TC01473

Appeal numbers: LON/2007/1518
LON/2007/1839
LON/2007/1837

VAT – Input Tax – Whether tax losses – If so whether tax they arose from fraudulent evasion – Whether Appellants transactions connected with this evasion – Whether Appellants knew or should have known – Mobilx & Others v HMRC [2010] STC 1436, CA applied – Appeals dismissed

FIRST-TIER TRIBUNAL

TAX

MIDLAND MORTGAGES LIMITED
MIDLAND ENTERPRISES UK LIMITED
MIDLAND COMMUNICATIONS UK LIMITED

Appellants

- and -

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

TRIBUNAL: JOHN BROOKS (TRIBUNAL JUDGE)
SONIA GABLE (MEMBER)

Sitting in public at Victoria House, Bloomsbury Place, London WC1 on 31 May – 3 June 2011; 6 – 10 June 2011; 13 – 15 June 2011 and at 45 Bedford Square, London WC1 on 23, 24 and 27 June 2011.

Michael Patchett-Joyce, instructed by Sydney Mitchell Solicitors, for the Appellants

Mark Cunningham QC and Nicholas Chapman, instructed by Howes Percival LLP, for the Respondents

DECISION

Introduction

1. Three companies, Midland Mortgages Limited, Midland Enterprises UK Limited and Midland Communications UK Limited, appeal against decisions made by HM Revenue and Customs ("HMRC") to deny their entitlement to deduct input tax in excess of £14.5m which arose as a result of 82 transactions or deals involving the wholesale trade in over 296,000 mobile phones between 18 April and 15 June 2006.

2. Midland Mortgages Limited appeals against:

(1) A decision of HMRC contained in a letter dated 7 August 2007, denying its entitlement to deduct input tax in the sum of £4,967,470.75 for the VAT accounting period ended 31 May 2006 ("05/06"); and

(2) A decision of HMRC, contained in letters dated 9 October 2007 and 7 April 2008, denying it the right to deduct input tax in the sum of £2,629,243.75 for the VAT period ended 30 June 2006 ("06/06").

3. Midland Enterprises UK Limited appeals against:

(1) A decision of HMRC, contained in letters dated 9 October and 30 November 2007, to deny its entitlement to deduct input tax in the sum of £1,507,012.50 for the VAT period ended 30 April 2006 ("04/06"); and

(2) A further decision of HMRC, notified in a letter incorrectly dated 30 November 2007, disallowing its claim for input tax in the sum of £1,354,063.00 for the period ended 30 June 2006 ("06/06").

4. Midland Communications UK Limited appeals against a decision of HMRC, contained in a letter dated 9 October 2007 to disallow its claim for repayment of input tax in the sum of £4,121,293.70 for the period ended 30 June 2006 ("06/06").

5. Although it had been directed that these appeals be consolidated, as appeals by different Appellants cannot be consolidated but can be heard together, the directions were revoked by Judge Theodore Wallace on 19 May 2011. He directed that the appeals of Midland Mortgages Limited be consolidated (under the reference LON/2007/1518); the appeals of Midland Enterprises UK Limited be consolidated (under the reference LON/2007/1839); and the appeals of Midland Mortgages Limited, Midland Enterprises UK Limited and Midland Communications UK Limited be heard together.

6. We were referred to *3RD Generation Communications Limited v HMRC* [2010] UKFTT 486 (TC) ("*3RD Generation*") in which the Tribunal identified the following four central issues to be determined in appeals of this type:

(1) Was there a tax loss?

(2) If so, did this loss result from a fraudulent evasion?

(3) If there was a fraudulent evasion, were the Appellant's transactions which were the subject of this appeal connected with that evasion? and

(4) If such a connection was established, did the Appellant know or should it have known that its transactions were connected with a fraudulent evasion of VAT?

These were the questions that had been asked by the Tribunal in *Blue Square Global v HMRC* and which were approved by the Court of Appeal, at [69], in the conjoined appeals of *Mobilx Ltd (in Administration) v HMRC; HMRC v Blue Sphere Global Ltd ("BSG"); Calltel Telecom Ltd and another v HMRC* [2010] STC 1436 ("*Mobilx*"). In answering these questions it is clear from *Mobile Export 365 v HMRC* [2007] EWHC 1737 (Ch) at [20] that the Tribunal is entitled to rely on inferences drawn from the primary facts.

7. Mr Mark Cunningham QC and Mr Nicholas Chapman, who appear for HMRC, contend that this is another archetypal case of missing trader intra-community ("MTIC") fraud, their primary case being that the Appellants, each of which has the same person, Imtiaz Ali, as its sole director, were knowing participants in an overall contrived scheme to defraud HMRC. Alternatively they contend that the companies should have known that the 82 transactions were connected to the fraudulent evasion of VAT.

8. However, Mr Michael Patchett-Joyce, who appears for the Appellants, maintains, as a matter of fact and law, that there is no case to answer as HMRC, on whom the burden of proof rests, have not only failed to discharge that burden but have acted in breach of fundamental principles of Community law and that, as such, the appeals must be allowed.

Evidence

9. We were provided with witness statements from the following HMRC officers:

(1) Cyril Haynes, who supported the lead officer (Joseph Martin who retired from HMRC in 2008 and who did not give evidence) in the extended verification process of repayment claims submitted by Midland Mortgages Limited, Midland Enterprises UK Limited and Midland Communications UK Limited.

(2) Farzana Malik, a member of HMRC's MTIC fraud team based in Coventry and case officer for Midland Communications UK Limited.

(3) Anna Hudson, a member of HMRC's MTIC fraud team in Birmingham who, since February 2010, has been responsible for the analysis of data obtained from the First Curacao International Bank ("FCIB") for the purposes of HMRC's civil investigations into MTIC fraud and analysed 17 of the 82 deals in this appeal.

(4) Gordon Smith, an officer based in HMRC's Blackburn office who gave evidence about Worldwide Enterprises Limited.

(5) Timothy Reardon, an officer based in London who gave evidence in relation to Computec Solutions Limited.

(6) Robert Godley, another officer, based in Blackburn. His evidence concerned Stockmart Limited.

(7) Martin Evans, a London based officer, who gave evidence about 3D Animations Limited.

(8) Jennifer Davis, from HMRC's Coventry office whose evidence was in relation to Birdwood Limited.

(9) Barry Patterson, another London based officer, who gave evidence concerning E K Hassan Foods Limited.

(10) Roderick Stone, who gave generic evidence which has been used in many MTIC proceedings consisting of an overview of the history of HMRC's policies and some of the commercial practices relevant to this and similar cases.

These witnesses (subject to corrections as appropriate), confirmed, under oath or affirmation, that their statements were true as did Gary Taylor, a director of PricewaterhouseCoopers LLP who, in his witness statement, gave generic evidence about the mobile phone industry and the wholesale "grey market" for mobile phones in the UK. Each of these witnesses was cross examined by Mr Patchett-Joyce.

10. We were also provided with witness statements, made on behalf of the Appellants, by Imtiaz Ali, the sole director of the Appellant companies, Stephen Plowman of Veracis Limited, Kamal Majevadia of Sydney Mitchell the Appellants' solicitors and Steven Simmods of Clement Keys Accountants, all of whom were expected to give oral evidence. However, due to his poor health, we did not hear from Mr Ali and, in the circumstances as what they had to say did not address any of the four central issues, none of the Appellants' other witnesses gave evidence.

11. As was agreed by the parties, we have admitted Mr Ali's witness statements into evidence but have given it less weight than would have been the case had Mr Ali given oral evidence under oath or affirmation which could have then been tested by cross examination. Also where there is a conflict between Mr Ali's evidence and that of the Respondents' witnesses, we have preferred the evidence of the witnesses who gave oral evidence over that of Mr Ali.

12. Other than Mr Ali's witness statements and two points from the witness statement of Steven Simmonds, the director of VAT Services at Clement Keys Chartered Accountants who advised Mr Ali and the Appellants in regard to VAT matters, to which we were referred by Mr Cunningham without objection, we have totally disregarded the evidence of Stephen Plowman, Kamal Majevadia, and Steven Simmods.

13. There was also extensive documentary evidence (which including the witness statements was contained in 43 ring binders extending to over 12,500 pages).

14. On the basis of this evidence we make the following findings of fact.

Facts

Background

15. Imtiaz Ali was born in 1967 and was 39 in 2006, the year that Midland Mortgages Limited, Midland Enterprises UK Limited and Midland Communications UK Limited participated in the transactions with which this appeal is concerned.

16. On completion of his schooling Mr Ali attended college and obtained a BTEC National Diploma in electrical and electronic engineering. In 1991 he graduated from University of Wales College, Cardiff, with a B.Eng honours degree in Electronics and obtained a Post Graduate Diploma in Electrical and Electromagnetic Engineering from the same University in 1992. However, following the completion of his Post Graduate Diploma, he was unable to find work in the field of electrical engineering and undertook a computer programming course which led to a number of positions and which eventually took him into a more sales based environment.

17. Between 2001 and 2004 Mr Ali became involved in a variety of start-up companies, largely focussed on computer software sales, but could not establish any "meaningful presence" due to competition in the industry. During this period he had also become involved in buying and selling residential properties for family and friends and decided to develop this into a line of business. In June 2004 he obtained a Certificate in Mortgage Advice and Practice, CeMAP 1, 2 and 3, from the Institute of Financial Services and subsequently began trading, on his own account, as a mortgage adviser under the name "IA Estates and Mortgages". The business was incorporated as Midland Mortgages Limited ("MML") on 21 February 2005 with Mr Ali as its sole director. Its principal shareholder was Midland Group Limited of which Mr Ali was the sole director and principal shareholder. MML's only business activity at this time was the provision of mortgage and insurance advice to members of the public. Its gross profit, between April 2005 and March 2006 was £14,999.

