[2011] UKFTT 825 (TC)

TC01661

Appeal number: MAN/08/0876

VAT – MTIC FRAUD – clean chain broker in a contra trading case – knew or should have known of the fraud? – yes – appeal dismissed.

FIRST-TIER TRIBUNAL

TAX

DI & GI ELECTRONICS LTD **Appellant**

- and -

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

TRIBUNAL: Judge Richard Barlow
Mrs Beverley Tanner

Sitting in public in Manchester on 10-14, 17-21 January and 21 and 22 March 2011 (further written submissions completed 19 May 2011).

Gulam Ahmed of counsel instructed by Salhan & Co for the Appellant

Lucy Wilson-Barnes and Tina Ranales-Cotos of counsel, instructed by Howes Percival & Co for the Respondents

DECISION

1. This is an appeal by DI & GI Electronics Ltd against the respondents' refusal, by a letter dated 13 June 2008, to allow a claim for credit of and repayment of input tax totalling £1,125,425 in respect of the appellant's three month tax period ending 31 July 2006 (07/06).

2. By way of introduction only, we mention that the appeal is what is called, in the jargon that has become well known through other appeals, an MTIC case and the appellant's transactions are what are known as clean chain broker transactions in which recovery of input tax is denied on the basis that those transactions are connected with fraudulent transactions through a contra-trader and the appellant either knew or should have known of that connection. In using the terms clean and dirty chains and broker, contra-trader or defaulter we do so only for convenience and, as has been pointed out before by the Tribunal (see the Decision in *Totel Distribution Ltd*), use of those terms, although now well understood, cannot be allowed to prejudge or influence the Tribunal's decision one way or the other as to the correct legal and factual position.

3. In this case the allegation is that the appellant dealt with a company called Trimax Trading International Ltd (Trimax) as its supplier and with Agrupacion de Alimentos Mediterraneos SA T/A Alimed (Alimed), a Spanish company, as its customer. The alleged contra-trader is Famecraft Ltd T/A Bristol Cash and Carry (Famecraft) which had sold the relevant goods to Trimax. Famecraft's supplier was Sinderby Enterprises Ltd (Sinderby).

4. Each of the five relevant transactions fell within a chain which consisted of a dispatch from Cyprus by Sinderby to the UK acquirer Famecraft which sold the goods in the UK to Trimax which sold the goods in the UK to the appellant which dispatched them to Alimed in Spain (though the appellant only sent the goods as far as France where Alimed took possession of them).

5. The Commissioners allege that Famecraft was a contra-trader which dishonestly engaged in these transactions (amongst many other such transactions) in order to cover up or disguise the fact that its VAT return for the period 08/06 contained very large input tax claims which were fraudulent claims because they fell within chains of transactions in which a company called Barato had dishonestly defaulted in respect of very large amounts of output tax. The Commissioners also rely upon an allegation that these clean chain transactions were apt to help Famecraft to pretend that it was a legitimate trader. They also allege that the money introduced into the clean chains through the appellant was apt to assist Famecraft to finance the dirty chain transactions and that the source of that additional finance was or would be ultimately, in part at least, the input tax claims made by the appellant. The appellant, as a dispatcher of goods to an overseas buyer was making supplies on which positive rate VAT was not payable but it had claimed input tax on its purchases, as they were supplies between UK based traders, and the appellant would therefore be in a repayment position; provided the Commissioners credited the input tax or if the Tribunal allows the appeal.

The legal issues.

6. In *Kittel –v- Belgium* [2008] STC 1537 the ECJ held, at paragraph [60], that on the one hand where a recipient of a supply buys goods and "did not and could not know that the transaction concerned was connected with fraud" then the Member State in which the recipient is registered for VAT cannot provide, by its domestic law, that such a transaction is void and cannot provide that input tax is not claimable on the transaction. On the other hand, at [61], the ECJ held that "where it is ascertained, having regard to objective factors, that the supply is to a taxable person who knew or should have known that, by his purchase, he was participating in a transaction connected with fraudulent evasion of VAT, it is for the national court to refuse that person entitlement to the right to deduct".

