



TC02058

**Appeal numbers: MAN/2007/00411
MAN 2008/00706**

VAT – MTIC fraud – contra trading – whether fraudulent VAT evasion established – only in relation to some defaults – whether connection to fraud established – yes, both directly and through contra trader – whether Appellant should have known of the connection – yes – appeal dismissed

FIRST-TIER TRIBUNAL

TAX CHAMBER

P S GILL & SON (UK) LIMITED

Appellant

-and-

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

Respondents

**TRIBUNAL: KEVIN POOLE (TRIBUNAL JUDGE)
PETER WHITEHEAD**

Sitting in public in Birmingham on 10 to 16 May 2011 with subsequent written submissions

Tim Brown (instructed by Tax & Legal Services Limited) for the Appellant

Richard Chapman (instructed by Howes Percival) for the Respondents

DECISION

Introduction

Background to the appeal

5 1. This is an MTIC appeal. It arises from the refusal of the Respondents
("HMRC", which will be used in this decision to refer also to Her Majesty's Customs
& Excise, the predecessor body to the Respondents) to repay sums totalling
£2,448,530 claimed by the Appellant ("PSG", which in this decision also refers to its
10 predecessor entities in carrying on its business) in respect of input VAT on the
following purchases:

(1) in PSG's VAT accounting period for the month of April 2006 (period
04/06), the purchase on 26 April 2006 of 5,000 Nokia 8800 and 7,000
Nokia N90 mobile phones for a total price of £3,721,000 plus £651,175 of
15 VAT from Kingswood Trading Services Limited ("Kingswood", which in
this decision also refers to the other companies managed by Ian Tuppen
with which PSG traded over the relevant period), which phones were sold
by PSG to 2Trade BVBA of Belgium ("2Trade") on the same day for
£3,869,500 (free of VAT);

20 (2) in PSG's VAT accounting period for the month of May 2006 (period
05/06):

(a) the purchase on 25 May 2006 of 5,000 Nokia 9300i, 3,750
Nokia N70 and 2,000 Nokia 8800 mobile phones for a total price of
£2,749,250 plus £481,118.75 of VAT from Kingswood, which
25 phones were sold by PSG to 2Trade on the same day for £2,859,875
(free of VAT);

(b) the purchase on 30 May 2006 of 2,400 Nokia 8800, 3,000
Nokia 9500 and 3,500 Sony Ericsson W810i mobile phones for a total
price of £2,497,100 plus £436,992.50 of VAT from Kingswood,
30 which phones were sold by PSG to 2Trade on the same day for
£2,597,100 (free of VAT); and

(c) the purchase on 31 May 2006 of 63,000 Pentium P4 SL7Z9
CPU's for a total price of £5,024,250 plus £879,243.75 of VAT from
Crestview Enterprises Limited ("Crestview"), which CPU's were sold
35 by PSG to Fone Link SL of Spain ("Fone Link") on the same day for
£5,229,000 (free of VAT).

2. HMRC claim to be entitled to refuse the repayment because they say PSG's
purchases giving rise to the relevant input VAT were connected to a fraudulent
evasion of VAT and PSG should have known of that fact. They do not allege that
PSG actually knew of that fact.

3. In relation to the purchase referred to at [1(2)(c)], HMRC say that the purchase can be traced back, through what they describe as a “contra trader”, to traders who fraudulently evaded VAT on supplies of other goods.

4. In relation to the remainder of the purchases listed above, HMRC say that the purchases can be traced directly back, through chains of sales and purchases of the same goods, to traders who fraudulently evaded VAT on their respective supplies of those goods.

5. PSG does not dispute the chains of sales alleged by HMRC. PSG accepts that the relevant VAT defaults took place. It does not however accept that the defaults were fraudulent and therefore it does not accept that a connection exists between PSG’s purchases and any fraudulent default. It also raises certain detailed objections to the “connections” asserted by HMRC to exist through the contra trader.

6. Even if a connection is in fact established between all of PSG’s purchases and one or more fraudulent VAT defaults, it also asserts that it neither knew nor should have known of such a connection.

Structure of this decision

7. We first summarise the sources of evidence made available to us, then set out the basic facts of the appeal which are substantially agreed between the parties. As the parties have largely agreed the legal principles which are applicable, we then set out those principles (identifying the few outstanding issues on them).

8. We then turn to the detail of the matters which are required to be proved by HMRC. First, we consider whether they have established the existence of VAT fraud connected to PSG’s purchases. We then consider the matters which lie at the heart of the appeal, namely whether PSG should have known of the connection to any such fraud. We do this by examining PSG’s trading history and then focusing specifically on the deals the subject of this appeal.

The Evidence

Introduction

9. We were supplied with a large amount of documentary evidence, mostly in the form of witness statements and exhibits from the following HMRC officers:

(1) Joseph Baines (responsible for verifying PSG’s VAT returns and associated VAT repayment claims which are the subject of this appeal);

(2) Michael Donald Phipps (PSG’s control officer for most of the time from May 2003 to April 2006);

(3) Sarah Jane Barker (responsible for verifying the VAT return of Crestview Enterprises Limited (“Crestview”), the alleged contra trader, for its VAT accounting period from 1 April to 30 June 2006);

(4) Peter Goulding (in relation to the alleged defaulter C and B Trading (UK) Limited (“C&B”));

(5) Vivian Barbara Parsons (in relation to the alleged defaulter RS Sales Agency Limited (“RS Sales”));

5 (6) John Michele Christopher Cordwell (in relation to the alleged defaulter Red Rose Consultancy (UK) Limited (“Red Rose”));

(7) Barry Michael Patterson (in relation to the alleged defaulter Zenith Sports (UK) Limited (“Zenith”));

10 (8) Fu Sang Lam (in relation to the alleged defaulter West 1 Facilities Management Limited (“West 1”));

(9) David Kenneth Leach (referring to and commenting on a witness statement of Officer David Skelly, who had since left HMRC, concerning an earlier disputed claim of PSG for a VAT repayment);

15 (10) Terence Mendes (in relation to First Curaçao International Bank NV (“FCIB”));

(11) David Young (in relation to FCIB’s Paris server information);

(12) Andrew Leatherby (in relation to IP address logging); and

(13) Guy Roderick Stone (in relation to MTIC generally and in relation to Ian Tuppen of Kingswood).

20 10. We also received a witness statement from Sukhdev Singh Gill (“Mr Gill”), the managing director of PSG. He had previously carried on PSG’s business as a sole trader and, before that, in partnership with his father and brother.

25 11. At the hearing, Mr Gill gave extensive oral testimony and the following HMRC officers also gave oral testimony: Mr Phipps, Mr Baines, Mr Leach and Mr Mendes (who, by agreement between the parties, gave some evidence about “Redhill verification” procedures as well as being cross examined on his evidence in relation to FCIB).

Non-contentious facts

30 12. Arising from this evidence, Mr Chapman’s well-structured closing submission on behalf of HMRC included the following list of “apparently non-contentious” facts (which we have edited only to fit the context and to remove cross-references to the evidence):

35 (1) PSG carries on business in the trade of clothing, electronics, general trading, import and export, and wholesaling of a variety of goods (“the Business”).

(2) PSG's VAT registration number is 112 6012 33.

(3) The Business, with its VAT registration number, had originally begun as a sole proprietor under the name of Mr Piara Singh, trading as PS Gill and Sons. In the original VAT1 the main trade classification was selected as being code 8217 – girls' wear and household textiles.

(4) With effect from 1 April 1981, the Business became a partnership between Mr Piara Singh and his two sons, Mr Gill and Mr Inderjit Singh.

(5) With effect from 1 April 2004, Mr Gill became the sole proprietor of the Business.

(6) PSG subsequently took over the Business, and its VAT registration number, following a transfer of a going concern on 1 April 2006.

(7) PSG stated on its VAT registration form dated 24 March 2006 that its estimated turnover in the following twelve month period was to exceed £1,000,000, that it expected [the VAT on] its purchases regularly to exceed the VAT on its taxable supplies and that it did not expect to be either buying from or selling goods to other EU Member States.

(8) PSG submitted VAT returns for the period 04/06 on or about 8 May 2006 and for the period 05/06 on or about 9 June 2006 ("the Returns"). The Returns were selected for in-depth verifications.

(9) By a decision dated 27 March 2007, Mr Joseph Baines (Higher Officer of HMRC) denied input tax claimed by PSG in the period 04/06 in the sum of £651,175. This related to six purchases of mobile phones from Kingswood which were combined into one sale to 2Trade.

(10) By a further decision dated 27 March 2007, Higher Officer Baines denied input tax claimed by PSG in the period 05/06 in the sum of £918,111.25. This related to seven purchases of mobile phones from Kingswood, which were combined into two sales to 2Trade.

(11) By a further decision dated 7 May 2008, Higher Officer Baines denied further input tax claimed by PSG in the period 05/06 in the sum of £879,243.75. This related to the purchase of computer processing units ("CPUs") from Crestview, which PSG sold to Fone Link.

(12) The basis for each of these decisions was that Higher Officer Baines was satisfied that the transactions formed part of an overall scheme to defraud HMRC and that PSG knew or should have known that this was the case.

(13) PSG issued a notice of appeal against the decisions of 27 March 2007, which was served on 3 April 2007. The grounds of appeal are as follows:

“The Appellant denies that he deliberately or recklessly ignored factors which indicated or may have indicated that the transaction entered into formed or may have formed part of an overall scheme to defraud the revenue.”

5 (14) PSG issued a notice of appeal against the decision of 7 May 2008, which was served on 20 May 2008. The grounds of appeal are in the same terms as the appeal against the decisions of 27 March 2007.

(15) By an order dated 14 July 2008, the two appeals were consolidated and directed to proceed under the reference MAN/07/0411.

10 (16) Various orders for directions have been made, culminating in a consent order approved on 22 January 2010 (“the 2010 Order”) listing the hearing of the appeal and providing for consequential directions.

(17) The appeal was listed for fifteen working days commencing on 9 May 2011.

15 13. Mr Brown on behalf of PSG, in his equally well-structured submission, agrees the above facts with one qualification. In relation to paragraphs [12(9)] and [12(10)], he states that in the two VAT periods PSG made only three purchases from Kingswood, each consisting of several different types of phone; it was Kingswood’s decision to invoice each type of phone separately, resulting in 13 separate invoices.
20 He submits that this is important when assessing circumstantial evidence of PSG’s knowledge, an exercise which he says should be carried out in the context of three mobile phone deals, not 13.

The Law

25 14. There was a large measure of agreement between the parties as to the law to be applied in this case. The basic law flows from the decision of the European Court of Justice in the combined cases of *Axel Kittel v Belgium; Belgium v Recolta Recycling* [2006] ECR I-6161, as explained in the Court of Appeal’s judgment in the combined cases of *Mobilx and others v HMRC* [2010] EWCA Civ 517.

30 15. In his closing submissions on behalf of HMRC, Mr Chapman set out a summary of the legal principles which he said should be applied, as follows:

(1) A claim for the repayment or deduction of input tax may be denied where the trader knew or should have known that, by his purchase, he was participating in a transaction connected with the fraudulent evasion of VAT.

35 (2) A trader may be regarded as a participant where he should have known that the only reasonable explanation for the circumstances in which his purchase took place was that it was a transaction connected with fraudulent evasion.

- (3) Tribunals should not unduly focus on due diligence.
- (4) It would be artificial only to look at the purchase in respect of which the input tax is to be denied. Surrounding circumstances and the totality of a trader's deals should be considered.
- 5 (5) The relevant time of knowledge is the time of the trader's transaction.
- (6) In a contra transaction, the apparently clean chain need not pre-date the allegedly dirty chain.
- (7) The burden of proof as to the state of the trader's knowledge is upon HMRC.
- 10 (8) The standard of proof is the balance of probabilities.
- (9) Circumstantial evidence of fraud of a sufficiently definite type will often indicate that a trader has chosen to ignore the obvious explanation as to why he was presented with an opportunity to reap a large and predictable reward over a short space of time.
- 15 (10) There is no need for the tax losses to be allocated to specific traders or apparently clean chains.

