TC02005

Appeal number: LON/2007/1244 & LON/2007/915

PROCEDURE –application for stay of proceedings pending five references to the CJEU- application refused

FIRST-TIER TRIBUNAL
TAX CHAMBER

M DARYANANI, MRS M DARYANANI, P DARYANANI AND R DARYANANI T/A TELETAPE **Appellants**

-and -

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

TT EXPORTS LIMITED **Appellant**

- and -

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

TRIBUNAL: JUDGE BARBARA MOSEDALE

Sitting in public at Bedford Square London on 29 March 2012

Mr R Holland, solicitor, of Dass Solicitors, for the Appellant

Mr A Westwood, Counsel, instructed by the General Counsel and Solicitor to HM Revenue and Customs, for the Respondents

DECISION

1. In these two appeals, joined and to be heard together because some of the partners in the Teletape partnership are directors of TT Exports, the appellants are reclaiming input tax incurred by them in VAT periods in the second quarter of 2006 which was denied by HMRC in various decision letters on the grounds that it was not repayable to them under the law as stated by the CJEU in *Kittel* C-439/04. In other words HMRC allege that the transactions entered into by the appellants were connected with the fraudulent evasion of VAT and that the appellants knew or ought to have known this. The amount of input tax at stake in the two appeals is approximately £12.5million.

2. The appeals were lodged against HMRC's various decisions from May 2007 to August 2009 although all relate to one or more of the VAT periods 04/06, 05/06 and 06/06. Not all the evidence has yet been served. In the meantime the appellants have applied for a direction that the appeals be stayed pending the release by the CJEU of its decision in the last of 5 references.

3. HMRC opposed the application and at the end of the oral hearing on 29 March I announced my decision which was to refuse the appellants' application. I also issued directions for the future conduct of the proceedings with a view to the case being set down for hearing once the evidence was served. I am now asked to set down my reasons in writing for refusing the stay.

The five references

4. The five references behind which the appellants wished their appeals stayed are:

(1) *Mehagében* C-80/11;

(2) *Dávid* C-142/11;

(3) *Bonik* C-285/11;

(4) *Tóth* C-324/11;

(5) *SIA Forvards V* C-563/11

5. The full text of these references is in Appendix I to this Decision.

6. I was informed that the current position with these references is that there was a oral hearing in the joined cases of *Mehagében* and *Dávid* this March. It is expected that the CJEU will dispense with a written opinion from the Advocate General and will probably issue its decision before the summer recess. I was handed the official report of the Judge Raporteur from this joined hearing.

7. *Bonik* is waiting a date for an oral hearing and the expectation is that this will be before the summer recess. The CJEU's decision, therefore, is unlikely to be published much before the end of this year.

8. It seems likely that *Tóth* is further behind *Bonik* and a decision unlikely until 2013; *SIA Forvards V* C-563/11 is a very recent reference and it seems reasonable to speculate that the CJEU will not rule on this case until mid-2013 at the earliest.

When should a stay be ordered?

9. Mr Holland referred me to the decision of the Inner House of the Court of Sesssion in the case of *HMRC v RBS Deutschland Holdings GmbH* [2006] ScotCS CSIH 10. In this case the Tribunal refused to sist (the Scottish term for 'stay') the appeal pending the decision of the CJEU in *Halifax & Others.* The Inner House overturned that decision on the grounds that the Tribunal was wrong to have decided that the *Halifax* decision would be irrelevant as a matter of law to the appeal in front of it. The Inner House went on to express the view that the Tribunal was wrong to say that as a matter of course a Tribunal would only sist a case against the wishes of one of the parties pending a decision which would be determinative of the issues in front of it. On the contrary the Inner House said:

> "…a Tribunal or court might sist proceedings against the wish of a party if it considered that a decision in another court would be of material assistance in resolving the issues before the Tribunal or court in question and that it was expedient to do so."

10. HMRC accepted this was a correct statement of the law: their position was that even if I considered that the decisions of the CJEU in the five cases would be of material assistance in this appeal I should nevertheless not exercise my discretion to stay this appeal: in their opinion it would not be expedient to do so.

11. I was also referred to the Upper Tribunal decision in *Mynt Ltd & others.* In this decision the Upper Tribunal ruled that the applications for permission to appeal of two of the appellants and the appeals against decisions of the FTT for the other two appellants would all be stayed pending the decision of the CJEU in four cases, being the first four of the cases behind which the appellants in these cases apply for their appeals to be stayed. A stay behind *SIA Forvards V* C-563/11 was not considered in that case: this is not surprising as the reference was only lodged at the CJEU in November and Mynt was before the Upper Tribunal only a week later.

12. The grounds of the *Mynt* decision were that there were at least three issues raised in those four cases to which the CJEU's view "may provide answers of relevance to the outcome of these appeals."

13. The test applied in *Mynt* appears to be different to that in *RBS Deutschland* in that a test of expediency was not explicitly applied, but then the issue was different: in *Mynt* the question was whether to stay an appeal to a higher court; in *RBS Deutschland* and in these appeals the question is whether to stay an appeal at first instance. The critical difference is that here there has been no hearing and no facts have been found. It is right therefore to balance whether the references will be of material assistance in the resolution of these appeals against questions of whether it is expedient to stay a case at first instance.

