TC02428

Appeal number: TC/2010/06595

VALUE ADDED TAX – input tax – MTIC fraud – credit for input tax denied on grounds that the appellant knew or should have known that its transaction was connected with fraud – whether appellant knew or should have known of connection with fraud – yes – appeal dismissed

FIRST-TIER TRIBUNAL
TAX CHAMBER

H S TANK & SONS LIMITED **Appellant**

- and -

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

TRIBUNAL: JUDGE JONATHAN CANNAN
MISS SUSAN STOTT

Sitting in public at Manchester on 25, 27-29 June 2012 and 2, 3, 24 July2012

Mr Sundeep Singh Virk of counsel instructed by Shakespeares Solicitors for the Appellant

Mrs Jennifer Newstead of counsel instructed by the General Counsel and Solicitor of HMRC for the Respondents

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DECISION

Introduction

1. On 4 February 2010 HMRC wrote to the appellant denying the appellant's right to deduct input tax on the purchase of 17,500 Apple iPod Nanos ("the iPods"). The input tax was incurred by the appellant in its VAT period 07/06. Entitlement to input tax credit was denied on the basis that the purchase of the iPods was connected with fraud and that the appellant knew or should have known that this was the case.

2. The amount of input tax for which credit has been denied is £353,412.50. The decision refusing input tax credit was the subject of a review which was notified to the appellant on 14 July 2010. The original decision was confirmed.

3. The grounds of appeal themselves run to some 68 paragraphs. Essentially however the appellant puts the respondents to proof that there was a fraud and that its transactions were connected with fraud. It contends that it did not know and could not have been expected to know of any connection with fraud. In the circumstances the appellant seeks directions of the tribunal awarding:

(1) The input tax in dispute;

(2) Compound interest, alternatively simple interest on that input tax;

(3) Damages; and

(4) Costs

4. Following the evidence we received written submissions from both parties on matters of law and matters of fact. We also heard supplementary oral submissions from both counsel. We have had regard to all material placed before us by the parties but we do not consider it necessary to deal with each and every submission in detail.

5. We set out below our findings as to the background facts which to a large extent are non-contentious. We then set out the law as we understand it, based on the submissions of the parties. Any differences between the parties as to the law were differences of emphasis rather than of substance. We set out our findings in relation to the contentious evidence and the inferences which the parties invite us to draw from that evidence. Finally we give reasons for our decision based on our understanding of the law and our findings of fact.

Background Facts

6. The business now operated by the appellant was originally set up by Mr Harbhajan Singh Tank ("HST") in Birmingham in 1968. It manufactured clothing products for wholesalers, shops and market traders. HST was later joined in the business by his four sons, Paramjit Singh Tank ("Paramjit"), Jaspal Singh Tank ("Billy"), Santokh Singh Tank ("Bobby") and Kuldip Singh Tank ("Kuldip").

7. The business was incorporated in 1976 and in 1977 it became registered for VAT. In 1979 the business moved to factory premises in Oldbury and expanded its manufacturing. At this time, Paramjit's son, Jatinder Singh Tank ("Jatinder") was 10 years old and he began helping in the business.

8. In or about 1985 the business developed a clothing brand called "Oxford Blue" which became the flagship brand of the business. In the late 1980s HST retired from the business and it was continued by his sons. In 1995 they took over Rongar Leisure Wear Limited which specialised in camping and outdoor equipment. In January 1996 this company changed its name to H S Tank & Sons Ltd which is the appellant in this appeal. The appellant continues to sell the Oxford Blue brand in the UK and abroad. At the same time the appellant manufactures garments for major international retailers and has been recognised with awards for export achievement. It has substantial manufacturing, warehousing and office premises in Birmingham. However it has been looking to diversify its business into other areas. For example it has looked at dealing in air conditioning units, massage chairs and electronic goods.

9. Over the years the appellant has had various VAT staggers, as VAT accounting periods are sometimes called. For certain periods it made monthly VAT returns and for other periods, including the return 07/06, it made quarterly returns. We do not consider these changes to be significant for the purposes of this appeal. The explanation, which we accept, is that the appellant at certain times was exporting large volumes to Europe.

10. The appellant entered into the following transactions which are directly relevant for the purposes of this appeal:

(1) On 28 July 2006 it contracted to purchase 17,500 Apple iPods from Fairford Partnership Limted ("Fairford");

The cost price of the iPods to the appellant was £115.40 per unit, giving a total sum due of £2,372,912.50. That sum included input tax of £353,412.50.

(2) On 28 July 2006 the appellant also contracted to sell the same number of Apple iPods to a Spanish company, Union Maquinista de Tecnologias de Sistemas SL ("UMTS").

The sale price to UMTS was £121.00 per unit giving a total sum due of £2,117,500. The iPods were to be delivered to UMTS at GR Distribution in France and the supply was zero-rated for VAT purposes.

11. Jatinder was responsible for conducting these transactions on behalf of the appellant. Mr Virk described him as the "guiding mind" in carrying out the deals. Jatinder has a degree in business studies and experience working in IT systems and support. He started working for the appellant full time in 1998, applying his skills in relation to the appellant's systems but he was also concerned with sales and purchasing. This involved extensive travelling to national and international trade fairs where he met existing and potential suppliers and customers.

12. The directors of the appellant had known the directors of Fairford for over 30 years. They had a business relationship involving clothing. Fairford itself traded principally in electronics and was based in Canary Wharf. It was part of a group of companies including Fairford Group plc. We refer to both companies as Fairford save where it is necessary to distinguish between the two. Jatinder visited their offices on a number of occasions in 2005 and 2006. In May or June 2006 he noted that they were dealing in iPods and he talked with the directors about potential opportunities for the appellant to do business with Fairford in such products. The demand for iPods was very high at that time. Indeed Jatinder had previously been to a trade fair in China where he had discussions with a potential supplier of iPods but he was concerned that they may be counterfeit.

13. The representative of UMTS was Mr Asif Iqbal. Jatinder's evidence was that Bobby met him in 2005 whilst attending an exhibition in Glasgow where the appellant had a stand exhibiting clothing products. Asif Iqbal had approached Bobby and told him that he dealt in electronic goods, including MP3 players, but was looking to get involved in clothing. He was particularly interested in high street designer brands. We would have expected to hear first hand evidence from Bobby in relation to his discussions with Asif Iqbal and we say more about this below. We are prepared to accept however that this is how the introduction to UMTS came about.

14. Jatinder's evidence was that he phoned Asif Iqbal in mid-July 2006 to see if he was interested in purchasing electronic goods. He was informed by Asif that he was looking to purchase MP3 players. An iPod is an MP3 player. In fact it appears that the conversation was some time before 10 July 2006 because on that date Bobby signed a UMTS "Business Trade Application Form" in his position as a director of the appellant.

15. There is an issue between the parties as to whether Fairford offered the iPods to the appellant before the appellant then contacted UMTS. Jatinder's evidence was that he was offered the iPods by Fairford and then approached UMTS. The respondents suggested that the first contact came from UMTS. We deal with this issue below. In any event the purchase and sale occurred at the end of July 2006 in the circumstances set out below. We have included timings on documents because to some extent they are relevant. However we recognise that timings particularly on faxes may not be reliable.

The Transactions and Associated Payments

27 July 2006

16. Pursuant to the Jatinder's discussions with Fairford mentioned above, he faxed Bill Bassi at Fairford Partnership enclosing company details. The fax stated that the appellant was always looking for a variety of products and would contact Bill if they had any requirements. It appears that Bill Bassi had earlier emailed Fairford's company details to the appellant. Bill Bassi then emailed Jatinder at 17.15 confirming that Fairford had 17,500 iPods available for immediate delivery at a unit price of

£115.40 excluding VAT. He indicated "*I have already 'haggled' with our supplier on the price and this is the very best that we can do and is not negotiable*".

17. Jatinder then faxed Asif at UMTS enclosing company details and stating that the appellant was always buying and selling a variety of products.

18. At 17.27 Jatinder emailed Asif offering 17,500 iPods at £121.00. He stated "*Unfortunately I am unable to budge on price as there is very little margin*". He copied the email to Bobby.

19. On the same date the appellant also obtained a Graydon International Credit Report on UMTS. We understand that Graydon is a leading credit reference agency.

28 July 2006

20. At 10.23 Jatinder emailed Asif giving a full specification of the 17,500 iPods including their colour (black or white), and whether they were Euro, US or Singapore specification. The email also stated that all came with English manuals and full warranty. Asif was asked to confirm UMTS' requirements as soon as possible.

21. At 12.00 Jatinder sent a purchase order to Bill at Fairford for the 17,500 iPods. The purchase order as sent was unsigned, but a document in identical terms with a stamp giving the appellant's company details and signed by Kuldip was also produced. At 13.24 Fairford sent a pro forma invoice to the appellant. The total sum payable for the iPods was £2,372,912.50 including VAT of £353,412.50. The payment terms were stated to be "*as agreed*". There was a retention of title clause in favour of Fairford Partnership. The invoice itself was signed by Mr Harjinder Chamdal, director.

22. At 14.17 UMTS faxed an order to the appellant for all the iPods at a price of £121.00. The order gave a shipping address of GR Distribution in St Folquin near Calais in France. The appellant then sent by fax an order confirmation and pro forma invoice to UMTS. Both those documents showed a delivery date of 28 July 2006. The total sum payable to the appellant for the iPods was £2,117,500.00 with no VAT.

23. At 16.24 Kay, an employee of the appellant, emailed Graydon asking for confirmation of the UMTS VAT number because the appellant had checked it on the EU Europa website and it was not showing as valid. Graydon responded at 17.15 that the VAT number appeared to be in order and asking for further details.

24. On the same date Fairford Partnership asked 1st Freight to carry out an inspection of the iPods. The inspection request identified Tradex Corporation Limited as the supplier to Fairford Partnership. The inspection type requested was "*100%*" and 1st Freight were asked to fax back an inspection report as soon as possible. There is no evidence that the appellant was aware of the contents of this inspection request.

31 July 2006

25. Fairford Partnership produced a document addressed to 1st Freight asking them to allocate the iPods to the appellant.

2 August 2006

26. 1st Freight produced 6 inspection reports addressed to Fairford Partnership Ltd, one for each colour and specification of iPod. In each case the inspection type carried out was "*inspection 5*" and stated: "*All goods were present, verified and counted for. All markings matched product and packaging. No damaged goods. Packaging was in fair condition*".

3 August 2006

27. The appellant enquired with 1st Freight about opening an account and they were sent an account application form and a document which described 1st Freight's services including "*full insurance available for goods in storage and transit*". The appellant completed the account application.

28. Jatinder then faxed 1st Freight giving them instructions to allocate the iPods to UMTS and to ship them to GR Distribution. The instruction noted that the goods were to be shipped on hold and not to be released until further written notice from the appellant. The fax also stated that the goods were to be insured until released to the appellant's customer.

29. At 13.30 Graydon emailed Kay following the previous email exchange. They confirmed that the VAT number belonged to an active trading company.

30. UMTS made payments totalling £907,500 from their account with First Curaçao International Bank ("FCIB") to the appellant's FCIB account. In addition UMTS also made a payment of £423,500 to the appellant which was repaid by the appellant on the same date. We consider evidence as to the circumstances of that repayment below.

