TC03062

Appeal number: LON/2008/01142

Value Added tax – Missing Trader Intra-Community Fraud (MTIC) – Input VAT claimed in respect of supply of mobile phones – fraud and orchestration conceded – did appellant know of connection with fraud- should appellant have known of connection with fraud –Axel Kittel v Belgian State and Mobilx v HMRC applied –failure to complete exports – output VAT claims out of time- held- Appellant should have known of connection with fraud – Appeal dismissed.

FIRST-TIER TRIBUNAL
TAX CHAMBER

WIRELESS WIZARDS LIMITED **Appellant**

- and -

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

TRIBUNAL: JUDGE RACHEL SHORT
GILL HUNTER

Sitting in public at 45 Bedford Sq London on 22 - 24 July 2013

Liban Ahmed for the Appellant

Paul O'Doherty, instructed by the General Counsel and Solicitor to HM Revenue and Customs, for the Respondents

DECISION

The matters under appeal

1. This is an appeal by Wireless Wizards ("WW") against a decision of HMRC, evidenced in a letter of 18 April 2008, to deny a claim for an amount of input tax of £1,039,086.20 for the VAT period 04/06 on the basis that the Appellant knew, or should have known, that the transactions to which the input VAT related were part of a scheme to defraud HMRC of VAT. Specifically, in the terms of the relevant case law, that the purchases by WW were supplies to a taxable person who "*knew, or should have known that, as a result of these purchases, it was participating in transactions connected with the fraudulent evasion of VAT*". That decision was appealed by WW on 15 May 2008.

2. The transactions in question were four acquisitions of mobile phones by WW from The Accessory People Global Limited ("TAP") and their on sale to World Communications who were based in Madrid. The only issue presented to us for a decision was whether HMRC have demonstrated to the required standard of proof that WW (acting through Vernon Hall ("Mr Hall"), its sole director), knew or should have known that the sales of mobile phones which it carried out as part of these four deals ("Deals 1 – 4") were connected with fraud.

3. The following issues were accepted by the Appellant and confirmed to the Tribunal –

(1) The deal chains set out in the deal sheets produced to the Tribunal

(2) Tax losses had arisen as a consequence of fraud

(3) Deals 1 – 4 were connected with these fraudulent tax losses

(4) The fraud in question was an orchestrated fraud involving TAP Global and WW's customer.

(5) The fraud in question was a "Missing Trader Intra-Community Fraud" ("MTIC").

4. The defaulting traders are accepted by the Appellant as Anfell Traders Limited in respect of Deals 1 and 2 and Computec Solutions Limited in respect of Deals 3 and 4. Anfell Traders became a missing trader having failed to account for £27 million of UK VAT. The VAT lost on Deals 1 & 2 involving Anfell Traders was £342,487.50. Computec became a missing trader having failed to account for more than £100 million of VAT. The VAT lost on Deals 3 & 4 involving Computec was £625,843.75.

The Law

5. The relevant EU legislation which sets out a VAT registered trader's right to reclaim input tax is the Sixth Directive 77/388/EEC, at Article 17. The UK legislation implementing the Directive's rules about input tax reclaims are sections 24 – 26 Value Added Tax Act 1994. These provisions state that if a registered trader has suffered input tax which is allowable, he has a right to offset this against his output tax liability or receive a repayment if the input tax exceeds the output tax due.

6. European cases have decided that the general rule in Article 17 is subject to an exception in the following circumstances :

> " *a taxable person who knew, or should have known that, by his purchase, he was taking part in a transaction connected with the fraudulent evasion of VAT must, for the purposes of the Sixth Directive, be regarded as a participant in that fraud, irrespective of whether or not he profited by the re-sale of the goods*
>
> *This is because in such a situation the taxable person aids the perpetrators of the fraud and becomes an accomplice.*
>
> *In addition, such an interpretation, by making it more difficult to carry out fraudulent transactions is apt to prevent them ……..*
>
> *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 the fraudulent evasion of VAT, it is for the national court to refuse that taxable person entitlement to the right to deduct". (Axel Kittel v Belgian State v Recolta Recycling SPRL (joined cases – C-439/04& C- 440/04) [2006] ECR 1 – 6161).*

7. The UK's own courts have commented on the application of the Kittel decision in the *Mobilx* decision of the Court of Appeal:

> "(*The test) includes those who should have known from the circumstances which surround their transactions that they were connected to a fraudulent evasion. If a trader should have known that the only reasonable explanation for the transaction in which he was involved was that it was connected with fraud and if it turns out that the transaction was connected with the fraudulent evasion of VAT then he should have known of that fact. He may properly be regarded as a participant for the reasons explained in Kittel.*
>
> *If he chooses to ignore the obvious inferences from the facts and circumstances in which he has been trading, he will not be entitled to deduct…..*
>
> *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 with fraud". (Mobilx Ltd v HMRC [2010] EWCA civ 517)*

8. There are also a number of recent decisions from this Tribunal which consider the same test, including *Else Refining and Recycling Limited v HMRC* ([2012] UKFTT 407(TC)) and notably *JDI Trading Limited v HMRC (*LON/2008/1179) which concluded, in a decision in favour of the taxpayer, that, in order to prove that a tax payer should have known of a connection with fraud, it is not sufficient for HMRC to establish that "*the taxpayer should have realised it was more likely than not that the transactions were connected to fraud*" in order to deny the right to deduct. HMRC must demonstrate that the only reasonable explanation for the circumstances in which the transactions took place is a connection with fraud.