18. Always looking for new business opportunities, Mr Ali became interested in the wholesale mobile phone market following discussions with a business acquaintance who was involved in the legal activity of "box breaking", taking advantage of the fact mobile phones were heavily subsidised by the network operators in the UK and cheaper than in other European Union Member States, he would purchase them from UK High Street retailers and split the SIM card from the phone, selling these overseas as two separate commodities at a profit.

19. Mr Ali's first foray into this market was to supply his acquaintance with small numbers of mobile phones purchased from High Street retailers. However, his ambitions were greater and, believing that any gaps in market or product knowledge could be overcome with commitment and a lot of hard work, he identified the International Phone Traders ("IPT") website as a specialist website used by hundreds of traders as an online telecommunications market. He considered that as the market operated was "demand based" and relied upon "back to back" transactions without extension of credit the risk was low.

20. He saw success in the market being dependent on many transactions being undertaken in a very short period of time "much like when a property chain of residential homes all complete at or near the same time to each other." Although he initially considered sourcing handsets directly from the manufacturers, after making enquires he found that this was not a viable option as a network of authorised dealers was already in place.

21. Megalla Limited had been established on 16 September 2004. On 3 June 2005 Companies House was informed of its change of name to Midland Communications UK Limited ("MCL"). Mr Ali was its sole director and its principal shareholder was the Midland Group Limited. MCL became the first of the Appellants to trade in the wholesale telecommunications market.

22. The business model operated by MCL, as described by Mr Ali, was straightforward and demand based involving contact with companies on the IPT website. After receiving an enquiry for stock MCL would undertake market research by contacting various suppliers and potential customers to establish a market price because, as Mr Ali says in his statement, "depending on availability and demand there would be price fluctuations on a day by day basis." Once satisfied that the enquiry was around the market price and it was able to source the mobile phones at a profit MCL would confirm acceptance of the order and place a similar order with its suppliers. From the nine deals MCL conducted in September 2005 it was apparent to Mr Ali that greater margins could be achieved selling overseas both within and outside the European Union and subsequent transactions were focussed on these markets.

23. Midland Enterprises UK Limited ("MEL") was incorporated on 4 March 2004 as Pearstone Commerce Limited. Companies House was notified of its change of name on 18 January 2006. Its principal shareholder was Midland Group Limited and its sole director was Mr Ali.

VAT Registrations

24. On 2 June 2005 Steven Simmonds of Clement Keys Accountants submitted an online application on behalf of MCL for it to be registered for VAT. Its main business activity was described on the application as being "import, export wholesale & distribution of telecommunications equipment" and its estimated taxable turnover for the subsequent 12 months was stated to be £250,000.

25. In view of the proposed business activity to be undertaken by MCL, Officer Farzana Malik made an unannounced pre-registration visit to its principal place of business, which was also that used by MML, on 29 June 2005. During this visit Mr Ali explained that MCL wanted to buy mobile phones wholesale and sell them not only to retailers but mainly to other wholesalers. He provided evidence of intending trade such as the bank account details and the amount of start-up capital available for the business.

26. The source of the business capital was an offset mortgage facility with Bristol and West Building Society which enabled him, subject to the mortgage on his house, to draw down up to £500,000. Mr Ali's cousin had a similar facility to borrow up to £500,000 and he allowed Mr Ali to have access to these funds.

27. Miss Malik explained carousel fraud to Mr Ali and issued him with HMRC Public Notice 726 'Joint and Several Liability' (to which we refer in greater detail below). Mr Ali said that he was already aware of carousel fraud which had been explained to him in detail by Mr Simmonds of Clement Keys Accountants with whom he had discussed Notice 726 "at length". Mr Ali told Miss Malik that he did not want to become involved in fraudulent trading as it could jeopardise his Financial Services Authority registration. He said he had too much to lose by getting involved with such fraud.

28. In view of Mr Ali's convincing disavowal of carousel fraud Miss Malik recommended that MCL should be registered for VAT from 1 July 2005 albeit with a precautionary measure of a "repayment inhibit". This meant that any repayment of VAT on MCL's first VAT return would not automatically be paid. She also requested a "Redhill" letter to be sent to MCL. The letter, which enclosed a further copy of Notice 726, advised the company of the risks of fraud in the mobile phone trade and suggested checks which could be made. MCL was duly registered for VAT from 1 July 2005 and required to make VAT returns for the quarter ending 30 September 2005 and every three months thereafter.

29. As Mr Ali intended that MCL would continue to trade in mobile phones for the foreseeable future and this was likely to result in VAT repayments he discussed the possibility of it being able to submit VAT returns on a monthly, as opposed to a quarterly basis, with Mr Simmonds. On 1 October 2005 Mr Ali submitted an online application to HMRC for MCL to be able to make monthly VAT returns. He contacted HMRC's National Advice Service ("NAS") by telephone on 12 October 2005 to enquire about the progress of this. On 2 November 2005 Miss Malik received, via email, a copy of a letter he had sent to HMRC's Wolverhampton Registration Unit requesting monthly returns for MCL. This request was refused in a letter of 21 November 2005 from HMRC's Registration Service on the instruction of Miss Malik and Mr Ali was told of this when he called the NAS on 23 November 2005. A further letter from Mr Simmonds was sent to HMRC's Registration Service on 2 December 2005 asking for a reconsideration of the decision not to allow monthly returns stating that the next return would show a repayment of £1m to MCL. Miss Malik replied on 12 December 2005 stating that given the tax risks in the trade sector in which MCL was operating the request for monthly returns would not be granted and that the decision was not an appealable matter. Despite this letter, on 16 January 2006, Mr Simmonds telephoned Miss Malik to make a further request for monthly returns only to be told, once again, that the answer was no.

30. The purpose of MEL was, according to Mr Ali, to supply UK specification Mercedes cars to Pakistan following an approach, in December 2005, by a business associate of Mr Ali's in Pakistan who was confident that such a market existed.

31. The first transaction was to be the supply of an S class Mercedes with a UK cost price of £66,252.43 and, on the basis of the estimated turnover, Mr Ali was advised by Mr Simmonds that MEL should be registered for VAT. However, the deal fell through and MEL made a loss as the car was eventually sold for £30,000. As a result of such an unpromising start further plans to continue in this trade were abandoned and the focus of MEL turned to the wholesale trade in mobile phones.

32. An application to register MEL for VAT was made on 20 February 2006. The business activity was described on the application as "Exporter of miscellaneous goods" which, unlike "import, export wholesale & distribution of telecommunications equipment" the business activity that had been included on MCL's registration application, did not trigger a pre-registration visit from HMRC. There was also a request that MEL be put on a different VAT return date or "stagger" than MCL as it was intended to divide the deals between MEL and MCL. This would enable VAT returns and repayment claims to be submitted to HMRC on a more regular basis to improve cash flow. MEL was registered for VAT from 13 February 2006.

33. The wholesale mobile telephone business of MCL and MEL soon eclipsed the mortgage business of MML and, in view of the profitability of the trade, by the middle of February 2006 Mr Ali had decided to utilise MML for the trade in mobile telephones. An application to open an account with the FCIB was made on 13 February 2006 and on 16 February 2006 MML made an application to register for VAT requesting its VAT stagger to be May, August, November and February to enable it to have a different VAT return cycle from MCL and MEL. It was stated on the application for registration that the current or future business of MML was "Financial and management services." Its estimated annual turnover was shown as £200,000. In the circumstances HMRC did not make a pre-registration visit as would almost certainly have been the case had it been indicated that MML proposed to engage in a wholesale trade involving mobile phones. MML was registered for VAT from 1 March 2006.

34. On 12 April 2006 Mr Simmonds informed HMRC by fax that, in addition to financial services, MML was now involved in the wholesale trade of telecommunications equipment.

35. When Mr Simmonds telephoned Miss Malik on 26 May 2006, to ascertain the progress of verification of MEL's VAT return on which a repayment was claimed, she asked him what had been the reasoning behind the registration of MEL and MML and she was told "monthly returns."

36. This confirms Mr Ali's statement where he says, "by utilising MCL, MEL and MML to trade in mobile phones, I was, in effect, able to submit VAT returns on a monthly basis thereby improving my cash flow." However, any cash flow advantage was short lived as, on 26 May 2006, Miss Malik aligned the VAT quarters of MCL, MEL and MML although this did not prevent the issue of VAT returns for the periods 04/06 and 05/06 for MEL and MML respectively.

Post Registration

37. MML, MCL and MEL all operated from the same Birmingham office moving to larger premises in the city in early 2006. There were 10 employees, six of whom were sales representatives whom Mr Ali describes as "constantly checking the market" primarily through the IPT website and "trying to strike up deals" on the telephone.

38. Each of the companies originally had accounts with HSBC although MML had an additional account with Lloyds TSB for its mortgage business. However, during 2006 HSBC gave notice that the accounts were to be closed within 30 days. The accounts of the companies were then moved to the Indian Bank of Baroda but were again given notice of closure in July 2006 and the main trading accounts were opened with the FCIB which was based in the Dutch Antilles and was the bank used by almost all companies involved in wholesale transactions involving mobile phones. Mr Ali explains that as most traders the companies dealt with also had FCIB accounts it allowed transactions to take place extremely close to each other which was very important in this "fast moving" industry.

39. MCL's first VAT return was for the period ended 30 September 2005 ("09/05"). This was a repayment claim for £466,196.47 and HMRC were provided with copy documentation in relation to the transactions on this return by Clement Keys on 5 October 2005. On 11 October 2005 Miss Malik wrote to MCL requesting a meeting to discuss the company's business activities and listed the documentation necessary for the repayment to be authorised. The transactions entered into by MCL during this period consisted of nine deals involving the wholesale supply of mobile phones generating a turnover of £4,517,466 producing a profit of £146,000 and were of a type that Miss Malik considered to be associated with MTIC fraud.