31. The appellant made payments totalling £906,800 from its FCIB account to Fairford Partnership's FCIB account.

32. International consignment notes known as CMRs show that the goods were shipped on 3 August 2006 in 3 separate consignments via Eurotunnel. Certificates of shipment stamped by 1st Freight on 10 August 2006 also show a shipment date of 3 August 2006. It is common ground however that the goods were not shipped until a few days later.

4 August 2006

33. Fairford Partnership repaid £906,800 to the appellant which then made payment of the same amount to Fairford Group's FCIB account.

7 August 2006

34. 1st Freight invoiced the appellant for their services, including secure transport fully insured to destination.

8 August 2006

35. The Eurotunnel transport documents show that in fact the goods were not shipped until the evening of 8 August 2006.

14 August 2006

36. The appellant transferred £275,000 from its HSBC account to its FCIB account.

17 August 2006

37. The appellant transferred £250,000 from its FCIB account to Fairford Partnership's Alliance & Leicester account.

18 August 2006

38. Harry Chamdal of Fairford Group faxed Jatinder with the previous invoice bearing his signature but also now bearing a Fairford Group stamp.

39. FCIB "Risk Management and Compliance" department emailed Jatinder and Paramjit seeking specific additional information and documentation for regulatory purposes in connection with the transfer of £250,000. The request included documentation to confirm that the VAT number of the customer/supplier was verified.

40. On the same day the appellant printed a Graydon report on Fairford Partnership. There is an issue as to when this was first available to the appellant.

41. Jatinder replied by return to FCIB providing the details requested including the Graydon report on Fairford Partnership.

21 August 2006

42. The appellant transferred £25,400.78 from its FCIB account to its HSBC account leaving a zero balance on the FCIB account.

43. On the same date Jatinder emailed FCIB expressing concern that wire transfers were taking too long, and asking when transfers dated 18 August and 21 August would be processed.

22 August 2006

44. Jatinder emailed Asif at UMTS referring to a conversation in the previous week and asking when payment would be made for the goods. He stated that the goods were waiting to be released but would not be released until payment was received. To date

only £907,500 had been received with a balance owing of £1,210,000. Jatinder also faxed a hard copy of this email to Asif on the same date.

23 August 2006

45. FCIB responded to Jatinder's previous email seeking further information about the £250,000 transfer.

25 August 2006

46. The appellant opened an account with International Credit Bank Limited ("ICB") with a transfer of £500.

18 September 2006

47. Jatinder re-faxed a hard copy of his email dated 22 August 2006 with a handwritten note on it stating "*Please advise when we can expect payment.?? Please see our bank details*".

1 October 2006

48. Fairford Partnership sent a "Receipt of Goods Confirmation" form dated 1 October 2006 to be completed and faxed back to Fairford Group as soon as possible.

2 October 2006

49. UMTS paid £699,710 into the appellant's ICB account. The appellant made a payment of £699,000 to Fairford Group.

50. UMTS made a further payment of £510,290 to the appellant's ICB account. The appellant made a payment of £510,380 to Fairford Group plc.

51. By this date, the appellant has been paid in full by UMTS. A sum of £6,732.50 was outstanding from the appellant to Fairford.

52. Bill Bassi of Fairford faxed 1st Freight with a release note dated 1 October 2006 authorising the iPods to be released to the appellant.

53. Jatinder faxed a receipt of goods to Fairford Partnership confirming that the goods had been received by and released to the appellant in good condition.

54. Jatinder faxed both 1st Freight and GR Distribution asking them to release the goods held at GR Distribution to UMTS.

3 October 2006

55. Jatinder faxed Asif at UMTS thanking him for payment and confirming that he had given instructions for the goods to be released to UMTS. He asked for an acknowledgement of receipt of the goods and confirmation that "*everything is ok*".

9 October 2006

56. Bill Bassi asked Jatinder to arrange a bank transfer of £6,732.50 to Fairford Partnership. That was the sum outstanding to Fairford and it was transferred on the same date.

57. We are satisfied from the evidence, which includes purchase orders, invoices and payment details, that the purchase and sale of the iPods by the appellant formed part of a longer transaction chain in which the same goods were sold by a French company Kom Team Sarl ("Kom Team") to A-Z Mobile Accessories Limited ("A-Z") who in turn sold to Tradex Corporation Limited ("Tradex"). Tradex then sold the goods to Fairford Partnership Limited. The transaction chain may be summarised as follows:

Transaction	**Invoice Date**	**Price / unit £**
Kom Team to A-Z	26/07/06	109.25
A-Z to Tradex	27/07/06	110.00
Tradex to Fairford	27/07/06	112.00
Fairford to HSTank	28/07/06	115.40
HSTank to UMTS	28/07/06	121.00

58. Kom Team was a French VAT registered company based in Paris. A-Z and Tradex were both UK VAT registered companies. There is no evidence that the appellant was aware of or had any knowledge about the identity of the traders in this transaction chain other than its immediate supplier and customer.

The Law

59. Domestic legislation governing the recovery of input tax is contained in sections 24 – 26 of the VAT Act 1994 and in the VAT Regulations 1995. There is no issue between the parties as to the application of these provisions and we do not set them out in detail. If a taxable person has incurred input tax that is properly allowable, he is entitled to set it against his output tax liability and, if the input tax credit due to him exceeds the output tax liability, he is entitled to a repayment.

60. There was no substantial dispute between the parties as to the legal principles to be applied on this appeal. The starting point is the judgment of the ECJ in *Axel Kittel v Belgium & Belgium v Recolta Recycling SPRL (C-439/04 and C-440/04) [2006] All ER (D) 69 (Jul)* which provides a legal basis for the respondents to refuse a taxable person the right to deduct in certain defined circumstances. In *Kittel*, the ECJ took the view that:

(1) where the tax authorities find that the right to deduct has been exercised fraudulently, those authorities are permitted to claim repayment of the deducted sums retroactively (at [55]);

(2) in the same way, a taxable person who knew or should have known that, by his purchase, he was taking part in a transaction connected with fraud must be regarded as a participant in that fraud (at [56]);

(3) that is the case, irrespective of whether or not he profited by the resale of the goods (at [56]);

(4) that is because in such a situation the taxable person aids the perpetrators of the fraud (at [57]).

The ECJ concluded at [61]:

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

61. In *Mobile Export 365/Shelford v HMRC [2009] EWHC 797 (Ch)* Sir Andrew Park gives a helpful description of MTIC fraud generally at [19]:

> "*A missing trader intra-community fraud, when conducted in relation to mobile telephones, always involves at least two elements. One of them is that one VAT registered trader acquires and sells telephones in circumstances where it is liable to account to HMRC for VAT but, for whatever reason, it does not in fact pay the VAT. That trader is sometimes described as the defaulting trader... The second element is that another VAT registered trader who is involved in the same chain of sales makes a claim to repayment of input tax. It will, I think, be apparent that, if the first trader had a liability to pay output tax to HMRC but did not meet it (for whatever reason), but the second trader recovers from HMRC an equivalent or possibly somewhat larger amount of input tax, there will be a serious loss of VAT to the Exchequer.*"

62. A trader which makes a claim for repayment of input tax on the despatch or export of goods is often known as a broker. The broker adds liquidity to the supply chains. It also ensures that the goods can circulate within the fraud - see Floyd J in *Calltel v HMRC [2009] EWHC 1081 (Ch)* at [81]:

> *"81. It will be recalled that the rationale in Kittel for refusing repayment where the purchaser knows that he was*

taking part in a transaction connected with fraudulent evasion of VAT was that he "aids the perpetrators of the fraud and becomes their accomplice". For my part I have no difficulty in seeing how the purchaser who is not in privity of contract with the importer aids the perpetrators of the fraud. He supplies liquidity into the supply chain, both rewarding the perpetrator of the fraud for the specific chain in question, and ensuring that the supply chains remain in place for future transactions. By being ready, despite knowledge of the evasion of VAT, to make purchases, the purchaser makes himself an accomplice in that evasion."

63. The defaulter is usually the original importer but any company in the chain or connected chains might dishonestly fail to account for output tax. See Christopher Clarke J in *Red 12 Trading Limited v HMRC* [2009] EWHC 2563 (Ch) at [84].

64. It is alleged by the respondents that the appellant's transactions are part of a scheme to defraud the revenue which in the language of MTIC fraud involved a "contra trader". The term contra trader is now well understood and has been considered in many cases by the First-tier Tribunal, the Upper Tribunal and the Court of Appeal. We note the description adopted by the Chancellor at paragraph 4 of his judgment in *Blue Sphere Global [2009] EWHC 1150 (Ch)* as to how contra trading is used to conceal the existence of MTIC fraud. In the present appeal the respondents allege that A-Z acted as a contra trader and the appellant's transactions form part of A-Z's acquisition chains, sometimes known as the "clean chains". Tax losses do not appear in the clean chains. Rather they appear in transaction chains in which the contra trader acts as a broker despatching or exporting goods out of the UK, sometimes known as the "dirty chains".

65. The Chancellor in *Blue Sphere Global* considered and rejected an argument that the connection between the transactions in the clean chain and the tax losses in the contra trader's chains was "*unreal and is inconsistent with the principles of legal certainty, fiscal neutrality, proportionality and freedom of movement"***.** That broad submission was dealt with at paragraphs 44 to 46 of the judgement:

" 44. There is force in the argument of counsel for BSG but I do not accept it. The nature of any particular necessary connection depends on its context, for example electrical, familial, physical or logical. The relevant context in this case is the scheme for charging and recovering VAT in the member states of the EU. The process of off-setting inputs against outputs in a particular period and accounting for the difference to the relevant revenue authority can connect two or more transactions or chains of transaction in which there is one common party whether or not the commodity sold is the same. If there is a connection in that sense it matters

> *not which transaction or chain came first. Such a connection is entirely consistent with the dicta in Optigen and Kittel because such connection does not alter the nature of the individual transactions. Nor does it offend against any principle of legal certainty, fiscal neutrality, proportionality or freedom of movement because, by itself, it has no effect.*
>
> *45. Given that the clean and dirty chains can be regarded as connected with one another, by the same token the clean chain is connected with any fraudulent evasion of VAT in the dirty chain because, in a case of contra-trading, the right to reclaim enjoyed by C (Infinity) in the dirty chain, which is the counterpart of the obligation of A to account for input tax paid by B, is transferred to E (BSG) in the clean chain. Such a transfer is apt, for the reasons given by the Tribunal in Olympia (paragraph 4 quoted in paragraph 4 above), to conceal the fraud committed by A in the dirty chain in its failure to account for the input tax received from B.*
>
> *46. Plainly not all persons involved in either chain, although connected, should be liable for any tax loss. The control mechanism lies in the need for either direct participation in the fraud or sufficient knowledge of it ..."*

66. The test in *Kittel* does not require a connection amounting to privity of contract between the broker and the defaulter. Such arguments were rejected by the Court of Appeal in *Mobilx* at [62]:

> *"The principle of legal certainty provides no warrant for restricting the connection, which must be established, to a fraudulent evasion which immediately precedes a trader's purchase ... He is a participant whatever the stage at which the evasion occurs."*

67. Where fraud is established the focus of the Tribunal is on the control mechanism described by the Chancellor at [46] of *Blue Sphere Global*, namely whether the Appellant knew or should have known of the connection with fraud.