The Background facts

The trading history of WW

9. WW was incorporated in the UK on 17 April 2002 and has been registered for VAT since August 2002 with VAT registration number 798 7141 71. Vernon Hall, ("Mr Hall") was appointed as director of the company on 20 September 2005. The company secretary is Sandra Hall. WW's registered office is 497A Green Lanes, London N4 1AL. Mr Hall acquired WW in September 2005. Mr Hall stated in an HMRC questionnaire dated 2 November 2005 that WW's business was "*wholesale trading of mobile telephones, computer components and other electrical goods*".

VAT history of WW

10. WW accounted for VAT on a quarterly basis. WW's VAT turnover for the periods from August 2002 – July 2007 is set out below, from which it is clear that a very significant increase in turnover occurred during the late 2005 to mid 2006 period.

Period	WW Annual Turn Over (£)	
01/08/02 – 31/07/03	14,591	
01/08/03 – 31/07/04	80,632	
01/08/04 – 31/07/05	14,870	
01/08/05 – 31/07/06	9,030,680.	

11. Mr Hall's first contact with TAP was in August 2005. He attended a meeting at TAP's offices on 26 September 2005. At that meeting TAP representatives were Steve Isles (TAP Group MD) and sales manager Chris Frazer.

12. Soon after this meeting, Mr Hall entered into a loan agreement for the financing of WW's activities from his associate, Mr Langley. The loan was made on 19 October 2005 and amounted to £400,000 at an interest rate of 15% for an initial twelve month term. This was later increased to £750,000 in May 2006 and by a further £10,000 in February 2008. The total value of the loan was £760,000 all of which remains outstanding. The loan was backed by a personal guarantee from Mr Hall.

13. HMRC visited WW's premises in November 2005, represented by Officer Kwame Ofori and on 25 June 2006, represented by Officer Davies.

Details of Deals 1 - 4

14. The detail of the four transactions to which the input tax which is the subject of this appeal relates is set out in detail below, all of the deals were transacted with the same parties between April and June 2006:

Deal 1 - 10,000 Nokia 6680 acquired from TAP Global at £188.50 each plus VAT. Purchased by World Communications for £196 each for a total of £1,960,000. Dated 24 April 2006. Payments made 15 June in two tranches £921,200 and £1,038,800.

Deal 2 1,500 Samsung D600S acquired from TAP Global for £169.50 each plus VAT, purchased by World Communications for £176.00 each for a total of £264,000. Dated 24 April 2006. Payment made 21 June.

Deal 3 5,000 Nokia 8800 acquired from TAP Global for £416.00 each plus VAT. Purchased by World Communications for £432.50 each for a total of £2,162,500. Dated 28 April 2006. Payments made 29 May £1,195,600 and 14 June £966,900.

Deal 4 5,000 Nokia 9300i acquired from TAP Global for £344.50 each plus VAT. Purchased by World Communications for £358.00 each for a total of £1,790,000. Dated 28 April 2006. Payments made 15 May £1,324,600 and 21 June £465,400.

The total value of all of these deals was £5,941,750.00. In each deal the entity which WW acquired its phones from was TAP and the entity which WW sold its phones to was World Communications. WW made payment to another TAP group entity, TAP Limited.

The Evidence

15. We were provided with witness statements from HMRC:

(1) Peter Davies, Higher Officer of HMRC in respect of Anfell Traders and WW

(2) Timothy Reardon –Higher Officer in respect of Computec Solutions Ltd

(3) Sarah Allen –Officer of HMRC, in respect of TAP

(4) Philip Hawkins – HMRC criminal investigator in respect of Operation Euripus and TAP

(5) John Ball – office of HMRC in respect of the payments made through FCIB

(6) Andrew Letherby – HMRC digital forensic officer, expert reports relating to FCIB servers and IP addresses

(7) John Fletcher – Director of KPMG LLP, provided an expert witness statement on the mobile phone handset industry in 2006.

(8) Roderick Stone –details of MTIC fraud in general

(9) Mathew Bycroft Higher Officer of HMRC MTIC team, allocated to WW in respect of this appeal.

16. Peter Davies, Mathew Bycroft and Sarah Allen also gave oral evidence before the Tribunal and were cross examined by Mr Ahmed.

17. Mr Hall, having made three witness statements, also gave oral evidence before the Tribunal. He was cross examined by Mr O'Doherty.

18. Mr Langley provided a witness statement and oral evidence before the Tribunal. Mr Langley was cross examined by Mr O'Doherty.

19. We were also provided with extensive documentary evidence which we referred to throughout the hearing.

On the basis of this evidence, we make the following findings of fact:

Mr Hall's involvement with the mobile phone industry.

20. Mr Hall stated that he had been involved in the retail side of the mobile phone industry since 1989 and had owned a company called Worldwide Communications UK between 1998 and 2003 that traded in the wholesale mobile phone industry. Under cross examination Mr Hall said that while he had some experience of the wholesale mobile phone industry; this was perhaps not as extensive as was suggested in his witness statement. Nevertheless, we take from this that Mr Hall had at least some basic knowledge of the way in which the wholesale mobile phone industry operated.

Mr Hall's purchase of WW.