14. I was referred to non-binding decisions of the FTT on this same issue.

Matrix Europe Limited [2011] UKFTT 792 (TC)

15. This decision of Judge Barlow in the FTT was issued in November 2011. There was an application by the appellants to stay the issue of the decision until after the CJEU had promulgated its decisions in *Mehagében, Dávid* and *Bonik.* The Judge refused the application. The grounds for this decision were that the reference in *Mehagében* was irrelevant as it was about a provision of Hungarian law which was quite different to UK law; similarly the reference in *Dávid* was similarly thought irrelevant as it appeared simply to be asking the CJEU to answer a question it had already answered in *Kittel;* and the reference in *Bonik* was also thought irrelevant as asking questions already answered in *Kittel.*

16. This decision, however, itself pre-dated the Upper Tribunal's decision in *Mynt* and in that case the Upper Tribunal ruled that those three references *were* potentially materially relevant to cases in which HMRC relied on *Kittel* and therefore I cannot consider *Matrix* persuasive on the question of relevance.

Unistar Group Ltd and *Unistar Trading Ltd*

17. In this application Judge Porter ruled in January 2012 that he would not stay the hearing of the appeals behind *Mehagében, Dávid* and *Bonik.* He adopted the reasoning of Judge Barlow in the application of *Matrix Europe Limited.* In summary he wished to avoid the evidence becoming stale and did not consider it certain that any of the three references would be of material assistance in resolving the appeal as he thought they would only be of so if the CJEU departed from its decision in *Kittel.*

Chandanmal, Nainani, Chandanmal T/A Narain Bros [2012] UKFTT 188 (TC)

18. In this decision I gave three reasons for refusing to stay the appeal: firstly it was virtually certain that due to other delays that the decision of the CJEU behind which the application was for the appeal to be stayed would be published before the hearing; the risk of evidence becoming more stale; and that I considered that there was only a small possibility that the CJEU decision in *Bonik* would be of material assistance in deciding the appeal largely because I considered it unlikely that the CJEU would depart from its decision in *Kittel.*

19. In summary, I must apply the test in *RBS Deutschland.* The Upper Tribunal having ruled in *Mynt* that those four references *might* be of material assistance in resolving appeals where the Tribunal applied the rule in *Kittel,* I must decide in these cases where HMRC relies on *Kittel* whether it is expedient to stay them pending those four cases. I consider *SIA Forvards* as well. In considering whether it is expedient to stay these appeals I will consider and weigh up the following factors:

> (1) how probable it is that any of the five references *will* be of material assistance (*Mynt* having decided that they *might* be but without giving a ruling on degree of probability);

(2) when the CJEU's decisions are likely to be published and what effect on the hearing of the case a stay behind such decisions is likely to have.

Probability cases will be of material assistance

Issues between the parties

20. The first matter to resolve, therefore, is how probable the five references or any one of them will be of material assistance in resolving this appeal. As it stands HMRC has alleged and the appellants have denied that their transactions were connected with the fraudulent evasion of VAT, and that even if they were the appellants deny that they knew this or should have known this. In addition, Mr Holland considers that there are other issues of law between them and considers that these issues are raised in the five references made to the CJEU:

(a) Can input tax be denied where there is no privity of contract between the fraudster and the taxpayer reclaiming input tax?

(b) Can *Kittel* be applied to deny a taxpayer's right to recover input tax if it has not been expressly enacted into UK law?

(c) What is the relevance of perceived inadequacies of the trader's due diligence?

Privity of contract issue

21. As I understood it, Mr Holland's position is that the references in *Mehagében* and *Dávid* raise the issue of privity of contract. Further, that if the CJEU were to rule that the law as explained in *Kittel* only applies where there is privity of contract between the fraudster and the taxpayer, then that must necessarily conclude these appeals in favour of the appellants as it is not even alleged that there was privity of contract between the defaulter and the appellants nor that the appellants were in a conspiracy with the defaulter.

22. In support of his position, Mr Holland referred me to the report of the Judge Raporteur of the oral hearing in *Mehagében* and *Dávid*. I was unable to read this as it was in French. Mr Holland, however, provided an unofficial translation of the last three paragraphs which contained the Judge Raporteur's summary of the European Commission's view on how the CJEU should answer the questions referred to it.

23. Mr Holland's translation, which HMRC did not question, was:

> "Articles 167, 178, 220, and 273 of Directive 2006/112 and Article 17, 18(1) and 22(8) of the Sixth VAT Directive must be interpreted in conformity with the principles of proportionality, neutrality, and legal certainty, such that they do not permit national legislation or administrative practice which, as regards "necessary precautions" makes the right to deduction conditional upon the recipient of the invoice proving that the company drawing up the invoice respected its legal obligations and in that regard establishes an objective responsibility on the part of the recipient of the invoice.

> Nor can the right of deduction of VAT be affected by the fact that the taxpayer knew or could have known that in the supply chain in which his own transaction, not itself tainted with fraud, was carried out another transaction before or after that taxpayer's transaction, amounted to VAT fraud or another violation.
>
> On the other hand, once it is established in the light of objective elements that the delivery is made to a taxpayer who knew or ought to have known that in making the purchase he was participating in an operation that was part of VAT fraud, it is that that point possible to refuse the right of deduction."

24. Mr Holland's reading of the Judge Raporteur's summary of the Commission's position was that the Commission was advising the CJEU to rule that input tax could only be denied where the taxpayer (such as the appellants in this case) made their purchase directly from fraudster and/or were in a conspiracy with the fraudster.

Court of Appeal's decision in Mobilx

25. Mr Justice Roth in *POWA (Jersey) Ltd* FTC/26/2010 has ruled that the Court of Appeal decision in *Mobilx Ltd* impliedly held that privity of contract was not part of the *Kittel* doctrine: see paragraphs 37-39 of the *POWA* decision. This Tribunal is bound by these rulings. This cannot be in any doubt and in any event is expressly stated in the Upper Tribunal decision in *S&I Electronics PLC* FTC 17/2009 and FTC 18/2009 at paragraphs 13-19.