68. The Court of Appeal in *Mobilx* considered in detail the "knowledge" element of the Kittel principle. It stated in terms at [59]:

> "*The test in Kittel is simple and should not be over-refined. It embraces not only those who know of the connection but those who 'should have known'.*"

69. The respondents must satisfy us that the appellant knew, or should have known that the transaction was connected with fraud. They do not need to establish knowledge of a particular fraud or the fraudulent intent of specific individuals. In *Megtian v HMRC [2010] EWHC 20 (Ch)* Briggs J stated as follows:

> *"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.*
>
> *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 inquiries. 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."*

70. In any particular case there may be specific details of the fraud that the broker knew about or should have known about. HMRC do not need to establish knowledge of such details. However they must establish that the appellant knew or should have known that there was a connection with fraud. It is not sufficient for HMRC to establish that the broker knew or should have known that its transactions were *likely* to be connected with fraud (see *Mobilx* at [60]). Each case must be dealt with by reference to its own facts and on the basis of the test outlined in *Mobilx*.

71. The respondents' case on knowledge is based on drawing inferences from a wide range of facts in order to establish the position that the Appellant must have known of its involvement in fraud (see the same approach recorded at [66] and [67] of the Judgment of Floyd J. in *Calltel Telecom Limited v HMRC [2009] EWHC 1081 (Ch)*).

72. In the alternative the respondents maintain that in all the circumstances the appellant should have known that its transactions were connected with fraud.

73. The meaning of "should have known" is considered at [50] – [52] of the judgment in *Mobilx*. The Court of Appeal's conclusions at [52] were that:

> *"If a taxpayer has the means at his disposal of knowing that by his purchase he is participating in a transaction connected with fraudulent evasion of VAT he loses his right to deduct, not as a penalty for negligence, but because the objective criteria for the scope of that right are not met."*

74. The Court of Appeal gave valuable guidance as to how the "should have known" test actually operates. The guidance is first articulated at [59], where, having observed that the test in *Kittel* "*... is simple and should not be over-refined,*" Moses LJ stated as follows:

> *"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 it turns out that the transaction was connected with fraudulent evasion of VAT then he should have known of that fact."*

75. Similar guidance appears elsewhere in the judgment. We approach our task on the basis that the respondents have to satisfy us that the evidence, looked at objectively, demonstrates that the connection with fraud was "*the only reasonable explanation*", or the only "*reasonable possibility*" or the "*only realistic possibility*" to explain the circumstances in which the appellant entered into the transaction.

76. As well as clarifying what is meant by the concept of "should have known", the Court of Appeal also offers some clear and helpful guidance as to how Tribunals should approach their fact-finding task.

77. In addressing the question of whether a trader should have known of the connection with fraud, the Tribunal must have regard to all the surrounding circumstances. The relevance of the "surrounding circumstances" is apparent at [59] and [60] of the *Mobilx* Judgment and at [84] where Moses LJ adopts paragraphs [109] – [111] of the judgment of Christopher Clarke J in *Red 12 v HMRC [2009] EWHC 2563*. At [111] of Red 12 Christopher Clarke J said,

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

78. As well as having regard to all the surrounding circumstances, the trader and consequently the Tribunal must have regard to the inferences that can properly be drawn from the primary facts. This is pointed out at [61] of the judgment in *Mobilx*:

> *"If he [the trader] chooses to ignore the obvious inferences from the facts and circumstances in which he has been trading, he will not be entitled to deduct."*

79. In relation to the significance of due diligence, the Court of Appeal in *Mobilx* said this at [75]:

> "*The ultimate question is not whether the trader exercised due diligence but rather whether he should have known that the only reasonable explanation for the circumstances in which his transaction took place was that it was connected to fraudulent evasion of VAT.*"

80. Then at [82] it said:

> "*…Tribunals should not unduly focus on the question whether a trader has acted with due diligence. Even if a trader has asked appropriate questions, he is not entitled to ignore the circumstances in which his transactions take place if the only reasonable explanation for them is that his transactions have been or will be connected to fraud. The danger in focussing on the question of due diligence is that it may deflect a Tribunal from asking the essential question posed in Kittel, namely, whether the trader should have known that by his purchase he was taking part in a transaction connected with fraudulent evasion of VAT. The circumstances may well establish that he was.*"

81. Shortly before this appeal commenced the ECJ released its decision in the joined cases of *Mahageben kft (C-80/11)* and *Peter David (C142/ 11)*. Both parties agreed that the judgment of the Court of Appeal in *Mobilx* was consistent with the judgment of the ECJ in these cases. It was common ground that the ECJ had not extended or restricted the judgment of the Court of Appeal in Mobilx.

82. Mr Virk placed considerable reliance on the tribunal decisions in *HT Purser [2011] UKFTT 860 (TC)* and *Brayfal [2010] UKFTT 99 (TC)*. There is now a large volume of authority from the Upper Tribunal, the Court of Appeal and the Court of Justice. Whilst decisions of the First-tier Tribunal can sometimes be helpful in illustrating the approach of a particular tribunal to a particular issue we are conscious that they are not authoritative. Whilst we have read and are familiar with those decisions we have not found them of assistance in dealing with the application of the law to the particular facts of the present appeal. Appeals such as this are extremely fact-sensitive and the parties accept that the law is well established.

83. The respondents accept that the burden of proof is on them to establish the connection with fraud and that the appellant knew or should have known of that

connection. Both parties accepted that the standard of proof by reference to which we must make our findings of fact is the balance of probabilities.

Findings of Fact

84. Based on our analysis of the law set out above, the factual issues which we have to resolve on this appeal may be summarised as follows:

(1) Is there a tax loss in transaction chains relevant to this appeal?

(2) If so, does that tax loss result from fraudulent evasion of VAT?

(3) If so, was the appellant's purchase of iPods from Fairford connected with the fraud?

(4) If so, did the appellant know or should it have known of the connection with fraud?

85. In considering each of these issues we set out the position of both parties.

86. Mr Virk cautioned us in relation to the effect of the passage of time on the quality of the evidence. We have taken that factor into account in our analysis of the evidence.

Is there a Tax Loss?

87. The respondents contend that A-Z acted as a contra trader. They accept that there was an apparently clean chain of transactions leading to the appellant. However they contend that this apparently clean chain is connected with other transactions of A-Z in which it acted as a broker and which trace directly to tax losses.

88. The appellant puts the respondents to proof as to the existence of A-Z's tax loss deal chains and its acquisition deal chains, including the deal chain allegedly leading to the appellant. The appellant also puts the respondents to proof that there were tax losses in the alleged tax loss deal chains.

89. The evidence in relation to A-Z is in the form of a witness statement from Ms Katrina Wheatcroft. The appellant did not challenge Ms Wheatcroft's evidence and she did not therefore give oral evidence. On the basis of her evidence we find the following facts and matters.

90. In A-Z's 08/06 VAT period it carried out 122 transactions, mainly involving mobile phones but also significant volumes of other electronic items. There were 56 transactions where it acquired goods from EU traders and sold to UK traders ("acquisition deals"), 52 transactions where it purchased goods from UK traders and sold to EU traders ("broker deals") and 14 transactions where it purchased from UK traders and sold to UK traders (so called "buffer deals"). In this section of our decision we consider whether the respondents have established the deal chains supporting those transactions and whether there are tax losses in the chains leading to A-Z's broker deals.

91. Ms Wheatcroft has been able to trace the transaction chains for 41 of the 56 acquisition transactions. In each case we are satisfied that A-Z acquired the goods from an EU trader and that each chain leads to a UK company which then sells the goods to an EU trader. The transaction chain involving the appellant which we have described above was one of these transaction chains.

92. Ms Wheatcroft has also been able to trace the transaction chains for the 52 broker deals. We are satisfied from her evidence and on the balance of probabilities that the chains trace back to the following UK traders:

(1) Grange Solutons UK Limited ("Grange")

(2) Worldwide Wholesalers Ltd ("Worldwide")

(3) Phone City Limited ("Phone City")

(4) G A Couriers ("GAC")

93. The VAT registration number of Grange may have been hijacked. We deal with this aspect below in the context of whether the tax losses were fraudulent. In any event there were 29 deals which trace back to Grange, although 3 of those deals were apparently cancelled. Vivien Parsons gives evidence that on 22 March 2007 an assessment to tax in the sum of £6,336,103 was issued to a taxable person purporting to be Grange, including the output tax due on these deals. The assessment was unpaid and we are satisfied that each of the deals traces to a tax loss.

94. There were 16 deals which trace back to Worldwide. Lydia Ndoinjeh gives evidence that on 25 June 2007 an assessment to tax in the sum of £1,891,103 was issued to Worldwide, including the output tax due on these deals. The assessment was unpaid and we are satisfied that each of the deals traces to a tax loss.

95. There were 3 deals which trace back to Phone City. George Edwards gives evidence that on 6 December 2007 an assessment to tax in the sum of £37,580,412 was issued to Worldwide, including the output tax due on these deals. The assessment was unpaid and we are satisfied that each of the deals traces to a tax loss.

96. There were 4 deals which trace back to GAC. Jason McGuinness gives evidence that GAC never submitted a VAT return for the short period in which it purported to trade. The output tax was therefore unpaid and we are satisfied that each of the deals traces to a tax loss. We understand that there was no assessment on GAC in relation to these deals because the period fell out of time. In cases of dishonesty the time periods are extended, but in any event we do not consider it is necessary for there to be an assessment before there can be a tax loss. In this case it is clear that there is a tax loss.

97. We are also satisfied from Ms Wheatcroft's evidence that A-Z conducted 14 buffer deals. These chains lead back to UK tax losses although we did not have any evidence as to the circumstances in which those tax losses arose and make no findings in that regard.

Does the Tax Loss result from Fraudulent Evasion?

98. The respondents contend that the tax losses in A-Z's broker deals described above were part of a fraudulent scheme. The appellant puts the respondents to proof that any tax losses which are established arose as a result of fraud.

99. Evidence as to nature of the tax losses is in the form of witnesses statements from the officers of HMRC identified above. Those officers were in some cases responsible for investigations into the defaulters and in other cases simply produced documents available to HMRC. In each case we are invited to find that the evidence establishes on the balance of probabilities that the tax losses we have found are the result of fraud rather than any other explanation. Again the evidence of the defaulter officers was not challenged by the appellant and they did not therefore give oral evidence. On the basis of their evidence we find the following facts and matters.

100. Mr Fateh Ahmed was the sole proprietor of an off licence business in Eccles and was VAT registered as such. In February 2006 the business incorporated and the VAT registration was transferred to Wade Tech Limited. The business activities were extended to include retail sales of mobile phones and accessories. On 13 June 2006 the company changed its name, or purported to change its name to Grange.

101. On 21 June 2006 HMRC wrote to Wade Tech after it had allegedly sought to verify the VAT registration details of certain companies. Mr Ahmed subsequently denied that he ever tried to confirm their details. At a visit by HMRC on 14 September 2006 Mr Ahmed denied that he had dealt in mobile phones. The company made returns showing no supplies of mobile phones. However documentation showed that it had purportedly supplied an extremely large volume of mobile phones, including the 29 deals which traced to A-Z. Grange has been treated by HMRC as a hijacked VAT registration and it has been the subject of assessments totalling some £81 million. Mr Ahmed agreed that the VAT registration number should be cancelled and that he should be registered as a sole proprietor with a new number.