21. The precise circumstances in which Mr Hall purchased the Appellant company, WW were not completely clear. Mr Hall originally stated that he had purchased WW through an advert in Loot and that he had purchased an existing company because it was easier to start trading with a company which already had some trading history. Under cross examination Mr Hall said that he could not recall exactly where he had purchased WW from. It is clear that WW was purchased as an existing company by Mr Hall with a view to entering into transactions with TAP.

Mr Hall's involvement with TAP.

22. It is a critical part of WW's case that TAP operated as a significant player in the mobile phone industry and made a very significant impression on Mr Hall when he visited their offices in September 2005. Mr Hall said that no one specifically introduced him to TAP; it was a large player who he had always been aware of in the industry. WW commenced trading with TAP at the end of October 2005.

23. The impressive nature of TAP's office was corroborated by the evidence of Sarah Allen, who visited their offices as part of a compliance visit on 13 December 2006. The Tribunal accept that TAP appeared to operate a successful business from impressive offices, with numerous signs of their success displayed, from the award photographs in the offices to the sports cars parked in the parking bays.

24. TAP's initial meeting with Mr Hall included discussions of its trading model, including the fact that it needed to release funds because its large VAT repayments were not being processed by HMRC as quickly as it would have liked. Mr Hall understood from those discussions that a company like WW could solve TAP's cash flow problems by transferring the VAT repayment period from TAP to WW, with WW replacing TAP as the entity re-claiming VAT on supplies made to EU clients. Mr Hall described this trading model as appearing "rational and sensible". According to Mr Hall, he specifically asked about the risk of fraud in dealing with TAP and was assured by TAP that it was the importer of the goods and knew where the goods came from. Mr Hall was aware that TAP had its own legal and compliance departments which carried out checks on WW and Mr Hall himself.

Mr Hall and WW's meetings with HMRC.

25. Mr Hall stated that he was aware of the risks of VAT fraud in the mobile phone industry and that he had seen HMRC's notice 726 "Joint and Several Liability", and that he understood that it would be relevant for a trader purchasing bulk wholesale mobile phones, although he was not certain that he would have been aware of the contents of this notice at the time when he was considering entering these transactions in November 2005. In particular Mr Hall said that he had no recollection of being given a copy of Notice 726 when HMRC visited his offices in November 2005 and HMRC could not provide any written evidence that this had been done. No notes were made of this visit by HMRC, but Officer Davies did state that it was standard practice for HMRC to provide this notice and raise the risk of fraud specifically in

visits of this type. HMRC state that a letter was sent to WW on 28 November 2005 accompanied by a Notice 726. The notes from Officer Davies' visit to WW in June 2006 do specifically refer to Notice 726 being provided and a discussion of the due diligence required on suppliers in this market, however that visit occurred after the date of the transactions which we are considering.

26. Mr Hall was aware of the need to ensure that a party such as TAP with whom he was trading had verified that they were the importers of the goods in question, but understood that as long as this had been established between WW and TAP, there was no risk of him being caught in MTIC fraud. Indeed, he saw TAP as a defence against MTIC fraud, because they had confirmed that they were the importer.

27. The other reason why Mr Hall was comfortable to deal with TAP was because VAT of £482,000 relating to earlier transactions between WW and TAP was authorised on 11 April 2006 and payment was made on 24 April 2006. Mr Hall assumed that HMRC would have notified WW if there was a problem with the supply chains through TAP and the fact that this re-payment was authorised led Mr Hall to believe that TAP was "clean" from an MTIC perspective. He took this repayment as a stamp of approval from HMRC that it was safe to trade with TAP.

28. HMRC said that this repayment was made on a "without prejudice" basis and that HMRC had not been able to trace the supply chain any further than TAP, this was in part to due a lack of resource at HMRC at that time, when a large number of MTIC investigations were being undertaken.

Mr Hall's experience of MTIC fraud

29. Mr Hall had been involved as a witness of fact in an earlier money laundering case which was related to an MTIC fraud. He provided witness evidence relating to the conviction for money laundering offences of Mr Nicolas and the entity known as Ellagold in August 1998. We were provided with copies of this witness statement and evidence of the criminal convictions in these cases but there was no evidence that Mr Hall was involved other than as a witness of fact. Mr Hall had been involved in the mobile phone business with Mr Nicolas and his brother (through an entity known as Xcell Communications) since 1997, but had broken off connections with them prior to the date of these transactions.

The deals themselves – Deals 1 - 4

30. Turning in detail to each of the specific deals, there were a number of places where Mr Hall's evidence was rather vague and he had difficulty in recalling the precise details of many aspects of these transactions. In this regard Mr Hall was not a particularly credible witness. His inability to recall even some of the basic facts about each of these deals, which were, by any standards, very significant deals, gave an impression of evasiveness.

Contract Terms

31. We were shown copies of letters from TAP to WW in respect of each of Deal 1- 4 headed "Brokerage export deal" appointing WW to act as broker and stating that "*the goods listed below have been imported, that the CMR documentation is pending and that we have declared VAT on the same*". That letter also set out the basis of WW's remuneration for acting as broker being in each case "*the difference between the amount of our pro forma invoice and the price at which the goods are sold to World Communications, subject to a maximum price of [*] per unit*".

32. We also saw a signed pro forma document which TAP signed for each deal confirming to WW that as supplier of the goods in question they were trading under HMCE guidelines, that VAT on the sale would be declared to HMCE and that the stock existed and was of legitimate quality.