16. Mr Brown in his closing submissions on behalf of PSG took issue only with paragraphs [15(6)] and [15(10)] of the above summary.

17. In relation to paragraph [15(6)], he did not fundamentally disagree with Mr Chapman's submission, he simply pointed out that:

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"Insofar as contra-transactions where the evasion occurs post-date the Appellant's transaction, HMRC must prove the Appellant ought to have known at the time of its transactions that another party was going to evade VAT at some point in the future."

18. In relation to paragraph [15(10)], his point was more substantial, and consisted of two limbs. If tax losses were not allocated to specific traders or apparently clean chains, he pointed out (in summary) that:

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(1) the identity of the alleged fraudulent defaulter would not be known, which would mean that fraud on the part of that defaulter could not be established; and

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(2) there was a real possibility that the amount of input tax denied to PSG would exceed the amount of VAT allegedly or actually unaccounted for by the defaulter, which would contravene the principle of fiscal neutrality.

19. He also submitted that if HMRC were to satisfy the test set out in paragraph [15(2)], they would have to exclude all other reasonable explanations for the circumstances in which each purchase took place. Finally, whilst accepting that the

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standard of proof was the usual civil standard of “balance of probabilities”, he submitted that the strength of evidence required to prove dishonesty was greater than that required to prove negligence.

20. We consider these submissions later in this decision, in the appropriate context

5 21. Subject to the points raised by Mr Brown (which we address in context later in this decision), we see no reason to disagree with the above general statements of legal principle set out by Mr Chapman.

Were PSG’s purchases connected with fraudulent evasion of VAT?

Introduction

10 22. This question clearly comprises two interlinked elements. First, HMRC must show that a fraudulent evasion of VAT has taken place and second, they must show that PSG’s purchases were connected with that evasion.

15 23. The evidence presented by HMRC was broken down by reference to “deals” to which they ascribed reference numbers. A summary of the deals is set out in tabular form in Part 1 of Schedule 1 to this decision. It is to be noted that this referencing system is entirely HMRC’s. It pays no regard to the fact that PSG negotiated and documented what it regarded as only four deals (three with Kingswood and one with Crestview):

20 (1) All the deals in 04/06 (numbered 1 to 6 by HMRC) which PSG documented as one purchase from Kingswood and sale to 2Trade on 26 April 2006;

(2) Deals 5 to 8 in 05/06, which PSG documented as one purchase from Kingswood on 25 May 2006 and sale to 2Trade on 26 May 2006;

25 (3) Deals 1 to 3 in 05/06, which PSG documented as one purchase from Kingswood on 30 May 2006 and one sale to 2Trade on 31 May 2006; and

(4) Deal 4 in 05/06, which comprised a single purchase from Crestview and sale to Fone Link on 31 May 2006.

30 24. It is also to be noted that HMRC’s referencing system does not align naturally with the chronological order of events. In particular, in period 05/06 deals 5 to 8 took place before deals 1 to 4.

25. HMRC have traced the chains of supply of the relevant goods back from PSG and Crestview, using information obtained from PSG and other traders.

35 26. Diagrammatic summaries of the deal chains so traced and of Crestview’s trading activities during its relevant VAT accounting period are set out in parts 2 (PSG’s deal chains) and 3 (Crestview’s activity) of Schedule 1 to this decision.

Direct connection to VAT defaulters

27. In relation to all of the deals except Deal 4 in 05/06, HMRC were able to trace back the chains of supply of the relevant goods (all of which were mobile phones of various types) directly from PSG to the VAT defaulters C&B and RS Sales.

5 28. PSG accepts that these chains of supply have been correctly traced (there was originally some doubt in relation to one of the chains, but this has been satisfactorily resolved and PSG no longer dispute it. In any event, we are also satisfied that all the chains have been correctly traced).

10 29. PSG also accepts that the VAT on the original supplies of the goods by C&B and RS Sales has gone unpaid.

30. However PSG does not accept that the defaults by C&B and RS Sales were fraudulent, and in relation to those defaults it therefore does not accept that PSG's purchases can be connected to fraudulent evasion of VAT.

15 31. As we understand PSG's position, it accepts that if the defaults of C&B and RS Sales are found to be fraudulent, then PSG's purchases would be connected with that fraudulent evasion of VAT (and we would also hold such connection to be self-evident).

Connection to VAT defaulters through contra trader

20 32. In relation to deal 4 in period 05/06, HMRC say that Crestview was acting as a contra trader, having acquired the CPUs on an intra-EU acquisition from a trader in Portugal, effectively free of VAT. (Readers of these decisions will require no explanation of contra trading, and for those seeking an explanation, a summary explanation is set out in Schedule 2 to this decision.)

25 33. An understanding of Crestview's overall trading activity in its relevant VAT accounting period (the three month period ended on 30 June 2006) can be obtained from the diagrammatic summary in Part 3 of Schedule 1 to this decision.

34. In a contra trading situation, HMRC must either:

30 (1) establish that the contra trader was acting fraudulently (in which case a clear "connection" to fraudulent VAT evasion within *Kittel* is easily established, the fraud in question being the contra trader's fraudulent contra trading activity); or

(2) establish a connection with some other VAT fraud (which will generally need to be the fraud of a fraudulent defaulter at the beginning of a "dirty chain" leading up to the contra trader).

35 35. Whilst Officer Barker in her first witness statement asserted that she was "satisfied that Crestview knew that they were involved in a fraud which also involved the appellant in this case", HMRC did not press this assertion in their statement of

case or at the hearing. Whilst there were some aspects of the evidence before us which pointed in that direction, we did not consider the overall evidence was sufficient to justify a finding that Crestview was itself acting fraudulently. It is quite clear however that it was acting as a contra trader, i.e. it was arranging its trading in a way designed to reduce the size of its VAT repayment claim by entering into deals, such as the sale to PSG in the present appeal, which generated an output tax liability (for which it received immediate payment from PSG) without any corresponding input tax liability. In its 06/06 VAT return, Crestview reclaimed net VAT of £1,540,386.52. But for the sale of CPUs to PSG on 31 May 2006, its VAT repayment claim would have been £2,419,630.27.

36. Given that HMRC have not established that Crestview was acting fraudulently, they must establish a connection between PSG's purchases and the fraudulent default(s) of one or more traders in a "dirty chain" (or chains) leading up to Crestview.

37. In the nature of contra trading structures, it is not generally possible to identify any specific link between any particular default in the contra trader's "dirty chains" and any particular taxable sale of the contra trader. Whether the contra trader is acting innocently or fraudulently in offsetting its input tax on its "export or dispatch" sales against its output tax liability on its "acquisition" deals, the reality of the situation is that the offsetting takes place on an overall basis rather than by matching specific input and output tax liabilities. Therefore there is generally no logical basis for directly linking a specific output tax amount of a contra trader (which forms the denied input tax liability of a trader in the position of PSG in this case) with any particular defaulter in the "dirty chains" of the contra trader.

38. HMRC have not made it clear whether they think this matters or not. In their statement of case, they argued that a connection existed with the VAT defaulters at the start of each dirty chain leading up to Crestview. In their closing submissions, however, they have referred to an alleged connection to a single dirty chain (citing factors which they say show a clear connection between PSG's purchase and the dirty chain leading back to the defaulter Red Rose) but they have also referred to the evidence of the alleged fraudulent default of Zenith and West 1, defaulters at the start of the other dirty chains leading up to Crestview. In doing so, they have covered all dirty chains of Crestview in its VAT accounting period 06/06 which culminate in a zero rated export or EU sale by Crestview. They are thus effectively saying that whichever such dirty chain or chains is (or are) connected to PSG's purchase, they can show a fraudulent VAT default at the start of the chain (or chains). Thus, they appear to be saying, a *Kittel* connection exists between PSG's purchase and one or more of a short list of fraudulent VAT defaults.

39. PSG does not accept that Red Rose, Zenith and West 1 have been guilty of fraudulent evasion of VAT, but it does accept that if they have been, then a connection can be established for the purposes of the *Kittel* test between such fraudulent evasion and PSG's purchase.

Allocation of fraudulent VAT defaults

40. We note that the input VAT being denied to PSG in respect of its purchase from Crestview is £879,243.75, and that the fraudulent VAT defaults alleged by HMRC to be potentially connected to PSG's purchase are as follows:

- 5 (1) Red Rose: £882,398.13;
- (2) West 1: £350,962.50;
- (3) Zenith: £351,750.00.

41. We note that HMRC maintain these fraudulent defaults are also connected to other input tax claims by Crestview and by Network Euro Limited (a purchaser of other goods from Crestview to a value of £976,250 plus VAT of £170,843.75 on 15 June 2006). They may well be seeking to disallow those other input claims based on a connection to the same fraudulent VAT defaults.

42. PSG have argued that any fraudulent VAT defaults found to exist must be specifically allocated to particular denials of input tax. If this is not done, they say, then two problems arise:

- (1) There is a very real possibility that HMRC would be seeking to deny more input VAT than has actually been fraudulently evaded by the defaulter. This, they say, would be contrary to the fundamental principle of fiscal neutrality.
- 20 (2) It would not be possible to prove there has been a fraudulent VAT default. To prove fraud requires proof of the necessary mental element on the part of the perpetrator, and unless you have identified who the alleged perpetrator of the fraud is, that cannot be done.

43. The first of these two problems was addressed head on by the Court of Appeal in *Mobilx*, and they held it to be irrelevant. As Moses LJ said at [65] and [66]:

30 “65. The *Kittel* principle is not concerned with penalty. It is true that there may well be no correlation between the amount of output tax of which the fraudulent trader has defrauded HMRC and the amount of input tax which another trader has been denied. But the principle is concerned with identifying the objective criteria which must be met before the right to deduct input tax arises. Those criteria are not met, as I have emphasised, where the trader is regarded as a participant in the fraud. No penalty is imposed; his transaction falls outwith the scope of VAT and, accordingly, he is denied the right to deduct input tax by reason of his participation.

35 66. It is not arguable that the principles of fiscal neutrality, legal certainty, free movement of goods and proportionality were infringed by the Court itself, when they were at pains to preserve those principles (see §§ 39-50). By enlarging the category of participation by reference

to a trader's state of knowledge before he chooses to enter into a transaction, the Court's decision remained compliant with those principles."

5 44. We accept and agree with this approach. In a non-contra trading situation, it is almost always the case that the amount of input tax being denied to the trader seeking repayment exceeds the amount of VAT fraudulently evaded by the original defaulter – as can be seen to be the case here (see the figures given in part 2 of Schedule 1 to this decision). We see no reason why that should not be the case in a contra trading situation. The rationale for denying the input VAT, as Moses LJ said in *Mobilx*, has
10 nothing to do with any correlation between the amount denied and the amount of the connected fraudulent default. It depends entirely upon the fact that the trader, as a participant in fraud, has forfeited the right to recover input VAT.

15 45. HMRC appear to have addressed the second problem by adducing evidence of the fraudulent VAT evasion of all potentially connected defaulters. They are effectively saying "we decline to allocate the input tax in this case to any one defaulter, but there are three such defaulters with whom we consider a connection primarily to exist. Whichever of those three defaulters you consider (and the evaded output VAT of the three of them totals nearly double the amount of input VAT being denied to PSG), we say that fraud can clearly be proved."

20 46. Whilst we are of the view from the evidence we have seen that the default most obviously connected to PSG's purchase of CPUs from Crestview is that of Red Rose, HMRC's approach seems to us to overcome any difficulty of the type identified by PSG which might otherwise arise from declining to allocate specific VAT defaults.