102. We are satisfied that Grange either entered into the 29 transactions without any intention of accounting for output tax thereon, or that it's VAT number was hijacked by persons purporting to be Grange. In any event we are satisfied that whoever entered into the transactions in the name of Grange never intended to account for VAT on those transactions, including those which led to A-Z's broker chains. They fraudulently failed to account for VAT on those transactions.

103. Worldwide was incorporated on 18 March 2005 and registered for VAT with effect from 1 November 2005. Between April 2006 and November 2006 it had no directors. In May 2006 a Mr Mahmood, holding himself out as a director, phoned HMRC in order to verify certain VAT numbers. At that time it appeared that Worldwide was wholesaling iPods and electronic goods. Despite requests by HMRC, Worldwide failed to produce trading records until October 2006. Thereafter HMRC were unable to contact Worldwide. It was de-registered with effect from 10 November 2006 having failed to submit a VAT return for period 07/06.

104. The records provided by Worldwide were incomplete. Assessments were issued totalling more than £3million. These were based in part on records produced by Worldwide and in part on records from other traders including A-Z. Nobody on behalf of Worldwide has contacted HMRC in relation to these assessments.

105. Mr Mahmood was disqualified from being a director based on his conduct in relation to Worldwide. The period of disqualification was 13 years which is in the top bracket and implies serious matters of unfitness on his part.

106. We are satisfied from the evidence that Worldwide never intended to account for VAT on its transactions, in particular those which were part of A-Z broker chains. It fraudulently failed to account for tax on those transactions.

107. Phone City was incorporated on 2 August 2004 and registered for VAT with effect from 1 February 2005. Its stated trading activity was "contract mobile phone distributors". In the year ended 31 July 2006 its annual turnover was more than £500 million generated from wholesaling mobile phones.

108. Phone City had a history of failing to provide records to HMRC on time. In relation to period 05/06 which was a monthly period it submitted a return seeking a VAT repayment of £908,006. During this period it appears that Phone City both acquired mobile phones from the EU and sold mobile phones to the EU, thus generating an overall repayment claim. When it finally provided records to HMRC in support of this return the records were incomplete. In particular there were no purchase invoices and insufficient evidence of despatch to the EU for the purpose of zero-rating such sales. In the absence of such records HMRC de-registered Phone City for VAT purposes with effect from 25 July 2006.

109. During subsequent investigations none of the officers of Phone City or its employee have admitted to any involvement in or responsibility for the company's deals. No records have been produced for the final period of trading in June and July 2006 and each individual connected with the company has denied any knowledge of the whereabouts of those records. Assessments and corrections to the returns made by HMRC disclose a liability of Phone City to HMRC of £34,014,672, the bulk of which is in connection with the final period of trading. Whilst the company made a return for its final period of trading, it under declared the output tax due by some £4.3 million.

110. Phone City was subsequently wound up and its directors disqualified from acting as company directors in each case for a period of 12 years. Again, this is in the top bracket and implies serious matters of unfitness on their part.

111. We are satisfied from the evidence that Phone City never intended to account for VAT on its transactions, in particular those which were part of A-Z broker chains. It fraudulently failed to account for tax on those transactions.

112. GAC was incorporated on 13 June 2006 and registered for VAT with effect from 15 June 2006 as a delivery service. The directors resigned on 18 June 2006 and were replaced by Mr Hanif Dar. A visit was conducted by HMRC on 11 September 2006 but the officers were told that the company had moved on 18 August 2006.

HMRC was unable to contact the officers of GAC and it never made any VAT returns or produced any records. Documentation obtained by HMRC from other sources showed GAC acquiring electronic goods from Poland. An assessment to output tax in the sum of £495,923 was issued in relation to some of the deals which HMRC had identified. GAC was dissolved on 10 March 2009.

113. We are satisfied from the evidence that GAC never intended to account for VAT on its transactions, in particular those which were part of A-Z broker chains. It fraudulently failed to account for tax on those transactions.

114. In addition to the evidence directly relating to each of the defaulters we also had other evidence of fraud, including evidence of an overall fraudulent scheme involving A-Z. The evidence of fraud in relation to the business of A-Z is compelling. We are satisfied that it was knowingly and deliberately involved in a scheme to defraud HMRC.

115. A-Z was certainly offsetting its input tax liability on goods purchased for despatch to the EU against its output tax liability on supplies of goods acquired from the EU. In period 08/06 the net value of its broker deals was £49,998,536 and the net value of its acquisitions was £49,620,293. The net VAT due to HMRC on the basis of this trading was £24,159. However, the mere fact that it was offsetting in this way is not without more indicative of fraud. In addition all of its broker deals in the period trace back to fraudulent defaulters as set out above. All of its acquisition deals, where traced, end with UK traders supplying to EU purchasers and generating a corresponding input tax credit or repayment. We find it unlikely that such a pattern would emerge in legitimate commercial deals. The same pattern emerges in period 05/06.

116. A-Z was ostensibly able to generate turnover of more than £400 million in the 12 months ending 31 August 2006. All deals were back to back with A-Z purchasing exactly the same quantities of goods as it sold to its purchaser. All the participants in the transaction chains leading to A-Z's broker deals made and received payments through FCIB. In very few of its deals did A-Z inspect the goods it was purchasing. It carried out little by way of the commercial checks or due diligence one would expect of a legitimate commercial company in a market it well knew to involve a serious risk of fraud.

117. The transaction chain we are concerned with in this appeal involved an acquisition by A-Z from Kom Team. A-Z failed to provide any CMR to evidence the goods arriving in the UK or any evidence of inspection. Whilst we do not question that the goods were imported into the UK by A-Z, it is telling that they were not able to produce basic supporting documents in relation to the transaction.

118. We are satisfied that A-Z acted as a contra trader in order to conceal the fraudulent defaults which gave rise to the tax losses identified above. By doing so it made it more likely that HMRC would make repayments of input tax to traders despatching goods to the EU or exporting goods out of the EU. It does not necessarily follow from that finding that all traders who despatched or exported goods originally

acquired by A-Z were knowing participants in the fraud. It may be that they were unwitting accomplices who effectively provided liquidity for the fraud and/or enabled the goods to circulate giving an opportunity for further tax losses arise.

119. The existence of an overall scheme to defraud HMRC is further evidenced by the documentation available in relation to the FCIB for the transaction chain involving the appellant. That evidence was adduced by Mr Daniel Payne. In the light of the cross examination of Mr Payne it is clear that he did not carry out a complete analysis of the payments made between the various parties in the transaction chain. In particular he did not take into account payments made through ICB because his task was limited to considering the material in relation to FCIB. He also did not consider the following payments related to the transactions which did pass through FCIB:

(1) £423,500 repaid by the appellant to UMTS on 3 August 2006.

(2) £275,000 paid into the FCIB account by the appellant on 14 August 2006.

(3) £250,000 paid by the appellant from its FCIB account to Fairford's Alliance and Leicester account on 17 August 2006.

(4) £25,400 transferred by the appellant from its FCIB account to its HSBC account on 21 August 2006.

120. We do not consider that the absence of any reference by Mr Payne in his analysis to these sums prevents us from making any findings of fact on the basis of his evidence. Nor does it affect the reliability of the underlying evidence adduced by Mr Payne. We can see various movements of funds from the account information which is exhibited to Mr Payne's witness statement. The narrative in the documentation associated with most of those movements enables us to be satisfied on the balance of probability that they were made in connection with transactions involving the 17,500 iPods with which we are concerned in this appeal. We can summarise our findings in the following tables:

121. The first table traces a sum of £423,500 paid by UMTS to the appellant on 3 August 2006. This is the sum which was repaid by the appellant to UMTS on the same day. It originated with a company called SNV Worldwide:

Payer / Payee	**£**
SNV > Best in Sweden	425,775
Best in Sweden > UMTS	425,250
UMTS > HS Tank	423,500

122. The second table traces further sums paid on 3 and 4 August 2006 from UMTS to the appellant and then to Fairford. They also originated with SNV:

Payer / Payee	£	£	£	£	Total £
SNV > Best in Sweden	121,650	364,950	182,475	243,300	912,375
Best in Sweden > UMTS	121,500	364,500	182,250	243,000	911,250
UMTS > HS Tank	121,000	363,000	181,500	242,000	907,500
HS Tank > Fairford					906,800
Fairford > Tradex					908,000
Tradex > A-Z Mobile					900,000
A-Z Mobile > Kom Team					900,000
Kom Team > RCCI					895,625
RCCI > SNV					897,000

123. RCCI, SNV and Best in Sweden were all VAT registered companies based in other Member States of the EU. Payments from SNV, Best in Sweden and UMTS ending with the appellant were all made on 3 August 2006. Payments from the appellant, Fairford, Tradex, A-Z Mobile, Kom Team and RCCI ending with SNV were all made on 4 August 2006. The narratives in the FCIB transaction listings show that all the payments made were in connection with the iPods which are the subject matter of the present appeal, save the funds moving between RCCI and SNV for which the only narrative is "*Part payment*". In all other transfers the narrative refers either to the known invoice number for the transaction between those parties or the number of iPods and/or the specification of the iPods. For example the transfer from Kom Team to RCCI of £895,625 has a narrative "*PART PAYMENT 17,500 ipods*".

124. The payment from RCCI to SNV has no more specific narrative but on the balance of probabilities, based on the amount involved and from RCCI's account the fact that payment was made immediately after RCCI received the transfer from Kom Team, we are satisfied that it also related to the 17,500 iPods.

125. We find as a fact therefore that a sum of just over £900,000 was transferred in a circular movement between the parties identified above with the small reductions and in one case a small increase indicated above. The movement started with transfers totalling £912,375 from SNV to Best in Sweden and ended with a transfer of £897,000 from RCCI to SNV. These movements of funds could not have occurred without contrivance between at least some of the parties involved. Having said that we do not infer from the movement of funds that the appellant was necessarily a knowing participant in that contrivance or that it should have known of the contrivance.

126. Based on all the evidence set out above we are satisfied that the appellant's transactions did form part of a scheme intended to defraud HMRC.

Were the Appellant's Transactions connected with Fraud?

127. The respondents contend that the evidence of a fraudulent scheme involving A-Z deliberately offsetting input tax on broker deals against output tax on acquisition deals sold to UK customers establishes the necessary connection with fraud for the purposes of the Kittel test.

128. As we understand Mr Virk's submissions, the appellant puts the respondent to proof of any connection but specifically denies that the appellant knew or should have known of the connection.

129. We are satisfied based on the judgment of the Chancellor in *Blue Sphere Global* that the appellant's transactions were connected with fraud. Indeed the connection in the present case is stronger than that described by the Chancellor because we have found that there was a scheme to defraud HMRC which included knowing participation in the fraud by A-Z. There was also an even more direct connection with fraud than that described by the Chancellor arising from the appellant's involvement, be it witting or unwitting, in the circular movement of funds described above.

Did the Appellant Know of the Connection with Fraud?

130. The respondents must satisfy us that the appellant knew of the connection with fraud at the time it entered into the purchase of the iPods. Alternatively that it should have known of that connection. Much of the evidence in this regard is evidence from which the respondents invite us to infer that the appellant either knew or should have known of the connection. In each case the appellant denies that it knew or should have known of the connection with fraud.