7. At [51] the ECJ had also held that a trader who has taken every precaution to ensure that his transaction is not connected with fraud, must be allowed to claim input tax. At [52] the Court held that a person who "did not and could not" know that his transaction was connected with fraud would be entitled to claim input tax despite a connection between his transaction and a VAT fraud.

8. The Court did not explain specifically what it meant by "should have known" but [51] and [52] of the judgment suggest that a trader should take, at least, reasonable precautions to avoid being involved in a transaction connected with fraud. Taken literally "every precaution" and "could not know" might suggest that the test is a very strict one. But bearing in mind [56] to [58] of the judgment we do not read it in that way. The Court used the word "should" for the first time in paragraph [56] and explained the rationale of the rule it then set out at [61]. It said that the rationale was that a person who either knew or should have known of the connection with fraud is to be "regarded as a participant" and that he "aids the perpetrators"; which appears to suggest a degree of blame that would not have attached to a person simply for overlooking a precaution that he might have taken or who could have known of a connection, but only in some obscure way.

9. The Court also explained the underlying rationale of the rule in terms of its being for the better prevention of fraud.

10. It is well established that the right to deduct input tax is exercisable immediately when a transaction occurs and the ECJ emphasised this in *Kittel*. One consequence of that is that the applicable circumstances known to the appellant at the time of a transaction and the actions taken by the appellant at or before the transaction occurred are the relevant facts and that information acquired by the appellant subsequently will be irrelevant. Actions taken by the appellant after a transaction will also be irrelevant as such but, of course, they may shed light on what the appellant knew at the time if, for example, they appear to amount to attempts to cover up the true circumstances applying at the time of the transaction.

11. The Court of Appeal judgment in *Mobilx and others –v- Revenue and Customs Commissioners* [2010] STC 1436 considered in detail the issues raised in cases of this sort and Moses LJ elaborated on the meaning of the "should have known" concept.

He held that it is not enough for HMRC to prove that the circumstances were such that it was more likely than not that a transaction in question was connected with fraud and that what they must prove is that the transaction was connected with fraud.

12. The *Mobilx* litigation included some decisions relating to contra-trading. Moses LJ specifically held that it matters not if the input transaction in question precedes the transaction which gives effect to the fraud. He held that if the taxable person is proved to have entered into a transaction that he knew or should have known, at the time of entering into it, was at that time connected with fraudulent evasion or would be so connected later; that is sufficient to deny recovery of input tax.

13. Moses LJ also held that, where an issue arises about what a person should have know, it is relevant to consider whether the only reasonable explanation for the circumstances surrounding the transaction is that it is connected with fraud. He also stressed the relevance of circumstantial evidence generally.

14. Mr Ahmed made submissions concerning the relevance of the remarks made by Lewison J in *Livewire –v- HMRC* [2009] STC 643 at [102] and [103] to the effect that in a contra-trading case there are two frauds namely the dirty chain default and its cover up by the contra-trader and that the clean chain broker must be shown to have known or to be a person who should have known of one or both of those frauds. The learned judge added: "If he knows or should have known that the contra-trader is engaging in fraudulent conduct and deals with him, he takes the risk of participating in a fraud, the precise details of which he does not and cannot know". At [105] the learned judge said: "In other words, if the taxable person knew of the fraudulent purpose of the contra-trader, whether he had knowledge of the dirty chain does not matter".

15. In *HMRC –v- Brayfal* [2011] STC 1338 at [19] Lewison J, after noting that there is no fraud in the clean chain, said that the clean chain broker must be shown to have known or to have had the means of knowledge that his transaction was connected with fraud and "he must either know or have the means of knowledge that the contra-trader is a fraudster". We assume the judge's reference to the means of knowledge is shorthand for the "should have known" concept as understood in the authorities because having the means of knowledge by itself is not sufficient to disallow input tax. But the relevance of the passage is that the reference to the contra-trader is to him as a fraudster without any specific type of fraud being specified. The judge then added that the taxpayer's input tax claim would also be disallowed if he had knowledge or the means of knowledge of the dirty chain.