26. But we are not being asked to depart from the Court of Appeal's ruling on privity of contract; we are merely asked to stay the hearing of this appeal until the CJEU has issued its decisions in references which are considered by the appellant to raise this issue. Therefore, that the Court of Appeal has ruled that privity of contract is not a pre-requisite to the application of *Kittel* is not, in my view, a reason per se to refuse a stay. Indeed, that was the view of the Upper Tribunal in *Mynt.*

Likelihood of CJEU finding privity of contract essential to application of Kittel

27. Mr Justice Roth in *POWA* considered the issue in very great detail at paragraphs 20-40. He pointed out that although in *Kittel* it seems that both the appellants had privity of contract with the fraudsters, this was clearly not the case in *Optigen & ors* C-484/03 [2006] ECR I-483. If the CJEU were now to require privity of contract before denial of input tax under the rule in *Optigen* and *Kittel*, this would mean that their decision in *Optigen* would be (in retrospect) impliedly overruled because their decision implied input tax could be denied where the taxpayer knew or should have known of fraud higher in the chain of transactions. Whereas if Mr Holland were correct they would have simply said the appellant's input tax could not be denied as they were not in a contractual relationship with the fraudster.

28. There is nothing in the CJEU's decision in *Kittel* to expressly indicate that input tax should only be denied if there was privity of contract or conspiracy between the fraudster and the taxpayer making the claim. Nor is there anything that would

impliedly indicate that the dicta should be so limited. The rationale of the decision was:

> "[56] In the same way, a taxable person who knew or should have known that, by his purchase, he was taking part in a transaction connected with fraudulent evasion of VAT must, for the purposes of the Sixth Directive, be regarded as a participant in that fraud, irrespective of whether or not he profited by the resale of the goods.
>
> [57] That is because in such a situation the taxable person aids the perpetrators of the fraud and becomes their accomplice."

29. In other words, the rationale for the CJEU's decision was that the taxpayer should be denied the right to input tax deduction if they knew or should have known that their transaction facilitated fraud: it should make no difference to the application of that rationale whether the taxpayer was in a direct contractual relationship with the fraudster or not.

30. In any event, the two cases referred to the CJEU in *Kittel* both concerned organised MTIC fraud. The context of the reference was organised MTIC fraud. The CJEU must be taken to have understood that the fraud did not depend on the broker being in a direct contractual relationship with the fraudster. And if they had thought this had mattered they would have said so. The logic of the court's rationale is that it is irrelevant.

31. Also for the CJEU to now rule that input tax deduction should only be made where it is proved that the taxpayer seeking deduction was in a conspiracy with the fraudster is clearly contrary to its own decision in *Kittel* where it considered not only knowledge of fraud sufficient to deny recovery, but mere constructive knowledge of the fraud was sufficient to deny recovery. Constructive knowledge is far removed from conspiracy.

32. For the CJEU to rule that either or both a direct contractual relationship or a conspiracy must be proved between the defaulter and the taxpayer would be to diverge from its earlier decisions of *Kittel* and *Optigen.* I am not aware of any case where the CJEU has expressly departed from one of its own decisions. Further, in view of its oft stated desire to prevent the VAT system being used for the purposes of fraud, it seems extremely unlikely that the Court would now do so and rule that a person who (on the assumption that a Tribunal made such a finding) entered into a transaction knowing it was connected to fraud, nevertheless was entitled to recover the VAT simply because it was not in a direct relationship with the fraudster.

33. Although if the question is referred it is open to the CJEU to rule that privity of contract is a prerequisite to liability under *Kittel,* the analysis of the Court of Appeal in *Mobilx* and of the Upper Tribunal in *POWA,* and the CJEU's reasoning in *Kittel* demonstrate that it is very unlikely that it would do so. The improbability of this is relevant to whether a stay should be granted.

The view of the UK government

34. It is Mr Holland's case that HMRC believe that there is a real chance that the CJEU will rule that privity of contract is a prerequisite to the application of *Kittel*. He says this because the UK government chose to put in oral submissions to the CJEU in *Mehagében* and *Dávid*. Mr Holland's view is that the UK Government advised the CJEU not to depart from their decision in *Kittel*.

35. HMRC did not produce any copy of the UK's oral submissions. All I had was a letter from Mr Holland to HMRC in which he set out his understanding of what was said and asked HMRC to confirm or deny it. HMRC has not responded. Mr Holland informed me that he had not himself attended the hearing: his understanding of what was said came from the official transcript (which he did not produce). In summary, HMRC had the opportunity to correct Mr Holland if his understanding was incorrect: they did not so I assume Mr Holland's summary was accurate.

36. However, it is of no help to the appellants. Whatever HMRC think, it is for this to Tribunal to form its own opinion on the likelihood of the references in those two cases being of material assistance in resolving the issues in front of this Tribunal.

Type of fraud

37. In any event, I do not agree with Mr Holland that by its proposed answers to the CJEU the Commission was suggesting that the CJEU limit the doctrine of *Kittel* to cases of privity of contract or conspiracy with the defaulter. Firstly, it seems unlikely that the Commission, itself concerned with fraud and familiar with the structure of organised MTIC where it is unlikely the broker would be in a direct relationship with the defaulter, would suggest that where there was no privity, input tax should nevertheless be repaid to a taxpayer proved to have knowledge of fraud.