25 47. Both in relation to the mobile phone deals (all of which trace back directly to tax losses) and the CPU deal (which traces back, indirectly via the contra trader Crestview, to tax losses), we find the relevant connection to have been established. The crucial issue is therefore whether the tax losses in question were fraudulent.

Was C&B guilty of fraudulent evasion of VAT?

30 48. From the witness statements of Officer Goulding, we are satisfied that C&B was guilty of fraudulent evasion of VAT.

35 49. All attempts by HMRC to set up a meeting with C&B from November 2005 were blocked, including after it came to light as a potential MTIC trader in April 2006 (as a result of evidence obtained from a freight forwarder). It made no response to formal demands to deliver a VAT return, none of its officers could be found and it was established from other MTIC traders that it had defaulted on payment of VAT totalling over £84 million in respect of activities during the months of March and April 2006.

50. Included in this default was the output VAT due on the sale of the telephones comprised in deals 1 to 6 in period 04/06 referred to in the schedule to this decision.

Was RS Sales guilty of fraudulent evasion of VAT?

51. From the witness statement of Officer Parsons, we are satisfied that RS Sales was guilty of fraudulent evasion of VAT.

52. In spite of being expressly told by HMRC that he was not permitted to use his personal VAT registration (in the name of “RS Sales Agency”) for the business of his company RS Sales Limited, Mr Rafik Sodawala did so or permitted a third party to do so. Having generated a total turnover as a sole trader from 14 May 2003 to 30 September 2005 of £115,141, no further VAT returns were submitted by him.

53. During the six weeks from 26 April 2006 to 4 July 2006, RS Sales issued false VAT invoices bearing the VAT number of Mr Sodawala as a result of which it incurred a VAT liability of some £29 million, none of which was returned or accounted for to HMRC. Mr Sodawala claimed that RS Sales’ business activity during the period in question was conducted by a third party called Mr Patel, who could not now be traced. Included in this default was the output VAT due on the sale of the telephones comprised in deals 1 to 3 and 5 to 8 in period 05/06 referred to in the schedule to this decision.

Was Crestview (the contra trader) guilty of fraudulent evasion of VAT?

54. See [35] above. Notwithstanding Officer Barker’s opinion (expressed in her first witness statement) that Crestview was acting fraudulently, that position was not pressed at the hearing. In any event, we do not consider the evidence before us to be sufficient to establish on a balance of probabilities that Crestview was acting fraudulently in the course of its contra trading activities.

Was Red Rose guilty of fraudulent evasion of VAT?

55. From the witness statements of Officer Cordwell, we are satisfied that Red Rose was guilty of fraudulent evasion of VAT.

56. After a Mr Askandar Almahruqi had registered for VAT towards the end of 2005, giving his proposed business as “IT Consultancy, Web Writing, Computer Accessories, Telecommunication and General Trading”, he applied in January 2006 for the transfer of the VAT registration into a newly incorporated company, which later changed its name to Red Rose. The company’s business was described as “other software consultancy and supply” and the expected turnover for the following 12 months was stated as £84,000.

57. It appears that the VAT registration number was transferred. On 24 May 2006 Red Rose wrote to HMRC (received on 30 May 2006) to notify them of its change of business address and name, and asking for a revised VAT registration certificate. In that letter, Red Rose said “the nature of our business will remain the same”.

58. Red Rose delivered VAT returns for its 02/06 and 05/06 VAT accounting periods. They showed a net VAT liability of £110 on total sales of less than £2,000.

59. Between approximately mid to late June 2006 and at least the end of August 2006, Red Rose was dealing in mobile phones in large volumes. This only came to HMRC's attention through information from other traders. From that information, it became apparent that Red Rose enjoyed a turnover of approximately £18 million from its trading during that period.

60. On 25 September 2006, HMRC attempted to visit Red Rose at its place of business. The premises were locked and HMRC obtained a mobile telephone number to contact the company. They cancelled Red Rose's VAT registration and informed the company over the telephone that if it wished to obtain reinstatement, it would need to supply all its business records. Nothing further was heard from Red Rose. It did not appeal the cancellation of its VAT registration or the assessments which were in due course raised against it by HMRC, totalling some £3.2 million. Those assessments all remain outstanding.

61. Included in the assessments was a sum of £882,398.13 in respect of output VAT on the sale of mobile phones which were sold on through two intermediary companies to Crestview; it is Crestview's input VAT of £885,066.87 on the purchase of those phones which HMRC claim was "designed to offset the output tax due on the 3 acquisition deals [i.e. PSG's purchase of CPU's and Network Euro Limited's purchase of phones from Crestview on 26 May and 15 June 2006 respectively] along with the input tax claimed by Crestview in respect of other deals traced to tax losses."

62. Red Rose was placed into liquidation on 21 February 2007.

Was Zenith guilty of fraudulent evasion of VAT?

63. From the witness statements of Officer Patterson, we are not satisfied that Zenith was guilty of fraudulent evasion of VAT.

64. An electronic application to register Zenith for VAT as an "intending trader" was received on 12 August 2005. Its intended business was stated as "wholeseller of sports accessories, mobile phone accessories, memory and more". Its expected turnover was given as £100,000 for the first twelve months. The application was "signed" by one Nasar Hussain, though the name of the director was given as Tarneum Butt (apparently a female name), who was described as Mr Hussain's sister.

65. Mr Hussain initially played a very active part in Zenith's contacts with HMRC in his capacity as "manager" or "employee", even describing himself as "director" at one point. He also appeared to be the most knowledgeable person concerning the company's business at a meeting with HMRC held on 27 March 2006. But he never became a director.

66. It appears that Zenith started to trade in CPUs, mobile phones and similar goods very shortly after that meeting, at the end of March 2006, though it was clearly making preparations to do so from an earlier date; in particular, HMRC received requests for verification of Zenith's VAT registration from other traders intending to deal with it from around the end of February 2006. Having submitted small payment VAT returns (less than £600 in total) for the VAT periods ended 30 November 2005

(11/05) and 28 February 2006 (02/06), it submitted a late return for the period to 31 May 2006 (05/06).

67. There appears to have been a change of officers at Zenith around the start of June 2006, and after a number of abortive attempts and telephone conversations
5 HMRC made a further visit to Zenith on 29 June 2006. A Miss Basharat introduced herself as the director (though Companies House records indicate that she resigned as such on 1 June 2006). An accountant also attended the meeting. Zenith's due diligence checks on trading partners were regarded as "poor" and records were produced showing sales of £122 million and purchases of some £125 million up to the
10 end of May 2006, with a net VAT repayment claim of some £427,000.

68. Zenith's records were taken by HMRC and after piecing the picture of trading together from them, HMRC wrote on 21 July 2006 saying that their examination of the records demonstrated a net VAT liability for the period 05/06 of some £1.7 million, and that Zenith's purchases all traced back to VAT defaults totalling some
15 £19 million. This compared to Zenith's VAT return showing a VAT liability (which was apparently paid) of some £30,000.

Zenith continued to trade. On 19 June 2006, it carried out the sales to Coast Telecom to a value of £2,010,000 plus VAT which generated a £351,750 VAT liability which it has never settled. This is one of the defaults identified by HMRC as
20 a fraudulent default in a dirty chain leading up to Crestview. This trade appeared to be a near exact repeat of an earlier trade on 8 June 2006, when it sold the same number and description of goods to Coast Telecom at the same price. In the earlier trade, its records showed it as having bought the goods from West 1 but in the later trade there was no record of Zenith's supplier.

69. There were a number of suspicious features to Zenith's trading but the picture that emerges is of a trader that had carried out a large number of trades without adequate checks on its suppliers and without keeping proper records. This was not a trader that simply absconded with large amounts of VAT and could not be found or contacted by HMRC. There were a number of contacts and a great deal of
30 information and material supplied by Zenith to HMRC. Zenith accounted for £30,000 of VAT on its trading in period 05/06.

70. On the basis of the evidence we have seen, we do not feel there is sufficient to establish on a balance of probabilities that Zenith was acting fraudulently when it defaulted on payment of the £351,750 of VAT arising from its 19 June 2006 sale to
35 Coast Telecom.

Was West 1 guilty of fraudulent evasion of VAT?

71. From the witness statements of Officer Fu Sang Lam, we are not satisfied that West 1 was guilty of fraudulent evasion of VAT.

72. West 1 was registered for VAT in 2000. For all its VAT accounting periods
40 from 06/02 up to 09/05, it either made a nil return or it made or claimed VAT

payments/repayments of between £200 and £7,000, based on net output supplies to a total value during that period of some £195,000.

73. West 1 appears to have started trading in CPUs at some time before 13 March 2003. There was some kind of problem arising out of that trading, as a result of which the owner of the business, a Mr Richard Harrison, had sold it in around April 2003 having only owned it for a few months. Although he said he was selling the business to a Mr Sajid Hussain, it appears he in fact sold it to a Mr Michael McGrath. The business made no supplies in its VAT periods 06/03 to 12/03 inclusive. Mr McGrath was appointed a director of West 1 on 27 January 2004, and it appears he had previously been involved in the company.

74. HMRC became aware in about July 2004 that West 1 was still active in a trade sector which was experiencing MTIC problems, though its trade does not appear to have been extensive at that time. In September 2004 they tried to arrange a meeting with West 1 but were unable to do so until they made a visit to Mr McGrath in his capacity as sole trader in another business called "Firecraft" on 7 October 2005. At that point they established that West 1 was buying and selling mobile phones, and discussed some of the issues around such trading with Mr McGrath.

75. West 1's major trading in MTIC goods started in October 2005. In its VAT return for period 12/05, it reported nearly £62 million of net output sales, and a net VAT liability to HMRC of just £5,708.87.

76. HMRC visited West 1 on 1 and 9 February 2006 to establish the basic pattern of its trading. Mr McGrath explained this to them and asked if West 1 could be placed on monthly VAT returns as it was seeking to get into the export market.

77. It was around this time that a Mr Ryan Foley became formally involved in West 1. He was appointed as company secretary on 10 February 2006, and as a director on 28 February 2006. He stated (at a meeting with HMRC on 8 November 2006) that he had bought West 1 from Mr McGrath for £20,000 which was paid at the end of April 2006. At this point, Mr McGrath drops out of the picture.

78. West 1's reported net sales figure for period 03/06 was £372.9 million (subsequently adjusted by HMRC on the basis of other records received by them to £690.8 million). West 1 (in a VAT return signed by Mr Foley) claimed a VAT repayment of £164,665. This was amended by HMRC, based on the records seen by them, to a VAT liability of £48.9 million. The basis of this amendment was set out in two letters from HMRC to West 1 dated 16 August 2006 and 19 September 2006.

79. In the meantime, HMRC had raised enquiries on specific details of West 1's trading for the purposes of its investigations of other traders, culminating in a letter dated 12 May 2006. By way of reply, they received (on 15 May 2006) a letter dated 12 April 2006 from West 1, purportedly from Mr Foley (though it was unsigned). It said that Mr Foley had recently acquired West 1 and it advised change of address details. On the same day, HMRC received West 1's VAT return for period 03/06 (referred to above). Attempts to contact Mr Foley at West 1's new address proved

5 mostly unsuccessful and what contact there was proved unsatisfactory, with only sketchy business records being produced. Eventually on 20 June 2006 HMRC left a “Regulation 25” letter addressed to West 1 at its business address, requiring it to make up a VAT return to 20 June and deliver it by the following day. When West 1 failed to deliver this return, it was de-registered for VAT with effect from 22 June 2006.

80. Using the few records which West 1 had supplied, HMRC compiled the amendments referred to above to West 1’s 03/06 VAT return.