16. We interpret Lewison J's remarks as meaning that the taxpayer must know or be a person who should have known of a fraud before input tax will be disallowed and the fraud in question will in fact be either the dirty chain fraud or the cover up by the contra-trader. But he need not know or be a person who should have known what precise form the fraud takes as long as he knew or should have known there was a fraud of some type being committed by the contra-trader or alternatively that he actually knew or should have known about the dirty chain fraud, the latter being less

likely to be capable of proof where the claimant is in the clean chain because he will have dealt only with the contra-trader.

17. In this case the question arises whether it is possible for the Commissioners to establish their case that the appellant should have known of the fraud where the appellant did not deal with the contra-trader itself but rather with what the Commissioners allege was a buffer trader interposed between the appellant and the contra-trader.

18. In that context the judgment of Briggs J in *Megtian –v- HMRC* [2010] STC 840 at [35] to[39] (especially [37] and [38]) is particularly relevant. Briggs J referred to the facts of *Livewire* and made it clear that he thought Lewison J's remarks should be seen in the context of the facts of that case. Paragraphs [37] and [38] of the judgment make it clear that the connection with fraud can take many forms and we interpret the concept of connection as not being limited to any particular type of connection. Clearly some connection which is only incidental would not be sufficient but any connection which furthers the aims of the fraud or assists in its being covered up or hinders its detection is in principle sufficient. That interpretation is consistent with the principles set out in *Mobilx* and *Kittel* itself.

19. Once a connection is established the real limiting factor is whether the appellant knew or should have known of it. In a case like the present one it may be more difficult for the Commissioners to prove their case but we do not regard it as fatal to their case that the appellant did not deal directly with the contra-trader.

20. The Tribunal was urged by Moses LJ not to over elaborate the tests set out in *Kittel* and, if we have here done so, it is only to make it clear that we have addressed Mr Ahmed's detailed submissions.

The basic facts.

21. There were five transactions in the chains already referred to. Each transaction concerned the purchase of mobile phones by the appellant from Trimax and the sale of the same phones by the appellant to Alimed. The first transaction occurred on 28 July 2006 and the other four occurred on 31 July 2006. Each transaction concerned a different type of phone. Sinderby's sale to Famecraft in the first transaction occurred on 26 July and the other steps in that chain occurred on 28 July. In respect of the other four transactions all the steps including Sinderby's sale to Famecraft occurred on 31 July. Sinderby undoubtedly acted as a dispatcher of goods and Famecraft as an acquirer as is shown by the fact that Sinderby did not charge VAT on the sale to Famecraft. The goods arrived and departed from the UK within a very short time on any view and possibly within the same day in respect of the 31 July transactions.

22. The unit prices of the phones, when the appellant sold them, varied between £331.70 and £460.10. The quantities of phones in the transactions varied between 2,500 and 5,000 units. The values of the appellant's transactions varied between £882,750 and £1,702,370.

23. Despite those variations, Famecraft's mark up on the phones (ie the difference in the price at which it bought from Sinderby and the price at which it sold to Trimax) was £1.50 for all 19,200 phones. The mark up achieved by Trimax was £1.00 per phone.

24. The appellant's mark up per phone was respectively £30.10, £21.70, £21.70, £23.10 and £21.35 for the five deals. The appellant's mark up was precisely 7% of its tax exclusive purchase price for each of the five deals.

25. In each transaction the price at which the appellant sold the goods to its Spanish customer was less than the tax inclusive price it had agreed to pay Trimax. However if the input tax claimed by the appellant is payable then it will have achieved the 7% mark up when that is paid and will presumably make a profit as its overheads are likely to be less than the difference.

26. We were told at the outset of the hearing that Alimed paid the appellant £6,881,170 on 14 August 2006. That was the full price for the goods in all five transactions. Later in evidence it appeared that full payment may not have been made by Alimed until 1 September. The appellant paid Trimax £5,178,715 on 14 August 2006 and £1,702,225 on 1 September 2006. Those amounts total virtually exactly what Alimed had paid the appellant but the appellant still owed Trimax £675,485. The appellant paid Trimax a further £452,625 on 28 September 2006 but at the hearing it was said that the outstanding amount had been reduced to £148,340 so another payment must have been made after 28 September 2006.

Evidence relating to Famecraft (alleged contra-trader).

