Those additional products ultimately became Deals 3a, 3b and 4.

15. After concluding the transactions which were the subject of the appeal to the FTT, Mr Orton continued to receive a few requests from HVT to supply products which he declined. By this point, Mr Orton was starting to have reservations as to whether he should be involved with deals such as this ([110]). The FTT found as a fact at [111] that Mr Orton had no knowledge of MTIC fraud until a meeting with HMRC several months after the disputed transactions were carried out.

16. In a section headed "Discussion" running from [145] to [185], the FTT considered the two issues before it. Paragraphs [147] to [162] concerned the question whether Shark Partners Ltd was a fraudulent defaulter which is not relevant for the purposes of our decision. Therefore, the FTT's analysis of whether Beigebell knew, or should have known, that its transactions were connected with fraudulent evasion of VAT was contained in the section headed "Beigebell and Jack Orton" that ran from [163] to [185].

17. At [164], the FTT referred back to its earlier finding that Mr Orton had no knowledge of MTIC fraud until several months after the transactions were completed. It was evidently considering whether it was permissible to conclude that Beigebell "should have known" of a connection to fraudulent evasion of VAT when, at the material times, Mr Orton did not even know that MTIC fraud existed. With that concern in mind, it quoted extracts from the judgments of Moses LJ in *Mobilx and others v HMRC* [2010] EWCA Civ 517 and of Arden LJ (as she then was) in *Davis & Dann Ltd v HMRC* [2016] EWCA Civ 142.

18. In *Davis & Dann*, it was common ground that, in order to establish that the taxpayer should have known that its transactions were connected with fraudulent evasion of

VAT, HMRC had to reach the high hurdle of showing that the taxpayer ought to have known that the only reasonable explanation of the transactions was that they were connected to a VAT fraud. Arden LJ referred to this level of knowledge as knowledge meeting "the no other reasonable explanation standard". The FTT derived guidance on the application of that standard from the following extract of Arden LJ's judgment:

> [64] Contrary to Mr Scorey's submission, the last sentence [of paragraph 53 of Moses LJ's judgment in *Mobilx*, in which he said "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"] does not say that a taxpayer who fails to make inquiries does not have the knowledge which meets the no other reasonable explanation standard. On the contrary he holds that he may have knowledge to that standard if he fails to make those inquiries.
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> [65] In my judgment, the consequence of HMRC's decision not to allege fraud against Bristol, CEMSA and GR Distributions was that it was no part of their case that those parties were fraudulent. However, in assessing whether the respondents' knowledge met the no other reasonable explanation standard, the FTT still had to go on to consider all the circumstances. The question is whether or not a reasonable person mindful of those circumstances ought to have concluded that the Transactions were connected with fraud. What matters is the perspective of the person alleged to have such knowledge. A finding of knowledge to the no other reasonable explanation standard can accordingly be reached irrespective of whether the other parties to the Transactions were in fact fraudulent.

19. The FTT concluded (see [171]) that the fact that Mr Orton had no previous knowledge of MTIC fraud did not, of itself, excuse him from the allegation that he "should have known" that Beigebell's transactions were connected to fraudulent evasion of VAT.

20. The FTT then turned to consider whether Beigebell actually knew that its transactions were connected with fraudulent evasion of VAT. The entirety of its reasoning on this question is set out at [173] and [174] as follows:

> 173. Mr Orton has been consistent in his denial of this allegation and we have seen no evidence which proves or even suggests that he did in fact know that the transactions which Beigebell entered into were part of a series of transactions designed to defraud HMRC of VAT, even on the balance of probabilities.
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> 174. We therefore find that Mr Orton did not know that these transactions were connected with fraud before he entered into them.

21. The FTT then returned to its consideration of whether Beigebell should have known that its transactions were connected with fraudulent evasion of VAT by applying the "no other reasonable explanation" standard to which Arden LJ had referred in *Davis & Dann*. We set out the FTT's reasoning on this issue in full:

178. The test put forward by Arden LJ in *David & Dann* seems to us to encapsulate the question we should be asking. She refers to it as the "no other reasonable explanation" standard.

179. She also says that when evaluating the facts against this standard:

> "The question is whether or not a reasonable person **mindful of those circumstances** [the FTT's emphasis] ought to have concluded that the transactions were connected with fraud. What matters is the perspective of the person alleged to have such knowledge."