131. In the following sections we consider the evidence relevant to the question of actual knowledge. We then consider evidence relevant to the question of what the appellant should have known. We record our findings of fact relevant to these issues and the inferences we draw from those facts. In the present case there is no single circumstance from which we can infer that the appellant knew or should have known of the connection with fraud. It is a matter of considering all the circumstances and then whether, on balance, we are satisfied that the appellant knew or should have known of the connection with fraud.

132. Both counsel provided comprehensive closing submissions on this issue. Mrs Newstead relied on the following facts and matters as being established and from which she invited us to infer that the appellant knew of the connection with fraud. There were a number of other matters relied on by the respondents either in the Statement of Case or in the witness statement of Mr Griffiths. To the extent that they were not relied on by Mrs Newstead in closing we have had no regard to those matters.

(1) Appellant's Background

133. We were provided with turnover figures for the appellant going back to 1996. We can see from those figures that the appellant had a turnover in 1998 of

approximately £5.5 million. By 2005 its turnover had fallen to £2 million. The respondents invited an inference that a decline in turnover led the appellant to knowingly become involved in VAT fraud. Jatinder stated in evidence that there was up to £2 million to add to this turnover from other group companies. We find as a fact on the basis of the evidence before us that the appellant's turnover had fallen in the periods leading up to the transaction. However whilst that provides some context to the transaction it does not really add much if anything to the respondents case on knowledge. We do not have any material from which we can see the profits being made by the appellant and it is in our view dangerous to read too much into the fall in turnover.

134. To some extent the appellant dealt in other goods outside its core business. There were some comparatively small deals in electronic keyboards and contract mobile phones. We accept that the appellant was looking to diversify into areas outside its core business. Deals in electronic goods such as iPods would be consistent with a legitimate desire to diversify.

(2) The Value of the Deal to the Appellant

135. We accept Mr Virk's submission that there is nothing inherently unreasonable about purchasing the iPods wholesale at £115.40 per unit and selling at £121.00 per unit when the evidence is that the retail price was £179.00. Those figures gave rise to a gross profit on the deal of £98,000.

136. Jatinder's evidence in response to questions by Mrs Newstead as to the value of the deal to the appellant was what we can only describe as evasive. In response to questions directed towards showing that this was a very valuable deal in the context of the appellant's business generally he said that "*any transaction we do in the company is valued to us*". Similar responses followed. In contrast, at the end of his evidence in response to questions from the tribunal he agreed that "*this was a particularly large deal*".

137. It is unfortunate that we do not have details of the appellant's profitability, but we find as a fact that this was a particularly large deal for the appellant and was important to the appellant in the context of its business as a whole. As a result whilst Jatinder had authority from the directors to commit the appellant to the purchase and sale of the iPods, he discussed the commercial aspects of the deal with the directors, including matters such as purchase price, sale price and funding. Jatinder accepted that he discussed those matters with his father and Bobby, although he was rather unforthcoming in cross-examination when asked about the involvement of the directors.

138. In the light of Jatinder's evidence we find it surprising that Bobby was not called to give evidence. Bobby was present at the tribunal throughout the hearing. He is a director of the appellant and his involvement in the deal and the circumstances leading up to the deal included:

(1) Opening an account with FCIB in late 2005 and early 2006 in which the documentation described him as the "*primary contact*".

(2) Meeting Asif Iqbal of UMTS for the first time at a trade exhibition in Glasgow.

(3) Completing a UMTS' Trade Application Form on behalf of the appellant on 10 July 2006.

(4) Discussing with Jatinder the purchase price, sale price and funding of the transaction.

(5) Expressing concerns that UMTS had not paid for the iPods as promised.

139. Mrs Newstead invites us to draw an adverse inference from the fact that none of the directors chose to give evidence. In circumstances where there is no explanation for the failure of a material witness to give evidence we are entitled to draw such an inference (See *Wisniewski v Central Manchester Health Authority [1998] EWCA Civ 596*). In our view it is appropriate for us to take into account the failure of Bobby in particular to give evidence when we consider the evidence of knowledge generally.

140. Given the value of the deal to the appellant, any reasonable businessman would want to ensure that the commercial risk was minimised. We are satisfied that Jatinder, in association with his father and Bobby, would in ordinary commercial circumstances have exercised caution in conducting this deal. We accept that there was a long-standing relationship with Fairford and they were entitled to take certain matters on trust, but there had been no previous dealings with UMTS. We would have expected the appellant to have exhibited a fair degree of caution in its dealings with UMTS in such a large deal.

(3) ***Conduct of the Deal***

141. Mrs Newstead submits that the deal fitted together surprisingly easily. She relies on a number of features in support of her submission that the deal was contrived rather than a genuine arms length commercial deal. We consider that the following factors relied on by the respondents under this heading are significant.

142. The evidence of negotiations as to the terms of the deal with both Fairford and UMTS are not what we would expect of a legitimate commercial deal. We consider this evidence in the context of what was a particularly large deal for the appellant which the directors would ordinarily be expected to approach with caution.

143. Jatinder's evidence was that negotiations were conducted by telephone. The documents before us show that offers of stock showing quantity, price and specification were confirmed by email. Once agreement was reached the deal was confirmed by faxing purchase orders, pro forma invoices and invoices. Again, there is nothing inherently unusual about that, but when one looks at the emails on 27 and 28 July 2006 they do not record what must have been key aspects of the deal, in particular dates of delivery and dates of payment. No other documents record these key aspects of the deal.

144. As far as price is concerned, Fairford's email on 27 July 2006 states this is the best price Fairford can do. It is quite plausible that this email was sent following prior negotiations by telephone which was Jatinder's evidence. At or about this time Jatinder says he researched the retail price of the iPods. Shortly afterwards Jatinder emailed UMTS offering the goods at a price of £121.00. He also told UMTS that he was unable to budge on price. At the same time Jatinder says he offered the goods at the same price to various other UK and EU potential customers. It is a little odd that in a market in which Jatinder accepted the price could change on a day to day basis there is no evidence of negotiations or counter-offer by UMTS or any movement in price by the appellant. Jatinder's evidence was that he wanted a margin of around £4 to £6. The offer to UMTS therefore would give him the top end of that margin but UMTS were not able, if they tried, to negotiate the price downwards. This is surprising given that UMTS was apparently a specialist dealer in electronic goods and the appellant was principally a clothing manufacturer new to the market.

145. If there were any meaningful negotiations with UMTS, and we are not satisfied that there were, it is surprising that those negotiations are not evidenced by any documents or by evidence from the directors of the appellant with whom Jatinder was allegedly discussing the deal.

146. As far as the date of delivery and date of payment are concerned, whilst the emails are silent it is true that the purchase orders and invoices do identify a date of delivery of 28 July 2006. However Jatinder's own evidence was that this was not the agreed date of delivery. He had simply discussed with UMTS that they wanted the goods as soon as possible, they would only have them when the appellant had been paid and a timescale of 7 days was discussed. We find it unlikely that in the circumstances of this deal such matters would not have been documented, either by way of email or fax.

147. We mention above Jatinder's evidence that he researched the retail price of iPods and contacted potential purchasers apart from UMTS offering them the iPods at a price of £121. The respondents suggest that this could not have happened in the 12 minutes between receiving Fairford's email offering the goods at £115.40 and offering the goods to UMTS at £121. We are not satisfied that the 12 minute timescale identified by Mrs Newstead is really relevant. Firstly because there is nothing inherently implausible about Jatinder's evidence that the email from Fairford was preceded by telephone discussions. Secondly because the email to UMTS which asked whether they were interested in purchasing the iPods does not preclude offers to other interested parties after that email was sent. It is however of some significance that there is no evidence of any faxes or emails to other potential customers at or about the same time as the email to UMTS.

148. Mrs Newstead relied upon contrivance based on the manner in which title and possession of the goods was dealt with by the parties to the transactions. The appellant did not dispute that on the basis of Fairford's invoice terms Fairford retained title to the goods until it was paid in full. The goods were shipped on hold. We do not consider it significant that the goods were allocated to the appellant prior to payment. From the documentation we have seen the process of allocation notified to 1st Freight

simply identifies the particular goods as being those which the appellant has contracted to purchase. Similarly we accept Mr Virk's submission that the shipping of goods on hold is entirely consistent with a legitimate commercial deal.

149. On 3 August 2006 UMTS made payments totalling £907,500 to the appellant. On the same date the appellant made payments totalling £906,800 to Fairford Partnership. At that stage the appellant gave instructions to 1st Freight allocating the goods to UMTS and also to ship the goods on hold to GR Distribution. It is notable that the appellant made no written request to Fairford asking if it could ship the goods to GR Distribution in France and there is no document from Fairford authorising such a shipment.

150. The circumstances in which shipment took place do suggest that the deal was not a legitimate commercial deal. The appellant was dealing with a customer it had never previously dealt with, in a large deal worth £2 million. The price of the goods could change on a daily basis. Jatinder's evidence was that UMTS had said that it wanted the goods as soon as possible, it had the funds available and would arrange payment within about 7 days. On 3 August 2006, some 6 days after the deal was done, £907,500 was paid. Jatinder said it was this payment which prompted him to give instructions for shipping. He was promised the balance within the next day or so. We find it surprising in those circumstances that the appellant was prepared to ship the goods to France before it had received the balance of the purchase price.

151. More surprising is that whilst the instructions to ship the goods were given by the appellant on 3 August 2006, the goods were not actually shipped until late on 8 August 2006. Jatinder did not know why there was a further period of 5 days before the goods were shipped to France. Whatever the reason, by 8 August 2006 UMTS had failed to pay the balance due of approximately £1.2 million. There was no reason why the appellant should not have withdrawn the shipping instruction when it was clear UMTS had not paid the balance due. Jatinder said he was concerned that UMTS had not paid but that he was reassured by them that payment would be made.

152. We think it unlikely that any reasonable businessman in these circumstances would have shipped the goods to France incurring shipping and insurance costs of £12,608 excluding VAT. We have no reason to think that Jatinder, discussing the deals with the directors, would have acted other than as a reasonable businessman in connection with this deal. He is an intelligent man with a degree in business studies and has been brought up in a commercial environment.

153. There was a period of almost 2 months between shipping the goods on 8 August 2006 and releasing the goods to UMTS on 2 October 2006 when the final payment was made. Jatinder's evidence was that he and Bobby were very concerned about the delay in payment. Jatinder said that he made various phone calls to Asif Iqbal chasing payment. The only documentary evidence of payment being chased is an email from Jatinder to Asif on 22 August 2006. It refers to a conversation between the two the previous week and asking when payment might be expected. A hard copy of the email appears to be have been faxed to Asif Iqbal on 18 September 2006 with the following handwritten note:

"*please advise when we can expect payment.?? Please see our bank details*"

154. Whilst it wasn't canvassed in evidence it is likely that the reference to bank details was the appellant confirming to UMTS its ICB bank account details. We are surprised at the absence of any further emails, faxes or letters chasing payment, either from the appellant to UMTS or from Fairford to the appellant. Notwithstanding a relationship of trust between the appellant and Fairford, in a transaction of this nature we would expect each party to commit its position to writing. Hence we would expect to see such documents expressing increasing concern at the delay in payment and the additional storage and insurance costs that were being incurred. We find as a fact that the appellant allowed the matter of payment to drift and that is a factor which suggests that the relationship between the appellant and UMTS was not an arms length commercial relationship.