27. Famecraft traded as Bristol Cash and Carry. Mr Cameron Watson, officer of HMRC, gave evidence and was cross examined about the company. Most of his evidence was accepted and the cross examination was directed at confirming that Famecraft did not deal directly with the appellant. Mr Humphries, officer, also gave evidence in the form of an unchallenged witness statement.

28. Famecraft registered for VAT from 14 June 2004 as a property owning company on the basis that it had opted to tax a commercial property but its first three returns were nil returns and then returns for 05/05, 08/05 and 11/05 were all repayment returns relating to setting up and stocking a business of selling wholesale goods. The 11/05 return declared sales of £484,640.

29. The return for 02/06 declared sales of £4,400,178 and purchases of £4,125,997. Sales of £1,261,958 to the EU turned out to be sales of razor blades to a Spanish company called CEMSA. Famecraft had paid its supplier only after receiving payment from its customer. HMRC informed the director of the risks of MTIC fraud in April 2006 but a repayment for 02/06 was authorised.

30. The company's VAT return for 05/06 declared sales of £75,666,852 and purchases of £73,656,683. Sales to the EU were £18,267,501. Purchases worth £71,466,172 had been supplied to Famecraft by a single supplier and it had sold the goods, which were razor blades, to several customers but principally to CEMSA.

31. Officer Okolo gave evidence about Famecraft's transactions in the period relevant to this appeal which was its 08/06 period.

32. In that period outputs were declared worth £319,199,291 and inputs were £309,748,499 and tax due to HMRC was declared as £4,145. Had a VAT return been made as at the end of July, Famecraft would have owed £27,041,787. Five of its transactions were sales to Trimax which were sales of mobile phones which Trimax sold to the appellant. In August 2006 Famecraft entered into 149 transactions in which it sold goods to a single Spanish customer which, because they were zero rated sales, enabled it to reverse the liability it had incurred by the end of July because it had large input tax claims to make for the August deals which were not offset by any output tax liability.

33. All the deal chains in August 2006 traced back to Barato which the appellant admits was a dishonest defaulter.

34. When HMRC attempted to inquire into Famecraft's activities post was returned marked gone away and the persons behind the company have in effect disappeared.

35. We have no hesitation in finding that the respondents have proved that Famecraft entered into transactions in period 08/06 for the purpose of obtaining repayment of input tax in order to further the fraud in which Barato were the defaulting trader. The immense increase in Famecraft's turnover in a short period is itself an indication of its being involved in fraud as the undisputed evidence is that the transactions were all back to back risk free transactions in the sense that Famecraft only paid for the goods when it was itself paid by its customers. The distinctly different pattern of trading at different times within the period in question is itself indicative that Famecraft had acted deliberately in putting itself in a position to make large input tax claims in the dirty chains leading to Barato and then making those claims.

36. We find that Famecraft acted dishonestly in engineering its trade in that way.

37. We find as a fact that there was a connexion between the appellant's transactions and the fraud because the output tax liability which Famecraft's sales to Trimax generated was used by Famecraft to set itself up in a position to make the input tax claims in August which themselves were related to the defaults of Barato. It is true that the appellant did not deal directly with Famecraft and that its transactions pre-dated the input tax claims that company made that were the final step in the dirty chain fraud. But as we have explained, on examination of the authorities, the type of connection with fraud that can give rise to a denial of input tax does not have to be directly with the contra-trader or to be in the dirty chain. The money introduced into the clean chain by the appellant's payments to Trimax for the goods which were then passed on to Famecraft assisted that company to trade in the dirty chains by providing liquidity. Had HMRC paid the appellant's repayment claim that liquidity would in part at least have been supplied by HMRC. The transaction also helped to reduce the risk of an inquiry from HMRC that a large input tax claim would have been likely to generate.

Evidence relating to the appellant and its transactions.

38. The evidence given on behalf of the appellant was that of Mr Talesh Patel, director, the only person actively concerned in the company at the relevant times. He stated that he had been involved in the computer and phone industry for some time before the appellant company was set up. In fact his involvement had been mainly with the installation of phones in cars and in retail sales rather than in wholesale or large scale transactions, though his previous involvement had given him a knowledge of mobile phone models and their functions.