33. Mr Hall said that he could not recall any details of the terms of the contracts which would have been signed by him on behalf of WW, but did accept that he would have reviewed this at the time. No detailed terms of dealing were exhibited by WW. Mr Hall's understanding was that goods would only be released on receipt of full payment from the purchaser in the EU. In fact, it is clear from the evidence of the cash flows in the FCIB accounts that this is not what happened in practice; for example in Deal 1 goods were released on 24 April but payment was not made until 15 June.

34. Mr Hall could not recall who he dealt with at World Communications, although they were the only customer for each of these four deals. He relied on TAP's relationship with World Communications and assumed that there was a trading history between these two companies. In particular, he did nothing to check World Communications' credit rating and operated on the basis that if World Communications failed to pay the money owing to WW, his first recourse would be to TAP.

Evidence of import/export – the CMR documentation.

35. Mr Hall told us that he understood that it was important to have confirmation that the goods which he was acquiring from TAP Global had been imported into the UK and that there was some evidence of that importation.

36. The letters which WW received from TAP Global for each of Deal 1 – 4 referred to the fact that CMR documentation was pending, but Mr Hall said that he could not re call seeing the actual CMR and his view was that TAP's letters were deliberately intending to mislead WW to believe that CMR documentation existed when in fact it did not.

37. We were also told that Magic Transport (the freight handler) had been accused of fraudulently creating CMR documentation from January 2003 to October 2006 and we were shown the evidence of this prosecution, but there was no direct suggestion that, had the CMR documentation been asked for, it would have been forged.

38. In respect of Deal 1 Mr Hall said that while WW had organised the shipping of the goods to the EU, he could not recall faxing a copy of the CMR documentation nor

did he know where it was kept. The only CMR documentation which was produced to the Tribunal related to the export by WW to Magic Transport (Consignee) dated 4 May 2006 and referred to Deal 4 (CMR number 2310596).

WW's profits on each deal.

39. The margins made by WW on each sale to World Communications are set out here and were not disputed by Mr Hall. Neither was it disputed that TAP set a capped price which WW should attempt to reach but not breach in its sales to World Communications:

£ sold by TAP	£ sold by WW	Ceiling £	Margin
188.50	196	196	3.9%
169.5	176	176	3.8%
416.50	432.50	432.50	3.8%
344.50	358	358	3.9%

40. Mr Hall explained that for each of Deals 1 – 4 in his negotiations with World Communications, which were mainly done by telephone, he could not re-call the details of the negotiations which were done or who he dealt with. No documentation in respect of WW's introduction to World Communications was produced by the Appellant. It was unclear, what, if anything, Mr Hall knew about World Communications prior to April 2006. Mr Hall agreed that the margin made by WW on each deal was very similar – approximately 4%. Mr Hall could not explain why the margins were so consistent on each deal. In respect of each of Deals 1 – 4 WW's written brokerage agreements with TAP included a maximum price at which the goods could be sold to World Communications. As set out above, WW sold at that ceiling price on each of Deals 1 – 4. Mr Hall also confirmed that World Communications did not do any due diligence on WW for any of these four deals.

41. When asked what he was required to do in order to earn these margins Mr Hall could not be very specific, he referred to the administration required and his need to deal with World Communications and the freight forwarders and said that he understood that he was being utilised for his knowledge of the mobile phone market.

FCIB bank account.

42. Mr Hall explained that WW had an existing bank account with First Curacao International Bank ("FCIB") when he acquired the company and this was maintained by him. He knew nothing about FCIB at that time and as far as he was concerned there was nothing odd in WW having an offshore bank account with this entity. We

were provided with evidence which established that all of the payments relating to each of Deals 1 – 4 passed through accounts held at FCIB, through two of FCIB's European servers (the so called Paris server and the London server) and that most of those payment instructions were made from a common IP address (86.132.122.186). (Payments for tranche 2 of Deal 1 and tranche 1 of Deal 3 were not made through this IP address).

The Freight Handlers

43. Mr Hall said that he knew little about the freight forwarders who were involved in each of these deals. He knew that stock was held by them and that title to the goods could change while they were held by them. This was his first experience of using a freight forwarder and he did not check their premises or their reputation. As with World Communications, he relied on TAP's knowledge of the freight companies for his own comfort. Mr Hall said that he did check some of the IMEI numbers of the phones being imported on his behalf, but could not be precise about when this was actually done. Mr Hall said that he expected the freight forwarders to inspect the goods on his behalf and assumed that this would be done. He was unclear about the circumstances in which WW would actually inspect the goods themselves. We did see documentary evidence that the goods had been inspected while at the freight forwarders in the UK, but it was not clear on whose behalf these inspections were made.

44. Mr Hall was unclear in respect of any of the Deals what the instruction to the freight forwarders to "*ship on hold*" and "*release"* meant and what it was that triggered the release of the goods from WW's ownership. He said he thought that ship on hold meant prepare for shipping and hold until further notice. Mr O'Docherty suggested it meant ship but hold at the destination. He was then asked what prompted the release of the goods in respect of Deal 1. (The goods were shipped on hold and release meant that World Communications took possession of the goods. Mr Hall could not recall whether that meant they had inspected them and were satisfied. He was asked if he had refreshed his memory about the deals and he said that he had.) He told us that because World Communications was TAP's customer he was relaxed about the deals. When asked why the goods were released on 24 April but payment was not received until 15 June, he said it was a long time ago and he could not remember all the detail.

Who owns the phones?