180. We consider that Mr Orton is a reasonable person. He is not, we consider, a reckless individual. He is still quite young and he might be accused of a certain naivety in his dealings with Mr Patel, but he is fundamentally, in our view, a sensible businessman with sound moral standards. We think therefore that we may use him as a suitable surrogate for the hypothetical reasonable man suggested by Arden LJ in *Davis & Dann*.

181. In addition we should note that he had been acquainted with Mr Patel for 20 years and counted him a close personal friend. He therefore trusted what he was told by Mr Patel. Given their lengthy relationship, and the fact that Mr Patel had brought Beigebell good deals in the past, he had no reason to doubt that these transactions would also prove to be good for Beigebell. He certainly had no reason to believe that he was being set up as the fall guy in an elaborate VAT fraud.

182. We must however ask ourselves if Mr Orton's behaviour passes the "no other reasonable explanation test".

183. Mr Orton explained to us that he had worked in the IT sector previously and was aware of the channel model operating in that sector. That model may not make total sense to us but its existence was not challenged by HMRC and no evidence was presented to us to undermine its existence. His alternative reasonable explanation for these transactions therefore was that, under the IT sector channel model, distributors were not allowed to sell directly to end-users. The interposition of third parties was therefore not unusual. He did not test whether or not HVT was an end-user or if ODL was a distributor for these purposes. He felt that he did not need to check this. All he knew was that the interposition of third parties in an otherwise complete deal chain was not unusual in the IT sector and that his long term friend had given him a rational explanation for the transactions.

184. He did therefore, in our view, have an alternative reasonable explanation for the transactions and his behaviour does therefore fulfil the "no other reasonable explanation" test proposed by Arden LJ.

22. Overall, therefore, the FTT concluded that Beigebell neither knew, nor should have known, that its transactions were connected with fraudulent evasion of VAT and it allowed the appeal.

The Grounds of Appeal against the Decision

23. With the permission of the Upper Tribunal, HMRC appeal against the Decision on the following grounds:

> (1) Ground 1 – The Decision was inadequately reasoned. HMRC had invited the FTT to make inferences, from a number of aspects of the transactions and Beigebell's involvement in them, that Beigebell either knew, or should have known that those transactions were connected with fraudulent evasion of VAT. However, nobody reading the Decision could understand why the FTT declined to make those inferences or why HMRC's case had been rejected.
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> (2) Ground 2 – The FTT wrongly approached the question of whether Beigebell "should have known" that its transactions were connected with fraudulent evasion of VAT by applying a subjective test rather than an objective test.
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> (3) Ground 3 – The FTT made a material factual error when stating, at [183] that HMRC were not challenging the existence of the "channel model" in the IT industry that Mr Orton said prevented ODL selling direct to HVT. HMRC had challenged that explanation repeatedly in cross-examination.

Ground 1 – Discussion

24. There was no real difference between the parties as to the extent of the FTT's duty to give reasons. Rather, the debate focused on whether the FTT had discharged that duty by giving adequate reasons in the Decision.

25. The extent of the duty to give reasons, and the rationale for that duty are encapsulated in the following passage of the Court of Appeal's judgment in *Weymont v Place* [2015] EWCA Civ 289:

> 4. But the relative immunity of the trial judge's findings of fact to interference on appeal depends upon the trial process having been conducted in a way which confirms that the trial judge has properly considered and understood the evidence; has taken into account the criticisms of the evidence advanced by the parties' legal representatives; and has reached a balanced and objective conclusion about points on which differing or inconsistent evidence has been given in making the factual findings which form the basis of his decision.
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> 5. An important aspect of this process is the production of a properly reasoned judgment which explains to the parties and to any wider readership why the judge has reached the decision he has made. This includes making a reference to the issues in the case; the legal principles or test which have to be applied; and to why, in cases of conflicting factual evidence, the judge came to accept the evidence of particular witnesses in preference to that of others.
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> 6. The judge is not, of course, required to deal with every point raised in argument, however peripheral, or with every part of the evidence. The process of adjudication involves the identification and determination of

> relevant issues. But within those bounds the parties are entitled to have explained to them how the judge has determined their substantive rights and, for that purpose, the judge is required to produce a fully reasoned judgment which does so: see *English v Emery Reimbold & Strick Ltd*. [2002] EWCA Civ 605. The production of such a judgment not only satisfies the court's duty to the parties but also imposes upon the judge the discipline of considering the detail of the evidence and the legal argument.