40. On 19 October 2005 Miss Malik accompanied by fellow HMRC Officer Michael Phipps met with Mr Ali and Mr Simmonds. Much of that meeting was spent discussing due diligence checks with reference to Notice 726. These were not regarded as satisfactory by Miss Malik as it was clear to her that virtually no financial or commercial checks had been carried out by Mr Ali and trading had commenced with little knowledge of his trading partners. She emphasised the importance of due diligence checks to cover the business in the event of fraud elsewhere in the chain of transactions and that the purpose of the checks was to arrive at a business decision and not to keep HMRC happy. Although both Mr Ali and especially Mr Simmonds had taken notes of the meeting, Miss Malik had promised to write a letter confirming their discussions.

41. As the expected letter had not arrived by 25 October 2005 Mr Ali telephoned Miss Malik and told her that Mr Simmonds had told him (ie the companies) not to trade until he had received the letter. He telephoned again on 27 October 2005 to ask about the letter and Miss Malik referred to Mr Ali having taken a note himself during the meeting and that Mr Simmonds had also taken copious notes. In the circumstances Mr Ali said he would continue to trade. Miss Malik's letter to Mr Ali confirming the points raised in the 19 October meeting was sent on 2 November 2005.

42. This advised that repayment for the 09/05 was being authorised on a "without prejudice basis", it also contained her view that the checks undertaken by MCL were insufficient. It stated:

> … during our meeting my colleague Mr Phipps and I pointed out to you that no business checks have been carried out to date and I will expect to see this situation rectified in future …

Other than matters relating to VAT registration, to which we have already referred, Miss Malik had "minimal" further contact with MCL and its representatives until 3 July 2006 when, together with HMRC Officer Joe Martin who was replacing her as case officer for MCL, she visited its new business premises. They noticed that there was little paperwork in the office and that the members of staff did not appear to be working in what Mr Ali describes as a "pressurised trading environment".

43. During the VAT period ended 31 December 2005 ("12/05") MCL conducted 12 deals generating a turnover of £8,522,841 resulting in a profit of £510,366. The VAT return submitted on 4 January 2006 sought a repayment of £1,405,123.62. This was repaid by HMRC in February 2006

44. A further repayment claim was made in the VAT return for the period ended 31 March 2006 ("03/06"). During this period 13 deals had been conducted generating a turnover of £20,413,586 and a profit of £809,850. The VAT repayment claim for £3,443,445.52 was repaid by HMRC in May 2006. The subsequent VAT periods are the subject matter of this appeal and we consider these in greater detail below.

45. Following their VAT registration, other than the single unsuccessful Mercedes transaction by MEL, MEL's and MML's business consisted solely of the wholesale export of mobile phones resulting in VAT repayment claims which were refused by HMRC. We also consider these in more detail below.

Due Diligence

46. As we have already noted due diligence was raised and discussed during the meetings that took place between Miss Malik and Mr Ali. It was clear from their very first meeting when Miss Malik issued Mr Ali with Notice 726 that he was aware of the potential dangers of MTIC fraud and the need to undertake due diligence and had engaged a specialist VAT adviser, Mr Simmonds, with whom he had previously discussed Notice 726.

47. Although Notice 726 is concerned with "Joint and Several Liability" it is made clear (at section 1.3) that is should be read by all VAT registered businesses that trade in goods or services that are subject to MTIC fraud, which includes mobile phones (section 1.4). Section 4.4 of the Notice asks "How can I avoid being caught up in MTIC fraud?" It is answered in section 4.5 which advises that "reasonable steps" are taken to "establish the legitimacy of your supply chain and avoid being caught up in a supply chain where VAT would go unpaid." It continues:

> We [HMRC] do not expect you to go beyond what is reasonable. You are not necessarily expected to know your supplier's supplier or the full range of selling prices throughout the supply chain. However, we would expect you to make a judgement on the integrity of your supply chain.

Although examples of checks are contained at section 8 of the Notice section 4.6 makes it abundantly clear that these are "guidelines" only as "a definitive checklist would merely enable fraudsters to ensure that they can satisfy such a list."

48. Mr Ali, who says that MML, MEL and MCL "would not trade with any company where we had reservations about their integrity", explains that there were eight principal steps to the due diligence system applied by the companies:

(1) Information such as Companies House records, proof of VAT registration and proof of incorporation would be required from potential trading partners who would be asked how long they had been trading. Also proof of identification, such as passports and utility bills, would be sought from the directors of those companies.

(2) The VAT registration numbers would be verified with HMRC at its Redhill Central UK Clearing Unit and via the "Europa" website.

(3) Credit checks and trade references would be obtained and enquiries made with Companies House in respect of UK suppliers.

(4) Veracis Limited (a specialist independent company) would be commissioned to undertake a site visit and prepare a report on a potential trading partner. The reports were generally obtained before trading commenced. However, with regard to A-Z Mobile Accessories Limited ("A-Z") and European customers the Veracis report was obtained after the first trade had taken place and cannot therefore have played any part in the decision to commence trading.

(5) On the assumption that there were not concerns about the integrity of the company concerned, a comprehensive due diligence file would be compiled containing the commercial documentation provided by the trader and the product of checks by MML, MCL or MEL and would include the Veracis report.

(6) Freight forwarders were engaged to physically inspect the goods prior to shipment using A1 Inspections Limited who would provide, in addition to an inspection report, an "excel" spreadsheet of IMEI numbers which they had scanned. However, the spreadsheets were not retained by the companies.

(7) A database of IMEI numbers was kept by Mr Ali which was routinely updated and checked to ascertain whether there was any duplication in the IMEI numbers of stock passing through MML, MCL or MEL which would suggest circularity.

(8) Before entering into any transaction with a supplier it would be required to complete a supplier declaration form which required an answer, either yes or no, to the following questions:

(a) Did they have title to the goods?

(b) Were the goods new with full manufacturers' warranty and standard specification?

(c) Were they selling the goods at a lower price than the price they had purchased from their supplier?

(d) If the goods have been subject to examination and were they satisfied that they exist exactly as specified?

(e) Can they confirm that the items supplied have not previously been supplied to [MML, MEL or MCL] or any third party? and

(f) Can IMEI numbers be supplied for at least 50% of the phones?

The supplier's declaration also required the supplier to confirm that VAT would be declared on the sale; that its supplier's VAT registration number was valid when the goods were purchased; that it held all relevant commercial documentation; that further enquiries into the background of its supplier had been undertaken; and that it had a signed declaration from its supplier confirming that they have title and are VAT registered and that they have done a similar check on their suppliers.

49. However, the due diligence undertaken has been criticised by HMRC as "limited". Officer Cyril Haynes refers to the inspection reports undertaken by A1 Inspections Limited as not being detailed but a general statement printed on an A4 sheet of paper stating that there had been a 100% check on the contents of each box and 10% check on IMEI numbers. Although Mr Ali says he was always led to believe by the freight forwarders that they had the resources to carry out these inspections he does not appear to have questioned the feasibility of the inspection when on one day, 5 May 2006, there were transactions involving over 56,000 mobile phones.

50. Also inspection reports which refer to the mobile phones carrying a "limited warranty" or where the software languages are Taglog, Tiengviet, or Russian do not appear to have had any bearing on the transactions. Neither does the apparent discrepancy between the number of pallets identified by A1 Inspections Limited and the number of pallets shipped as shown in the CMR

51. A further example of the limited nature of the due diligence can be seen in the apparent lack of action taken in relation to the Veracis report on Tradesmart Limited ("Tradesmart"), a UK supplier involved in multi million pound mobile phone transactions with whom MEL traded in April 2006. Tradesmart was visited by Veracis on 27 June 2006 to undertake due diligence checks on behalf of its client and the report refers to just £40,000 capital with which Tradesmart began trading.

52. We now consider the returns and transactions which form the subject matter of this appeal.

MEL 04/06 Return

53. In its 04/06 VAT return MEL made a claim for a repayment of £1,519,595.28. Other than that involving the Mercedes all of the transactions during this period concerned the sale of mobile phones.

54. As these transactions were traced to defaulting traders MEL was informed by a letter from HMRC, dated 9 October 2007, that £1,507,012.50 of its repayment claim, in relation to the following transactions, had been disallowed.

55. On 18 April 2006 MEL sold 3,000 Nokia 8800, 5,000 Nokia N70 and 4,000 Nokia 9300i mobile phones to Opal 53 GMbH ("Opal"), a company based in Germany. MEL had purchased these phones from Tradesmart which had, in turn, acquired them from Trade Easy Limited ("Trade Easy") on 18 April 2006. Trade Easy had bought them from Worldwide Enterprises Limited ("Worldwide"), on the same day.

56. On 19 April 2006 MEL sold:

(1) 4,000 Nokia 6280 and 2,000 Sony Ericson W9001 mobile phones to Power Communication Trading BV ("Powercom") based in the Netherlands, and

(2) 3,000 Nokia 8801 mobile phones to Opal.

The chain of transactions for all of these phones can be traced through back to back deals on 19 April 2006 from A-Z (MEL's supplier) through Westpoint One Limited (Westpoint") and Stylez Limited ("Stylez") to Worldwide.

57. The following movement of funds has been traced through the FCIB accounts for the transactions relating to sale of the 4,000 Nokia 6280s to Powercom on 19 April 2006 (which had been sold on to SL Computer Electronics Limited ("SL"), a UK based company, by Powercom):

(1) SL paid Powercom £836,000 on 27 April 2006;

(2) A payment of £834,000 from Powercom was received into MEL's FCIB account on 27 April 2006;

(3) MEL paid A-Z in two instalments. £500,000 on 28 April 2006 and £442,350 on 4 May 2006;

(4) A-Z made two payments to its supplier Westpoint: the first of £500,000 on 28 April 2006 which was followed by £440,000 on 4 May 2006;

(5) Westpoint which had acquired the phones from Stylez paid it in two payments, £500,000 on 28 April 2006 and £438,060 on 4 May 2006;

(6) Stylez had acquired the goods from Worldwide. It did not pay Worldwide but paid £500,000 on 28 April 2006 and £438,120 on 4 May 2006 to Alagu Muthusamy a signatory on Computec's bank account;

(7) Alagu Muthusamy combined the £500,000 with funds of £774,200 which had been received from Global to make a payment of £1,274,000 to Flash Tech Limited ("Flash Tech") a company based in Cyprus on 28 April 2006; and

(8) Flash Tech made a payment of £1,274,000 to SL.