45. When asked about the details of the time at which ownership of the phones in each of the deals passed, Mr Hall was very unclear, again, saying that he relied on TAP's instructions to ensure that goods were released and payments made. Mr Hall could not recall what triggered the release of the goods in respect of Deal 1, but did accept that the while the goods were released on 24 April, full payment was not made until 15 June 2006. While Mr Hall said that he had reviewed the purchase order for Deal 1, he could not recall when inspection had taken place or when payment should

have been made. Mr Hall said that he was aware that he had the right to inspect the phones while they were in the warehouse and he thought that he had undertaken "quite a few" inspections, but he could not recall the precise dates.

46. Mr Hall was equally unclear about the dates when the goods were released and payment made for Deal 2. Invoices were issued for 24 April 2006 but full payment was not made until 21 June 2006. Mr Hall could not clarify when these phones were shipped to World Communications or when they were released by WW. In fact the release notification was signed on 24 April. In respect of Deal 3, the facts are more confused, payment for the phones was made in two tranches (29 May and 14 June 2006), but the goods appear to have been released and shipped on 28 April and 4 May respectively. In addition, the two tranches of payment amounted to more than the actual price due for the phones. Mr Hall could not explain why he had overpaid by £256,000 for the phones nor why he had not sought to recover the overpayment. Deal 4 follows a similar pattern, with a fax relating to the release of the goods dated 28 April 2006 but payment being made on 15 and 21 June 2006.

47. Mr Hall was vague about whether he was offering credit to World Communications as the purchaser. He said that he had not done due diligence on the creditworthiness of World Communications because this was not required; if a customer failed to pay this was TAP's problem not his. He stated that he did not offer credit to World Communications, but could not explain how this could be correct when on all of the deals payment was made on deferred terms.

Insuring the phones

48. Mr Hall said that he did not insure the goods himself in any of the deals while they were in WW's ownership. He relied on TAP to make good any losses in respect of the phones which WW were transferring and relied on TAP's insurance. Mr Hall could not recall having reviewed a copy of TAP's insurance documents for the goods in each of the deals and was not aware of the precise terms of this insurance contract. He agreed that he should have reviewed the terms of this insurance, particularly since the terms of the shipping instructions for each of the deals was "CIF" (Cost insurance and freight). We were told that the insurance covering these Deals was in the name of TAP (with Axa Insurance).

Timing of deals.

49. From the evidence of the payments made through the FCIB accounts, it is clear that the payment instructions for each of the payments for Deals 1 – 4 were made in a relatively short space of time, and outside normal business hours. Mr Hall explained that in order to make the payments, he had to log onto an FCIB website and instruct payments. Mr Hall was not clear about this, but it was suggested that in some circumstances this would have been done in response to a telephone call from World Communications.

50. We were shown details of the payment flow through the FCIB bank accounts of the payments for Deal 1 – for which £1,040,99.25 was transferred by Mr Hall to TAP via the FCIB account at 23.24 pm on 14 June with a six minute time delay between receipt of payment from World Communications at 23.18pm on the same evening and payment out to TAP. Similarly in respect of Deal 3 payments made on 27 May through the FCIB bank accounts, these payments were also made late at night, in this case at 00.48 am with a similarly small time delay between receipt and on payment; a twelve minute delay between the receipt of the payment by Wireless Wizards from World Communications and payment out to TAP. Mr Hall said that he often worked irregular hours and that there was nothing unusual in him being at his computer late at night.

The loan funding

51. In contrast to Mr Hall, Mr Langley's evidence was clear and precise. He confirmed that he had known Mr Hall for twenty years and knew that he was involved in the retail mobile phone business. Mr Langley's own expertise was in the property business. Mr Langley knew that Mr Hall had been involved in previous failed businesses but blamed Mr Hall's business partners for that. As far as this deal with TAP was concerned, he understood that WW were to be the intermediary, or broker in a pre arranged deal. Having done some checks on TAP (through the internet) Mr Langley described the deal with TAP as a "no brainer" for WW. His £760,000 investment was on the basis of his knowledge of Mr Hall's experience in the mobile phone business. Mr Langley understood the business proposition from TAP to be that they had cash flow problems which WW could help to solve. Mr Langley said that he was aware that there was an issue with fraud in the mobile phone industry and he did ask Mr Hall about this, but both he and Mr Hall thought that this would only be a risk if exporting was involved.

52. Mr Langley explained that he took a personal guarantee against Mr Hall because he knew that this financing was "bordering on the top of Mr Hall's assets". Nevertheless the guarantee has not been called and as at the date of the hearing Mr Hall is indebted to Mr Langley to the tune of £1.5million from this transaction (taking account of the 15 – 20% interest rates).

The Arguments

Appellant

53. The essence of WW's argument is that, while there might have been some aspects of their deals with TAP Global which were unusual there was nothing to suggest that they might have been connected to fraud, particularly given the nature of TAP. WW was drawn in by TAP's considerable presence in the mobile phone market and treated them as a trusted supplier. TAP Global were described as having a "*significant and impressive history in the market*" and WW was drawn into a trap by a large and credible business. TAP intentionally both provided a plausible alternative explanation for each deal, namely that TAP needed help with cash flow to fund its large VAT re payments (the same in each case) and led WW to believe that the

mobile phones had been properly imported (by reference in particular to the obtaining of a CMR in their letters of 24 and 28 April 2006 to WW).