81. There was no contact from Mr Foley until some 4 months later in late October 2006. This resulted in a meeting at HMRC’s Uxbridge office on 8 November 2006. At that meeting, Mr Foley demonstrated a lack of understanding of the VAT rules and explained the inaccurate 03/06 return as a mistake. No VAT return was ever submitted in respect of the period from 1 April 2006 up to West 1’s deregistration.

82. Whilst inaccuracies of the scale found by HMRC in West 1’s 03/06 VAT returns are hard to explain away as a “mistake”, we note that Mr Foley did not simply disappear when the repayment claim was rejected and he did contact and meet with HMRC in the autumn of 2006. Whilst his motivation for doing so was clearly not altruistic, the fact that he did so does not sit comfortably with HMRC’s view of him as a fraudulent VAT evader who had been caught red handed. Without further evidence we do not consider there is sufficient in the material before us to enable us to make a finding that West 1 was acting fraudulently (as opposed to grossly negligently, motivated by greed).

Summary of findings on whether PSG’s purchases were connected with fraudulent evasion of VAT

83. We therefore find that the only VAT defaults which have been proven on a balance of probabilities to be attributable to fraud are those of RS Sales, C&B and Red Rose.

84. We find that PSG’s purchases from Kingswood in deals 1-6 of period 04/06 are connected to the fraudulent default of C&B.

85. We find that PSG’s purchases from Kingswood in deals 1-3 and 5-8 of period 05/06 are connected to the fraudulent default of RS Sales.

86. We find that PSG’s purchase in deal 4 of period 05/06 is connected to the fraudulent default of Red Rose. The fact that we have not felt able to find the defaults of Zenith and West 1 to be fraudulent does not affect our conclusion that this purchase of PSG’s is sufficiently “connected” to a fraudulent evasion of VAT for the purposes of the *Kittel* test.

Should PSG have known of the connection?

Introduction

87. First, it is important to point out that it is not necessary for HMRC to show that PSG should have known of the details of the specific fraud (nor, therefore, of the particular connection to it) in each case. As Briggs J said in *Megtian v HMRC* [2010] EWHC 18 (Ch) at [37] to [38]:

10 “[37] In my judgment, there are likely to be many cases in which a participant in a sophisticated fraud is shown to have actual or blind-eye knowledge that the transaction in which he is participating is connected with that fraud, without knowing, for example, whether his chain is a clean or dirty chain, whether contra-trading is necessarily involved at all, or whether the fraud has at its heart merely a dishonest intention to abscond without paying tax, or that intention plus one or more multifarious means of achieving a cover-up while the absconding takes place.

15 [38] Similarly, I consider that there are likely to be many cases in which facts about the transaction known to the broker are sufficient to enable it to be said that the broker ought to have known that his transaction was connected with a tax fraud, without it having to be, or even being possible for it to be, demonstrated precisely which aspects of a sophisticated multifaceted fraud he would have discovered, had he made reasonable enquiries. In my judgment, sophisticated frauds in the real world are not invariably susceptible, as a matter of law, to being carved up into self-contained boxes even though, on the facts of particular cases, including *Livewire*, that may be an appropriate basis for analysis.”

88. To put it more succinctly, as Moses LJ said in *Mobilx* at [59]:

30 “The test in *Kittel* is simple and should not be over-refined. It embraces not only those who know of the connection [*with fraud*] but those who “should have known”. Thus it includes those who should have known from the circumstances which surround their transactions that they were connected to fraudulent evasion. If a trader should have known that the only reasonable explanation for the transaction in which he was involved was that it was connected with fraud and if it turns out that the transaction was connected with fraudulent evasion of VAT then he should have known of that fact. He may properly be regarded as a participant for the reasons explained in *Kittel*.”

89. In order to form a view of what PSG (through Mr Gill) should have known, it is therefore important to set these particular transactions in their proper context. As Moses LJ made clear, it is only by doing so that an informed view can be reached as to what PSG “should have known”. An examination of the context requires, as a first step, an examination of the trading history of PSG.

History of PSG's dealings

(a) Introduction and summary

5 90. The business currently run through PSG was started no later than 1 February 1975 by Mr Piara Singh Gill. The subsequent history of its structure is set out at [12(1)] to [12(6)] above.

91. From 1975 until March 2003, the business manufactured and sold weatherproof outerwear and clothing materials.

10 92. We set out in tabular form in Schedule 3 to this decision a summary of the VAT returns made by the business for the period from 1 January 1999 to 31 May 2006. From this it can be seen that:

15 (1) Up to December 2002, the business was averaging just under £121,000 of outputs per quarter; for the calendar year 2003, that changed to nearly £321,000 per quarter; for the calendar year 2004, it changed to over £2.75 million per quarter; for the calendar year 2005, in spite of a slow start it changed to £18.9 million per quarter; and in the first five months of 2006 it was running at a rate equivalent to an average of £77.3 million per quarter.

20 (2) The turnover was very erratic, especially from March 2003 onwards. Months or quarters generating sales of many millions of pounds were interspersed with months or quarters in which there were next to no sales.

25 (3) The general levels of sales in the “busy” months grew in early 2004 to a level of between approximately £0.5 million and £2.4 million. In the second half of 2004, it levelled off somewhat in the range £1.2 million to £2.6 million. During this period (in September 2004) PSG sold one batch of CF memory cards for export to Dubai to a value of £2.55 million (we heard evidence about this deal – see below).

30 (4) During the first five months of 2005, there was only one “busy” month (approximately £1.5 million of sales in February 2005). From June 2005 however, things accelerated rapidly, from £4 million to £13.6 million in September 2005.

35 (5) There were then just two large individual transactions (about which we heard some evidence – see below) in October/November 2005 and in January-March 2006, in which PSG traded some computer software to a value of some £100 million plus VAT, which it sold in an export deal to Dubai. These were the last deals before the deals in April and May 2006 which are the subject of this appeal.

(b) March 2003 deals

93. In March 2003 PSG commenced trading in electronic goods. Mr Gill's evidence was that he had investigated the market intensively in 2002-03 and had attempted (unsuccessfully) to get chip manufacturers or authorised distributors to sell
5 to him. He had a contact in Dubai (a Mr Showki) who ran a company called Data Easy, which dealt in such goods. Mr Showki told Mr Gill that he was interested in purchasing some memory chips if Mr Gill could source them at a competitive price. Mr Gill found a small UK supplier called Westpoint Services Limited in Cardiff via their website through a search engine, obtained some samples (which he had checked
10 by a friend in the electronic retailing sector) and then bought and sold the goods for export to Dubai.

94. In his witness statement, Mr Gill gave evidence that he had done a second deal involving the same parties and double the quantity of the same product in May 2003. As before, he made a net profit of approximately £1 per chip, which satisfied him as
15 he was new to the market. In fact, from records supplied by PSG to HMRC, it is apparent that this second deal took place also in March 2003, just eight days after the first deal. The combined value of the two deals was just over £300,000 plus VAT, and the records supplied to HMRC showed that PSG made exactly £1 gross profit per chip. HMRC subsequently traced Westpoint's purchase of the chips back to a
20 company called Risebrook Resources Limited, which officer Baines described as a "defaulting missing trader".

(c) August 2003 deal

95. In or about August 2003, PSG carried out another trade in computer chips. It bought from a company called Redstar Marketing (GB) Limited ("Redstar") in
25 Llanelli (which Mr Gill said he had found through internet trading sites) and exported the goods to a company in Hong Kong called Vortex Technology Limited. The size of this deal was of the order of £200,000. Mr Gill said he had generated this deal himself by visiting Redstar and then offering the available chips to Vortex, a company he had made contact with as a result of his research.

30 96. HMRC's records show that Redstar's annual return to Companies House dated 28 March 2003 shows that its entire issued share capital was transferred on 25 November 2002 to one Shiao Chuan Yang of Taiwan (its sole director) and Redstar had two joint company secretaries (Tai Chim Lau and Yeung Tak Tang), with addresses in Swansea and Hong Kong. Mr Gill made no mention of any Chinese
35 connections of Redstar known to him and he was not asked about it in cross examination, so it is not possible to read anything more than coincidence into this.

97. Mr Gill was clearly intending to expand the overseas trading of the business at this time. His advisers wrote to HMRC on 6 November 2003 requesting that the business be placed on monthly VAT returns as things had now changed so that the
40 majority of sales were by way of export. HMRC placed the business on monthly VAT returns with effect from the period 01/04. It remained on monthly returns until 1 September 2007.

(d) November 2003 deals

98. In November 2003, the business sold three large consignments of clothing for export, having been approached by three different UK suppliers and three different EU purchasers (all of whom were previously unknown to Mr Gill) “out of the blue” within a very short space of time. The three deals came to a combined value of approximately £500,000. According to the notes of an HMRC visit to PSG on 17 May 2004, Mr Gill could not recall the names of any of the contacts he had dealt with at the three suppliers and three customers. He did not ask any of the three customers (Green Leaf in Spain, Negolux and Masters Trading in Luxembourg) how they had obtained PSG’s details. One of the deals related to leather jackets, a product in which PSG had not previously traded.

(e) First deal with Ian Tuppen’s companies – January and March 2004

99. There is some uncertainty about the date of Mr Gill’s first contact with Mr Ian Tuppen, the individual behind Kingswood and its associated companies. In his witness statement, Mr Gill said Mr Tuppen had contacted him “in January 2004”. References to contact with Mr Tuppen in other correspondence and in a meeting placed the date somewhat earlier. But whatever the date of that first contact, it appears that the first trading between the business and Mr Tuppen’s companies took place on 30 January 2004, when the business bought 21,600 “surface mounted semi conductors” from Mr Tuppen’s company for £473,040 plus VAT and sold them on to a company called Grantwell Limited in Hong Kong for £496,800. This was followed up by another trade of 43,200 semi-conductors on 25 March 2004 at a slightly lower unit price (bought for £915,840 plus VAT and sold for £961,200), with delivery initially required to Moscow (but subsequently changed to Dubai).

100. From January 2004, the business dealt regularly with Mr Tuppen’s companies, indeed we were informed that from then on, until PSG’s deal with Crestview in May 2006, Kingswood was PSG’s sole supplier for its non-clothing trading deals.

(f) April 2004 – first deal with United Kingdom Trading of Dubai

101. In a report of a meeting that took place between officers Furber and Skelley of HMRC and Mr Gill on 17 May 2004 (which was predominantly concerned with discussions about the clothing deals done in the previous November), there is a record of some discussion which also took place about a deal which PSG had done in April 2004. Some further detail about this deal also emerged from a report of a meeting between officers Phipps and Skelley of HMRC, Mr Gill and his tax advisers on 3 December 2004.

102. Mr Gill said that a “first time customer” had approached PSG to source some semi-conductors. It is apparent from the report of the 3 December 2004 meeting that this customer was United King Trading Company (“UKT”) in Dubai. Mr Gill said UKT had initially approached him with a letter of introduction, and he made no checks on them. In spite of this, he had sold them £1.6 million of semi-conductors sourced from Kingswood, allowing “14-20 days” of credit, on the strength of a phone

call and the fact that UKT was based in Dubai, where Mr Gill considered the laws to be “strict”.

103. From a comparison of an analysis of deals between PSG and UKT contained in the report of the 3 December 2004 meeting and the VAT return information of PSG, it is apparent that all PSG’s deals of any size from April until at least some time in November 2004 were sales to UKT. It is also noteworthy that the mark-up made on each of those deals was almost exactly 5% - ranging from 5.002% to 5.004%.

(g) September 2004 deal with UKT

104. One of the deals with UKT “went wrong”. This was a sale of 15,000 Lexar Compact Flash memory cards on 30 September 2004 for £2,550,000. PSG bought the cards from Kingswood for £161.90 each (plus VAT) and sold them to UKT for £170.00 each, (a mark-up of 5.003%).