26. That said, while the production of a properly reasoned judgment is an important aspect of civil justice, it is important that this tribunal is not unduly critical of the Decision under appeal. As Lord Hope said at [25] of *R (Jones) v First-tier Tribunal (Social Entitlement Chamber)* [2013] 2 AC 48:

> It is well established, as an aspect of tribunal law and practice, that judicial restraint should be exercised when the reasons that a tribunal gives for its decision are being examined. The appellate court should not assume too readily that the tribunal misdirected itself just because not every step in its reasoning is fully set out in it.

27. As is common in appeals to the FTT of this kind, HMRC's case that Beigebell actually knew that its transactions were connected with fraudulent evasion of VAT invited the FTT to make inferences as to Beigebell's knowledge from the presence of particular factors. As Mr Puzey put it in his oral submissions, in the absence of any "signed confession" or other document that demonstrated that Beigebell actually knew of the connection to fraud, it was difficult for HMRC to put their case in any other way. It was appropriate for HMRC to put their case in this way given the dictum of Christopher Clarke J in *Red 12 Trading Ltd v HMRC* [2009] EWHC 2563 at [111] (which the FTT cited at [18] of the Decision):

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

28. We will not set out all the factual matters from which HMRC invited the FTT to draw inferences as to knowledge which were set out in their Statement of Case and opening submissions since, by summarising a few, we can give a flavour of HMRC's overall case:

> (1) Beigebell's transactions were part of highly contrived chains undertaken on a "back to back" basis such that each seller in the chain on-sold an identical quantity of stock to that purchased. In each deal, Beigebell was able to match its customer's order to its supplier's available stock without being left holding excess stock and without having to obtain stock

from one or more other suppliers[1]. It would only be possible to effect such a contrived series of transactions in a short period of time if all parties, including Beigebell were aware of what was going on.

(2) Beigebell did not know HVT and did not enter into formal written contracts with it. It was running a risk: if HVT failed to purchase goods, Beigebell could be left holding goods which it had purchased from ODL. Beigebell would only be prepared to run that risk, that was not adequately addressed in contractual documentation, if it knew perfectly well that, because its transactions were part of a contrived VAT fraud, its counterparties would not let it down.

(3) Beigebell had no experience in this trade sector, but was entering into large transactions. Nevertheless, the due diligence that it performed on its counterparties was inadequate. HMRC argued that the absence of cogent checks indicated that Beigebell realised that such checks were unnecessary as it was aware that it was operating in contrived chains that were not part of any ordinary commercial venture, but rather were part of a fraudulent scheme to evade VAT.

(4) The deals were "pre-arranged". Beigebell made a profit of some £30,000 despite adding no value to the goods it purchased. That was "too good to be true". It must have known that it could only make that kind of profit if its transactions were connected to fraud.

29. The FTT's rejection of HMRC's case on actual knowledge is effectively set out in just six lines in paragraphs [173] and [174]. As the Court of Appeal held in *Weymont v Place*, the FTT was not obliged to set out every submission or argument that HMRC raised or deal with all the evidence. However, a necessary component of explaining to HMRC why they had lost involved demonstrating that HMRC's case had been addressed. Neither HMRC nor anyone else reading the Decision would realise that HMRC's case was that aspects of the transactions and Beigebell's participation in them gave rise to an inference that it must have known those transactions were connected with fraudulent evasion of VAT. Still less does the Decision explain why the FTT declined to draw any of the inferences that HMRC invited it to draw. We acknowledge that "judicial restraint" is called for when considering the adequacy of the FTT's reasons. However, this is not a situation in which the FTT has simply failed to set out every step of its reasoning. Rather, the FTT has not given any reasons, even of a general nature, for rejecting the entirety of HMRC's case.

30. In addition, paragraphs [173] and [174] of the Decision indicate that the FTT may have misunderstood the nature of HMRC's case, or what HMRC needed to establish that case. The FTT stated that it had seen "no evidence which proves or even suggests that [Mr Orton] did in fact know that [Beigebell's transactions were connected with fraud]". The difficulty with this statement is that there was clearly evidence that

[1] HMRC acknowledged that in deals 3a and 3b, Beigebell purchased goods from two sources, but combined these into a single sale.