38. Secondly, contrary to Mr Holland's reading, it seems to me that the Commission was merely attempting to draw a distinction between a taxpayer whose transaction was itself unaffected by the fraud ("not itself tainted with fraud") but nevertheless in a chain of transactions where one of the earlier or later transactions was tainted with fraud, and a taxpayer whose transaction itself was affected by the fraud ("participating in an operation that was part of VAT fraud").

39. In my view, the Commission was *not* drawing a distinction between a transaction involving the fraudster and one not involving a fraudster, but between a transaction which does not facilitate fraud and one which does. Many descriptions of organised MTIC fraud have been given. I have included my own in Appendix II to this decision. MTIC fraud is impossible without the sale by the "broker" as the fraud depends on the broker paying more for the goods that it purchases from the "buffer" than it receives from the EU purchaser. In organised MTIC fraud, the broker participates (knowingly or unknowingly) in transactions which are an integral and essential part of the fraud. This contrasts with mere acquisition fraud where a subsequent transaction on an open market is irrelevant to the commission of the fraud.

40. But did the CJEU make this distinction? In *Kittel* the CJEU ruled:

> "[61] where it is ascertained, having regard to objective factors, that the supply is to a taxable person who knew or should have known that, by his purchase, he was participating in a transaction *connected* with fraudulent evasion of VAT, it is for the national court to refuse that taxable person entitlement to the right to deduct." (my emphasis)?

41. This does not appear to make the distinction between a mere acquisition fraud or organised MTIC fraud. Nevertheless, the two cases referred to the Court when it gave this answer (*Kittel* and *Recolta)* both involved organised MTIC fraud, and the question which the CJEU rephrased and asked itself was:

> "[27] By its questions, which must be considered together, the referring court asks essentially whether, where a recipient of a supply of goods is a taxable person who did not and could not know *that the transaction concerned was part of a fraud* committed by the seller, Article 17 of the Sixth Directive must be interpreted as meaning that it precludes a rule of national law under which ….that taxable person to lose his right to deduct that tax." (my emphasis)

42. Here it is quite clear that the CJEU is contemplating an organised fraud where the appellant's transaction was organised by a fraudster and was therefore a part of the fraud. This is because the CJEU uses the phrase "the transaction concerned was part of a fraud" clearly referring to the taxpayer's transaction. And although the conclusion itself at paragraph [61] does not make it explicitly clear that the CJEU intended to limit its comments to organised fraud of which the transaction at issue forms a part, nevertheless in its earlier explanation for its conclusion the Court said:

> "[56] In the same way, a taxable person who knew or should have known that, by his purchase, he was taking part in a transaction connected with fraudulent evasion of VAT must, for the purposes of the Sixth Directive, be regarded as a participant in that fraud, irrespective of whether or not he profited by the resale of the goods.
>
> [57] That is because in such a situation the taxable person aids the perpetrators of the fraud and becomes their accomplice."

43. As this was at least part of the reasoning for the CJEU's conclusion, it seems they had in mind an organised fraud where the transaction on which input tax was refused was a part of the organised fraud because why else refer to "participant" and aiding the perpetrators? The broker's purchase and sale only aids the fraudsters if it is part of an organised fraud: it would be irrelevant to a person committing acquisition fraud higher in the chain.

44. I think it likely that the CJEU use of "connection" was intended to reflect the idea that the appellant's transaction in some way facilitated the fraud. Therefore, the Commission's suggested response in *Mehagében* and *Dávid* seems apt to prompt the CJEU into making it clear whether it is their view that such a distinction exists.

45. If the CJEU were to make such a distinction, how would it affect these appeals? Is there a risk that the hearing of these appeals would be unnecessary were the CJEU to follow what I consider the Commission suggested and explicitly distinguish between acquisition fraud and organised MTIC fraud?

46. In these appeals HMRC allege that the appellants' transactions were part of an organised MTIC fraud. So even assuming that the CJEU agrees with what I think that the Commission was proposing, it will be of no assistance to the appellants if HMRC can make good their allegation that their transactions were part of an organised MTIC fraud. As the Tribunal hearing the substantive appeal will have to make a decision as a matter of fact whether the alleged fraud was an organised MTIC fraud, the hearing must take place in any event. On this ground, a stay until the CJEU has clarified whether the application of *Kittel* depends on such a finding serves no purpose.

Implementation of *Kittel* into UK law

47. Privity of contract was not the only matter Mr Holland considers will be raised in the five references which will in his view be of material assistance to the Tribunal in resolving these appeals. Mr Holland considers that the question of whether *Kittel* has been properly implemented into national law will also arise.

48. Mr Holland considers that the question of whether *Kittel* has been properly implemented into UK law is a matter of European law. There is of course no question that *Kittel* is part of UK law: the Court of Appeal, applying national rules of statutory interpretation, ruled in *Mobilx* [2010] EWCA Civ 517 at paragraphs [45] – [49] that the doctrine of *Kittel* is part of the law of the UK. In particular, the Court of Appeal decided that the Value Added Tax Act 1994 must be read to be consistent with the CJEU's reading of the Sixth VAT Directive in *Kittel*.

49. The argument is over whether *EU law* requires implementation of EU concepts to be *express* in legislation rather than *implied*. The only question asked in the five references pertinent to this issue appears to be Question 2 in *Bonik* (see appendix). In the context of the formalities for tax deduction, the referring court asks whether the Directive

> "require that the formalities be expressly laid down by means of legislation in the form of an act of the Member State's highest legislative body or does it allow those formalities not to be laid down by means of legislation, but to constitute an administrative (and tax investigation) practice and case-law?"