39. The appellant company had been set up by a man called Lord Uppal, though he was not a member of the peerage, who was a family friend of Mr Patel and Mr Patel had been appointed as the company secretary on 16 November 2002. There was another director, a Mr Dilbag, whom the appellant had not met. Mr Uppal had originally run the company as a supplier of white goods but had decided to begin to deal with phones and brought Mr Patel in to assist with that as he had knowledge of phones. From 1 July 2003 Mr Uppal became the company secretary and Mr Patel became a director. Mr Uppal resigned on 29 July 2005 leaving Mr Patel in sole charge.

40. At first, Mr Patel conducted sporadic deals in mobile phones in which the company bought from a UK trader and sold to a UK trader. The transactions were what Mr Patel termed ‘back to back’ by which he meant the same goods were bought and sold without being taken into stock by the appellant and the appellant received payment from its customer before making a payment to its supplier. He explained that the benefit of this method of trading was that the stock can devalue very quickly if taken into the physical possession of a trader so that matching suppliers and customers was a safer method of trading.

41. However, Mr Patel also knew that better profit margins could be achieved by buying in the UK and then exporting goods in what he termed the grey market.

42. Mr Patel said that the company had conducted 33 domestic deals in 2004 but that in 2005 it had managed to do 10 deals in computer equipment in which goods were purchased from a UK supplier and sold to an overseas buyer. He said that export deals in computer equipment gave a profit margin of “roughly at least 10%” but that figure later tumbled because of competition from China.

43. In 2006 there were no domestic deals and Mr Patel said he thought there were 7 exports in period 01/06 (three months ending 31 January 2006) which were back to back mobile phone deals on which the company made “between 6 and 7%”. He said he thought the company did four deals in 04/06.

44. In the period 07/06 Mr Patel had conducted the five transactions already referred to and, although his evidence was somewhat confused and difficult to follow, he described the sequence of events relating to the deals as involving the following steps. Alimed, the customer, had contacted him having seen the appellant’s details on a website set up for mobile phone traders. A man called Antonio spoke to Mr Patel and

asked about stock which he followed up with a stock request form in an email or fax. Mr Patel then set about finding the stock by contacting various suppliers he had previously dealt with, though in each of the relevant cases the supplier turned out to be Trimax.

45. Initially, Mr Patel suggested that once he had sourced the stock there would be negotiations about price. He said in respect of a deal that was discussed in June "The negotiations would come down to price and terms. It would come down to the price we got the stock for as well". In respect of that proposed deal he said that Antonio (ie Alimed) had a fixed price and there was no margin so the deal did not go ahead.

46. The first deal that did go ahead had begun with a request from Alimed in an email dated 28 July 2006 and timed at 14.22 GMT for "around 4,000 black Nokia 8800s". Mr Patel said Antonio had probably phoned him earlier in the day with the same request. He said he called Trimax and they had 3,700 available. He said that he would have looked on the websites traders used to see who had such stock. By 16.34 Mr Patel was able to obtain an offer of 3,700 phones from Trimax at £430 each which he sold to Alimed for £460.10 at some time on the same day. By 16.55 Mr. Patel had sent instructions to 1st Freight so the sale to Alimed must have been agreed between 14.22 and 16.55 if not sooner. Mr Patel's evidence in chief was that Trimax would have quoted a price but that he would have negotiated with Alimed "if there was movement in it – there might be movement of 10 or 50 pence I cannot remember".

47. The other four deals all occurred on 31 July. At 12.38 on that day Alimed sent an email in the following terms "We would like to know which stock you have available today. We are especially interested in the following goods: -2500 Nokia 9300i – 5000 Nokia N91 – 5000 Nokia N80- - 3000 Sony Ericson W810i". At 13.33 Trimax sent the appellant a stock offer for exactly those goods. Mr Patel's evidence was that the stock offer would have followed a telephone enquiry to Trimax. By 14.22 Alimed had sent a purchase order for some of the goods. When he was cross examined he said that the deals followed "… some form of negotiation. If I was trying to sell the stock I would reduce my price to get the deal". It seems therefore that he was asserting that Trimax presented a non-negotiable price but that he adjusted the price he charged Alimed slightly in order to secure the deals. At other points in his evidence Mr Patel said that there was some movement on price by Trimax in some cases but that he always negotiated with the buyer.