"suggested" that Mr Orton knew the transactions were connected with fraud. That evidence consisted of the factors on which HMRC relied as supporting the inferences they were inviting the FTT to draw: for example, the contrived nature of the transaction chains and what HMRC argued was inadequate contractual documentation and due diligence. Of course, ultimately, the FTT had to decide whether that evidence supported the inference of knowledge that HMRC were inviting it to draw, but in saying that there was "no evidence" for HMRC's case, the FTT suggested that it might not have fully understood that case. Had the FTT provided fuller reasons for rejecting HMRC's case on actual knowledge, it might have been able to demonstrate that it properly understood that case. However, the FTT's highly abbreviated reasoning leaves us with a very real concern that the FTT did not understood HMRC's case fully.

31. In urging us to conclude that the FTT's decision on actual knowledge was adequately reasoned, Beigebell referred us to the decision of the Upper Tribunal in *HMRC v Greenisland Football Club* [2018] UKUT 440 (TCC). Ground 3 of HMRC's appeal in that case involved the question of whether the FTT had been entitled to find that the respondent football club had a reasonable excuse for issuing a zero-rating certificate. The club's case was that, through its officer Mr Munn, it had obtained professional advice that a zero-rating certificate could properly be issued. HMRC, however, did not accept that any such professional advice had been taken, noting that the existence of professional advice had not been mentioned until a late stage in proceedings. The FTT concluded that there was a reasonable excuse and HMRC appealed on the basis that this finding was irrational and/or not properly reasoned. Dismissing HMRC's appeal on this issue, Horner J said, at [67]:

> 67. It is important to appreciate that FTT did give reasons for the conclusion they reached. They believed Mr Munn. He was in their view a "totally credible witness". There is no point in asking this Tribunal to reach a different conclusion and reject Mr Munn's evidence unless there are grounds that would enable this Tribunal to do so. The FTT saw Mr Munn give evidence, they heard him give evidence and they watched him being cross-examined. They accepted his testimony as being truthful. Of course, points can be made, and were undoubtedly made before the FTT to challenge the veracity of Mr Munn's account as to the issue of the certificate and the reason that this issue was raised only shortly before the final hearing. It was also legitimate for HMRC to draw attention to the fact that there was no corroborating evidence from the accountants, for example, who provided the advice that this clubhouse construction should be zero rated which confirmed the opinion that Mr Munn had already reached. But, the FTT believed Mr Munn and this is a conclusion they were entitled to reach.

32. We derive relatively little assistance from this authority. There is no universal rule as to the extent of reasons that has to be given for a decision. That will depend on the nature of the issues in dispute. We quite accept that, where the factual dispute was about whether or not professional advice was taken, it was appropriate for the FTT to state that they accepted the evidence of the witness who confirmed that it was taken. However, the factual issues in dispute in this case were more extensive and, as we have stated, to produce a properly reasoned decision the FTT needed to show that it had engaged with the case that HMRC were presenting. It was not sufficient for it simply

to say that it accepted Mr Orton was an honest witness who denied actual knowledge of any connection with fraud. We therefore conclude that the FTT's decision on whether Beigebell had actual knowledge was inadequately reasoned.

33. As will be seen from our discussion of Ground 2, the FTT's analysis of Beigebell's means of knowledge was flawed as it involved the application of a subjective, rather than an objective test. In those circumstances, we do not consider it necessary to engage in a detailed examination of the essentially academic question of whether the FTT gave adequate reasons when applying the incorrect test.

34. The essence of the FTT's reasoning on means of knowledge is set out at [183]. It concludes that connection with VAT fraud was not the only reasonable explanation for the transactions. There was another reasonable explanation namely that, under the "IT sector channel model", distributors were not allowed to sell to end-users. HMRC's case, was that, given the presence of the factors we have referred to at [28], a reasonable business person would not have accepted this alternative explanation.

35. In those circumstances, we consider that the FTT's reasoning at [183] was deficient because it does not explain why the FTT concluded that the alternative explanation was reasonable in the light of the factors which HMRC argued made the explanation unreasonable. We suspect that, at least in part, the lack of reasoning in this regard arose because the FTT was applying an incorrect test: it did not realise that it needed to consider whether the alternative explanation was reasonable because of its general finding that Mr Orton was a "sensible businessman with sound moral standards". Nevertheless, in order to be adequately reasoned, the FTT's conclusion on means of knowledge would need at least to engage with HMRC's case that the alternative explanation was not a reasonable one. Since it did not do so, in our judgment, the FTT's conclusion on means of knowledge was vitiated by essentially the same failure to give reasons as appeared in its discussion of actual knowledge.