105. Mr Gill explained to officers Phipps and Skelley on 3 December 2004 that Kingswood had approached him with an opportunity to sell the products, without discussing quantities. Mr Gill had contacted UKT and established they were interested. He spoke to someone called “Jane” there, but did not know her surname. When asked why he had not carried out any trades in the months from June to August 2004, he explained it was because he did not have the necessary finance to do so. He only lined up the September trade when he received the VAT repayment from HMRC from his May and June 2004 returns. As this was issued by cheque on 21 September 2004, this deal was therefore clearly arranged in a matter of a few days.

106. Mr Gill told the officers that he had “used the internet” to check on similar products in arriving at a selling price. He did not check prices on the manufacturer’s website.

107. The goods were supposedly sent by air to Dubai, on 4 October 2004. Officer Phipps started to verify the deal for the purposes of the claimed VAT repayment on 8 October 2004. On that same day, he received notification that HMRC had inspected the shipment in question at Heathrow and found that it consisted of 500 mobile phones rather than 15,000 Compact Flash memory cards.

108. On 15 October 2004, Mr Gill telephoned officer Phipps to enquire about progress on the verification. Officer Phipps asked Mr Gill if he could supply any further documents in relation to the sale; Mr Gill said he would try to obtain some and rang back later the same day to say he had received confirmation from UKT that the goods had been received in Dubai. This letter was faxed to HMRC the following day. It took the form of a letter from UKT dated 15 October 2004 with the following content:

“Dear Sir,

This is to inform that we have received the goods in proper order and good condition.

Thank you and best regards.”

109. In fact it is clear that this letter was giving inaccurate information. Officer Phipps only told Mr Gill of his information about the incorrectly described mobile phones when they spoke on 29 October 2004. In reply, Mr Gill said he had heard
5 from UKT that they had not received the goods and he had requested their written confirmation of this. UKT sent a fax dated 19 October 2004 to PSG stating that their 15 October letter was “an error”, and that they had not in fact received the goods. The fax dated 19 October 2004 from UKT appears to have been sent only on 2 November 2004, along with two further communications bearing the dates 26 October and 2
10 November 2004, supposedly chasing up the delivery of the goods in increasingly assertive terms. However on 22 October 2004 PSG had received five BACS payments totalling just under £1.1 million from UKT and on 25 October 2004 PSG had paid over approximately £1.3 million to Kingswood.

110. PSG also contacted their forwarding agent Syrius (UK) Limited (“Syrius”) for
15 an explanation and on 1 November 2004 Syrius informed them that the goods had been mistakenly shipped to Luxembourg but they would be redirected to “Apex in Dubai” (Apex obviously being a different company from UKT).

111. Syrius subsequently told PSG that the goods had been road freighted from
20 there back to Schipol Airport in Holland and flown from there to Dubai on 4 November 2004. The evidence of that air shipment took the form of an airwaybill for a shipment said to be from PSG to UKT on 4 November 2004 via Malaysia Airlines. On that document, the goods were described as “computer parts” and a weight of 162kg was given for the entire load. HMRC enquiries established the unpackaged weight of the 15,000 cards would have been approximately 270kg (and PSG’s own
25 invoice gave a total weight of 765-770 kg), so they were not satisfied that the document provided sufficient evidence that the goods had indeed been exported.

112. The confusion lasted a long time, and on 6 December 2004 Syrius sent a fax to
30 PSG which appears to have been a copy of a fax they were sending to a company called “My Secrets Limited” concerning a similar mix-up; the documents in this fax included a letter from Negolux to Syrius complaining that Syrius had delivered “30,000 pieces of Lexuar [*sic*] 2GB Compact Flash instead of 256 MB memory cards”. It does not seem that PSG expressed any surprise that the mysterious Negolux who had approached them out of the blue the previous November to source some
exported clothing now appeared to be entangled with their memory card trading.

113. The documents and account provided by Syrius were so garbled that it was
35 impossible to establish a clear picture from them of precisely what had happened. All that was certain was that UKT had sent a fax to PSG on 15 October 2004 confirming that they had received the expected goods, and they had made payments of some £1.1 million to PSG before it came to light that the goods could not have been received by
40 them. Also, they paid the final balance of the money due to PSG even though it is clear that the goods supposedly sent to them by airfreight on 4 November 2004 cannot have been the contract goods, due to their inadequate weight.

114. Mr Gill seeks to explain this experience away as a mix-up by Syrius which was largely sorted out before Syrius became insolvent. He says that there were no features of this experience which should have made him suspicious about carrying on trading as he had before, because the problems were “entirely with Syrius”.
5 Accordingly, he claims there was nothing to give rise to any suspicions on his part as to continued dealing with Kingswood.

115. We consider that a cautious and prudent businessman (as Mr Gill described himself) should have been suspicious at the repeated and easy opportunities offered to him, without any significant expertise or effort on his part, to generate apparently
10 risk-free profits of 5% even when goods clearly went missing. The fact that Kingswood was offering him these opportunities out of the blue was too good to be true, and the fact that UKT also approached him out of the blue shortly after he started dealing with Kingswood should also have made him suspicious.

116. Mr Gill did accept in cross examination that on any view his experience in the
15 September 2004 deal with UKT acted as a “wake up call” as to the importance of insurance as the goods were not insured in that deal and he had a real concern that if they did not arrive at UKT he would not get paid but still have to pay Kingswood.

(h) October 2005 deal with Euro Gulf Trading of Dubai – Safeguard Secure Viewer software

20 117. We had very little evidence about PSG’s dealings from September 2004 up to October 2005. On 27 October 2005, it bought 70,000 units of “Safeguard Secure Viewer” which Mr Gill described as “a software program to open documents where nobody else can view them”. It bought them from Kingswood and sold them on in
25 two equal halves on 4 and 14 November 2005 to Euro Gulf Trading (“EGT”) in Dubai, at a mark-up of 5.16%. Mr Gill said this was not the first deal he had done with EGT, but he was not asked how he had first come to deal with them.

118. Mr Gill said that in October/November 2005, Kingswood were giving PSG about 30 days credit, and he was sure he never paid them more than 7 to 10 days late. He allowed EGT 30 days credit. In cross examination, he said he thought EGT had
30 paid him within the 30 days he allowed them. The deal generated a VAT repayment claim of £6,639,500, which was paid by HMRC without significant delay and was received by PSG on 29 December 2005.

119. In fact, rather than PSG paying Kingswood by the end of November 2005 and EGT paying PSG around the middle of December 2005 (in accordance with the stated
35 credit terms), EGT paid PSG on 17 January 2006 and PSG paid Kingswood on the same day.

120. The payments were made through accounts with FCIB and they were not a straightforward matter of a single payment received by PSG and paid on to EGT. PSG received the money due to it from EGT in a large number of instalments and
40 paid it on to Kingswood in different instalments in the following sequence, all on 17 January 2006:

Money received from EGT	Money paid on to Kingswood
3 payments totalling £7.9 million	£8 million in one payment
3 payments totalling £8.5 million	£9 million in one payment
2 payments totalling £3.55 million	£4 million in one payment
2 payments totalling £5 million	£5.3 million in one payment
2 payments totalling £6 million	£6.5 million in one payment
£3 million in one payment	£3.2 million in one payment
2 payments totalling £5.95 million	£8,579,500 in one payment
Total received: £39.9 million	Total paid: £44,579,500

121. The difference between the two amounts was funded by the VAT refund of £6,639,500, which had been received by PSG on 29 December 2005; just over £5 million of it had been transferred to PSG’s FCIB account on 4 January 2006.

5 122. Mr Gill was unclear and unconvincing in his answers to questions about how these payments came about. He could not remember whether he had chased EGT for payment after their 30 days were up, even though this was by far the largest deal he had done at that time and he would have been personally ruined if he had had to pay Kingswood without receiving payment from EGT. He was unclear about whether
10 EGT had warned him the money was on its way, though he was expecting it in tranches rather than a single payment. He said Kingswood did chase him for payment, but he was not clear about what he told them. After some hesitation he said he had been checking his account (as he usually did, twice a day) and saw that some money had been received. He passed it on. He did not think to wait until he had
15 received all the money that was due, nor did he question why it was being received in such a large number of comparatively small instalments. He denied that the payments had been prompted by the receipt of PSG’s VAT repayment, but we found his evidence in that regard wholly unconvincing.

20 123. Mr Gill did not allege he could have paid Kingswood without receiving the bulk of the funds first from EGT. On his evidence as to the credit terms between PSG and its two counterparties, he was due to pay Kingswood between 8 and 18 days before he could expect to receive the funds from EGT and yet he asserted there was no arrangement with Kingswood that he would only pay them when he received payment from EGT. Given that he described himself as “cautious” and “prudent” in
25 business matters, we consider there must have either been such an arrangement (in which case he was at best misleading the Tribunal in his evidence) or he was showing a quite extraordinary lack of basic business sense in this, his largest deal to date. Having seen Mr Gill give evidence, we find that there was an understanding or

arrangement with Kingswood that they would only be paid as and when PSG received payment from its customer EGT and its VAT repayment. The willingness of Kingswood to enter into such an arrangement should have aroused Mr Gill's suspicions about the bona fides of Kingswood.

5 (i) *January 2006 sale of further software to EGT*

124. There was a further large transaction involving the purchase of more of the same software from Kingswood and its sale for export to EGT in January 2006. This sale of 105,000 units generated a VAT repayment claim of nearly £10 million. However, there were problems with the deal, summarised in a letter dated 20 March
10 2006 from PSG to HMRC. In essence, there appears to have been a problem with the shipping. The goods were shipped by sea in three containers, one of which was misdirected by the shipping company and arrived late in Dubai. As a result of the late arrival of the third container, EGT was unable to fulfil its own customer's requirements so it cancelled the order. The customer did agree to keep the goods in
15 its warehouse in Dubai and attempt to find another buyer, but in the meantime the original deal was effectively cancelled, with new invoices to be issued as and when the goods were sold.

125. It appears that Kingswood went along with this, cancelling their invoice(s) to PSG and agreeing to re-invoice them as and when new buyers were found for the
20 software. PSG said that activation codes were required to make the software work, which perhaps explains why Kingswood felt comfortable with this arrangement. The net effect was that PSG included an entry in its March 2006 VAT return which effectively reversed the nearly £10 million VAT repayment claim in its January 2006 return.

126. Although the evidence about this deal before us was sparse, there are a number of obvious points arising from this sequence of events which were not addressed during Mr Gill's cross examination. The first is that on his own evidence, he was personally extending further credit of over £55 million to EGT at a time when they were already overdue in paying him some £30 million from the October 2005 deal referred to above (this deal took place at a time when the business was still being
30 conducted by him as a sole trader with full personal liability). Second, Kingswood were affording him the same benefit (except that the amounts were larger, because of the additional VAT). There is no suggestion that the goods had been shipped "on hold", and Mr Gill's letter dated 20 March 2006 refers to the fact that the goods which had by then arrived in Dubai were already in the customer's warehouse. PSG was therefore entirely dependent upon the customer and EGT to fulfil their promises, with no continued hold over the goods. Mr Gill gave no indication as to why he thought Kingswood should be so relaxed about the non-receipt of payment for their goods that had been shipped to Dubai out of their control, nor that he had even given the matter
35 40 any thought.

127. We find the apparent ease with which this very large transaction was effectively deferred as suspicious as the fact of it being entered into at all at a time when there were very large overdue payments outstanding from previous trading with

the same counterparties. There is nothing in PSG's VAT returns for April or May to indicate that the problem in relation to the January shipment of software to EGT had been resolved at the time PSG and Kingswood were doing the deals the subject of this appeal during those months, in particular there is no repayment claim by PSG in respect of any later invoicing from Kingswood resulting from a sale of all or part of the software which had been languishing in the customer's warehouse in Dubai.