58. On 25 April 2006 MEL sold 6,000 Nokia N90s and 4,500 Nokia N70s to Roddacom Trade SL ("Roddacom"), based in Spain.

59. The N90s had been bought from Tradesmart which had acquired the phones from Global Access Limited ("Global"). The N70s had been purchased from A-Z which had acquired its goods from Westpoint which in turn had acquired them from Global. The phones had been bought by Global from Computec Enterprises Limited ("Computec").

60. The movement of funds through the FCIB accounts in respect of the 25 April 2006 transactions involving the Nokia N70s was as follows:

(1) Roddacom, which had sold the 4,500 Nokia N70s to on to Sigma Sixty BV ("Sigma") a Netherlands company on 4 May 2006 received £999,999 from Sigma;

(2) Roddacom paid £996,750 to MEL on 4 May 2006;

(3) £996,750 was transferred from MEL's account to MCL's FCIB account also on 4 May 2006;

(4) A-Z was paid £1,126,237.50 on 5 May 2006 by MCL;

(5) A-Z paid Westpoint £1,123,593.75 on 5 May 2006;

(6) Two payments were made on 5 May 2006 by Westpoint, the first of £1,000,000 and the second £122,536.25 to Global;

(7) Global paid Alagu Muthusamy £1,121,478.75 on 5 May 2006;

(8) Alagu Muthusamy then paid Flash Tech £1,110,408.75 on 5 May 2006;

(9) Flash Tech paid SL £1,109,283.75 also on 5 May 2006; and

(10) On 4 May 2006 SL had paid Sigma £1,001,250.

61. Most of the phones sold by MEL were of a type manufactured for the European market. However, the Nokia 8801, of which MEL sold 3,000 on 19 April 2006, is a tri-band mobile phone with two frequencies suitable for America and one for Europe. Although marketed for international use, it is clearly aimed at and sold in the North American market, eg the plugs for their chargers are the American (as opposed to European) two-pin plugs. Monthly retail sales figures compiled by GfK, a market research firm, show that in a particular month during 2006 only two phones of this type had been bought in the European Union and the UAE combined.

62. Worldwide was registered for VAT with effect from 26 January 2005. Although its application for registration for VAT was somewhat vague, during the registration process it was indicated that its business was the wholesale trade in clothing and accessories. In its first VAT return Worldwide declared only the purchase and sale of 500 pairs of trousers. The next return showed a small claim for input tax with no declared sales. No further returns were submitted and it was thought by HMRC that the company had ceased trading. However, the discovery of documents at Point of Logistics, a freight agent, showed the release of stock to Worldwide and allocation to Stylez which suggested to HMRC that Worldwide was acquiring goods to sell on to UK customers.

63. Another cause of concern for HMRC was an item of post that had been returned from the notified place of business for Worldwide as undeliverable around 23 January 2006. Companies House records showed that new officers had been appointed to the company and Gordon Smith, an officer of HMRC, unsuccessfully attempted to visit the new company personnel and found that properties at the addresses given to Companies House appeared to have been demolished as part of an on-going urban regeneration. Mr Smith raised a VAT assessment in the sum of £36,925,961.20 on Worldwide being the amount known to have been charged as VAT by the company based on invoices obtained by customers. Worldwide's VAT registration was cancelled with effect from 18 May 2006. To date neither this assessment nor any part of it has been paid by Worldwide.

64. The application for registration for VAT submitted by Computec showed its business activities were "software development and consultancy and computer components" and its principal place of business was an accommodation address. Information obtained by HMRC from Point of Logistics showed that Computec was acquiring mobile phones from Estonia. HMRC Officers visited the accommodation address on 5 May 2006 and, as they were unable to find anyone from the company, left two letters for Computec. The first was a direction under the VAT Regulations to shorten the company's VAT period to 5 May 2006 and the second cancelled its VAT registration informing Computec that at least £967,487.50 was due to HMRC. Computec had issued invoices on 16 days between 3 April 2006 and 9 May 2006 to a value of over £600m from an accommodation address with the debt to HMRC during this period amounting to £105,110,557.23. It did not make any declarations of trading to HMRC submitting nil returns from the date of its registration and did not submit a return for its final period of trading to 10 May 2006. The VAT due remains outstanding.

MML 05/06 Return

65. In its 05/06 VAT return MML claimed a repayment of input tax in the sum of £4,982,548.47. It was notified by HMRC, on 7 August 2007, that as all of its transactions during the period had been traced to defaulting traders its claim £4,967,470.75 had been disallowed. The following transactions took place during this period.

66. On 2 May 2006 MML sold:

(1) 3,000 Nokia N90s and 2,000 Sony Ericsson W900is to Roddacom;

(2) 4,350 Nokia 9300is to Powercom; and

(3) 4,000 Nokia N70s to Opal.

67. The Nokia N90s sold to Roddacom and the Nokia 9300is sold to Powercom had been bought from Tradesmart by MML. Tradesmart had acquired these phones from First Associates Limited ("First Associates") which had bought them from Computec.

68. The Sony Ericson W900is sold to Roddacom and the Nokia N70s sold to Opal were purchased by MML from A-Z. A-Z had bought these phones from Westpoint

which had acquired them from Global. Global's supplier had been Computec. These transactions all occurred on 2 May 2006.

69. The following movement of funds has been traced through the FCIB accounts in respect of the transaction involving the 4,350 Nokia 9300is:

(1) Powercom which had sold the goods on to SL received payment of £1,337,625 from SL on 9 May 2006;

(2) Powercom then paid £1,335,450 into the FCIB account of MCL on 9 May 2006;

(3) MML had been supplied by Tradesmart. On 9 May 2006 MCL paid Tradesmart £1,507,818.75;

(4) Tradesmart paid its supplier, First Associates, £1,505,263.13 on 9 May 2006;

(5) First Associates which had been supplied by Computec paid Flash Tech £1,504,240.88 on 9 May 2006;

(6) On the same day Flash Tech paid SL £1,495,060.43; and

(7) SL paid Powercom £1,495,040.63 also on 9 May 2006.

70. On 3 May 2006 MML sold:

(1) 2,800 Nokia 9300is and 1,500 Samsung P300s to Roddacom; and

(2) 1,500 Sony Ericsson W900is and 3,450 Nokia N90s to Opal.

71. MML had bought the Nokia 9300is and Sony Ericsson W900is from Tradesmart which had purchased the phones from First Associates which had, in turn, acquired them from Computec. The Samsung P300s and Nokia N90s were also traced back to Computec but in the case of these phones it was via A-Z, Westpoint and Global. All of these transactions took place on the same day, 3 May 2006.

72. The FCIB accounts show that the following movement of funds took place on 9 May 2006 in respect of the transactions involving the Sony Ericsson W900is which MML had sold on to Opal:

(1) Opal which had sold the goods to Sigma received a payment of £485,250 from Sigma;

(2) Opal paid £457,000 to MCL;

(3) MCL paid Tradesmart, MML's supplier, £516,412.50;

(4) Tradesmart had acquired the phones from First Associates to which it paid £515,513.24;

(5) Although First Associates acquired the phones from Computec it paid £512,006.25 to Flash Tech;

(6) Flash Tech then combined the £512,006.25 with another sum received from First Associates and made a payment of £1,436,193.75 to SL; and

(7) SL paid Sigma £459,000.

73. Further transactions were entered into by MML when, on 4 May 2006, it sold:

(1) 2,800 Nokia N90s and 3,000 Nokia 9300is to Opal;

(2) 3,000 Nokia 8801s to Compagnie International de Paris SARL ("CIDP"); and

(3) 3,000 Nokia 9500s and 4,000 Nokia 6280s to Roddacom.

74. MML had purchased the Nokia N90s, 8801s and 9500s from Tradesmart which, in turn, had acquired them from Global. Global's supplier for these phones was Computec. The other phones sold on 4 May 2006 had been bought from A-Z which had acquired them from Westpoint. The supplier for Westpoint was Global and Global was supplied by Computec.

75. The following movements of funds through the FCIB accounts, all of which took place on 10 May 2006, have been traced in respect of the transactions involving the Nokia 8801s:

(1) CIDP which had sold the phones to Sigma received a payment of £1,159,000;

(2) CIDP paid £1,158,000 to MCL;

(3) MCL paid £1,307,774 to Tradesmart;

(4) Tradesmart paid £1,306,012.50 to Global;

(5) Global, which had acquired the phones from Computec, paid Alagu Muthusamy £1,305,307.50;

(6) Alagu Muthusamy combined the £1,305,307.50 with £637,347 that he had received and paid £1,933,137 to Flash Tech;

(7) Flash Tech then paid £1,933,137 to SL; and

(8) SL paid Sigma £1,161,000.

76. On 5 May 2006 MML sold 56,010 mobile phones in the following transactions:

(1) 2,750 Nokia 8801s, 1,400 Nokia 9300is, 3,000 Nokia N90s and 4,500 Nokia N70s to CIDP;

(2) 2,000 Nokia N90s, 3,360 Nokia 8800s, 2,000 Sony Ericsson W800is, 2,000 Samsung D600s and 3,000 Samsung P300s to Opal;

(3) 1,500 Sony Ericsson W900is, 4,000 Nokia 7610s, 2,500 Nokia 9500s and 3,000 Samsung D800s to Powercom; and

(4) 5,000 Nokia 6280s, 5,000 Nokia 9300s, 3,000 Nokia 6230is, 3,000 Sony Ericsson W900is and 5,000 Nokia 9300is to Roddacom.