36. In conclusion, Ground 1 of HMRC's appeal succeeds. The Decision gave inadequate reasons for concluding that Beigebell had no actual knowledge or means of knowledge that its transactions were connected to fraudulent evasion of VAT.

Ground 2 – Discussion

37. It was common ground that the question of "means of knowledge" involves the application of an objective test namely whether, even if Beigebell did not actually know that its transactions were connected with fraud, a reasonable businessperson with ordinary competence in Beigebell's position would have known.

38. HMRC argue that, in concluding that Mr Orton was a "suitable surrogate for the hypothetical reasonable man" at [180], the FTT paved the way for an error of law that consisted of applying a subjective test when ascertaining Beigebell's "means of knowledge". Despite Mr Brown's valiant arguments to the contrary, we have reached the clear conclusion that the FTT did make the error of law that HMRC suggest.

39. The "alternative reasonable explanation" of the transactions that the FTT puts forward at [183] involves statements of Mr Orton's subjective views. Specifically, it is stated that he genuinely believed that the transactions were explicable by the "IT sector channel model" and that his long-term friend, Mr Patel, had given him a rational explanation for the transactions. However, there is no analysis of whether that belief, or Mr Patel's explanation, were reasonable. Indeed, the Decision contains suggestions which, on their face, appear to call into question whether either was reasonable. For example:

> (1) The "IT sector channel model" explanation involved the proposition that ODL was a "distributor" who could not sell direct to an "end user" such as HVT. Yet Mr Orton made no attempt to check that ODL was indeed a distributor, or that HVT was indeed an end user because he felt he did not need to check this given the explanations that Mr Patel had given him.
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> (2) The FTT states that the IT sector channel model "may not make total sense to us". If the explanation advanced did not make sense to the FTT there was an obvious issue as to whether it was objectively reasonable.
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> (3) At [180], the FTT observed that Mr Orton "might be accused of a certain naivety in his dealings with Mr Patel". If Mr Orton was "naïve" in accepting the explanation of the transactions that Mr Patel was advancing, that was, at the very least, an indication that the explanation was not reasonable.

40. If the FTT had properly in mind that the "means of knowledge" test involved the application of an objective standard, it would have asked whether it was reasonable to conclude that the transactions could be explained by the IT sector channel model in circumstances where there was no assurance that ODL was a "distributor" or that HVT was an "end user". Similarly, it would have asked whether a reasonable person would have been satisfied by an explanation which apparently did not make sense to the FTT. It would have asked whether, by exhibiting naivety in his dealings with Mr Patel, Mr Orton had fallen below the standard of a reasonable businessperson of ordinary competence so as to render unreasonable the belief in the explanation that Mr Patel gave.

41. The FTT clearly thought that it did not need to address issues such as these because of its finding at [180] that Mr Orton was a "reasonable person" and a "sensible businessman with sound moral standards". We are satisfied that the FTT considered that because Mr Orton was "reasonable", it necessarily followed that his beliefs as to the explanation of the transactions afforded by the IT sector channel model were reasonable. However, this is to misunderstand the nature of the objective test that is involved in assessing a person's means of knowledge. Applying such a test does not involve an impressionistic analysis of whether, at a high degree of generality, a person can be regarded as "reasonable" or not. Rather, it involves a consideration of whether particular beliefs or actions are objectively reasonable. Even if a person generally behaves reasonably and holds reasonable beliefs, it is possible for such a person's beliefs on particular issues to be unreasonable.

42. The FTT appears to suggest that its approach of treating Mr Orton as a surrogate for the reasonable person was either permitted, or mandated, by Arden LJ's judgment

in *Davis & Dann*. However, in our view it is not. In paragraph [65] of her judgment in *Davis & Dann*, Arden LJ notes that the question is whether a reasonable person mindful of all the circumstances ought to have concluded that the transactions were connected with fraud. She also notes that "What matters is the perspective of the person alleged to have such knowledge". Those passages are not, however, suggesting that the means of knowledge test is to be applied to a taxpayer's subjective perception of particular circumstances. Rather, read in context, Arden LJ is saying that an objective standard has to be applied in the light of all relevant circumstances and that the question is whether it was reasonable for the taxpayer (the person whose input tax is being denied) to have known that its transactions were connected with fraud; not whether it was reasonable for some other participant in the transaction chains to know that the transactions were so connected.