48. It is an uncontrovertible fact that in each deal the appellant's mark up was exactly 7%.

49. The rest of the deal paperwork consists, for each deal, of a purchase order from Alimed to the appellant, a pro-forma invoice from Trimax to the appellant, a purchase order from the appellant to Trimax, an invoice and supplier declaration from Trimax to the appellant, an invoice from the appellant to Alimed, an allocation form from Trimax to 1st Freight Limited, instructions from the appellant to 1st Freight Limited, an inspection report from 1st Freight Limited to the appellant, a release note from the appellant to 1st Freight Limited; and shipping documents.

50. The paperwork and the giving of instructions to the freight forwarder, their examination of the goods and the arrangement of transport all appears to have occurred in a very short time on any view and in effect within a single day.

51. Trimax's pro forma invoices and the invoices themselves contain "terms and conditions" which include the following: "Ownership of goods/services remains the property of Trimax Trading Int'l Ltd until full settlement has been made". "UK sales – payment must be made in full and at point of allocation or on pro-forma". The invoices also made the transaction subject to Trimax's standard terms and conditions which Mr Patel said he had received only after the transactions had taken place. Those terms make time for payment of the essence and provide for interest on late payment. They also provide for retention of title until full payment and that any unpaid for goods will be held by the customer as bailee and that they must be stored and marked so as to be identifiable as Trimax's property. Trimax retained the right to re-possess the goods at any time before payment. Trimax also required that any proceeds of sale of the goods were to be held on trust for Trimax until property passed to the customer.

52. Trimax issued allocation forms addressed to the freight forwarder directing it to allocate goods to the appellant to be released on final written instructions only.

53. The appellant's invoices to Alimed required payment on receipt of invoice. The appellant's terms and conditions included the following. "All goods remain the property of DI&GI Electronics Ltd/supplier until goods are payed for in full. Title is pasted their after". "Goods will not be released untill payed for in full".

54. Assuming the reference to the supplier in the appellant's invoice means that the goods remained the property of Trimax, though Alimed would not have known of the identity of the supplier at least from the documents issued between the parties, the terms between the parties are compatible with the appellant's case which was that the goods would be sent to the foreign buyer on terms that the buyer would not become the owner until it had paid for the goods. There is still a contradiction in the terms of the various parties because although the buyer should receive title on payment the appellant would not obtain title to the goods until it had paid Trimax.

55. In fact what happened was quite different from what was required by the documents because Trimax was not paid before the goods were sent to Alimed in France.

56. Mr Patel's evidence was that what happened was that once it became clear the appellant could not pay Trimax in full that company transferred the goods to it despite their terms of business because a credit agreement was entered into between Trimax and the appellant. Alimed had paid in full by 1 September but the credit agreement was not entered into until 9 September. Mr Patel was asked why Alimed would be prepared to wait for the transfer of the goods after it had paid in full and he said they would expect to receive the goods on payment "in the ideal world but when you trade you are in the real world". Mr Patel's evidence about this was not entirely clear but it seemed he was asserting that the delay in payment only affected one of the

transactions because the part payment of the sums due had enabled the first four to be dealt with in the way intended by the documents.

57. Mr Patel's evidence was that he had first learnt what ship on hold terms meant, which were applicable to the transactions in question, some time before these transactions and that it had been explained to him by a freight forwarder when he had entered into an export transaction. He did not claim to have clarified with any of the parties involved in these deals that their understanding of those terms was the same as his.

58. The role of 1st Freight, the freight forwarder to which the goods had been sent on their arrival in the UK, involved storing the goods, inspecting them and then forwarding them to Alimed's nominated destination in France.

59. The appellant had not previously dealt with 1st Freight.

60. The appellant's directions to 1st Freight were contained in an order form which ordered the following services. Freight tickets, invoice, CMR, confirmation of delivery, 100% IMEI scan report and full inspection of goods report (type 4). The terms and conditions of shipment were stated to be "Ship on hold (terms), goods shipped after full inspection only" and "GR Distribution must hold goods until orthrisaction for release is sent by 1st Freight limited".