155. Jatinder's evidence in cross examination was that the appellant did not try to find a new customer for the goods because UMTS had already paid a substantial sum towards the goods. He suggested that the appellant would have to recover the £906,800 it had paid Fairford in order to repay UMTS and that this was not practical. At the end of his evidence in response to questions from the tribunal Jatinder accepted that he could have sold the goods to a new customer and used funds from that sale to complete the purchase from Fairford. Not only did he accept that was a viable option but for the first time he said that following discussions with the directors they looked around for a new customer but there was no-one available to purchase the iPods. He put this forward as a factual account of what had happened. If this was true it is not credible that the first time it would be put forward is at the end of his oral evidence. We do not accept that the appellant ever tried to find a replacement customer.

156. The respondents point to the payment of £423,500 made by UMTS on 3 August 2006 and the repayment of that sum by the appellant on the same day. It is suggested that Jatinder's initial explanation, namely that Asif Iqbal had requested repayment because of an issue with UMTS' bank account lacks credibility. Narratives on the FCIB accounts of UMTS, and Best in Sweden show the same sum passing through their accounts described as "*refund of funds*" and "*cancelled deal*" respectively. The funds ended up with SNV Worldwide. We cannot impute any knowledge of these transfers to the appellant, however the narrative on the appellant's account when the money was returned reads "*INSPECTION CHECKLIST 3.5K WHITE USA NANO*". That narrative was entered by Jatinder but he could not recall why he had entered it. Indeed when he was asked about the narrative he changed his evidence as to why the money was returned. He said he couldn't remember why the money was returned. We regard his evidence on this point as unsatisfactory.

157. Jatinder said in evidence that the appellant did the deal on a "*pro forma*" basis to counter the risk of non-payment by UMTS. We can understand that contracting on terms whereby the goods will not be released until payment has been received significantly reduces the risks associated with the transaction. However that protection arises from the contractual terms. It does not arise from the practise of issuing pro forma invoices which themselves make no reference to the terms of

payment. Indeed VAT invoices were issued by the parties on the same day that the pro forma invoices were issued. In answer to questions from the Tribunal Jatinder acknowledged that the pro forma invoice simply confirmed the details of the order.

158. Mr Virk submitted that the only credible evidence as to how traders in this market operate comes from Jatinder. He submitted that we cannot make any findings as to what might reasonably be expected of businesses operating in this market. We disagree. The whole purpose of a specialist tribunal including a lay member is to bring to bear its experience as to commercial practices and the way in which businesses operate. In some appeals and in relation to some issues expert evidence as to commercial practices will be necessary. The issues in the present appeal do not fall into that category.

159. Mrs Newstead also relies on further matters as suggesting that the deal is contrived. We do not consider that they really point towards knowledge on the part of the appellant, but for completeness we set out our reasons below.

(1) The purchase and sale were back to back, with the appellant able to source and sell the exact quantity of mixed specification iPods on the same day. We do not consider that this factor indicates contrivance. We are concerned here with one deal. The fact that in a single deal the appellant was able to find a purchaser for a single consignment of iPods offered by a particular supplier may be consistent with a contrived deal but it is not in our minds indicative of contrivance. On this particular aspect we accept Mr Virk's submission that there is nothing inherently contrived about the mechanics of the deal.

(2) Jatinder's evidence as to how the deal came about, in particular whether Fairford or UMTS made the first enquiry about supplying or purchasing iPods, is inconsistent with the documents. In his evidence Jatinder stated that Fairford offered to supply the iPods and Jatinder then offered them to UMTS. By that time he knew that UMTS were interested in purchasing MP3 players. There is nothing inherently unreliable about Jatinder's evidence in this regard. We do not think that the contemporaneous faxes from Fairford and Jatinder on 27 July 2006 are necessarily inconsistent with his evidence. Mrs Newstead relies on notes of a meeting involving Jatinder and HMRC officers on 23 July 2007 where it is recorded that:

> *"[UMTS] contacted HST to purchase electronics from [China], but HST purchased these from Fairford instead – [Jatinder] phoned round contacts, Fairford gave [Jatinder] a price for the goods."*

We accept that there is an inconsistency with Jatinder's evidence, but none of the HMRC officers present at the meeting have given evidence before us. We are prepared to accept that the note in this regard may not be a reliable record of what Jatinder said at the meeting.

(3) Mrs Newstead submits that the appellant ought to have queried why Fairford was not exporting the iPods itself when it held itself out as a specialist global trader. We do not consider that in the circumstances of this transaction there was any real reason for the appellant to make such an enquiry.

(4) It is suggested on behalf of the respondents that Jatinder was vague and contradictory about when the deal with Fairford was done, in particular when the appellant became contractually bound to purchase the goods from Fairford. Jatinder was certainly not clear in relation to contractual matters but we take into account that he is not a lawyer. We do not consider that Jatinder's evidence this regard was vague. In his mind at the time, UMTS committed to the deal when they sent a purchase order to the appellant. As soon as he received that document he sent a purchase order to Fairford committing the appellant to the purchase.

(5) The respondents identify the specification of the iPods, namely 10,000 United States specification, 2,500 Singapore specification and 5,000 European specification. It is suggested that this indicates the importation was not for genuine commercial reasons because there was no apparent reason for the iPods to be imported into the UK in the first place. We do not regard this as a relevant factor in the present appeal. Firstly, as Mr Virk pointed out we had no evidence as to the significance of iPod specification, other than from Jatinder himself. Jatinder told us that in reality the specification of iPods was universal and they could be used in any market, subject possibly to a straightforward language change. Secondly, this is not a case where the appellant had previously received any warnings about the prevalence of MTIC fraud in such markets. It might have been wise for the appellant to have sought advice from its professional advisers as to the risks associated with the specific transactions. However we are prepared to accept that in the circumstances of this case the appellant's failure to seek such advice does not indicate knowledge of the connection with fraud.

(6) Funds paid by the appellant to Fairford Partnership on 3 August 2006 were paid back to the appellant so that it could then make a payment to Fairford Group's FCIB account. On other occasions funds were paid either to Fairford Partnership or Fairford Group. We do not consider these to be "third party" payments in way Mrs Newstead uses that term in her submissions. The companies were plainly part of the same group and under the same control. We accept Mr Virk's submission that the way in which Fairford wanted the payments dealt with does not suggest contrivance or knowledge on the part of the appellant.

160. Mrs Newstead did not place much if any reliance in her closing submissions on the fact that payments received by the appellant from UMTS were immediately paid to Fairford. This factor is consistent with the way in which MTIC frauds operate, but we accept Mr Virk's submission that it is also consistent with a legitimate commercial deal.

161. For the sake of completeness we should also say that we accept Mr Virk's submission that shipping the goods to France when the purchaser is a Spanish company is entirely consistent with a legitimate commercial deal.

*(4) **Due Diligence***

162. The respondents submit that the due diligence conducted by the appellant on Fairford and UMTS was very limited and the appellant largely ignored the commercial checks which were carried out.

163. We can deal with the due diligence in relation to Fairford relatively briefly. The appellant had never previously traded in electronic goods and had received no warnings as to the risk of MTIC fraud in that market from HMRC or its professional advisers. It was not disputed that the appellant's directors had a long established trading relationship with the directors of Fairford. We are satisfied that the Appellant obtained a Graydon credit report on Fairford on 27 July 2006, before it committed to the purchase. Its practice was to obtain Graydon reports on all new customers and suppliers. However the appellant relied more on its own personal knowledge of the directors. In the circumstances we accept Mr Virk's submission that there was no reason for the appellant to carry out any further commercial checks on Fairford.

164. UMTS was quite different. Mr Virk submitted that the supplier was more relevant than the customer when it comes to carrying out due diligence. We do not accept that submission. The appellant had never traded with UMTS before and knew little about its commercial history or that of its director. Whilst the appellant was not giving credit to UMTS, it was entering into a very sizeable commitment on the strength of a purchase order from UMTS. We are satisfied that the appellant would, in ordinary commercial dealings, want to satisfy itself that UMTS would be able to fulfil its obligations and pay for the goods on time. If it did not, the appellant risked having to find another buyer for the iPods with the possibility of an adverse price movement in the meantime. It also risked incurring wasted costs shipping the goods to France and back to the UK if the deal was not completed.

165. There is some difficulty in identifying what material was available to the appellant in relation to UMTS prior to entering into the transaction. It certainly had a Graydon credit report indicating that UMTS had been incorporated on 1 September 2000. No indication is given as to when UMTS had commenced trading. "Trade morality" was described as good and "Payments" were described as regular. What these terms meant is not described. The credit rating was 3, which is an above average risk in the Graydon scales. The "amount advised" for credit was €1,202 and the director was identified as Asif Iqbal.

166. It is clear that none of the other documents, whether they were obtained before or after the transaction, does anything more than confirm that UMTS was a commercial entity in Spain and registered for VAT. Many of the documents are formal documents in Spanish. For the first time at the hearing Jatinder claimed that he had asked various contacts to translate those documents for him over the phone. He purported to give a detailed account of who had translated the documents for him and described making a note of what each of the documents was. We have serious reservations as to whether this evidence was true. In any event we find as a fact that there was no material from which Jatinder or the directors could make any judgment as to the risk of non-payment.

167. Jatinder accepted that trade references are a useful form of due diligence, but that he did not seek trade references for UMTS.

168. The absence of any material from which the appellant could assess the financial standing and reliability of UMTS is telling. In his evidence he stated that due diligence was carried out to confirm that the customer existed, and if they were asking for credit how much credit they should be given. However that ignores the other commercial risks associated with the transaction, in particular the risk of non-payment and being left with the goods.

169. Jatinder did have cause to question the VAT number of UMTS. We accept that the appellant searched on the Europa website of the EU in order to confirm the validity of UMTS' VAT number. The number was not confirmed as valid and on 28 July 2006 the appellant emailed Graydon asking them to confirm that the number was valid. On 3 August 2006 Graydons confirmed that the VAT number belonged to an active trading company. This is an example of at least some due diligence on the part of the appellant. However we do not consider it very significant in relation to the issue of knowledge because in order to zero rate the supply to UMTS the appellant would need to satisfy itself that the VAT number was valid.

170. Jatinder gave evidence that the iPod was a very popular product and it was "*a seller's market*". He said that the appellant could easily have found a customer from its database. In those circumstances it seems strange that the appellant should contract to sell the goods to UMTS, knowing so little about its financial standing and reliability.

171. The significance of due diligence in the present case is the fact that Jatinder agreed to sell to UMTS, exposing the appellant to the risk that UMTS would not complete the deal, without carrying out any real commercial checks. That is a factor indicating that it was not a legitimate commercial deal.

172. The respondents also rely on the fact that the appellant did no due diligence on 1st Freight which was responsible for storing the iPods and shipping them to France. We do not consider this to be a significant factor in the context of this appeal. We consider that a business in the position of the appellant would ordinarily be entitled to rely on the recommendation of Fairford. What is significant in our view is the fact that Jatinder did not visit 1st Freight at any stage to inspect the goods himself and we consider this aspect below.