54. The actions of HMRC did nothing to alleviate this level of comfort, particularly the repayment of the £482,000 in VAT (after an extended verification process) for the 01/06 VAT period on 11 April 2006 which WW took as a "green light" to trade with TAP. This was compounded by the failure by HMRC talk about VAT MTIC fraud in their visits of 5 November 2005 (Officer Ofori). According to WW HMRC gave no specific warnings about the risk of MTIC fraud in deal chains in which WW was involved. WW knew about their immediate supplier, TAP and their purchaser World Communications but had no information about any other participants in the chain of transactions and had no reason to enquire further.

HMRC

55. HMRC's argument is that WW, as the broker in a chain of transactions for each of Deals 1-4, was sufficiently involved in the transactions to have known about the fraud. WW played an integral role in the supply chain to which the fraud was related. On the basis of the circumstances known to WW and the information provided to them, they should have known that the transactions were connected with fraud.

56. Mr Hall had experience in this market and was associated with convicted MTIC fraudsters, including the Nicolas brothers, who were convicted of MTIC related fraud in 2000. (The Cornhill – Xcell Communications case involving Andrew Nicolas in 1998).

57. HMRC had pointed out the risks of MTIC fraud to WW, in their letter of 28 November 2005, well before these transactions were entered into and Mr Hall should have been aware of the contents of Notice 726.

58. The circumstances of the transactions were sufficiently artificial to demonstrate fraud, particularly; (i) the lack of commerciality in WW's dealings, evidenced by the failure to take out insurance for the phones, WW's lack of knowledge or memory of how the transactions were effected, the other parties to the transactions, including the freight carriers, and WW's lack of credit checks on its counterparties (ii) the standardised margins made by WW with the customer it had been given, suggesting that no real commercial risk was being taken (iii) the circularity of funds via the FCIB account through a common IP address. The deals that were given to WW were contrived and too good to be true and WW must have known this when it agreed to enter into them and this indicated that the deals were fraudulent.

59. In the alternative, HMRC argue that even if WW did not have actual knowledge of fraud, it should have known that these transactions were fraudulent. WW, through Mr Hall, was aware of the risk of fraud in the mobile phone market and that knowledge, combined with the suspicious circumstances surrounding these Deals should have put WW on notice of the risk of fraud and the need to conduct further due diligence, which was not carried out.

Discussion

60. There is no doubt that there are many aspects of these deals which would make a normal business person suspicious. Mr Hall's lack of knowledge of, or ability to remember, what might be considered to be the fundamental elements of transactions which were, in the light of WW's pre-existing business, extremely significant, is surprising to say the least. These were clearly not normal business transactions either for the mobile phone, or any other type of UK business. However, in order to deny WW's right to have its VAT re-paid, HMRC have to demonstrate more than that these were contrived, non-commercial transactions.

61. It is clear that the onus of proof is on HMRC to establish the basis on which the right to a reclaim for input tax can be denied. HMRC have to demonstrate on the basis of the civil standard of proof (more likely than not) that WW "*knew, or should have known that by these particular purchases WW was taking part in a transaction connected with fraud*". This is a relatively high standard, as stated in the JDI decision, the test is not that WW knew or should have known that the deals were likely to have been fraudulent, or that there was a risk they might have been fraudulent, but that WW knew or should have known that each of the supplies in Deals 1 – 4 were connected with fraud.

62. The test is to be applied by reference to a reasonable person in Mr Hall's and WW's position, knowing what Mr Hall (and WW) knew or should have known. The Appellant has argued that the test is whether WW "knew for sure" it was dealing with fraudulent transactions. The Tribunal considers that the test is not quite that stringent. The test is whether taking all the circumstances of the deals as known to WW, it was clear that the deals were fraudulent or, in the alternative, that the only reasonable explanation for those deals was that they were fraudulent. In applying this test it is necessary to strip away the hindsight which we now have of what the deals actually involved and apply the test by reference to what was known to WW at the time, in summer 2006 when these deals were done.

63. HMRC made much of Mr Hall's previous involvement in MTIC cases. There was some dispute over this and especially the extent of his involvement in other MTIC frauds and relationship with those who were so involved. What is clear to the Tribunal is that Mr Hall had been in mobile phone market since 1989 and had given evidence in an MTIC related case. While this does not imply that his actions in the Deals must also have been with knowledge of fraud, we do think that his prior involvement in this area imposes an obligation to apply a higher standard of due diligence, even if Mr Hall's past activities are not strictly relevant to these particular transactions and this particular fraud.

Did WW know that these purchases were connected with fraud?

64. HMRC's first argument is that WW actually knew that these transactions were connected with fraud. The Tribunal has tried to establish what it was that Mr Hall and WW did actually know about these transactions on the basis of the evidence produced to the Tribunal. This was not made easy by Mr Hall's main response to questions about what he knew being his lack of detailed memory and knowledge. Mr Hall was not a very satisfactory witness in that regard and we have drawn our own conclusions

as much from what Mr Hall could not tell us, as from the limited amount of information which he was willing to provide.

What did WW definitely know about these deals:

65.

(1) That TAP was a party, and as a matter of deduction, that there must have been at least two other parties involved in each of Deals 1 – 4 other than WW and World Communications, being the manufacturer and an end retail customer.

(2) What TAP had told him about its VAT repayments and cash flow requirements. Mr Hall did not verify TAP's cash flow as far as we are aware.