61. GR Distribution was Alimed's freight forwarder or warehouse keeper and the appellant had not previously dealt with that company.

62. Mr Patel was questioned about the sequence of events in respect of the sales, the inspections, the report from 1st Freight and his own checks to ensure that the IMEI numbers supplied by 1st Freight did not show that he had dealt with the same phones before; which was why he wanted the numbers. Comparing those details and the time the checks would have taken, even on Mr Patel's own estimates, with the times the goods arrived at the Channel Tunnel for export it was obvious that, in some cases at least, the goods had left 1st Freight before Mr Patel could have been satisfied that all was in order.

63. Mr Patel had not made specific enquiries about whether the goods were insured for travel to France or whether insurance remained in place until the risk passed to Alimed. He produced a report on 1st Freight that had been prepared by a consultancy firm called CTM which said that 1st Freight had insurance for premises, contents and goods in transit but he admitted that he was not given that report until after the deals in question had occurred. At first he claimed that he had been satisfied that there would be insurance in place because other freight forwarders he had dealt with had had insurance. He said he assumed 1st Freight would have insurance for the price of the goods he had paid. He later claimed that he had been told on the telephone by CTM that 1st Freight had insurance before he received the written due diligence report.

64. Mr Patel produced an email from Antonio (of Alimed) which had been sent on 27 July and in which Antonio asserted that GR "has commercial insurance in place and

Alimed will independently insure all stock sold by DI & GI Electronics Ltd to Alimed".

65. Mr Patel said that he had met a Mr Shah whom he described as the owner of Trimax at a Temple they both attended. He had visited Trimax's premises and had been told that Trimax dealt in commodity trading and other ventures including import and export on a large scale. The formal due diligence enquiries that he had made about Trimax were quite extensive but they included a company credit report which suggested putting a limit of £20,000 on any credit that might be allowed. Mr Patel said he was not worried by that as he was not proposing to allow Trimax to have credit. He also said that Mr Shah drove a car that was "worth more than my home" which we took it to mean that Mr Patel had good reason to think that Mr Shah was a man of substance. It is also clear that Mr Shah had other businesses beside Trimax.

66. Mr Patel produced due diligence enquiries about Alimed. Some of the documents were in Spanish which Mr Patel admitted he could not read and, unless those documents referred to credit limits, no enquiries had been made about Alimed's creditworthiness and, if they did deal with that; they were not of any value to Mr Patel. Again, he said that as the goods were being sent on ship on hold terms he did not regard the absence of evidence about Alimed's financial standing as a matter for concern.

Discussion of the evidence and the Tribunal's findings.

67. Most of the basic facts in this appeal are not in dispute.

68. We find that in his evidence Mr Patel exaggerated the extent of his knowledge of mobile phone trading before he entered into the transactions in phones. It was clear that his work involving installing phones in cars and selling at retail level had no real bearing on his involvement in wholesale transactions of the sort involved in this appeal.

69. Mr Patel was unable to offer any convincing explanation of how he was able to develop the level of business he had achieved through the appellant company by the time the transactions involved in this appeal occurred. From the initial sporadic trading in UK to UK deals he had been able to achieve sales in 2005 and 2006 involving exports of goods beginning with computer equipment and then changing to mobile phones with values amounting to millions of pounds.

70. In the few days relevant to this appeal deals worth £6,881,170 were carried out with very little effort on the part of the appellant. Although Mr Patel said that he put a lot of effort into developing contacts and keeping a close watch on what was happening in the industry; it is a fact that the first deal was first envisaged when Alimed asked about "around 4,000" phones and was completed in respect of 3,700 phones within just over two and a half hours at most. The other deals involved even less effort. Alimed requested specific numbers of four different types of phones which Mr Patel sourced within the hour and less than an hour later the appellant had

received a purchase order from Alimed which we find shows that the deals had been concluded.