43. Ground 2 of HMRC's appeal therefore succeeds.

Ground 3 – Discussion

44. Both parties are agreed that the FTT was wrong to conclude at [183] that HMRC did not challenge the existence of the "channel model". As their Ground 3, HMRC argue that the existence of this factual error was material to the Decision in two respects. First if, as HMRC had maintained, the channel model did not actually exist, that would have a material bearing on whether the channel model provided an "alternative reasonable explanation" for Beigebell's transactions. Second, since the FTT did not appreciate that HMRC were challenging the existence of the channel model in cross-examination, it did not address alleged inconsistencies in Mr Orton's evidence on the channel model with the result that the FTT reached an unduly favourable conclusion as to Mr Orton's credibility as a witness.

45. Beigebell accepts that the FTT made the factual error that HMRC allege. However, it argues that the error was not material to the Decision since HMRC had not put in any evidence to demonstrate that the channel model did not exist. Therefore, whether or not HMRC challenged the existence of that model in cross-examination did not matter since, if HMRC wished to assert that the channel model did not exist, they needed to produce some evidence to support that assertion.

46. Given the way that the parties put their respective arguments on Ground 3, we will start by summarising where references to the "channel model" appeared in written and oral evidence.

47. Mr Orton stated in paragraph 1 of his witness statement dated 20 March 2018, that while he worked for an IT security company, he gained knowledge of how the sales channel works in the IT industry. This passage of his witness statement did not, however, explain what he considered that "sales channel" to involve.

48. Paragraph 14 of Mr Orton's witness statement contained an explanation of how Beigebell came to be interposed into Deal 5. Broadly, Mr Patel told him that ODL could not sell goods to HVT because of a "restriction from the manufacturer on selling outside of the UK". At paragraph 16 of his witness statement, Mr Orton said that Mr Patel's

explanation sounded plausible in the light of Mr Orton's experience of how the "channel works in the IT Sector". Again, Mr Orton's witness statement did not elaborate on the precise nature of the "channel" to which he was referring.

49. Mr Orton's witness statement also exhibited a letter that he said he received from Mr Patel in February 2016[2]. That letter repeats and amplifies the explanation referred to at paragraph 14 of Mr Orton's witness statement to the effect that Beigebell was interposed because San Disk would not supply ODL with SD cards that were intended for resale to a non-UK customer. The letter contained a reference to the IT sales channel in the following paragraph, but did not explain in any detail how the sales channel operated:

> In my opinion this deal is a simple resale deal that is no different to any other deal that is done by the IT channel or Beigebell, product is sourced on client request and then sold to them as requested subject to pricing being agreed.

50. References to the "channel model" also came up in Mr Orton's cross-examination, primarily in the context of the extent of the existing business relationship between HVT and ODL. Mr Puzey, acting for HMRC, put it to Mr Orton that ODL and HVT had already traded directly with each other in the past so that there was no rationale for Beigebell to be interposed in transactions between them. In passages of that cross-examination Mr Orton suggested that, although HVT and ODL had some kind of "business relationship", ODL was precluded from selling goods to HVT because of the "channel model" that prevented distributors selling to end users.

51. In our judgment, at no point in his witness evidence served prior to the hearing did Mr Orton explain exactly what the "channel model" was. HMRC could scarcely be required to produce evidence to demonstrate that the "channel model" did not exist when they had not even been told with any precision what that "channel model" was said to involve.

52. Moreover, as amplified by his cross-examination, Mr Orton seemed to be advancing two propositions. The first was that Mr Patel could not participate in a transaction that involved San Disk 512 GB SD cards being sold to a non-UK purchaser such as HVT. The second was that a "channel model" prevented ODL selling direct to HVT. Having read the transcripts, the relationship between those propositions is not entirely clear to us and it was not even clear to us whether the two propositions were distinct or whether they were both aspects of what was said to be a single overarching restriction.

53. The FTT clearly did not itself fully understand what the channel model was said to involve (see its reference at [183] to the model not making "total sense to us"). Nevertheless, the FTT indicated at [183] that it did not need to turn its mind to the

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[2] We describe the letter in this way because Mr Patel did not himself give evidence and so did not confirm that he was actually the author of the letter.

question of whether the "channel model" actually existed because it thought that its existence was not challenged.