April and May 2006 deals

128. This then is the background against which we are to assess the deals the subject of this appeal. We consider those deals in turn.

10 (a) *April deal – sale of Nokia telephones to 2Trade BVBA for £3,869,500 (input VAT claimed of £651,175)*

129. The first deal the subject of this appeal took place on 26 April 2006. It was documented by Kingswood as six separate sales to PSG, but PSG invoiced it as a single sale to 2Trade.

15 130. This was PSG's first deal in mobile phones. Mr Gill said in evidence that he had done some "limited general research" into that market sector over the two or three months leading up to this first trade. As a result, he decided to move into the sector (though it is not disputed he was well aware of the VAT fraud prevalent in that market sector). In his witness statement he said he found 2Trade as a possible customer as a result of finding them "on one of the trading websites" (though he could not remember which one). He said that he telephoned "Mrs de Volere" (the correct spelling is "Voldere") of 2Trade, who introduced herself as the proprietor of 2Trade, and they subsequently exchanged details of their respective companies by faxed letters.

25 131. Officer Baines' witness statement on the other hand was quite clear in saying that Mr Gill had told him on two occasions that the first approach had come from 2Trade, and officer Baines was not pressed on the point during his cross examination.

132. In their first meeting on 24 May 2006, officer Baines' note of the meeting contains the following:

30 " JB Customers?

SSG 2 Trade BV Europe. They contacted me.

JB Why?

SSG Think they looked at websites.

JB Do you know what IPT website it?

35 SSG Generally get people contact us, could be re CPUs, freight forwarder, can't explain why other than get known in trade."

133. Further, in a long and detailed letter dated 20 June 2006 which was sent to PSG by officer Baines in the early stages of verification of PSG's April VAT return, the following text was included:

5 “How and why did your customer come to contact you out of the blue? Have you any correspondence prior to this contact? Have you further auditable evidence of e-mail or telephone contact – I would think it not unreasonable to expect some degree of contact prior to entering into multi-million pound deals.”

10 134. In replying to this letter on behalf of PSG, Tax and Legal Services Limited (“TLS”) said in their even longer letter dated 4 July 2006:

15 **“3. INTRODUCTIONS:** Our client receives many letters of introduction, usually as a result of customers looking at their web site. Our client only deals with those customers following extensive due diligence which in this case comprised discussions with Mrs Hyacinth de Voldere who is a director of 2Trade BVBA, and credit and tax checks which proved satisfactory.”

135. If Mr Gill had previously said that the approach to 2Trade had come from him and not them, this would have been a very obvious point to have picked up and corrected in TLS's letter of 4 July 2006.

20 136. In a subsequent meeting, spread over two days (17 and 21 August 2006), officer Baines' typed note of the relevant question and reply reads as follows:

 “197. How did contact come about? A. By phone – I got an unsolicited introduction and stock request from 2Trade – people in the trade know me – I get about 5 introductions a week but I do not record them”

25 137. The typed note was prepared after the meeting on the basis of manuscript notes taken at the meeting. The manuscript note in question reads as follows:

 “Got to meet 2Trade through an introduction and stock request – people in the trade know me, I don't know how people get hold of my name – I may get 5 a week but I don't keep copies.

30 Just an introduction – unsolicited.”

35 138. Having seen Mr Gill give evidence, we are satisfied that officer Baines' record of what Mr Gill said at the meetings in May and August 2006 gives the truth. We therefore find as a fact that 2Trade did indeed approach PSG “out of the blue”. This is all the more suspicious because PSG had never traded in mobile phones before, so there would be no reason why someone involved in that market would think to approach them for stock.

139. In TLS's letter dated 4 July 2006, it was said that Mr Gill had carried out “extensive due diligence” on 2Trade, in the form of:

5 “discussions with Mrs Hyacint de Voldere who is a director of 2Trade BVBA, and credit and tax checks which proved satisfactory. The foreign language documents provided comprise copies of the Belgian VAT/Tax Certificate and details of the company showing share capital, date of commencement, tax registration details and directors details. Our client confirmed the contents of these documents prior to trading.”

140. In fact, the due diligence carried out by Mr Gill on 2Trade before dealing with them consisted of:

10 (1) the receipt by fax on 25 April 2006 (timed at 17.48) of an introductory letter in English, in which 2Trade described itself as “worldwide traders in mobile phones and computer parts and have several years of experience in the industry.”

15 (2) Attached to this letter were two official looking documents, apparently in Flemish, totalling three pages. One of them appears to include an official looking stamp and a number that is clearly a Belgian VAT number. The other appears to be some kind of summary of constitutional information, but beyond the reference to Hyacint de Voldere’s name there is no obvious significance to any of the information in it. Mr Gill did not pretend to understand it.

20 (3) There was also some reference in the documentary evidence to the existence of some kind of check on 2Trade’s VAT number – possibly even a verification of it by HMRC’s Redhill office. We were not directed to (and could not find) a copy of such a document in the evidence, but we are prepared to assume for present purposes that such a check was made.

25 141. Mr Gill confirmed that he had not sought or taken up any references on 2Trade, or visited their business premises.

142. Mr Gill said he sent a copy of his own introduction documents to 2Trade, and at lunchtime on the following day (26 April 2006), Mr Gill received a fax from Ms de Voldere at 2Trade entitled “Stock Request”, as follows:

30 “Dear Mr Gill,

We are looking for the following stock CIF Netherlands.

Quantity	Description
10,000	Nokia 8800
10,000	Nokia N90
35 5,000	Nokia 9300i

Please transmit us your best price cif.

Best regards”

143. Mr Gill said he contacted Kingswood in an attempt to source the stock. They told him they only had available smaller quantities of the phones requested, namely 5,000 Nokia 8800’s and 7,000 Nokia N90’s. Mr Gill discussed prices with Kingswood, offered a price to 2Trade (which was accepted without negotiation) and then agreed the deal with both parties. He agreed with 2Trade that they would insure the goods but he would pay for the shipping cost. He obtained no evidence from 2Trade that any insurance had been put in place, in spite of his previous experience when goods had gone astray and he might have ended up having to pay for them without being able to require payment from his customer.

144. It is notable that the price charged by PSG to 2Trade represented a mark up of almost exactly 4%. The slight variation is accounted for by the fact that the unit prices per phone have clearly been marked up by 4% and then adjusted to the nearest round figure.

145. 2Trade, in spite of being a Belgian company, required the phones to be shipped to a warehouse in the Netherlands. This did not concern Mr Gill. The goods were held on behalf of Kingswood at the warehouse of a company called Capital Logistics (GB) Limited (“Capital”) in Stoke on Trent. Kingswood released the phones to PSG unconditionally by an instruction to Capital on 26 April 2006 and they were transported by SKD Transport Limited of Oldbury to the Netherlands. The shipping document which accompanied the goods included the instruction “ship on hold”, though there was no reference to that instruction on the fax sent by PSG to Capital or in Capital’s records. Nor was there a copy of any written release note from PSG instructing the release of the consignment. PSG’s invoice stated “Terms: Strictly 30 Days Net” as well as “C&F”.

146. In his witness statement, Mr Gill said he had made no attempt to source from another supplier the remainder of the mobile phones requested by 2Trade. He said this was because he was “concerned about the cost”. Given the size of the deals he had completed with Kingswood over the previous six months, this seems a little odd. This point was not put to Mr Gill in cross examination, so we do not read too much into it, except to observe that it implies Mr Gill clearly had a very special relationship with Kingswood. This is borne out by the fact that the invoices from Kingswood contained no reference to payment terms, nor did the purchase order from PSG to Kingswood.

147. It is apparent from the statement of officer Mendes that Mr Gill received into his FCIB account on 9 May 2006 two sums totalling £3,869,500 (the exact net sale proceeds of PSG’s invoiced sale to 2Trade). Mr Gill paid this amount on to Kingswood’s FCIB account on the same day. In his statement, officer Mendes confirms there is no evidence in Mr Gill’s FCIB account of the outstanding balance of £502,674.50 ever being paid by him to Kingswood, and this is also apparent on the face of the FCIB statements included in the documents before us. Mr Gill was not expressly asked about this in his cross examination, but he gave no evidence to suggest he had in fact paid this outstanding amount through any other means, or that

there had been any serious attempt by Kingswood to pursue it. We find this suspicious. Either there was an understanding between PSG and Kingswood that PSG would not be required to pay any more than it received, or Kingswood were simply not chasing up payment of very large amounts of money due to it. Either way, we find it very suspicious and consider that Mr Gill should have had the same reaction.

148. Mr Gill said he had carried out a Creditsafe check on 2Trade before dealing with them, but he was unable to produce any evidence to that effect and we find that he did not in fact do so. He admitted he had not met anyone from 2Trade or visited their premises or attempted to take up any trade or other references before dealing with them.

(b) 25 & 30 May 2006 deals – sale of Nokia and Sony Ericsson telephones to 2Trade BVBA for £5,456,975 (input VAT claimed of £918,111.25)

149. We received much less evidence about this pair of deals. They appear to have followed a similar pattern to the April deal referred to above. A stock request was received for a large number of phones from 2Trade. A stock offer (presumably in response to a telephone call, though that was not made clear) was received from Kingswood for a much smaller quantity.

150. PSG appears again simply to have taken the prices offered by Kingswood and marked up the unit price for each phone by 4%, then rounded to the nearest 25p (except, oddly, in the case of the phones comprised in deal 05/06 – 7 as referred to in Schedule 1, in which the unit price was rounded up to the nearest 25p, even though that meant a larger adjustment (18p per unit) than if the price had been rounded down).

151. Payment followed a similar pattern as before. Mr Gill received payment into his FCIB account for three of the 25 May 2006 deals from 2Trade on 21 June 2006 (by way of three separate payments, which he aggregated and passed on to Kingswood in one payment, after making a small deduction whose purpose was unclear). He received payment for the other 25 May deal on 4 July 2006, by way of a single payment which he passed on with an extra amount which made up for the shortfall on the earlier payments apart from a few hundred pounds.

152. He received payment for the 30 May deals into his FCIB account in three instalments on 4 July 2006. He aggregated them, added another £3,000 or so to round the combined amount up to £2.6 million and then paid that amount out to Kingswood on the same day in one payment.

153. As before, PSG had therefore paid over the sale proceeds (more or less) but not the balance of the purchase price due to Kingswood. In aggregate, the sum due to Kingswood under the 25 and 30 May invoices was £5,246,350 plus £918,111.25 VAT, totalling £6,164,461.25. The only evidence before the Tribunal is that a total of £5,459,461.25 was actually paid by PSG, leaving an outstanding balance of £687,000. Similar observations apply to this unpaid balance as to the unpaid balance on the April 2006 deals, as set out above.

(c) May 2006 deal with Crestview and Fone Link

154. On Mr Gill's own admission, both Crestview and Fone Link approached him, unsolicited, on 25 May 2006. He had given contradictory stories to HMRC as to whether Crestview or Fone Link approached him first, but it was within a matter of hours on 25 May.

155. He confirmed that after exchange of introduction letters, Crestview had sent him a stock offer of 63,000 CPUs and within a matter of hours Fone Link had also introduced themselves and submitted an entirely unsolicited enquiry for the same number of the same items.

156. Crestview's introduction fax was timed at 10.24 on 25 May 2006. PSG's reply with its own introduction letter and material was timed at 11.53 on that day.

157. Fone Link's introduction fax was timed at 15.05 on 25 May 2006. PSG's introduction fax to Fone Link was timed at 14.13 (though with a one hour time difference to Spain, that would have been 15.13 Spanish time) so it appears to have been sent almost immediately in reply to Fone Link's introduction.