(5) ***Insurance***

173. We have touched upon the insurance position above. We have made findings of fact in relation to the conduct of the transaction, including our finding that in the circumstances of this transaction no reasonable businessman would have shipped the iPods to France when £1.2 million was outstanding and overdue from UMTS.

174. The iPods were shipped to France on 8 August 2006. The balance was not finally paid until 2 October 2006. There is no evidence or documentation to suggest that Jatinder gave any consideration to the insurance position whilst the goods were in

storage at GR Distribution. Indeed there was no evidence or documentation referring to the responsibility for storage charges during this period.

175. Mrs Newstead relies upon what she described as a "*casual attitude to insurance*". On the one hand she says that the appellant did not seek insurance for the iPods until 3 August 2006 when it asked 1st Freight to ship the goods to France. At the same time as it gave those instructions the appellant requested "*shipment is to be insured until released to our customer*". On the other hand Mrs Newstead states that the appellant did not have an insurable interest in the goods. Whether or not that is right is debatable. However the point appears to be that if the appellant thought that it required insurance it failed to adequately check that it had sufficient insurance. Mr Virk submits that the evidence establishes that the goods were in fact fully insured, through a combination of 1st Freight's insurance policy and the Appellant's marine insurance policy.

176. The position in relation to insurance is far from clear and we do not have copies of the relevant insurance policies. We are unable to make findings of fact as to whether or not the goods were fully insured in transit to France. More significant is what Jatinder believed the insurance position to be at the time of the deal, both in relation to transit and storage.

177. In the ordinary course, a business in the position of the appellant would want to satisfy itself that it was covered by insurance for any risk of damage or loss to which it was exposed whilst goods were in storage or being transported. It did not appear from the evidence that Jatinder had any real understanding of the risks against which the appellant might want to be insured, or the sufficiency of the insurance which was in place. The real point here is that we would expect a reasonable businessman to take steps to satisfy himself as to the insurance position, raising the matter directly with the vendor of the goods, the freight forwarder and the appellant's own insurance broker. He failed to do so, other than simply making a request to 1st Freight to insure the goods until release. Having said that, the nature of that failure is such that it is explicable as an oversight.

178. More significant is that there is no evidence of Jatinder obtaining any quotes for that insurance or that consideration was given by him to the insurance position or the costs of storage whilst the goods were at GR Distribution in France. He had asked for insurance until the goods were released to UMTS. On 7 August 2006 1st Freight sent invoices covering "*Secure Transport – Fully Insured to Destination*". On any view Jatinder and the directors ought to have been alert to the fact that there would be additional costs for insurance and storage depending on how long the goods were at GR Distribution in France. In the circumstances of this transaction it does not appear to us that this is readily explicable as an oversight.

(6) ***Inspections***

179. Fairford provided a copy of its inspection reports on the iPods to the appellant. The reports were dated 2 August 2006. We do not regard it as significant that Jatinder did not know what a "type 5" inspection entailed. The description of the packaging as

"fair" is something that we would have expected Jatinder to query. In particular we would have expected him to clarify whether the condition of the retail packaging was anything less than good. However we accept that this may be accounted for as an oversight.

180. Jatinder copied the inspection reports to UMTS. He said this was an oversight. He accepted that by copying the inspection reports to UMTS he was effectively disclosing the identity of his supplier, Fairford. He further accepted that this risked prejudicing future business with UMTS who might go directly to Fairford in future. Again, we accept that it may have been an oversight.

181. It is relevant in our view that at no stage did Jatinder go to 1st Freight to inspect the goods himself. Jatinder accepted that he had thought about visiting 1st Freight but did not do so and gave no explanation as to why he did not do so. He was alert to the possibility from attending trade fairs in the Far East that iPods were susceptible to counterfeiting. 1st Freight's warehouse was at Chadwell Heath in Essex. It would not have been a long trip and would also have given him an opportunity to look at 1st Freight's operations. We acknowledge that to some extent he relied upon trust and long-standing relationships with the directors of Fairford. However this was a large transaction for the appellant involving a consignment worth over £2 million. We regard this as a further example of Jatinder not taking the steps a reasonable businessman might be expected to take.

(7) ***Serial Numbers***

182. The respondents submit that a reasonable commercial businessman would have obtained the serial numbers of the iPods in the transaction. Obtaining the serial numbers would enable the appellant to validate any returned iPods. If the purchaser did want to return some or all of the iPods for any reason the appellant would be unable to verify whether they were the same iPods it had sold. Likewise if the appellant needed to return the iPods to Fairford for any reason.

183. We can see that in relation to warranty issues, wholesalers and retailers could return goods directly to Apple Inc. However where for example goods are damaged in transit or whilst in storage circumstances can plainly arise that a purchaser will have cause to return the goods to its supplier. Jatinder did not appear to be alert to this possibility. He did not enquire with 1st Freight as to the feasibility or cost of obtaining the serial numbers of the iPods. It may be that it wasn't feasible or would have been prohibitively expensive. The relevant point is he did not attempt to find out.

184. We do not go so far as to say, as the respondents submit, that the appellant should have obtained the serial numbers. We had no evidence before us as to where the serial numbers were on the product and/or its packaging. Nor did we have any evidence as to whether those serial numbers were in machine readable form. We do however find that Jatinder did not even consider the issue. Again, that may be a question of oversight on his part. This was his first transaction in such products and he might not have fully considered the possibility. We accept Mr Virk's submission that

it does not necessarily indicate that Jatinder knew that the transaction was connected with fraud.

*(8) **Banking Arrangements***

185. All parties in the transaction chain banked with FCIB. For the reasons given above we are satisfied that there was circularity in the movement of funds on 3 and 4 August 2006. We do not consider that it was a matter of co-incidence that all parties involved in the circular flow of funds banked with FCIB. It appears to us that this was a matter of design. It is a factor pointing towards knowledge on the part of the appellant although it is not in our view determinative of that issue. It remains possible that the appellant was unwittingly persuaded to open an FCIB account and to use it for the purposes of these transactions.

186. Jatinder's evidence was that FCIB approached the appellant in 2005 with a view to obtaining their business. An appointment was arranged and Jatinder briefly attended a meeting which took place with a representative of FCIB together with his father and Bobby. The reason Jatinder gave for the appellant opening an FCIB account was that HSBC were unable to offer online banking with instantaneous transfers of large amounts. We were referred to evidence as to whether HSBC were able to provide online CHAPS or SWIFT transfer facilities to customers such as the appellant. We are prepared to accept Mr Virk's submission on the evidence before us that FCIB did offer facilities to businesses such as the appellant which HSBC were not able to offer. Hence there was a commercial reason why the appellant might have wanted to open and use its FCIB account in order to make immediate payments.

187. It is clear that on 21 August 2006 the appellant had decided to close its FCIB account and the balance was reduced to zero. The account itself was not formally closed until 9 November 2006. As we have found above, the appellant opened its ICB account on 25 August 2006. The ICB account number was "1054601936". Payments into that account from UMTS were described on the statement as "*Transfer from 'umtssl' – '1054601634'*". Payments out of the account to Fairford were described on the statement as "*Transfer to 'FAIRFORDGROUPPLC' – '1054601820'*". The account numbers are very close together and we find as a fact that at or about the same time as the appellant opened its account with ICB, UMTS and Fairford Group also opened accounts with ICB. We asked Jatinder about this and he "*could not be 100% sure*" whether UMTS or Fairford had an ICB account. He said that he had had no discussions with Fairford or UMTS about opening an ICB account.

188. We note that the documents obtained by HMRC from Tradex include an ICB statement for Tradex showing account number 1054601207 opened on 30 June 2006. From this it also appears and we find as a fact that A-Z had an ICB account number 1054602137. Both these accounts were used for payments in relation to the 17,500 iPods in October 2006.

189. The evidence of Mr Griffiths was that he was unable to find any trace of ICB on the internet. The ICB statements in evidence give no address, telephone number or

other identifying details. His evidence in this regard was not challenged and we accept it.

190. Jatinder's evidence was that the appellant was approached by ICB to open an account. The fact that the appellant opened an account with the same bank to which Fairford and UMTS also migrated cannot be put down to co-incidence as Jatinder's evidence would suggest. We consider that the appellant's banking arrangements are significant in suggesting that the appellant and its counter-parties were not dealing on a commercial basis at arms length. There was no commercial reason why they should arrange their affairs so as to share the same bank.

(9) Fluctuations in the Appellant's Turnover

191. The respondents rely on fluctuations in the appellant's turnover. In particular they point to the fact that the turnover in 2006 was some £7 million against a turnover of between £ 2-3 million in the previous 3 years. £2 million of that turnover related to the transaction in this appeal. The balance appears to be related to various other deals with Fab Designs Ltd ("Fab") referred to below.

192. The increase in turnover due to the transaction in this appeal does not add anything to the respondents' case on knowledge. For the reasons given below we are not satisfied we can make any relevant findings of fact in relation to the appellants deals with Fab. The increase in turnover therefore does not help us in assessing whether the appellant knew of the connection with fraud.

(10) Circularity of Funding

193. We have found that there was a circular movement of just over £900,000 between the parties identified above. The movement started with transfers totalling £912,375 from SNV to Best in Sweden and ended with a transfer of £897,000 from RCCI to SNV. We have also found that the appellant's transactions with Fairford and UMTS formed part of a scheme intended to defraud HMRC.

194. We accept Mr Virk's submission that the mere fact that the appellant's receipts and payments in August 2006 formed part of the circular flow of funds does not necessarily indicate that it knowingly participated in the fraud.

(11) Previous Involvement with MTIC Fraud

195. The respondents rely on what they say is the appellant's previous involvement with MTIC fraud as part of their case on knowledge. In particular that the appellant acted as a buffer trader in 10 deals between May and August 2006. They allege that those deals have all the hallmarks of MTIC fraud, including:

(1) Absence of any effective due diligence by the appellant,

(2) Use of an account with an overseas institution, Universal Mercantile Building Society Ekonomisk Forening ("UMBS").

(3) Circularity of funds in each of the deals with all parties banking with UMBS

(4) Various alleged links between the appellant, Fab and Fairford and other companies in the deal chains.

196. There is no evidence before us which establishes the deal chains for the 10 deals in question. Nor is there any sufficient evidence from which we can be satisfied that there was a fraudulent defaulter in those deal chains. In the circumstances we have had no regard to the appellant's dealings with Fab.

197. The respondents also rely on deals involving a company called Chak de Phattay Limited ("Chak"). We make the following findings of fact in relation to Chak.

198. Chak was a company registered for VAT with a business activity declared to be "wholesale of spirits". The directors of Chak were Bobby and Kuldip. Jatinder's oral evidence to us confirmed an account previously given in correspondence. He had a contact in Birmingham called Assad Chohan ("Chohan") who had experience of dealing in diamonds. Towards the end of 2005 Chohan told Jatinder that there was a shortage of quality diamonds due to the war in Sierra Leone which gave an opportunity to make substantial profits. Chohan told Jatinder that his company had been deregistered by HMRC and he could not become registered because of his previous history. He asked Jatinder if he could buy diamonds through one of Jatinder's companies. Jatinder didn't enquire as to why Chohan's company had been de-registered or why Chohan was unable to be registered for VAT. However he put forward Chak as a trading vehicle, apparently with the consent of Kuldip.