50. This question appears to be asked in the context of the formalities of tax deduction. The rule in *Kittel* would not commonly be regarded as a rule of formality: it is not rule requiring a document to be held but a rule about actual or constructive knowledge.

51. Even if the answer given could be construed as applying to the rule in *Kittel* as well as formalities, how likely is it that the CJEU's answer to this question would be that only express legislation is sufficient? To me it seems very unlikely the CJEU would take such a view when this has not been its view in some 60 years of jurisprudence and its own decision in *Kittel* was based on interpretation of the Sixth VAT Directive and its implied meaning rather than express words.

52. And even were such a ruling to be given, would this necessarily decide the appeals in favour of the appellants? The Court of Appeal in *Mobilx* has merely interpreted the Value Added Tax Act. In that sense how is it possible to say that *Kittel* is not expressly provided for in the Value Added Tax Act? The Court of Appeal has ruled that it is.

Conclusion on the incorporation into UK law point

53. My view is that there is only a remote possibility that the CJEU's answer to question 2 in *Bonik* would determine the appeals in favour of the appellants.

Due diligence issue.

54. Little was said on this issue by Mr Holland. Questions about due diligence are raised in *Mehagében* and *Dávid* but it is difficult to see how this can be relevant to the taxpayers' appeals as UK law is quite different. There is no legal requirement to carry out due diligence in the UK. While a failure to carry out due diligence per se or to carry out a particular commercial check or a failure to respond to results of due diligence might be relevant in cases of alleged MTIC fraud in this country, that is only in connection with the question of knowledge or means of knowledge. There is no bar to recovery merely because due diligence has not been carried out.

55. Nevertheless, *Mynt* has ruled that these cases *may* be of assistance on this issue: I conclude that for the reasons given about that the probability of this is nevertheless low.

And other matter of relevance in the references?

56. Mr Holland did not suggest that any of the five references contained any other questions that would be of material assistance and I am unable to discern anything else in them of relevance either. In particular, *Tóth* and *SIA Forvards* do not appear to raise any issues of relevance not raised in the other three references. And their factual circumstances appear quite different to those in these appeals.

Expediency

Date cases to be decided

57. I mentioned in paragraphs 6-8 above that while the CJEU's decision in *Mehagében* and *Dávid* is fairly imminent, *Bonik* is unlikely to be before the end of 2012, and *Tóth* and *SIA Forvards V* not until 2013. It is certainly likely to be more than a year before the decision in the last case.

58. This by itself tells me little: it is common practice for cases to be stayed in this Tribunal often for years pending the resolution of another case.

59. However, the longer the stay is likely to last the more it has to be justified. In particular, the longer the stay, the more the "lead" case decision needs to be likely to render the hearing in the stayed case unnecessary.

Delay in hearing of evidence

60. Appeals in which it is alleged (as in this case) that the appellants knowingly entered into a transaction which was connected to fraud often involve long hearings and a great deal of oral evidence.

61. Mr Holland's view is that as six years have already passed since the facts at issue in this appeal occurred, the evidence will be no more stale in two years' time than it is now. He also says delay prejudices the appellants more than HMRC, because largely HMRC rely on the documentary evidence and not infrequently substitute new officers as their witnesses in cases where the officer at the time of the events the subject of the appeal had retired, resigned or died. The appellants, on the other hand, are giving evidence of what they did and why and their evidence would be more affected by fading memories. His point is that he does not think HMRC should complain of the delay.

62. However, the Tribunal is concerned with the administration of justice and not with the parties' views on whether the delay is prejudicial to their case. I find that as the matters at issue in this appeal took place six years ago, in the interests of avoiding evidence becoming even more stale, the hearing should be as soon as possible conducive with fairness. I tend to the view that bearing in mind both the likely importance of oral evidence from the witnesses in this case and the six year lapse since the events on which they will give evidence, I would have to be convinced that there was a very real chance that the CJEU decision would make the hearing in this appeal irrelevant before I would order a stay.

Conclusions

63. The main reason why it might be fair to order a stay of any particular appeal is that to fail to do so is likely to put the parties to unnecessary expense. A tribunal should be careful before ordering a hearing to go ahead where the decision in another case might render the hearing superfluous.

64. In the balance in this case are five references, four of which the Upper Tribunal has identified as potentially relevant to appeals involving *Kittel.*

65. I have concluded that there is nothing in the *SIA Forvards* reference that is relevant and not raised in the earlier references. Therefore in any event any stay would only be appropriate behind the first four references, *Mehagében, Dávid, Bonik* and *Toth.*

66. In respect of those four references, I have, however, concluded that on the privity of contract issue, the question of the incorporation of *Kittel* into UK law and due diligence issue that it is fairly remote that the CJEU's decision on any of these

issues would render the hearing in these appeals superfluous or indeed materially affect the Tribunal's understanding of the law. It is more likely, in my view, that the CJEU might restrict, in cases without privity of contract between taxpayer and fraudster, the meaning of 'connection' in the *Kittel* sense to cases where the fraud is proved to be organised MTIC fraud. Although that might materially change the conclusion of the Tribunal hearing these appeals, it would not affect its fact-finding role and in particular that it must decide whether the fraud was organised MTIC. It would therefore not render the hearing superfluous.

67. I also note that, bearing in mind the other directions I have issued in this case which will take some time to work through and that this Tribunal has a backlog of long cases to be heard, it is extremely unlikely that this case will come on for hearing until 2013 and this is very likely to be after the CJEU has issued its decisions in *Mehagében*, *Dávid* and *Bonik*. So the Tribunal determining these appeals will have the benefit of the CJEU's decisions in those cases. For this reason too, I consider it right that these appeals should continue to be prepared for hearing.