(3) That mobile phones made outside the UK were being imported by TAP into the UK from France and then re-exported from UK to a warehouse in France, by TAP which had a French operation itself. - (It is worth mentioning here that we were told that the phones carried two pin chargers which would not work in the UK. Mr Hall said that he did not know they were two pin plugs – but that is because he did not check the phone consignments).

(4) The profit margins which were being made on deals, both the standard 4% margin made on each of the four deals and the ceilings set on sale amounts. The overall profit to WW was £234,759 for funding VAT of £1,039,086 for one month.

(5) That this profit margin was being made on the basis of WW having to do very little in order to earn it.

(6) The time when payments were made and received and the process for making those payments, with very short timing difference, outside normal business hours and via an offshore bank account.

(7) That HMRC had repaid in put VAT to WW for earlier periods in respect of similar deals, despite having undertaken a verification procedure.

What did WW know about this market?

66. Mr Hall certainly knew that fraud was prevalent in this market, even if, as he suggested, HMRC had not pointed this out to him in respect of WW, he had some experience in this market and must have picked up at least the rudiments of MTIC frauds from his involvement as a witness in the earlier MTIC related deal. The Respondent made much of Mr Hall's links with Andrew Nicolas and his links with Anfell Traders (the missing trader in this case) but Mr Hall said he had ended his connections with the Nicolas brothers some time before these deals occurred. The Tribunal was not provided with any specific evidence in respect of these transactions of a link between Andrew Nicolas and Mr Hall.

What facts didn't WW know?

67. It is equally important to establish what WW and Mr Hall did not know directly:

(1) The details of the deal chains above TAP

(2) That the CMR documentation which was referred to by TAP did not exist or was forged

(3) That other entities were accessing the FCIB account through the same IP addresses and that the payments made through those accounts were circular

(4) Anything about the condition of the mobile phones themselves – Mr Hall admitted that he only checked one of the phone consignments IMIE numbers on one occasion.

68. In respect of each of these issues, the Tribunal's view is that WW could have obtained further relevant information but in the circumstances, chose not to enquire.

What Commercial issues did WW not know or understand?

69. There were a number of significant commercial issues which Mr Hall said he was not aware of, or was not able to recall, many of which we consider to be fundamental to the deals which he was supposed to be managing:

(1) He did not enter into any insurance of his own for the phones while they were in WW's ownership and possession and had no information about the insurance which had been entered into by TAP, although he seemed to assume that he was covered by TAP's insurance

(2) WW had no detailed knowledge of the freight carriers who were appointed to ship the goods to France and the other EU destinations.

(3) WW did no checks on the creditworthiness of its customer, World Communications and had no clear idea of how it was managing the risk of a customer failing to pay.

(4) WW had only very vague details of the commercial terms on which TAP was dealing with WW, including whether any credit was being offered and had no such terms itself

(5) WW had no real understanding of how the sales to World Communications were effected or when legal ownership to goods passed and the significance of the time when this happened.

(6) WW through Mr Hall seemed to believe that there was no risk of MTIC fraud if the goods had been imported. If anything the opposite is the case: there would be no possibility of MTIC fraud if the transactions in question were purely domestic supplies of goods.

(7) Mr Hall did not understand what the terms 'ship on hold' and 'release' meant, whether he obtained CMRs for his exports, and that he needed export evidence for the sales to be zero-rated as exports.

70. We accept WW's submissions that it did not know anything about the deals which had been entered into above the level of TAP (neither did HMRC at that time, since they were happy to re pay WW's VAT for the 01/06 VAT period.). We also accept that WW did not know anything about the circularity of payments which were passing through the FCIB account. HMRC have not provided evidence that WW did know any further details about either of these aspects of the deal. It was only necessary for WW to understand and undertake their part of the circle in order for the fraud to succeed.

71. We have considered whether Mr Hall and WW's willingness to be involved in deals about which they seem so disinterested in the fundamental commercial terms and risks involved can only be explained by the fact that they knew that these were fraudulent deals and can be treated in itself as evidence that WW knew that the deals were fraudulent. We agree with HMRC that Mr Hall knew that these deals were too good to be true, but on the basis of the evidence provided do not consider that this is sufficient to demonstrate that Mr Hall had actual knowledge that the deals were fraudulent.

72. Despite HMRC's contentions, we do not consider that the fact that these deals are non commercial is enough to lead to a conclusion that fraud must be the explanation. There are many other reasons why a businessman might deal on non strictly commercial terms. The failure by WW to establish clear fundamental commercial terms is not necessarily indicative of fraud; it could merely be reckless commercial dealing.

73. Equally, while the contrived elements of the transactions certainly appear suspicious, we do not consider that this is enough in itself to establish that fraud must be the explanation. While contrivance might often be present in fraudulent deals, that does not mean that contrivance indicates the necessary existence of fraud.

74. On the basis of the evidence provided, the Tribunal has concluded that HMRC have not demonstrated that on the balance of probabilities WW had actual knowledge of the fraud in respect of each of the four deals.

Should WW have known that these Deals were connected with fraud?

75. It would be easy to establish that WW should have suspected that fraud was present here, but that is not the test which we are asked to apply. We are asked whether WW should have known that fraud was present.

76. The Appellant has approached the test by asking, - "*what else should WW have asked which would have revealed that fraud was present?"* We do not think that this is quite the right approach. Earlier decisions warn against concentrating too much on the due diligence which might or might not have been done by the taxpayer. On the other hand, neither do we think it is enough to suggest, as HMRC do, that the cumulative effect of a number of contrived and non-commercial circumstances must lead to the conclusion that WW should have known that fraud was present. HMRC

say that in this case "cumulative circumstances" amount to constructive knowledge of fraud. HMRC's evidence was directed at establishing that the deals were artificial and non-commercial, but we think that there is a gap between establishing non-commerciality and establishing that fraud is the only reasonable explanation.