54. In those circumstances, it is clear to us that the FTT's mistaken conclusion that the existence of the channel model was unchallenged was material to its decision. If it had realised that HMRC did not accept that the "channel model" even existed, the FTT might well have reached a different conclusion on whether an explanation based on the channel model was reasonable. It might well also have considered whether the explanation of Beigebell's interposition in the transaction (as set out in Mr Orton's witness statement and Mr Patel's letter) was consistent with the evidence as to the nature of the "channel model" that emerged in cross-examination. In our judgment, because the FTT did not believe the existence of the channel model to be controversial, it did not engage with issues such as this which could well have had a bearing on its overall conclusions.

55. Overall, therefore, the FTT made an error of law when it concluded that the existence of the channel model was unchallenged. The error was material to the Decision for the reasons set out above. HMRC's appeal on Ground 3 therefore succeeds.

56. Having reached that conclusion we do not need to consider whether HMRC are correct to argue that the FTT would have reached a different conclusion as to Mr Orton's credibility as a witness if it had realised that the very existence of the "channel model" was in dispute. Questions of witness credibility are, *par excellence*, issues that should, absent exceptional circumstances, be left to the FTT. Given that we are going to remit this appeal back to the FTT as discussed in the "Disposition" section below, it would be wrong for us to express any view on the question of Mr Orton's credibility as a witness and nothing in this decision should be taken as doing so.

Disposition

57. We have concluded that the Decision contains errors of law. In those circumstances, s12 of the Tribunals, Courts and Enforcement Act 2007 provides that:

> (1) We may, but need not, set aside the decision of the FTT; and
>
> (2) If we do set aside the decision, we must either:
>
> > (a) remit the case to the FTT with directions for its reconsideration or
> >
> > (b) re-make the decision.

58. Since the errors of law we have identified were material to the Decision, we are in no doubt that the decision must be set aside.

59. Beigebell argued that if, contrary to its arguments, we found errors of law in the Decision, the appropriate direction would be to remit the appeal back to the same FTT with a direction that they should give further reasons for their decision. We will not follow that course. Having allowed HMRC's appeal on Grounds 2 and 3, we have

identified flaws in the Decision that are not confined to the extent of the FTT's reasons. Rather, as we have concluded, the FTT decided the "means of knowledge" question by applying the wrong test. It also made its overall decision following a material error as to whether the existence of the "channel model" was in dispute or not in circumstances where the "channel model" was at the heart of Beigebell's explanation as to why it neither knew, nor should have known, that its transactions were connected with fraudulent evasion of VAT. We do not consider that these deficiencies could be remedied simply by the same FTT providing further reasons.

60. In any event, the FTT's failure to provide reasons was not restricted to a discrete area. Rather, as we have explained, the lack of reasons suggested that the FTT had not engaged with HMRC's case and indeed we have a very real concern that the FTT might not have fully appreciated the nature of HMRC's case. If the FTT simply provided further reasons for an unchanged conclusion, the concern that HMRC's case was not properly addressed, and perhaps not properly understood, would remain.

61. We therefore consider that the question whether Beigebell had actual knowledge or means of knowledge needs to be reconsidered in such a way as to demonstrate that HMRC's case has been properly understood and reflected on and that the correct legal test has been applied. HMRC suggested that the Upper Tribunal could do this by remaking the decision itself based on the totality of the written evidence before the FTT and the transcript of the oral evidence. However, we regard that as unworkable. Reading a transcript is no substitute for hearing live evidence, particularly when questions of credibility are in issue.

62. Conceptually we could remit the appeal to the same FTT for reconsideration. We have considered whether such a direction would be appropriate in the light of the following guidance of the Court of Appeal in *HCA International Limited v Competition and Markets Authority* [2015] EWCA Civ 492:

> 68.The principle as it seems to me must be that remission will be made to the same decision maker unless that would cause reasonably perceived unfairness to the affected parties or would damage public confidence in the decision making process. The basis on which the court will approach these two interlocking concepts of "reasonably perceived unfairness to the affected parties" and "damage to the public confidence in the decision making process" may depend heavily on the circumstances of the remission.
>
> 69.A variety of factors will undoubtedly be relevant to the application of these principles. I would not want to limit those factors by setting out anything that could be regarded as an exhaustive list as the Employment Appeal Tribunal seems to have attempted to do in the *Sinclair Roche* case. There will be many different situations which cannot be predicted from a single case.
>
> 70.It is, however, always the case that the presence of actual bias, apparent bias or confirmation bias would make remission to the original decision maker undesirable, because any such bias would amount both to reasonably perceived unfairness to an affected party and potentially serious damage to public confidence in the decision making process.