199. Chohan introduced Jatinder to a Dutch company called African Networks BV. In turn Jatinder introduced African Networks to a Birmingham based company called Diamond Merchants Ltd which he knew through a contact called Imran Sarwah. Jatinder gave evidence that his understanding of the deal was that he would be paid a 1% commission by Chohan on behalf of African Networks for making the introduction.

200. Jatinder's evidence about the circumstances of these dealings was inconsistent and vague. In his witness statement Jatinder's evidence was that he considered the transactions involved minimum risk as he would only be taking a commission. Further, that he decided to make use of Chak to facilitate the transaction. He made no mention of Chohan wanting to use a company because he could not be VAT registered.

201. Jatinder arranged the documentation for the deal. In fact that documentation shows that on 29 November 2005 Chak invoiced Diamond Merchants for a supply of diamonds in the sum of £3,090,369.60 plus VAT of £540,814.68 rather than for commission. Jatinder did not explain why he had not simply invoiced African Networks for his commission. When asked why, he simply said *"I thought this*

transaction would have been best suited for this, using the company". He conspicuously failed to answer the question.

202. In January 2006 there were further invoices but this time Chak was buying from Diamond Merchants and selling to African Networks. The result of the diamond deals was that Chak's VAT return for 01/06 showed total sales of £6,268,279 and purchases of £6,229,454. There was a net VAT reclaim of £13,993. In fact the reclaim was queried by HMRC and during the course of their enquiries Chak reversed the transactions by issuing two credit notes on 28 April 2006.

203. Jatinder's evidence was that he thought he had been drawn into a fraud but he did not understand the nature of the fraud. In his closing submissions Mr Virk accepted that Chak had been drawn into a sham transaction. The evidence before us is not sufficient for us to make any findings of fact in relation to the fraud other than those set out above. We are satisfied that the transactions were connected with fraud but we cannot be satisfied that Jatinder was aware of the fraud at the time the transactions were carried out. However Jatinder is an intelligent man. We find that the circumstances in which Jatinder caused Chak to enter into these transactions suggest that he was prepared to disregard what must have been obvious concerns about the transactions in pursuit of a profit. In making this finding we reject Mr Virk's submission that the circumstances of the Chak dealings are irrelevant to the issues before us. They provide evidence which is relevant to Jatinder's state of mind at the time he entered into the iPod transactions.

204. Finally in this section the respondents also rely upon transactions involving a company called Azure Promotions Limited ("Azure"). Jatinder's uncle Billy is a director of Azure which has had a VAT repayment claim of £649,923 for period 05/06 refused by HMRC. They rely upon various connections involving the officers of Azure and similarities between Azure's dealings in mobile phones and the dealings of the appellant.

205. There was no documentary evidence before us from which we could make any findings of fact in relation to Azure's transactions and we do not take it into account in our consideration of the issues on this appeal.

(12) ***Subsequent Non-Compliance***

206. Finally the respondents say that the appellant has failed without reasonable excuse to pay certain VAT returns subsequent to period 07/06. The outstanding liability is £124,356. Jatinder's evidence, although he did not have responsibility for such matters, was that the accountants had advised the appellant it could legitimately withhold payment pending resolution of the 07/06 claim.

207. Whether or not the accountants advised in those terms, Mr Griffiths' evidence was that HMRC do not pursue outstanding amounts in such circumstances. We do not consider that the appellant's failure to pay this liability casts any light on whether it knew that the transactions in 2006 were connected with fraud.

(13) ***Miscellaneous Points in relation to Knowledge***

208. We have covered Mr Virk's submissions in response to the matters relied upon by the respondents. The broad thrust of his submissions was that there are a number of reasonable explanations for the circumstances of the transactions which do not involve fraud. In addition he also relied upon the following facts and matters as supporting an inference that the appellant did not know of the connection with fraud.

209. Mr Virk submitted that the evidence relied upon by the respondents to establish knowledge was entirely circumstantial. That is undoubtedly the case but often in civil fraud cases there is no direct evidence of fraud. In *Dadourian Group International Ltd v Simms [2009] EWCA Civ 169* the Court of Appeal dealt with a similar submission:

> "*… At times [counsel] came close to suggesting that fraud can only be established where there is direct evidence. If that were the case, few allegations of fraud would ever come to trial. Fraudsters rarely sit down and reduce their dishonest agreement to writing. Frauds are commonly proved on the basis of inviting the fact-finder to draw proper inferences from the primary facts…*"

210. Fraud, as Mr Virk submitted, is a concealed act. It is concealed from the victim and it may also be concealed from other parties. It is likely that the orchestrator of a fraud will want to conceal his identity and in so far as possible the existence and nature of the fraud from any persons who do not need to know. Depending on the circumstances it may be difficult for an innocent party to know or have the means of knowing that a transaction is connected with fraud.

211. We accept that submission and take it into account in our consideration of the inferences we can draw from the evidence. However the nature of MTIC fraud is such that a business can effectively participate in the fraud either wittingly or unwittingly. A business can know that a transaction is connected with fraud where it does not know the identity of the fraudster and where it does not know the detailed nature of the fraud itself. The knowledge or means of knowledge comes from all the circumstances in which the transaction presents itself.

212. In some cases of MTIC fraud the goods do not actually exist. The respondents accept that the goods in the present transaction existed and were shipped to France. Mr Virk invited us to draw a positive inference in favour of the appellant from this fact. We do not think it appropriate to do so. The existence of the goods sheds no light on whether or not the appellant knew or should have known of a connection with fraud.

(14) ***The Credibility of Jatinder's Evidence***

213. Mrs Newstead submitted that Jatinder lacked credibility as a witness. She relied upon the following matters in this regard:

(a) New evidence which he gave for the first time at the hearing in relation to translating due diligence documentation for UMTS.

(b) That his answers were often evasive, for example his refusal to accept that this was a particularly valuable deal for the appellant.

(c) The failure of the directors to give evidence.

214. We have dealt with each of these matters above in our consideration of the factors relied upon by the respondents to establish knowledge. We found Jatinder's evidence unsatisfactory in a number of other respects and we have noted these in our findings above.

215. For his part Mr Virk invites us to take into account that the evidence was concerned with matters of great detail some 6 years ago and which will involve some slippage of memory due to the passage of time. He also submits that neither Jatinder nor the appellant have ever been involved in any allegation of fraud before. The appellant has a good reputation and would risk losing it if it became involved in a transaction connected with fraud.

216. We have taken these factors into account in assessing the significance of the evidence.

Decision on Knowledge

217. We have considered all the factors and inferences referred to above. As we have previously said there is no one circumstance from which we can infer knowledge. It is a process of considering all the circumstances as a whole.

218. There are a number of areas where we have found that a reasonable businessman would not have acted as Jatinder did in carrying out the iPod transactions. The relevance of those findings is that we would not expect an intelligent commercially aware businessman such as Jatinder, consulting with the directors, to carry out such a significant transaction in the way that he did. The fact that he did is a further indicator of knowledge.

219. There are also a number of areas where we have found that the explanation may be oversight rather than anything more sinister. However we do not lose sight of the fact that the cumulative effect of a number of oversights can lead to an inference that the Jatinder's approach to the transaction was so casual that he did not really care about the commercial risks associated with the transaction.

220. We have identified under each heading the significance we place on the various facts and matters relied upon by both parties in their submissions. On the basis of all the evidence the inescapable conclusion is that Jatinder knew at the time he entered into the transaction that it was connected with fraud.

Should the Appellant have Known of the Connection with Fraud?

221. The respondents contend that if the appellant did not know of the connection with fraud then it should have known of that connection. The appellant denies that it should have known of any such connection.

222. The facts and matters relied upon by the respondents in this regard are much the same as those set out above in relation to actual knowledge. The respondents say that those facts and matters should have made the appellant aware, through Jatinder, that the only reasonable explanation for the circumstances in which the deal took place is that it was connected with fraud.

223. Mr Virk submitted that there were a multitude of reasonable and legitimate explanations for the circumstances in which the transaction came to be carried out. He cross-examined Mr Griffiths to this effect. It is only right and proper that Mr Virk should put his case to Mr Griffiths, and that Mr Griffiths should answer the questions put to him. In the end however we have not found these passages of cross-examination particularly helpful in reaching our decision. As Mr Virk submitted Mr Griffiths is "*essentially a desk based witness and is not a witness of fact*". We agree with that submission. We can illustrate the point by reference to the cross-examination and re-examination of Mr Griffiths. The following passages are from cross-examination:

"*Mr Virk:* *… it is possible that this transaction wasn't actually connected with fraud and was a genuine transaction, isn't it? That's possible.*

Mr Griffiths: *It is possible.*

Then later:

"*Mr Virk:* *So it is possible that a reasonable company looking at the circumstances of the transaction … could not have known of the fraud. That's possible, isn't it?*

Mr Griffiths: *It is possible.*

224. The following passage is from re-examination:

"*Ms Newstead:* *Given all the circumstances of the transaction that you have looked at what did you consider to be the only reasonable explanation for the iPod transaction to be?*

Mr Griffiths: *I considered it the only possible explanation was that it was connected to fraud.*

225. Whether or not Mr Griffiths thinks that there is a reasonable explanation for the transactions other than fraud is really beside the point. With due respect that is a question we as a tribunal must answer.

226. Mr Virk also put to Mr Griffiths various criticisms of the enquiries he made for the purposes of making his decision and bringing evidence before this tribunal. In some respects there were omissions and Mr Griffiths acknowledged as much. However, as we have said we are concerned with determining the issues on this appeal by reference to the underlying evidence.

227. We have considered each of the factors set out above in the context of whether the appellant should have known of the connection with fraud. In this context we do not rely on the absence of due diligence. HMRC do not put their case on the basis that the appellant would have been likely to discover the connection with fraud if it had carried out further checks. Rather it is all the circumstances in which the appellant was able to secure a supplier and a customer for the iPods and generate a substantial profit with no experience in the market.

228. We are satisfied that if the appellant did not know of the connection with fraud the circumstances were such that Jatinder must have realised that the only reasonable explanation for the circumstances in which appellant came to enter into the transactions was the connection with fraud.

Generally

229. The input tax credit denied by HMRC is in the sum of £353,412.50. This is the input tax incurred by the appellant on purchasing the iPods. After denying that input tax credit the appellant's VAT return for 07/06 showed net tax repayable for the period of £17,791.90. The respondents say that the appellant has been given credit for that sum in its VAT account. Any issues as to the treatment of that sum do not arise from the decision of HMRC to refuse input tax credit and are not otherwise within the jurisdiction of the tribunal. If the appellant considers that it has not been repaid this sum or that it has not had an appropriate credit in its VAT account then that is a matter to be pursued with HMRC, if necessary through the civil courts.

230. In the event that it should succeed on the appeal the appellant claimed compound interest on the repayment due. We did not hear detailed argument on that claim and in the circumstances we need say no more about it.

231. The appellant also claimed entitlement to damages. The tribunal has no such jurisdiction and even if the appellant had been successful Mr Virk did not identify any basis upon which we could award damages.

232. For all the reasons set out above we dismiss the appeal. Any application for costs pursuant to Rule 10 of the Tribunal Rules should be made within 28 days of the release of this decision. The requirement of Rule 10(3)(b) to include a schedule of costs may be dispensed with.

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

JONATHAN CANNAN
TRIBUNAL JUDGE

RELEASE DATE: 9 November 2012