68. When I also take into account the undesirability of the evidence being stale, I have no difficulty in coming to the decision that the exercise of my discretion should be against the stay applied for by the appellants.

69. I dismiss the application for a stay in these two appeals.

70. 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.

BARBARA MOSEDALE
TRIBUNAL JUDGE

RELEASE DATE: 30 April 2012

ANNEX 1 - FULL TEXT OF THE FIVE REFERENCES TO CJEU

Mahagében Kft v Nemzeti Adó és Vámhivatal Dél-dunántúli Regionális Adó Főigazgatósága (Case C-80/11)

Questions referred

Must Directive 2006/112/EC 1 be interpreted as meaning that a taxable person who fulfils the material conditions for the right to deduct VAT in accordance with the provisions of that Directive may be deprived of his right to deduct by national legislation or practice that prohibits deductions in respect of VAT paid when a product is bought, where the invoice is the only valid document that confirms that the product was sold, and the taxable person is not in possession of any document from the issuer of the invoice which certifies that it was in possession of the product, and could have supplied it or satisfied its obligations as regards declaration? May a Member State require the recipient of the invoice to be in possession of a document proving that it is in possession of the product, or that the product was supplied or delivered to it, to ensure the correct collection of VAT and to prevent evasion under Article 273 of the Directive?

Is the concept of due diligence set out in Paragraph 44(5) of the Hungarian Law on VAT compatible with the principles of neutrality and proportionality already upheld several times by the European Court of Justice in connection with the application of the Directive if, in applying that concept, the tax authority and established case-law require the recipient of the invoice to ascertain whether the issuer of the invoice is a taxable person, whether it has entered goods purchased in its records and is in possession of the purchase invoice, and whether it has satisfied its obligations as to declaration and payment of VAT ?

Must Articles 167 and 178(a) of the Directive 2006/112/EC on the common system of value added tax be interpreted as meaning that they preclude national legislation or practice that requires a taxable person receiving an invoice to verify compliance with the law by the company issuing the invoice in order for the former to assert his right to deduct?

Péter Dávid v Nemzeti Adó- és Vámhivatal Észak-alföldi Regionális Adó Főigazgatósága (Case C-142/11)

Questions referred

Are the provisions relating to VAT deductions in Sixth Council Directive 77/388/EEC of 17 May 1977 on the harmonisation of the laws of the Member States relating to turnover taxes - Common system of value added tax: uniform basis of assessment, as amended by Council Directive 2001/115/EC of 20 December 2001 ('*the Sixth Directive*') and, as regards 2007, in Council Directive 2006/112/EC of 28 November 2006 on the common system of value added tax to be interpreted as meaning that the right of deduction of a taxable person may be restricted or prohibited by the tax

authority, on the basis of strict liability, if the invoice issuer cannot guarantee that the involvement of further subcontractors complied with the rules?

Where the tax authority does not dispute that the economic activity detailed in the invoice actually took place, nor that the form of the invoice complies with the legal provisions, may the authority lawfully prohibit a VAT refund if the identity of the other subcontractors used by the invoice issuer cannot be determined, or invoices have not been issued in accordance with the rules by the latter?

Is a tax authority which prohibits the exercise of the right of deduction in accordance with paragraph 2 obliged to ensure during its procedures that the taxable person with the right of deduction was aware of unlawful conduct, possibly engaged in for the purpose of tax avoidance, of the companies behind the subcontracting chain, or even colluded in such conduct?

Bonik EOOD v Direktor na Direktsia 'Obzhalvane i upravlenie na izpalnenieto', Varna (Case C-285/11)

Questions referred

1. Can the concept 'absence of actual supply' be inferred by interpretation from the provisions of Articles 178(a) and (b), 14, 62, 63, 167 and 168 of Directive 2006/112 and, if so, is 'absence of actual supply' coextensive, as regards its definition, with the concept 'tax evasion' or is it included in that concept? What does the concept 'tax evasion' cover within the meaning of the Directive?

2. In the light of the definition of 'tax evasion' and of recitals 26 and 59 in the preamble in conjunction with Article 178(b) of the Directive, does the Directive require that the formalities be expressly laid down by means of legislation in the form of an act of the Member State's highest legislative body or does it allow those formalities not to be laid down by means of legislation, but to constitute an administrative (and tax investigation) practice and case-law? May formalities be introduced by legislative acts of the administrative authorities and/or by instructions of the administration?

3. If it is a concept which differs from 'tax evasion' and is not covered by the definition of the latter, does 'absence of actual supply' constitute a formality as referred to in Article 178(b) or a measure as referred to in recital 59 in the preamble to the Directive, the introduction of which results in refusal of the right of deduction and jeopardises the neutrality of VAT, a fundamental principle of the common system of value added tax which was introduced by the relevant Community legislation?

4. Is it permissible to lay down formalities for taxable persons according to which they must provide evidence of supplies which preceded the supply between them (that is, the final customer and his supplier) in order for the supply to be deemed to have been actually carried out, if the authority does not dispute that the persons concerned (the final suppliers) have carried out downstream supplies of the same goods in the same quantities to downstream customers?