> 71.It is important also to understand the kind of unfairness that is relevant to the question of whether the decision should be remitted to the original decision maker. The unfairness concerned is such as contravenes the public law duty of fairness, not some abstract concept of unfairness based on a colloquial usage of that word. It is well-established that what fairness requires will vary with the factual circumstances, but what is required in order to achieve fairness is a matter of law, and not a matter of discretion for the decision maker.

63. We emphasise that there is no suggestion that the FTT was biased or gave an appearance of bias. Nevertheless, the FTT reached conclusions favourable to Beigebell without demonstrating that it had adequately engaged with, or appreciated, HMRC's case and following an application of the wrong test on "means of knowledge". If we directed the same FTT to reconsider its decision we would see some risk of public confidence in the decision making process being damaged. If Beigebell succeeded at such a re-hearing, a dispassionate observer might legitimately entertain concerns that the FTT was subconsciously influenced by its earlier, flawed, decision. If HMRC succeeded, a dispassionate observer might be concerned that the FTT had "over-compensated".

64. We therefore consider that the appropriate direction is for the appeal to be remitted to a differently constituted tribunal for a rehearing. The next logical question to consider is whether findings of fact that the FTT has already made should continue to "stand" in that re-hearing particularly given that in Mr Puzey's skeleton argument he noted that the "primary facts are not in dispute" as indeed was demonstrated by the fact that, except in Ground 3, HMRC challenged none of the FTT's findings of primary fact.

65. We see no difficulty with directing that the FTT's findings of primary fact relating to Shark Partners Ltd (and, to the extent relevant, its findings relating to SD 2013 Ltd) should continue to stand in the appeal as remitted. Those findings related to the first issue before the FTT which we have summarised at [5] above and there has been no challenge to the FTT's conclusions on that issue.

66. However, we see real difficulties associated with seeking to tie the FTT's hands as regards at least some findings of primary fact relating to the question of Beigebell's knowledge or means of knowledge. For example, at [111] of the Decision, the FTT accepted Mr Orton's evidence that he had no knowledge of MTIC fraud until some months after the transactions. Understandably, Beigebell submitted that it should be able to retain the benefit of this finding in any remitted appeal. However, it seems to us that there would be some difficulty associated with this course.

67. It is quite possible that the FTT's decision to accept Mr Orton's evidence as to when he first became aware of MTIC fraud was influenced by its perception that he was an honest and reliable witness. Yet, as we have noted in Ground 3, the FTT did not realise that HMRC were challenging whether the "channel model" to which Mr Orton referred in his evidence even existed. If it had realised that the existence of the "channel model" was disputed, it might have concluded that it did not accept Mr Orton's evidence that the channel model existed or provided a rationale for Beigebell's interposition in chains of transactions. That in turn might, depending on the FTT's

reasons for not accepting that evidence, cause it to reflect on Mr Orton's reliability generally and, in particular, the reliability of his evidence as to when he became aware of MTIC fraud.

68. We give this example not to suggest that we regard Mr Orton's evidence as unreliable. As we have already noted, we make no such suggestion and will leave the question of Mr Orton's reliability as a witness to the FTT to which this appeal is remitted. Rather, we give the example to explain why we regard it as difficult to ringfence particular findings of fact with a bearing on knowledge or means of knowledge and direct that those findings are to stand in the remitted appeal.

69. With the exception of findings relating to Shark Partners Ltd and SD 2013 Ltd we will not, therefore, make any directions that existing findings of primary fact are to stand in the appeal as remitted. We would, however, urge the parties to adopt a common-sense and pragmatic approach. The proceedings both before us and the FTT demonstrate that very few primary facts are in dispute. The parties should therefore seek to ensure that, in the remitted appeal, as many primary facts as possible are agreed so as to enable the hearing of that appeal to be reasonably short and to take place in a reasonable timescale.

70. In conclusion, therefore, we dispose of this appeal as follows:

(1) The Decision is set aside.

(2) The appeal is remitted to a differently constituted FTT for rehearing. The panel for the remitted appeal should include both a judge and a tribunal member.

(3) In the remitted appeals, the findings of primary fact relating to Shark Partners Ltd and SD 2013 Ltd made in the Decision are to stand as is the FTT's conclusion that Shark Partners Ltd was a fraudulent defaulter.

UPPER TRIBUNAL JUDGE JONATHAN RICHARDS

UPPER TRIBUNAL JUDGE JONATHAN CANNAN

RELEASE DATE: 4 June 2020