71. The respondents rely on the evidence of the ease with which the deals appear to have been conducted as evidence of contrivance such as to indicate that these deals fell outside of any normal trading pattern. Whilst we might consider that piece of evidence by itself does not prove that allegation, after all the appellant might just have been very lucky to have found the goods it wanted to supply as quickly as it did, we certainly agree that it is circumstantial evidence suggestive of possible contrivance.

72. We find that the fact that Trimax was prepared to deal with the appellant on terms much more favourable than its standard terms and to do so without specifying any variation in its terms and the fact that the appellant was prepared to deal with Alimed in a similar fashion are both significant facts. Trimax released goods worth millions of pounds to the appellant, knowing that it was making an onward sale, which was apparent from the fact that Trimax had to authorise the freight forwarder to release the goods, but without knowledge of the destination and contrary to its terms of business which required payment before release. It should have been obvious to Mr Patel that Trimax, as a large scale trader which was owned by a person whose other companies were involved in import and export, would have been very likely to have been able to find an overseas buyer for itself; just as easily as he had. Even if Mr Patel did not realise that, a directing mind of any reasonably competently run company would have been able to observe that that was the case and as the appellant is a company that is the correct test to apply.

73. Similarly it should have been obvious to Mr Patel, or it would have been obvious to the appellant if it was being run reasonably competently that, in the fast moving market with the risk of rapid declines in stock value claimed by Mr Patel as a reason for not holding stock; there were risks in dealing with Alimed without assessing its creditworthiness and that his explanation that ship on hold terms would avoid such risks is simply not credible. Had Alimed failed to pay for the goods and had they needed to have been repatriated, then the appellant would have incurred expense in shipping costs and the risk of a fall in the market price. The appellant would also then not have been able to pay Trimax in accordance with the terms that Mr Patel says had been agreed.

74. We also regard the ease with which the deals were conducted as being highly indicative of fraud which anyone presented with these opportunities ought to have realised; given the fact, of which Mr Patel was fully aware even on his own admission, that fraud was a significant feature of the wholesale market in phones being dealt with on back to back and on ship on hold terms. To be asked to supply four million pounds worth of goods in one day (ie the four deals which occurred on 31 July) and then finding a supplier able to supply exactly those goods within an hour is so exceptionally fortunate as to raise a strong case for saying that the deals were contrived and that Mr Patel knew that or at the very least the company should be taken to have known it.

75. Mr Patel had said that there were negotiations about the prices of the deals. It appeared that he was claiming that the supplier had sometimes, or he may have meant always, presented a non-negotiable price but he claimed to have negotiated, at least, with the buyer. We have asked ourselves what plausible explanations there might be for the fact that each of the deals in question in this appeal achieved a mark up of exactly 7% for the appellant despite the different types and values of goods and the different quantities involved. Only two have come to mind. Firstly, Mr Patel may have been presented with a fait accompli by both supplier and customer who were acting in conjunction with each other. That should have raised suspicions in Mr Patel's mind. It could possibly be explained by an implausibly high degree of naïveté on his part but for the fact that he asserted he had in fact always negotiated the price of the goods, so that if he did in fact just accept a price offered by both counterparties he was lying when he gave evidence of negotiation. The second possible explanation that might apply would be that Mr Patel had been told to apply a formula to the purchase price but that was not something he claimed to have occurred and it would in any case be so obviously indicative of fraud that had such an explanation been given it would have been fatal to the appellant's case.

76. We hold that the circumstantial evidence surrounding these transactions proves to the requisite degree (the balance of probability applicable to civil cases), that the appellant did know that those transactions were connected with fraud. We hold that the evidence of the 7% mark up, which is additional to the purely circumstantial evidence, adds certainty to a finding that we would have made even without that evidence. For the avoidance of doubt we find that Mr Patel himself knew that these transactions were connected with fraud. Our finding is not based only on what a reasonably competently run company would have known or should be taken to have know.

Conclusion.

77. The appeal is dismissed. The appellant is not entitled to the input tax in question. Any application for costs is directed to be made within 42 days of the release of this decision. At the time of making any such application the amount claimed need not be stated or set out. Assessment will be made after an award is made in principle but any application should specify what method of assessment the applicant seeks.

78. 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.

RICHARD BARLOW

TRIBUNAL JUDGE
RELEASE DATE: 14 December 2011