158. Perhaps the immediacy of PSG's response is explained by the timing of the most significant document in this section of the evidence. Timed at 14.00 (i.e. more than an hour before the introduction fax sent from Fone Link) there was a fax from Fone Link to PSG. This fax was headed "shipping instructions", and read as follows:

"Dear Sir/Madam,

In reference to the purchase order that we have faxed to you (P.O. NUMBER 115) asking for 63,000 SLZ79 P4/630 INTEL PENTIUM CPU PROCESSORS, please deliver the goods to the following address:

Luxemburg Logistics S.A.R.L.

Unit 18, Rue Desjoncs L-18

18 Howald (Luxemburg)

We also need copy of inspection certificate.

Regards

T.H. Sarfraz"

159. It can be seen that this document, referring to a particular purchase order which had not even been sent to PSG by that time, was unintentionally sent out of sequence. When it was received, it was the very first thing PSG had heard from Fone Link (preceding even the introduction letter). The actual purchase order to which it refers was only faxed by Fone Link to PSG at 18.29.

160. By then, PSG had been approached by Crestview with a stock offer, timed at 16.13 on their fax. That stock offer read as follows:

“Hi

We have the following stock to offer in JSA Logistics:

5 UNITS: 63000 (200 BOXES) STOCK: CPU SL7Z9 PRICE: £80.00

Please advise if you are interested in the above.

Kind Regards,

Kevan Anderson”

161. Mr Gill said he had not noticed that the shipping instructions appeared to have
10 been received from Fone Link before their introduction or any negotiations about an
order. His explanation was that he worked in a fairly large building and often he was
out of his office for a while, with correspondence being piled on his desk for him to
consider on his return. We find that explanation wholly implausible. From this
15 sequence of events alone, it should have been completely plain to Mr Gill that the
only explanation for the Crestview/Fone Link deal was that it was connected to VAT
fraud.

162. The price agreed follows the pattern of PSG’s previous deals. Crestview
offered the stock to it at a certain price per unit. PSG added 4%, rounded it to the
nearest 25p (in this case, a rounding up from £82.94 to £83) and obtained agreement
20 to that price without difficulty.

163. The pattern of payments made pursuant to this transaction is also suspicious.
Mr Gill was not asked about the payment arrangements that had been negotiated with
Crestview and Fone Link. No payment terms appear to have been mentioned in the
negotiations with Crestview – certainly none appeared on their invoice.

25 164. PSG’s invoice to Fone Link included the endorsement “Terms: Strictly 30
Days Net”. The invoice was dated 1 June 2006, and payment should therefore have
been made by 1 July 2006. In fact, payment was received by PSG in eight instalments
of between £429,000 and £760,000 each over the period 24 July to 4 August 2006.
Mr Gill did not mention any difficulties about obtaining payment, or any attempts by
30 him to chase payment once it was overdue (or indeed any chasing by Crestview for
payment). The total sum of £5,229,000 was received into PSG’s FCIB account and
paid on to Crestview but there is no evidence that PSG ever paid the outstanding
balance of £674,493.75 or was chased for that balance by Crestview. We consider
35 that this would only have happened if there was some understanding in place at the
time of the deal that PSG would only pay over what it received or if Mr Gill totally
closed his eyes to the question of payment terms at that time. Either way, if Mr Gill
was not actually aware of a connection to VAT fraud, we consider that he should have
been.

Other issues relating to constructive knowledge

165. Mr Chapman sought to persuade us that a number of other circumstances indicated that PSG should have been well aware of the connection of its deals to fraud.

5 166. It is true that PSG's due diligence on 2Trade, Crestview and Fone Link was extremely sketchy, and much of it was carried out late. Personal visits to traders can reveal a certain amount about their business and we would expect any sensible businessman trading in such high values at least to visit the business premises of his customers and suppliers and personally meet the individuals managing them. Mr Gill
10 did not do this. The discovery, for example, that one individual was supposedly running a multi-million pound import/export business on his own from his home might prompt a prudent businessman to question the substance and bona fides of the business. Beyond this sort of general impression, it is however difficult to say what extra useful knowledge PSG would have acquired from carrying out due diligence on
15 its trading partners, including personal visits, trade and professional references and obtaining timely full financial information. As for due diligence on Kingswood, there is again something to be said for the proposition that after dealing with them exclusively for two apparently largely trouble-free years, there would have been very little to be gained by going through the exercise of gathering further information
20 about them which would have been unlikely to uncover fraud.

167. Similarly, detailed points about whether PSG insured the goods or failed to obtain evidence that they had been insured by its purchasers might point to commercial naivety, but in the circumstances of this case we do not consider them to point unequivocally in the direction of constructive knowledge of fraud. Similar
25 observations apply to the lack of detailed trading terms and conditions – a common feature among many businesses.

168. There is undoubtedly voluminous evidence that strongly supports the proposition that orchestrated fraud lay behind all of the deals the subject of this appeal (and many others to which we were referred in the course of the evidence). In the
30 absence of some evidence unequivocally showing PSG's involvement in that fraud, however, that evidence does not advance HMRC's case against PSG. It is quite possible for parties to be involved on the fringes of a massive fraud as innocent and naive dupes rather than as actual participants and the size and complexity of the fraud does not change this fact.

35 169. Mr Brown submitted that because PSG had traded with Kingswood for over two years by April 2006, without any comment from HMRC in respect of the previous transactions where tax losses had occurred, as to the nature of the deals including due diligence, HMRC had effectively affirmed PSG's view that it had undertaken sufficient checks to protect itself. This, in our view, misses the point. A
40 trader must exercise his own independent judgment based on his own detailed knowledge not only on the due diligence he has carried out on his counterparties but also on the circumstances surrounding each individual deal, set in its historical context.

170. We take the view that this is one of those cases where the circumstances in which the deals were generated (including the history of the trading relationship with Kingswood) and the basis on which they were conducted are far more relevant in assessing what knowledge PSG should have had of the connection to fraud. In our
5 view, for all the reasons set out above, we find that PSG should have been aware that the only explanation for the deals the subject of this appeal was that they were connected to VAT fraud.

Conclusion and decision

171. HMRC have established on a balance of probabilities that fraudulent VAT
10 evasion did take place by the traders C&B, RS Sales and Red Rose (see [48] to [50], [51] to [53] and [55] to [62] above) and that the purchases by PSG the subject of this appeal were connected to that fraudulent evasion (see [47] above).

172. HMRC have not pleaded or argued that PSG actually knew of the connection. However, we find that even if it did not know of that connection, the nature of the
15 deals it carried out in the circumstances in which it did so were such that it should have known that those deals were connected to VAT fraud.

173. The appeal is therefore dismissed.

174. In accordance with the order made in the preliminary application at the start of the appeal hearing, we direct that PSG should pay HMRC's costs of the appeal up to
20 (but not including) 1 April 2009 on the standard basis, to be assessed if not agreed.

175. 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
25 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.

30

**KEVIN POOLE
TRIBUNAL JUDGE**

RELEASE DATE: 21 May 2012

Schedule 1 part 1 – Summary of deals giving rise to denied input VAT of PSG

Deal Period/Ref	Purchase Date	Products	Purchase Price (ex VAT)	Purchase VAT	Sale Price (no VAT)	Bought from	Sold to	Defaulter
04/06 – 1	26 April 2006	3000 x Nokia N90 phones	£789,000	£138,075	£820,500	Kingswood	2Trade	C&B
04/06 – 2	26 April 2006	2500 x Nokia N90 phones	£657,500	£115,062.50	£683,750	Kingswood	2Trade	C&B
04/06 – 3	26 April 2006	1500 x Nokia N90 phones	£394,500	£69,037.50	£410,250	Kingswood	2Trade	C&B
04/06 – 4	26 April 2006	2200 x Nokia 8800 phones	£827,200	£144,760	£860,200	Kingswood	2Trade	C&B
04/06 – 5	26 April 2006	1500 x Nokia 8800 phones	£564,000	£98,700	£586,500	Kingswood	2Trade	C&B
04/06 – 6	26 April 2006	1300 x Nokia 8800 phones	£488,800	£85,540	£508,300	Kingswood	2Trade	C&B
05/06 – 1	30 May 2006	2400 x Nokia 8800 phones	£825,600	£144,480	£858,600	Kingswood	2Trade	RS Sales
05/06 – 2	30 May 2006	3000 x Nokia 9500 phones	£849,000	£148,575	£882,750	Kingswood	2Trade	RS Sales
05/06 – 3	30 May 2006	3500 x Sony Ericsson W810i phones	£822,500	£143,937.50	£855,750	Kingswood	2Trade	RS Sales
05/06 – 4	31 May 2006	63000 x Pentium P4 SL7ZP CPUs	£5,024,250	£879,243.75	£5,229,000	Crestview	Fone Link	<i>See Note 1</i>
05/06 – 5	25 May 2006	2000 x Nokia 9300i phones	£550,000	£96,250	£572,000	Kingswood	2Trade	RS Sales
05/06 – 6	25 May 2006	2000 x Nokia 8800 phones	£688,000	£120,400	£715,500	Kingswood	2Trade	RS Sales
05/06 – 7	25 May 2006	3750 x Nokia N70 phones	£686,250	£120,093.75	£714,375	Kingswood	2Trade	RS Sales
05/06 – 8	25 May 2006	3000 x Nokia 9300i phones	£825,000	£144,375	£858,000	Kingswood	2Trade	RS Sales

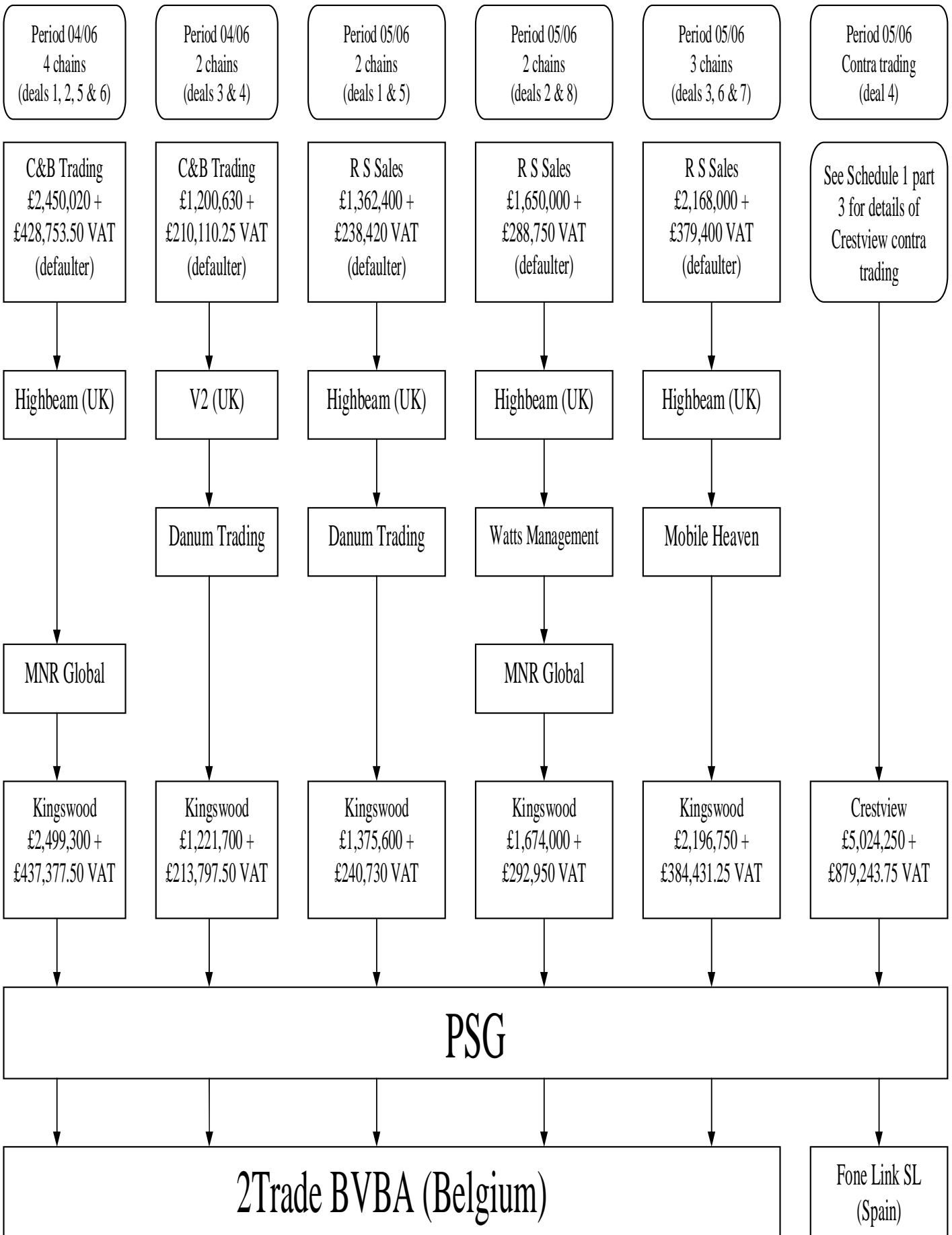
Note 1: Through Crestview as contra trader, HMRC connect this purchase to fraudulent defaults by Red Rose, Zenith and West 1.