77. MML was supplied with these mobile phones by Cell Trading Limited (Cell Trading"), A-Z, and Tradesmart. In each transaction the supply chain could be traced to Computec via other companies including Tradesmart, Westpoint, Stylez and

Global. The movement of funds through the FCIB accounts has been traced in four of these transactions although we have only referred to one of these, the sale of 2,750 Nokia 8801s for £1,067,000 to CIDP, as an example.

78. Following its acquisition CIDP sold the goods on to Sigma leading to the following movement of funds in the FCIB:

(1) Sigma paid CIDP £1,068,375 on 11 May 2006;

(2) CIDP paid £1,067,000 to MCL's FCIB account also on 11 May 2006;

(3) MML had purchased the phones from Cell Trading for £1,205,256.25 and on 15 May 2006 MCL paid Cell Trading £1,205,256.25;

(4) Cell Trading bought the Nokia 8801's from Tradesmart for £1,202,025 and this amount was paid by MCL to Tradesmart on 26 May 2006;

(5) Tradesmart's supplier was Global and on 26 May 2006 Tradesmart paid Global the purchase price of £1,200,409.38;

(6) Global had been supplied by Computec. However, payment of £1,199,763.18 was made to Worldwide on 26 May 2006;

(7) Worldwide paid Flash Tech £1,871,148.18 on 26 May 2006;

(8) Also on 26 May 2006, Flash Tech paid SL £1,870,460.68; and

(9) SL paid Sigma £1,069,750 on 26 May 2006.

79. On 8 May 2006 MML sold:

(1) 2,000 Nokia 8801s and 3,000 Nokia N91s to Opal;

(2) 2,000 Nokia 6230is and 3,000 Nokia 6280s to Roddacom; and

(3) 3,000 Nokia 9300is and 2,000 Sony Ericsson W810is to CIDP.

80. MML had purchased the Nokia 8801s, N91s, 6230is and 9300is from Tradesmart which in turn had bought them from First Associates. First Associates had acquired these mobile phones from Stockmart Limited ("Stockmart"). The Nokia 6280s and Sony Ericsson W810is had been obtained by MML from A-Z. A-Z had been supplied by Westpoint which, in turn, had purchased the phones from Global. Global's supplier was Stockmart.

81. Stockmart was incorporated on 23 February 2001 and was registered for VAT on 1 May 2001. The business activity on the application for registration was described as "Buyers and Sellers of Stock." Following a visit to the company's premises HMRC officers became concerned when it appeared that it was involved in circular inter-company transactions whilst making claims for the recovery of input tax. The company subsequently changed its address and HMRC was notified that it was moving into a new trade class, the buying and selling of electrical items. In January 2006 it requested monthly VAT returns which was refused by HMRC.

82. On 15 February 2006 HMRC received a letter signed by the company secretary to say that the company had been sold. After that letter had been received further

correspondence from HMRC was returned as "undelivered" on a regular basis. Although Stockmart had submitted its VAT returns from its first period in 2001 until the end of August 2005 it failed to file its returns for the periods ended 30 November 2005, 28 February 2006 and a final return covering the period from 1 March to 20 May 2006 which had been left at its premises by Robert Godley, an HMRC Officer who had been unable to locate the directors. Information on HMRC files obtained from freight forwarder Point of Logistics indicated that Stockmart had been involved in unusually high value sales of mobile phones and schedules of known deals indicated that the trade was in excess of £300m. Stockmart was de-registered for VAT purposes from 20 May 2005 and assessments were issued in the sums of £52,241,252, £1,059,398.80 and £269,500. To date these amounts remain unpaid.

83. The circular movement of funds has been found in the FCIB accounts in respect of two of the transactions that took place on 8 May 2006. Although funds have also been traced through the FCIB in respect of the sale of the 3,000 Nokia N91s by MML to Opal these do not show circularity of payments but do show that no payment was made to Stockmart.

84. It has already been noted (in paragraph 61, above) that the Nokia 8801 was manufactured for the American market and (in paragraph 64, above) that Computec is a defaulting trader.

MML 06/06 Return

85. During June 2006 MML conducted 13 transactions all of which involved mobile phones with a total value of over £17m. In its VAT return for the period MML had made a claim for the repayment of £2,639,631.22 input tax. It was notified that as its transactions had been traced to defaulting traders £2,629,243.75 of its claim had been disallowed.

86. On 5 June 2006 it sold 5,000 Nokia 9300is and 3,500 Samsung to CIDP purchasing these phones from A-Z. A-Z had been supplied by Westpoint which in turn had acquired the goods from Stylez. Stylez had bought these from 3D Animations Limited ("3D").

87. 3D was incorporated on 5 April 2006 and registered for VAT on 3 May that year. Its intended business activity was "Design, Multimedia and Animation Graphics" and its anticipated turnover was £89,000. Although it was required to submit quarterly VAT returns no returns were in fact submitted as it was de-registered by HMRC before the end of its first quarter. On 1 June 2006 3D's principal place of business was visited by HMRC Officer Thomas Lane as information obtained from freight forwarders suggested that 3D had been allocated substantial amount of stock consisting predominantly of mobile phones. The premises turned out to be a residential address and Mr Lane was unable to make contact with anyone and posted, through the letterbox, a letter bringing forward the VAT return date to the date of the letter together with another letter giving 3D seven days to contact HMRC to confirm it was actively trading from that address failing which it would be de-registered. 3D failed to respond to these letters. On the basis of the evidence from the freight

forwarders it appeared that the gross sales of 3D were in the region of £886m and assessments were issued for £129m which has not been paid and remains outstanding.

88. On 6 June 2006 MML sold 4,000 Nokia E60s and 2,800 Nokia N80s to Symbolix SARL ("Symbolix"), a company based in Luxembourg. These phones had been bought by MML from A-Z which had acquired them from Westpoint. Westpoint's supplier had been Mopani Limited ("Mopani") and Mopani had acquired the phones from Birdwood Limited ("Birdwood"). Analysis of the FCIB accounts shows that payment of £1,020,000 for the 4,000 Nokia E60s was made to MCL by Symbolix on 5 July 2006.

89. On 7 June 2006 MML sold 3,990 Nokia 8801s and 4,000 Samsung P300s to Opal. As with the 6 June 2006 transactions the chain of supply for these phones can be traced through A-Z, Westpoint and Mopani to Birdwood.

90. On 8 June 2006 MML again sold mobile phones to Opal. This time they were 5,000 Nokia N80s and 5,000 Nokia 9300is. These phones had been supplied by A-Z which had bought them from Westpoint. Westpoint's supplier had been Red Tape International Limited ("Red Tape") which had acquired them from Birdwood.

91. On 9 June 2006 MML sold 4,000 Nokia N80s to Symbolix. The chain of supply was the same as the 6 June 2006 transactions with MML and can be traced back to Birdwood via A-Z, Westpoint and Mopani.

92. Birdwood was incorporated on 9 March 2006. It applied for VAT registration on 5 April 2006 and its intended trade was "suppliers of towels, hats, cutlery and general products". The estimated turnover was £200,000. Following its registration information was obtained by HMRC following a visit to freight forwarders Point of Logistics. This indicated that Birdwood had, contrary to the information provided on its registration application, bought and sold mobile phones acquiring these from European Union countries and selling them to UK companies. In the circumstances HMRC officers called at the company's principal place of business on 9 June 2006 but were unable to obtain an answer. A letter was posted through the door amending the VAT accounting period to end on 9 June 2006. Other than a telephone call to HMRC's National Advice Service on 9 June by its director regarding the VAT registration number there has been no response from Birdwood and HMRC has not been able to establish any contact. Assessments, based on the information obtained from its customers by HMRC, have been raised against Birdwood totalling £25,848,709 which remains unpaid.

93. On 12 June 2006 MML sold:

(1) 5,000 Nokia N70s and 5,000 Nokia E60s to Roddacom; and

(2) 6,000 Nokia 6280s to Symbolix.

94. It had obtained the phones for these transactions from A-Z which had been supplied by Westpoint. Westpoint had purchased the phones from Mopani which had acquired them from E K Hassan Foods Limited ("E K Hassan").

95. The final transaction undertaken by MML during this period occurred on 14 June 2006 when it sold 3,000 Nokia 8801s to Symbolix. MML had been supplied by A-Z which had acquired the phones from Westpoint. Its supplier was Centaurs Limited ("Centaurs") which had received its supply from E K Hassan.

96. E K Hassan, was first registered for VAT as a partnership. Following its incorporation, on 5 April 2004, and subsequent transfer of the business as a going concern the VAT number was transferred to the company. On its application to register for VAT, sent to HMRC at the same time as details of the transfer as a going concern, the main business of the company was described as "general grocery". The application also stated that no regular VAT repayments were expected and gave the anticipated turnover as £150,000. Information obtained by HMRC from freight forwarders in 2006 showed that E K Hassan was trading in mobile phones and that 57,247 phones had been traded over two days. The company was identified as a potentially missing trader and a visit was made to the business address but E K Hassan could not be found. On 25 October 2006 an assessment for £28,347,908.02 was sent to the company by letter and remains outstanding. On 17 July 2007 further letters requesting payment were sent to the company's principal place of business, registered office and director's home address and an address believed to be new business premises. Further assessments were issued for £437,224 on 21 November 2007, £610,960 on 14 March 2008 and £1,185,250 on 9 June 2008. E K Hassan was wound up on 12 December 2007 without payment of any of the outstanding VAT.