5. Under the common system of value added tax and the provisions of Articles 168 and 178 of Directive 2006/112, is the right of the trader to recognition of VAT payments in respect of a given transaction

(a) to be assessed solely in relation to the specific transaction to which the trader is party, having regard to the trader's intention to be a party to the transaction, and/or

(b) to be assessed taking account of all transactions, including upstream and downstream transactions, which form a supply chain of which the transaction in question is part, having regard to the intentions of the other parties in the chain, which the trader does not know and/or about which he cannot find out, or to the acts and/or omissions of the issuer of the invoice and of the other parties in the chain, namely his upstream suppliers, whom the person to whom the supply is made cannot control and of whom he cannot demand particular conduct, and/or

(c) to be assessed taking account of fraudulent acts and intentions of other parties in the chain, of whose participation the trader did not know and about whose acts or intentions it cannot be established whether he was able to find out, regardless of whether those acts or intentions date from before or after a given transaction?

6. Depending on the answer to question 5: Are transactions such as those at issue in the main proceedings to be regarded as supplies for consideration as referred to in Article 2 of Directive 2006/112 or as part of the taxable person's economic activity within the meaning of Article 9(1) of the Directive?

7. Is it permissible for transactions such as those at issue in the main proceedings, which were properly documented and declared for VAT purposes by the supplier, in respect of which the customer has in fact acquired the right of ownership of the goods invoiced and there are no indications as to whether he actually received the goods from a person who was not the issuer of the invoice, not to be regarded as supplies for consideration as referred to in Article 2 of Directive 2006/112 merely because the supplier was not found at the address indicated and did not produce the documents requested during the tax investigation or did not provide evidence to the tax authorities for all the circumstances under which the supplies were carried out, including the origin of the goods sold?

8. Does it constitute a permissible measure for the purpose of ensuring the collection of tax and preventing tax evasion that the right of deduction is made dependent on the conduct of the supplier and/or his upstream suppliers?

9. Depending on the answers to questions 2, 3 and [4]: Do measures of the tax authorities such as those at issue in the main proceedings, which lead to exclusion of the VAT arrangements in relation to the transactions concluded by a bona fide trader, infringe the principles of Community law of proportionality, equal treatment and legal certainty?

10. Depending on the answers to the above questions: In circumstances such as those of the main proceedings, does the person to whom the supplies are made have a right to deduct the tax invoiced to him by the suppliers?

Gábor Tóth v Nemzeti Adó- és Vámhivatal Észak-magyarországi Regionális Adó Főigazgatósága, as successor to Adó- és Pénzügyi Ellenőrzési Hivatal Hatósági Főosztály Észak-magyarországi Kihelyezett Hatósági Osztály (Case C-324/11)

Questions referred

1. Is the principle of tax neutrality (Article 9 of Council Directive 2006/112/EC of 28 November 2006 on the common system of value added tax) infringed by a legal interpretation which prevents the addressee of an invoice from exercising his right to deduct where the operator who issued it has, prior to full performance of the contract or issue of the invoice, had his business operator's licence withdrawn by the municipal authority?

2. Can the fact that the individual operator who issued the invoice has not declared the workers whom he employs (who, as a result, work 'in the black economy'), and the fact that, for that reason, the tax authority has found that the said operator 'has no declared workers', prevent the addressee of that invoice from exercising the right to deduct, having regard to the principle of tax neutrality?

3. Can it be held that the addressee of the invoice is guilty of a lack of care when he does not verify either whether a legal relationship exists between the workers employed on a work site and the issuer of the invoice or whether the latter has fulfilled his tax-return obligations or any other obligations relating to those workers? Can it be held that such conduct constitutes an objective factor which demonstrates that the addressee of the invoice knew or ought to have known that he was participating in a transaction involving fraudulent evasion of VAT?

4. Having regard to the principle of tax neutrality, can the national court take the above circumstances into consideration when its overall assessment leads it to the conclusion that the economic transaction did not take place between the persons specified on the invoice?

SIA Forvards V v Valsts ieņēmumu dienests (Case C-563/11)

Questions referred

Must Article 17(2)(a) of the Sixth Directive be interpreted as meaning that the right to deduct value added tax paid when goods are purchased can be denied to a taxable person who fulfils all the essential requirements for deduction of value added tax, without any abusive conduct on his part having been demonstrated, when the other party to the transactions was not able to effect the supply of the goods for factual or legal reasons (the other party to the transaction is fictitious or the person responsible for it denies the existence of any economic activity or of a specific transaction and that person has no capacity to fulfil the contract)?

May a refusal to recognise the right to deduct value added tax be based as such on the circumstance that the other party to the transaction (the person indicated on the

invoice) is considered fictitious (that is to say, his transaction does not relate to an economic activity)? Can the right to deduct input tax also be denied where no abusive practice on the part of the applicant for deduction of the input tax has been ascertained?

ANNEX 2 – DESCRIPTION OF MTIC FRAUD

Many previous tribunals and higher Courts have given a description of MTIC fraud. I rely on the descriptions given by Burton J in *R (Just Fabulous (UK) Ltd) v HMRC* [2007] EWHC 521 at paragraphs 5-7; by Lewison J in *HMRC v Livewire Telecom Ltd* [2009] EWHC 15 (Ch) at paragraph 1 and by Floyd J in *Mobilx Ltd (In Administration) v HMRC* [2009] EWHC 133 at paragraphs 2-3.

Simple missing trader fraud relies on a VAT free purchase by the fraudster. The fraudster then sells the goods on at a price including VAT but fraudulently fails to account to the tax authority for the VAT. A normal method of acquiring goods VAT free is to purchase them from another EU member state as the VAT rules provide that intra-EU transactions are free of VAT. This gives simple missing trader fraud the name of "acquisition fraud" as VAT legislation refers to cross border intra-EU purchases as acquisitions.