5 Note 2: PSG invoiced all 6 deals in 04/06 on one invoice and regarded them as a single deal.

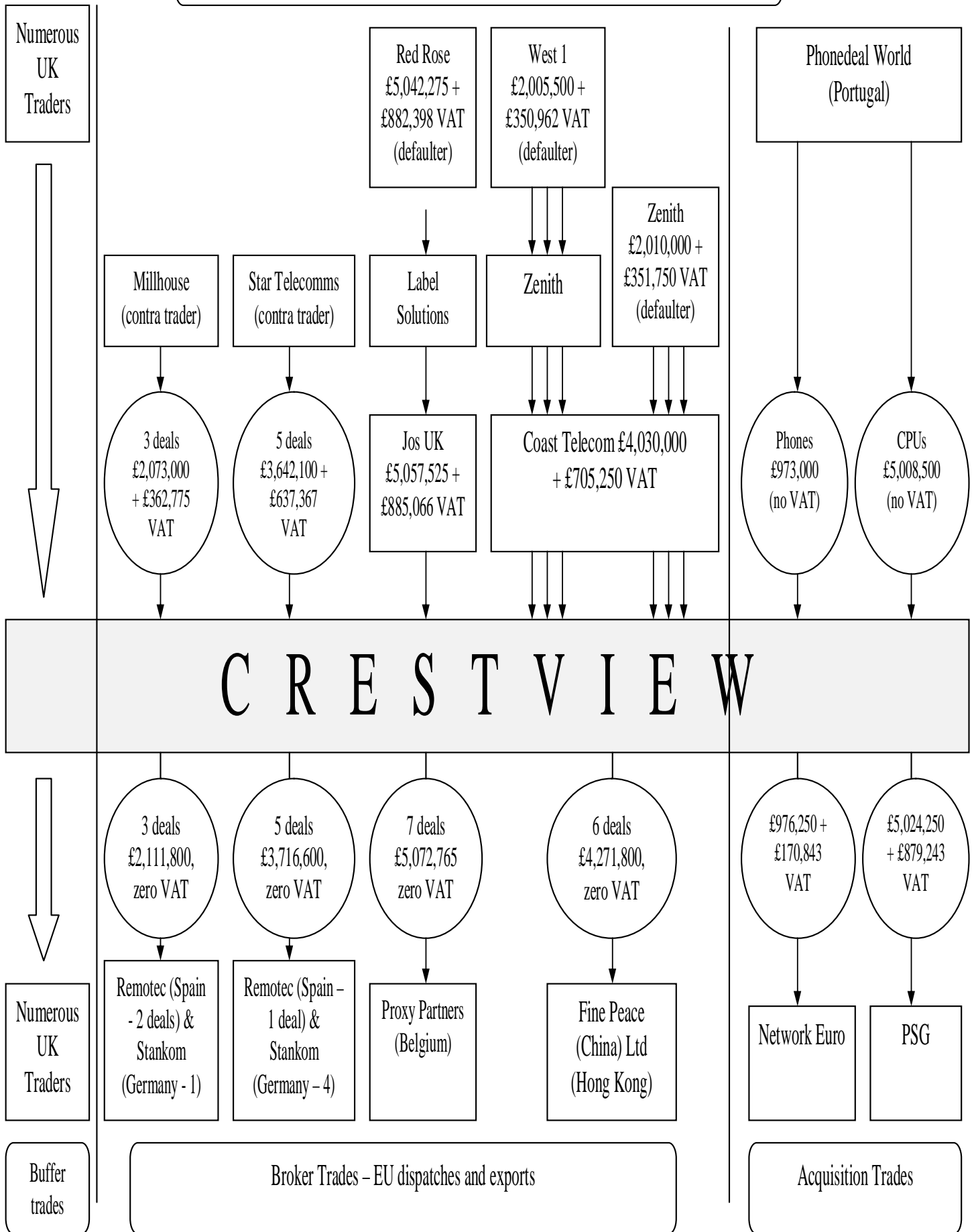
Note 3: PSG invoiced deals 1-3 in 05/06 on one invoice and regarded them as a single deal.

Note 4: PSG invoiced deals 5-8 in 05/06 on one invoice and regarded them as a single deal.

Schedule 1 part 2 - Summary of deal chains generating input VAT of PSG under appeal



Schedule 1 part 3 – Summary of Crestview trading for 3 month VAT period 06/06



Schedule 2

Explanation of contra trading

1. The essence of the concept of contra trading (which is HMRC's own coinage) is that it comprises an extra step inserted into what might be called a "classic VAT fraud" in order to conceal that fraud and in order to make it harder for HMRC to recover the lost VAT if and when they do detect it.
5
2. A classic VAT fraud for these purposes arises when a UK trader acquires goods from another EU country, effectively free of VAT. He then supplies them to another UK trader, charging VAT. He then disappears with that VAT without paying it over to HMRC. That is where the actual fraud is perpetrated.
10
3. The goods are then supplied to another overseas customer without having to charge VAT (but reclaiming the VAT paid to the missing trader as input tax under the normal rules), either directly by the first purchaser from the missing trader or (more usually, in the interests of concealment) after a chain of supplies through other UK traders (all of whom will charge output VAT and suffer input VAT under the normal rules, usually each generating a very small profit and corresponding net output VAT liability).
15
4. Each of the UK traders will ensure that he receives the VAT on his onward sale in order to pay the VAT due to his own supplier. At some point, however, the goods must be sold overseas in order to generate the VAT repayment claim from HMRC which repays to the last UK trader in the chain the VAT which he has paid to his supplier.
20
5. In practice that last trader in the chain is the party mainly at risk in the whole structure, as HMRC can withhold his VAT repayment until they are satisfied that it is untainted by fraud.
25
6. As HMRC became more careful about investigating chains of transactions before releasing VAT repayments, the the concept of contra trading was developed as a counter measure. A trader with a potentially large (and therefore suspect and vulnerable) repayment claim ("Trader 1") would enter into a separate transaction or series of transactions designed to substantially reduce or eliminate that repayment claim.
30
7. The means of doing so would be to acquire goods from an EU supplier (to an appropriate value) in a VAT free purchase and then generate an output VAT liability by selling them on to a UK trader ("Trader 2") who would then sell the goods overseas again in a zero rated sale.
35
8. The repayment claim of Trader 1 (which could be traced back directly to fraudulent VAT defaults by traders who had supplied goods to him, directly or through other UK traders) would be reduced or cancelled out by his output tax liability to Trader 2, so HMRC would be less likely to investigate Trader 1's dealings in detail and would not have the leverage of an outstanding VAT repayment claim while doing so; and if they investigated Trader 2's large VAT repayment claim, they
40

would find no fraudulent VAT default in the chain of UK purchases and sales of the goods leading up to Trader 2.

5 9. The chain of transactions leading from Trader 1 to Trader 2 (there may be other UK traders between them, all accounting properly for input and output VAT) is known by HMRC as the “clean chain”.

10. In contrast, the chain of transactions leading from the original fraudulent trader to Trader 1 (usually involving other UK traders, called “buffers” by HMRC, all accounting properly for input and output VAT) is known as the “dirty chain”.

10 11. The shifting of the VAT repayment claim by Trader 1 from the dirty chain to the clean chain means that effectively a “cut-out” has been inserted between the original fraud and the trader (Trader 2) which is ultimately claiming the repayment that actually crystallises the loss flowing from that fraud.

15 12. Trader 2 will assert that it neither had nor could have had knowledge of any fraud. This gives HMRC another hurdle to overcome if they try to recover their loss by refusing to satisfy the repayment claim of Trader 2, the ultimate dispatcher/exporter.

Schedule 3

Summary of VAT returns from 1.1.99 to 31.5.06

VAT Period	Outputs	Inputs	Net VAT	EC Supplies	EC Acquns
03/99	0	26,113	-13,367	0	0
06/99	118,163	119,310	-10,178	0	0
09/99	142,095	45,380	-1,197	0	0
12/99	171,577	112,244	-4,588	0	0
03/00	119,711	76,290	1,696	0	0
06/00	60,977	71,122	-1,058	0	0
09/00	114,178	85,631	-2,434	0	0
12/00	259,090	415,240	-26,596	0	0
03/01	179,421	55,184	11,667	0	0
06/01	84,620	39,400	2,922	0	0
09/01	159,879	57,317	15,057	0	0
12/01	203,425	187,125	-13,246	0	0
03/02	27,795	70,903	-8,229	0	0
06/02	77,210	38,370	2,973	0	0
09/02	156,335	32,638	7,107	70,851	0
12/02	60,267	64,150	-3,040	8,602	0
03/03	349,348	353,136	-53,265	0	21,675
06/03	28,187	38,168	2,483	0	9,009
09/03	299,327	273,628	-39,235	0	8,505
12/03	606,481	555,666	-84,978	525,041	17,612
01/04	498,523	505,950	-83,051	0	8,946
02/04	1,864	5,781	-600	0	0
03/04	996,208	926,292	-157,782	0	0
04/04	1,682,100	1,627,221	-281,164	0	14,092
05/04	2,406,804	2,339,494	-401,492	0	37,367
06/04	6,234	32,057	-962	0	19,903

07/04	10,595	13,270	-395.69	0	0
08/04	26,223	17,367	1,708	0	0
09/04	2,578,374	2,440,544	-422,485	0	0
10/04	36,276	13,402	2,346	0	0
11/04	1,186,680	1,763,535	-305,146	0	14,810
12/04	1,616,489	920,803	-157,859	960,000	0
01/05	14,855	38,567	-602	0	16,491
02/05	1,567,121	1,524,020	-260,659	1,015,000	23,468
03/05	7,904	29,663	-830	0	16,673
04/05	1,520	43,284	-1,201	0	24,159
05/05	0	3,970,155	-690,303	0	23,160
06/05	4,146,620	4,569,121	-794,566	0	1,789
07/05	4,806,731	9,508,514	-1,661,460	0	0
08/05	9,987,906	12,912,539	-2,253,094	0	2,532
09/05	13,645,842	16,647,678	-2,894,094	0	0
10/05	1,747,341	37,970,907	-6,639,530	0	0
11/05	39,881,676	103,699	-11,561	0	0
12/05	7,090	7,435	300.68	0	0
01/06	59,850,653	56,973,559	-9,968,202	0	0
02/06	851	90,435	-5,846	0	0
03/06	59,678,434	76,793,323	9,957,387	0	0
04/06	3,871,051	3,731,000	-652,653	0	0
05/06	5,457,808	10,309,224	-1,801,881	5,456,975	0