MEL 06/06 Return

97. MEL, which had not conducted any trading after the transactions of 25 April 2006, resumed trading on 5 June 2006. On 30 June 2006 an online voluntary disclosure was made by claiming repayment of £1,357,855.27 for the 06/06 period. However, as all transactions during the period had been traced to defaulting traders, HMRC notified MEL, on 1 November 2007, that £1,354,063 of the claim had been disallowed.

98. On 5 June 2006 had sold 5,000 Nokia N70s to Symbolix. The phones had been purchased by MEL from Tradesmart which, in turn, had acquired them from Aaro Limited ("Aaro") which had been supplied by 3D.

99. On 6 June 2006 MEL sold 3,800 Nokia 8801s to CIDP. This time the phones had been supplied to MEL by A-Z and can be traced via Westpoint and Mopani to Birdwood.

100. On 7 June 2006 3,000 Nokia 9300is were sold by MEL to Symbolix. The supply chains for these phones again leads to Birdwood but this time via Tradesmart and Aaro.

101. MEL sold 3,900 Nokia N80s to Symbolix on 9 June 2006. Its supplier was Tradesmart which acquired the phones from Red Tape. Red Tape's supplier was Birdwood.

102. On 14 June 2006 MEL sold 5,000 Nokia N91s and 3,000 Samsung P300s to Opal. It had acquired the phones from Tradesmart which had been supplied by Centaurs. Centaurs had obtained the phones from E K Hassan.

103. The final transaction during this period was the sale by MEL, on 15 June 2006, of 2,800 Nokia N80's to Roddacom. MEL had been supplied by Tradesmart which had bought the phones from Aaro which, in turn, had acquired them from E K Hassan.

104. It has already been noted (at paragraphs 92 and 96, above) that Birdwood and E K Hassan are defaulting traders and that the Nokia 8801 is a mobile phone that is aimed at the American market (see paragraph 61, above).

MCL 06/06 Return

105. Having received repayments in respect of previous return periods MCL submitted its 06/06 VAT return seeking repayment of £4,131,184.32 in respect of its transactions in mobile phones which resulted in a turnover of over £27m. On 9 October 2007 MCL was informed by HMRC that all of its transactions could be traced to defaulting traders and as such £4,121,293.70 of the claim for repayment was disallowed.

106. On 5 June 2006 MCL sold 4,700 Nokia 8801s and 4,850 Nokia N80s to Opal. These had been bought by MCL from Tradesmart which in turn had purchased them from Aaro. Aaro had acquired the phones from 3D.

107. The following movements in funds in the FCIB accounts has been found in respect of the transaction involving the 4,700 Nokia 8801s which were sold MCL to Opal for £1,736,650:

(1) On 18 July 2006 Opal made two payments to MCL, the first of £750,000 and the second of £986,650;

(2) MCL paid Tradesmart £1,070,000 on 18 July 2006, £570,000 on 19 July and £320,487.50 on 20 July 2006 (the invoice price for the phones was £1,960,487.50);

(3) Tradesmart paid Aaro £1,070,000 and £530,000 on 18 July 2006 and £357,762.25 on 19 July 2006 (the invoice price was £1,957,762.25);

(4) Aaro was supplied by 3D at an invoice price of £1,956,621.75. However, it paid Leriant Trading Limited ("Leriant") a UK company £530,000 on 18 July 2006, £1,070,000 and £356,622 on 19 July 2006;

(5) Leriant paid Sigma £891,350 and £750,000 on 18 July 2006; and

(6) Sigma paid Opal £530,000, £100,000 and £899,000 on 18 July 2006.

108. On 6 June 2006 MCL entered into three transactions selling Opal 4,000 Nokia 9300is, 4,000 Nokia 8800s and 3,000 Nokia 9500s. In each of these transactions MCL had acquired the phones from Tradesmart and they could be traced back to Birdwood via Aaro.

109. On 7 June 2006 MCL sold:

(1) 3,850 Nokia N80s and 5,000 Nokia 8800 Blacks to Symbolix; and

(2) 5,000 Nokia E60s to Opal.

110. In all three transactions MCL had been supplied by Tradesmart which had been supplied by Aaro which, in turn, had acquired the phones from Birdwood.

111. An analysis of the FCIB accounts in relation to the transaction involving the Nokia N80s showed a circularity of funds and the presence of non-traders involved in the movement of funds.

112. On 8 June 2008 MCL sold 3,000 Samsung P300s and 2,500 Nokia 8800 Blacks to Symbolix. These phones had been supplied by Tradesmart which had acquired them from Red Tape. Red Tape's supplier was Birdwood.

113. MCL sold 6,000 Nokia 9300is and 6,000 Nokia N91s to Opal on 9 June 2006. It had obtained the phones from Tradesmart and they can be traced via Red Tape to Birdwood.

114. On 12 June 2006 MCL sold:

(1) 4,000 Nokia N80s and 6,000 Nokia 8801s to Opal; and

(2) 6,000 Nokia N91s to Symbolix

115. All of these phones had been supplied to MCL by Tradesmart. Tradesmart's supplier was Aaro and it had acquired the phones from E K Hassan.

116. With regard to the transactions in respect of the Nokia N80s and N91s the analysis of the FCIB accounts shows the circularity of funds, the presence of non-dealers and that no payment has been made to E K Hassan.

117. The final transactions of MCL during this period involved the sale of 4,000 Nokia N90s and 3,000 Nokia Blacks to Symbolix on 15 June 2006. As in other transactions during this period MCL had purchased the phones from Tradesmart and these can be traced via Aaro to E K Hassan.

Discussion and Conclusion

118. The decision of the European Court of Justice ("ECJ") in *Axel Kittel v Belgium; Belgium v Recolta Recycling* (C-439/04 and C-440/04) [2006] ECR 1 – 6161 ("*Kittel*") provides the basis for denying a taxable person the right to deduct input tax where it is ascertained, having regard to objective factors, that the taxable person "knew or should have known" that by his purchase he was participating in a transaction connected with the fraudulent evasion of VAT (at [61] of that decision). The application of the principle enunciated in *Kittel*, which has been the subject of many appeals before this Tribunal and the Chancery Division of the High Court was considered by the Court of Appeal in *Mobilx* where Moses LJ, giving the judgment of the court, said at [59 -60]:

> [59] "The test in *Kittel* is simple and should not be over-refined. It embraces not only those who know of the connection but those who "should have known". Thus it includes those who should have known from the circumstances which surround their transactions that they were connected to fraudulent evasion. If a trader should have known that the only reasonable explanation for the transaction in which he was involved was that it was connected with fraud and if it turns out that the transaction was connected with fraudulent evasion of VAT then he should have known of that fact. He may properly be regarded as a participant for the reasons explained in *Kittel*.
>
> [60] The true principle to be derived from *Kittel* does not extend to circumstances in which a taxable person should have known that by his purchase it was more likely than not that his transaction was connected with fraudulent evasion. But a trader may be regarded as a participant where he should have known that the only reasonable explanation for the circumstances in which his purchase took place was that it was a transaction connected with such fraudulent evasion."

119. The parties agreed that, following *Mobilx*, where Moses LJ had said at [81], "it is plain that if HMRC wishes to assert that a trader's state of knowledge was such that his purchase is outwith the scope of the right to deduct it must prove that assertion", the burden of proof was on HMRC and that the civil standard, the balance of probabilities, applied. However, we do not accept Mr Patchett-Joyce's submission that the more serious the allegation the more cogent must be the proof so as to satisfy the civil standard. Although the standard of proof was not considered by the Court of Appeal in *Mobilx* the prevailing authority is the decision of the House of Lords in *Re B* [2009] 1 AC 11. This was confirmed by the Supreme Court in *Re S-B (Children)* [2010] AC 678 where Lady Hale, giving the judgment of the Court said, at [34]:

> "… there is no necessary connection between the seriousness of an allegation and the improbability that it has taken place. The test is the balance of probabilities, nothing more and nothing less."

120. Mr Patchett-Joyce submitted that there are two elements intrinsic to the burden of proof: the party who bears the burden must first assert its case and secondly, prove it. The first step required HMRC to make clear the basis on which they oppose the appeal which, he suggested, was something that they had failed to do. The basis given in the decision letters was that the right to deduct input tax was "denied" which Mr Patchett-Joyce submitted was a mutually exclusive basis from the approach of the Court of Appeal in *Mobilx* which was that the purchase was "outwith the scope" of the right of deduction. This, he contended, infringed the fundamental principle of legal certainty.

121. In response Mr Cunningham referred us to two, post *Mobilx*, decisions of the Tribunal, *Emblaze v HMRC* [2010] UKFTT 410 (TC) ("*Emblaze*") and *Excel RTI Solutions Limited (in Administration) v HMRC* [2010] UKFTT 519 (TC) ("*Excel*"). He had been counsel for HMRC and Mr Patchett-Joyce had represented the Appellant in these cases and this issue had been raised by Mr Patchett-Joyce in both. We agree with the Tribunal Judge (Theodore Wallace) who at [227] of *Excel* saw no reason to depart from the conclusion he expressed in *Emblaze* at [210] that:

> "…there is no dichotomy between loss of the right to deduct because a trader knows or should have known that his purchase is connected with the fraudulent evasion of VAT and such purchase being outwith the right of deduction. Since the relevant time for knowledge is when the trader enters into the transaction the loss of right is ab initio; we see no difference in substance between such right being lost before it is gained and the transaction being outwith the right. In our judgment there was no material change in Customs' position so as to infringe the need for legal certainty."

122.In addition to the principle of legal certainty, Mr Patchett-Joyce, who reminded us that none of HMRC's witnesses could point to any evidence to suggest that any of the Appellants had any knowledge of the participants in the deal chains other than its immediate supplier or customer, submits that, by concentrating on domestic law with reference to only one judgment of the Court of Justice of the European Union (the "ECJ") *Kittel* through the prism of *Mobilx*, HMRC have fallen into fundamental error by failing to recognise the primacy of European law, including the case law of the ECJ. He referred to the principles of fiscal neutrality, equal treatment/non-discrimination, proportionality and effectiveness.