Although this is the simplest form of the fraud it depends on the defaulter having a genuine buyer willing to purchase the goods and pay the price plus VAT. The profit to the defaulter is the VAT which is paid by the genuine buyer but which the defaulter fails to account for (hence the description "defaulter"). It is possible, in order to induce a genuine buyer to buy the goods, that the defaulter enticed the buyer with a price below the market price, possibly a price below the price he paid for the goods: in such a case the "profit" of the fraud will be less than the VAT defaulted on as it will be reduced by the loss on the net sale price.

This "simple" fraud has a limit. It requires the identification of genuine buyers prepared to buy stock, so the need for genuine market demand limits the possible extent of this fraud. As the defaulter is dealing in a genuine market, it is also limited by the likelihood that the genuine buyer would prefer to buy from a trader known to the market, so it will have come-back if something goes wrong. And although pricing below the market price might tempt some buyers, it might also make them suspicious.

Organised missing trader fraud or carousel fraud

But out of this simple missing trader fraud was born a much more sophisticated fraud. This fraud dispenses with the genuine market: the defaulter creates an artificial market. Therefore, a genuine market does not limit the extent of the fraud: on the contrary the fraud can be committed as often as the fraudster desires – at least until suspicions are raised. It is a pernicious fraud as it has no natural limit other than perhaps the pockets of the governments of EU member States.

As it relies on an artificial market, how does the fraudster realise his profit? The fraudster realises his profit through a more sophisticated means. This fraud relies not

only a VAT free acquisition by the defaulter but a VAT free cross-border sale by the buyer. This person is in MTIC-speak termed the "broker". The point of the fraud is that the broker, when selling the goods pays his vendor *more* than he receives from his buyer. The difference is (less expenses) the profit of the defaulter. In this organised fraud the defaulter still defaults on the VAT on the sale to his buyer of course: otherwise he would be out of pocket. But what is perhaps not always appreciated is that that default, although fraudulent, is no longer the object of the fraud. The sale by the defaulter is artificially generated for the purpose of creating a chain of transactions in which the broker is induced to pay more for the goods than he receives.

Why would a broker pay more than he receives? This is because he makes a VAT-free cross border sale. This means the *net* VAT price he pays is *less* than his VAT free sale price. But once he has reclaimed the VAT paid to his vendor from the tax authorities, as subject to *Kittel* he is entitled to do by law, he has made a profit on the deal. This is also a VAT fraud by the defaulter because, even if the broker is unaware of the fraud, the defaulter has organised a series of transactions the purpose of which was to get the broker to pay more than he receives by relying on a VAT refund from the tax authorities.

In this artificial market, the goods are bought and sold but there is no real market for the goods. For this type of fraud it is not even necessary for the goods to actually exist.

Why sometimes termed 'carousel fraud'

The fraudster is arranging a chain of transactions in which the sale to and by the broker is essential for the fraud to work. So he has to arrange a sale to the broker and a sale by the broker. Rather than selling to and buying from the broker directly, the fraudster is likely to use other persons or companies ("buffers") who may or may not understand their role in the fraud. But to induce them to participate in the transaction chain he has to arrange for them to 'trade' at a profit. Therefore, ultimately a company controlled by the fraudster must be at both the start and end of the chain of deals to ensure these artificially generated deals take place.

As the fraud has no limit, it made sense for the fraudster to re-use the same goods and the same buffers and brokers and commit the fraud as often as possible sending the same goods round the same transaction chain. This gave the fraud its name of "carousel" fraud because the goods may go round in circle. But it is often a misnomer. Although the transaction chain (or at least the chain of money as the goods may not exist) must start and end with the fraudster or a company or person controlled by him, it is not necessarily the same person or company at the start and end of each chain. Further, the fraudster is likely to use a large number of buffers and brokers in lots of different chains in order to commit the fraud as often as possible. Therefore, although the same goods may circulate many times, they do not necessarily pass through the hands of the same broker more than once.

Variations on a theme

There are a number of variations on this fraud. The fraud as described does not depend on the broker knowing that his role is vital to a fraud. It is possible that so far as the broker is aware, he is simply buying and selling goods at a profit. Whether any particular alleged broker is aware of the fraud (if proved) is a question of fact.

In another version of the fraud, however, the broker is not independent of the fraudster. In such a case, the fraudster controls and funds both the defaulter and broker and the object of the fraud is quite simply the broker's VAT refund. But otherwise the fraud works as described in the previous paragraph where the broker is independent of the fraudster.

Protecting the broker

It will be important to the fraudster (even where the broker is entirely independent of the fraudster) that the broker recovers its input tax (or at least believes that he will) because otherwise the broker will not buy the goods. The fraudster must be supposed to want to protect the brokers he uses, as a fraud takes effort to organise and it must be easier if the same broker can be used in a transaction chain time and time again.

A method of protecting the broker's input tax reclaim, as mentioned above, was to introduce buffers in the chain between the defaulter and the broker so that the broker was not purchasing directly from the defaulter. Of course, the buffers themselves may not understand that their transaction was part of a series of transactions organised for the purpose of fraud.

A more sophisticated method of protecting the broker's reclaim is known as "contra-trading" which relies on two chains of transactions. The broker is sold goods in a clean chain free of a default. The default occurs in a parallel dirty chain. The fraud works because a buffer who trades in both chains, and in MTIC-speak is referred to as the "contra-trader", off sets the VAT due on his sale to the broker by a matching VAT free cross border sale in the "dirty" chain. At root, though, the fraudster's object is exactly the same: to induce the broker to pay more for the goods than he receives by relying on a VAT refund from the tax authorities. Whether the contra-trader or broker knows that they are participating in a fraud are questions of fact in any individual case.