123.However, Mr Cunningham contends that all of these European points were emphatically and bindingly disposed of by the Court of Appeal in *Mobilx* where, after referring to the "test" and "true principle" derived from Kittel (to which we have referred in paragraph 118, above), Moses LJ said, at [61-62]:

> [61] "Such an approach does not infringe the principle of legal certainty. It is difficult to see how an argument to the contrary can be mounted in the light of the decision of the court in *Kittel*. The route it adopted was designed to avoid any such infringement. A trader who decides to participate in a transaction connected to fraudulent evasion, despite knowledge of that connection, is making an informed choice; he knows where he stands and knows before he enters into the transaction that if found out, he will not be entitled to deduct input tax. The extension of that principle to a taxable person who has the means of knowledge but chooses not to deploy it, similarly, does not infringe that principle. If he has the means of knowledge available and chooses not to deploy it he knows that, if found out, he will not be entitled to deduct. If he chooses to ignore obvious inferences from the facts and circumstances in which he has been trading, he will not be entitled to deduct.
>
> [62] The principle of legal certainty provides no warrant for restricting the connection, which must be established, to a fraudulent evasion which immediately precedes a trader's purchase. If the circumstances of that 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. That trader's knowledge brings him within the category of participant. He is a participant whatever the stage at which the evasion occurs."

He continued at [66]:

> "It is not arguable that the principles of fiscal neutrality, legal certainty, free movement of goods and proportionality were infringed by the Court itself, when they were at pains to preserve those principles (see §§ 39-50). By enlarging the category of participation by reference to a trader's state of knowledge before he chooses to enter into a transaction, the Court's decision remained compliant with those principles"

124. The issues of legal certainty, fiscal neutrality, proportionality and equal treatment were also raised in *Excel* where Judge Wallace accepted, at [228], that these were covered by the decision of the Court of Appeal in *Mobilx*. In relation to proportionality he said at [230]:

> "It is clear that in the present case Customs could have proceeded against other parties in the chains including the counterparties to the defaulters and that Customs produced little or no evidence as to their due diligence, however that does not protect Excel against disallowance. The ruling in *Kittel* at [61] was specific that,
>
> "By contrast, where it is ascertained, having regard to objective factors, that the supply is to a taxable person who knew or should have known that, by his purchase he was participating in a transaction connected with fraudulent evasion of VAT, it is for the national court to refuse that taxable person entitlement of the right to deduct."
>
> This is not qualified in any way."

125. Mr Patchett-Joyce suggested, and we accept, that the Tribunal in *Excel* may have read the words "*it is for the national court to refuse*" as mandatory and considered that the ECJ had been directing the domestic court, the Tribunal, in a particular way. He referred us to the French version (which is both the language of the case and the authentic version) of *Kittel* at [61] where the phrase is "*… il appartient à la jurisdiction nationale de refuser audit assujetti le bénéfice du droit à déduction*" which, to give it its literal translation means that the right of deduction "*belongs*" to the national jurisdiction ie the question of the entitlement of the right to deduct is a matter for the national court or tribunal to decide.

126. However, we do not accept that, because of the primacy of European law, it is open for us to apply a directly applicable European law right of deduction as explained by the ECJ in *Magoora* [2008] EUECJ C-414/07 which, Mr Patchett-Joyce contended, had been "misunderstood" by the Court of Appeal in *Mobilx*. We agree with Judge Wallace where he said in *Excel* at [232]:

> "Any challenge to the interpretation of *Kittel* by the Court of Appeal in *Mobilx* is a matter for a higher tribunal."

127. In reaching our decision Mr Cunningham urged us to consider the totality of the evidence and not look at it in a transaction by transaction tunnel-visioned way disregarding other deals. In support of this proposition we were again referred to *Mobilx* where Moses LJ said at [83]:

> "I can do no better than repeat the words of Christopher Clarke J in *Red12 v HMRC* [2009] EWHC 2563:-

> "109 Examining individual transactions on their merits does not, however, require them to be regarded in isolation without regard to their attendant circumstances and context. Nor does it require the tribunal to ignore compelling similarities between one transaction and another or preclude the drawing of inferences, where appropriate, from a pattern of transactions of which the individual transaction in question forms part, as to its true nature e.g. that it is part of a fraudulent scheme. The character of an individual transaction may be discerned from material other than the bare facts of the transaction itself, including circumstantial and "similar fact" evidence. That is not to alter its character by reference to earlier or later transactions but to discern it.
>
> 110 To look only at the purchase in respect of which input tax was sought to be deducted would be wholly artificial. A sale of 1,000 mobile telephones may be entirely regular, or entirely regular so far as the taxpayer is (or ought to be) aware. If so, the fact that there is fraud somewhere else in the chain cannot disentitle the taxpayer to a return of input tax. The same transaction may be viewed differently if it is the fourth in line of a chain of transactions all of which have identical percentage mark ups, made by a trader who has practically no capital as part of a huge and unexplained turnover with no left over stock, and mirrored by over 40 other similar chains in all of which the taxpayer has participated and in each of which there has been a defaulting trader. A tribunal could legitimately think it unlikely that the fact that all 46 of the transactions in issue can be traced to tax losses to HMRC is a result of innocent coincidence. Similarly, three suspicious involvements may pale into insignificance if the trader has been obviously honest in thousands.
>
> 111 Further in determining what it was that the taxpayer knew or ought to have known the tribunal is entitled to look at the totality of the deals effected by the taxpayer (and their characteristics), and at what the taxpayer did or omitted to do, and what it could have done, together with the surrounding circumstances in respect of all of them."

128.However, Mr Patchett-Joyce submitted that we should approach the decision in *Red12* with care as it was contrary to the Opinion of the Advocate General, and the subsequent judgment of the ECJ in *Optigen* [2006] EUECJ C-354/03 where it was said at [47]:

> "As the Advocate General observed in point 28 of his Opinion, each transaction must therefore be regarded on its own merits and the character of a particular transaction in the chain cannot be altered by earlier or subsequent events."

The Advocate-General explains, at [30] of his Opinion in *Optigen*, that the rule for considering each transaction individually, without regard to its purpose or results, is founded on the requirements of fiscal neutrality and legal certainty.

129.Although he seems to have mistakenly referred to *Kittel*, when it would appear that he meant the paragraph to which we have referred above from the judgment in

Optigen, we agree with, and adopt, the approach of Judge Wallace in *Excel* where he said at [231]:

> "Mr Patchett-Joyce also relied on the statement at [47] in *Kittel* that each transaction must be "regarded on its own merits." We are satisfied that although in principle each transaction must be considered individually and per se that does not mean that the context is not relevant including most importantly the other deals. Any other approach would be contrary to common sense.

130. We now turn to the four central issues identified in *3RD Generation*.

Tax Loss

131. The first of these issues, which is a question of fact, is whether there was a tax loss.

132. We heard the evidence of HMRC Officers Gordon Smith, Timothy Reardon, Robert Godley, Martin Evans, Jennifer Davies and Barry Patterson who gave evidence that Worldwide, Computec, Stockmart, 3D, Birdwood and E K Hasssan respectively were all "missing" traders and between them had defaulted on over £375m. This includes the £14,554,688.67 that arose in respect of the 82 deals with which this appeal is concerned. As each of the officers confirmed that there has been no recovery of tax since making their statements and Mr Patchett-Joyce did not advance any positive case in respect of this issue we have no hesitation in finding that there was a loss of tax

Fraudulent Evasion

133. Having found that there was tax loss, the next issue to address, which is again a question of fact, is did this loss result from a fraudulent evasion?

134. There are clearly common features regarding the defaulting traders which are apparent from the evidence of the HMRC Officers, not only are they "missing" but each appears to have had an explosion in its turnover after failing to submit VAT returns. Mr Cunningham submits, and we agree, that fraud is the only feasible explanation for this and, as such, it must follow that the loss of tax results from a fraudulent evasion.

135. It is not therefore necessary to consider Mr Cunningham's further submission that the entire body of trading, the 82 deals in this case, were orchestrated, contrived, artificial and a schematic fraudulent evasion of tax. However, given that none of the participants in the 82 deals appears to have made a loss, despite trading in what Mr Ali has described as a volatile market with "price fluctuations on a day by day basis", we find that, on balance, there was an artificial contrived scheme to defraud HMRC that resulted in a loss of tax.

Were Appellants' Transactions Connected with Evasion

136.Given our finding that there was a loss of tax arising out of fraudulent evasion it is necessary to consider whether the transactions of MML, MEl and MCL, which are the subject of this appeal, were connected with that evasion.

137.In relation to this issue Mr Patchett-Joyce referred us to the French language version of *Kittel* and pointed out, as we have already noted, that French is both the language of the case and the authentic version. The phrase used in the French version at [61] "*il participait à une opération impliquée dans une fraude à la TVA*" has been translated in the English version as "*he was participating in a transaction connected with fraudulent evasion of VAT*". The words "*impliquée dans*" are used consistently throughout the French version of the case whereas this is translated into English as "*connected with*" at [2], [28], [51], [52], [56], [59], [60] and [61], and as "*involved in*" at [17] and "*part of*" at [27].

138."*Impliquée dans*" has also been translated as "*involved in*" in *Teleos and Others* [2008] STC 706 at [16] and [58] and *Netto Supermarkt* [2008] STC 3280 at [23] and as "*aimed at*" in *R* [2011] STC 138 at [28].

139.As the French text has consistently used "*impliquée dans*" Mr Patchett-Joyce submits that it is this phrase, rather than the wider or looser "*connected with*", which must properly be construed. However, as Mr Cunningham reminds us, despite Mr Patchett-Joyce's engaging argument we are bound by the Court of Appeal in *Mobilx* and find, as there is a clear link through the deal chains described above, that the transactions of MML, MEL and MCL are connected with the fraudulent evasion of VAT.

Knew or Should Have Known

140.The last of the central issues identified in *3RD Generation* is whether MML, MEL and MCL, through Mr Ali who was the sole director of each of the companies, knew or should have known, as at 18 April 2006 the date of the first of the 82 transactions, that the transactions were connected with a fraudulent evasion of VAT?

141.We find that at that time Mr Ali was not naïve but an intelligent, well-educated and experienced businessman. He was aware of the risks of MTIC fraud having been advised by Mr Simmonds in relation to Notice 726 and the need for a system of due diligence. He was also warned of the risk of MTIC fraud in numerous visits and letters from HMRC in addition to being issued with more than one copy of Notice 726 by HMRC. The inevitable conclusion we draw from this is that Mr Ali was clearly aware of the dangers and risks of MTIC fraud inherent in the wholesale trade and export of mobile phones.

142.Mr Cunningham submits that Mr Ali knew that the transactions entered into were connected with a fraudulent evasion of VAT and pointed to the fact that there was no evidence that Mr Ali had undertaken any credible market research before commencing trade in mobile phones; that he had made no enquiries of freight forwarders as to the origin of the mobile phones or how often they had changed

hands; the colossal increase in the Appellants' turnover; and what he submitted was Mr Ali's indifference to due diligence.

143.There was also, as we have found, the existence of fraud in a contrived scheme. Mr Cunningham contends that the Appellants' could not have been in their pivotal positions in the transaction chains by accident or ignorance. He again referred us to *Red12* where Christopher Clarke J said, at [110], "a tribunal could legitimately think it unlikely that the fact that all 46 of the transactions in issue can be traced to tax losses to HMRC is a result of innocent coincidence" and invited us to reach the same conclusion.

144.In addition Mr Cunningham argues that Mr Ali must have known that the Appellants were dealing in fraudulent chains from the market itself. On this issue we were referred to the recent decision of the Tribunal in *Eyedial v HMRC* [2011] UKFTT 47 (TC) where the Tribunal Judge (Colin Bishopp) said, at [47-49]:

> [47]"Those warning signs were, however, all too obvious and any prudent company director (and it is by that standard that Miss Field must be judged) would have realised at a very early stage that this was a market in which an honest trader should not be involved and that the individual transactions could not rationally be explained otherwise than by an underlying fraudulent purpose. Moreover, some of the precautions which Miss Field took, even after Mr Armstrong's meetings with her, were manifestly inadequate.
>
> [48] We begin with the nature of the goods in which Eyedial traded. They were, without exception, mobile phones manufactured to a continental European specification, in that the battery charger supplied with them was in every case of the two-pin variety suitable for use in continental Europe but not in the United Kingdom. There is no evident reason why phones of that specification should be in the United Kingdom at all. No mobile phones are manufactured in this country and the goods in which Eyedial dealt must therefore have been imported. Miss Field asserted that mobile phones were more expensive in continental Europe and that is why she was able to buy relatively cheaply in the UK and sell at a profit in Europe. That assertion, if it is correct, may well explain her ability to export, but it does not explain why the goods entered this country in the first place; if it is correct that mobile phones can be sold at a higher price on the continent, it makes little sense to bring them to the UK in order to sell them for less. The only obvious explanation for the presence of the goods in the UK—and Miss Field offered no other—is that, in order to satisfy the conditions for zero-rating a supply, the goods must cross frontiers between Member States.
>
> [49] Mr Macnab [counsel for HMRC] put it to Miss Field that Eyedial added no value in the transaction chains. That is, it bought goods and sold exactly the same goods without adding anything, by adapting them, holding stock, sourcing goods of an unusual specification, buying in bulk and selling in smaller quantities, or in any other similar way. Miss Field evidently had some difficulty in understanding the concept, apparently thinking that "adding value" meant no more than

> securing a higher price. The point is, however, an entirely valid one, and we were left with no explanation of how it was that Miss Field was able to identify suppliers of phones at one price, and purchasers for exactly the same phones—exactly the same in quantity, model and specification—at a higher price when, as she conceded, she had no previous experience in the trade. In our judgment any person diligently and honestly undertaking a business consisting of purchases and sales would ask himself or herself why it was that profits could be so easily made in such circumstances.

145. Mr Patchett-Joyce submitted that "adding value" did not necessarily have to involve a physical change to the phones and could be achieved by transporting them to the customer's location. We agree but, as no mobile phones are manufactured in the UK, this still leaves unanswered the question identified by Judge Bishopp as to why the phones should be in the country in such quantities at all, especially the Nokia 8801's which were manufactured for and aimed at the American market. In the circumstances we consider that Mr Ali must have been known that they had been imported.

146. We also note that MML, MEL and MCL were always able to supply exactly what customer wanted in each one of the 82 deals eg consignments of phones were ordered in peculiar numbers such as 3,450 Nokia N90s, 3,360 Nokia 8800s, 4,850 Nokia N80s, and 3,990 Nokia 8801s and consider that this does not seem to be indicative of an "order driven business". Neither do the irregular trading patterns of the companies, eg there were four deals on 2 May, four on 3 May 2006, five on 4 May, 18 on 5 May and 6 on 8 May 2006 but no further deals were made until 5 June 2006. We consider this to be somewhat unusual in what Mr Ali described as a "demand based" business.

147. Mr Cunningham referred to the fact that MML, MEL and MCL all had accounts with the FCIB as a factor indicating knowledge of fraud as the FCIB was the bank of choice for participants in the typical MTIC wholesale trade in mobile phones.

148. Although we do not consider that this alone would be significant we do note that Mr Ali had referred to the advantage of such accounts to allow transactions to take place extremely close to each other in such a "fast moving" industry whereas this has not been evident from the movement of funds in the FCIB accounts. These show payment being received some days after a transaction had taken place.

149. It is also clear that MML, MEL and MCL could not have met the payment of approximately £9m of input tax without some additional source of finance as the funds available from mortgage arrangements of Mr Ali, the VAT repayments received and their profits combined would have been insufficient.

150. We accept, as Mr Patchett-Joyce said, that the applications for different VAT staggers by the companies when applying to register for VAT was perfectly legitimate. However, the reference by MML to its existing business when it clearly intended to become involved in the wholesale trading of mobile phones and sought registration for VAT in order to make repayment claims was highly misleading.

151. Although HMRC was notified of a change of business shortly after MML was registered this avoided any pre-registration visit which would inevitably have delayed claims for repayment.

152. We also note that despite the volatile market with "price fluctuations on a day-to-day basis" each of the Appellants made a profit in every one of the 82 deals.

153. Taking all of these factors into account we find that Mr Ali and therefore MML, MEL and MCL did know that the 82 transactions, with which these appeals are concerned, were connected to the fraudulent evasion of VAT.

154. However, even if Mr Ali did not have knowledge that the transactions were connected with fraud we find, for the above reasons, that the only reasonable explanation for the circumstances in which these transactions took place is that they were connected to the fraudulent evasion of VAT and he, and therefore MML, MEL and MCL, should have known that they were connected to fraud.

155. As such we find that HMRC were correct to deny the claims to recover the input tax attributable to these transactions.

156. We therefore dismiss the appeals.

157. In reaching this decision we should make it absolutely clear that we have not given any weight to, or taken any account of the matter described by Mr Patchett-Joyce as the "Revenue's last hurrah".

158. This was raised without warning by Mr Cunningham in his final submissions and, as it had not been included in HMRC's Statement of Case, correspondence between the parties or in his skeleton argument, took Mr Patchett-Joyce by surprise. We agree with Lightman J where he said at [21] of his decision in *Mobile Export 365 Limited v HMRC* [2007] EWHC 1737 (Ch):

> "I should conclude by saying a word about springing surprises on opponents, …. Such tactics are not acceptable conduct today in any civil proceedings. They are clearly repugnant to the Overriding Objective laid down in CPR 1.1 (where applicable) and the duty of the parties and their legal representatives to help the court to further that objective. The objection to them is not limited to proceedings to which the CPR are applicable"

Although the CPR do not apply to proceedings before the Tribunal, the Tribunal Procedure (First-tier Tribunal) (Tax Chamber) Rules 2009 do. Rule 2 of these rules provides for a similar overriding objective to the CPR for cases to be dealt with "fairly and justly" and, as with the CPR, places a duty on the parties to further that objective.

Costs

159. The issue of costs in this appeal was the subject of a direction made by a Tribunal Judge (Sir Stephen Oliver QC) on 26 January 2011 in which he disapplied Rule 10 of

the Tribunal Procedure (First-tier Tribunal) (Tax Chamber) Rules 2009 and directed that the previous cost rules applicable to VAT proceedings applied giving the Tribunal a general costs discretion.

160. As we have not heard submissions on costs we direct that that, given our decision and if advised to do so, HMRC may either file and serve written submissions in support of an application for costs on the Tribunal and Appellants (to which the Appellants may respond within 28 days of receipt) within 28 days of release of this decision or alternatively make an application for an oral hearing within that time. In the absence of any application for an oral hearing and should HMRC apply for costs, we will decide the matter on the basis of written representations.

161. This document contains full findings of fact and reasons for the decision. Any party dissatisfied with this decision has a right to apply for permission to appeal against it pursuant to Rule 39 of the Tribunal Procedure (First-tier Tribunal) (Tax Chamber) Rules 2009. The application must be received by this Tribunal not later than 56 days after this decision is sent to that party. The parties are referred to "Guidance to accompany a Decision from the First-tier Tribunal (Tax Chamber)" which accompanies and forms part of this decision notice.

JOHN BROOKS

TRIBUNAL JUDGE
RELEASE DATE: 27 September 2011