77. We do acknowledge Mr Hall's comments about his dealing with TAP. Mr Hall would not be the first person in business to have suspended judgement as a result of dealing with a creditable and powerful counterparty with which he very much wants to do business and in circumstances where there is a prospect of great profits.

78. However, there were a number of suspicious circumstances which would have been apparent to WW –

(1) WW were being given the opportunity to make a large profit for no risk

(2) The deals were all carried out within a very short time frame

(3) There was always a willing buyer at more or less set price

(4) Payments were made through the offshore account of FCIB outside normal banking hours

(5) Payments were being made to a person other then the supplier of the goods (payments were made to TAP Limited, but WW's contract was with TAP).

79. In any other market, this might have aroused suspicions, in this particular market, it definitely should have. We agree with HMRC that the hallmarks of MTIC trades are clearly visible and would have been visible to Mr Hall. Given Mr Hall's experience of this market, this should have put him on notice that there was a significant risk of fraud. On the basis of the *Mobilx* decision, in cases like this the Tribunal should look at totality of evidence. On the basis of Mr Hall's evidence, or in many cases, lack of ability to provide any evidence, the Tribunal's view is that WW intentionally failed to asked questions which might have made it aware of fraud. We think that this puts them in the same category as taxpayers who intentionally ignore the existence of fraud. To use the terminology applied in another similar decision, Mr Hall and WW had at least "blind eye knowledge" that fraud was the only reasonable explanation for these deals.

80. The Tribunal would point to a number of specific basic enquiries which could have been made which would have led to a confirmation that these were fraudulent deals;

(1) *What are the goods which are the subject of this contract*? Mr Hall knew very little about the details of the type and specification of the mobile phones being imported. Most significant here is apparent lack of interest by WW in the location and security of the goods. These go to heart of commerciality of the deal. The Tribunal would expect this to be clearly established for any type of deal in any market. There is no evidence of inspection of the goods in any of these deals (other than a cursory inspection for Deal 1). If full details of the

goods had been ascertained it would have been clear that they were not phones which could have been used in the UK.

(2) *Can these goods be legally sold?* WW failed to obtain actual evidence of import documentation from TAP (the CMR documents). If they had followed this up, TAP would not have been able to provide this. Another basic question which we would expect anyone involved in any kind of commerce to establish. In this instance this meant insisting on the production of CMR documentation.

(3) *What is the character of the seller*? Even in a market where there was no risk of fraud, a certain level of due diligence could be expected for deals of the significance of these to WW. Without any such due diligence, a purchaser risks not just fraudulent dealing but any number of other legal and regulatory risks. For all WW knew he could have been dealing in goods contravening all sorts of laws and regulations. HMRC referred to the 2005 accounts of TAP, which would have been available to Mr Hall (and Mr Langley) which had either of them reviewed them made it clear that TAP had made a £1.6 million loss.

Lack of understanding of terms of dealing.

81. Tribunal does not consider that Mr Hall's contentions of how much he did not know about the details of these transactions is helpful to his case. Mr Hall described the transactions in one instance as similar to a franchising arrangement, which was at odds with the commercial facts of the deals, but revealing about how Mr Hall actually saw his role. In fact, the extent of Mr Hall's ignorance about even most basic details of the deals is almost so great as to lead us to conclude that no valid contracts were ever made either between WW and TAP or WW and World Communications. From this perspective WW is merely providing financing for the deals undertaken by WW and World Communications with little or no active involvement in the deals themselves. The Tribunal does not however consider that it is able to restrict the Appellant's right to re-claim VAT on this basis, particularly by reference to the decision in Bonik [*Bonik EOOD v Director na Direktsia* [2012] EU ECJ c-285/11]

82. Nevertheless we have concluded that Mr Hall's absence of knowledge, or recall, of many of the fundamental commercial aspects of these transactions, and his misunderstanding of what was required in order to successfully export the goods, supports our conclusion that he at least suspected, and should have known, that the deals were connected with fraud. Our conclusion is that Mr Hall believed that he did not need to understand the commercial aspects of these deals, or the risks which they entailed because he was merely providing the financing and an entity which could be used by TAP for deals which he should have known were fraudulent.

Conclusion

83. The Tribunal is aware of recent Tribunal decisions which have stressed that the test which HMRC has to pass in order to demonstrate that a taxpayer should have

known that transactions were connected with fraud is a stringent one and that a number of suspicious circumstances, and circularity of payments in particular, is not generally sufficient to establish this.

84. We have concluded that WW should have known that these deals were very likely to be connected with fraud, both because of information from HMRC about prevalence of fraud in this market, (Notice 726 and HMRC's letter of 28/11/05) Mr Hall's knowledge of the mobile phone market, including his involvement as a witness in an earlier MTIC case and the lack of commerciality surrounding these transactions. The combination of these would have made a reasonable business person carry out further investigations, which WW failed to do, to ascertain whether these deals were actually connected with fraud. Had Mr Hall undertaken these investigations, he would have been in a position to know that these deals were connected with fraud.

85. Neither the reputation of TAP nor the actions of HMRC in repaying earlier VAT are sufficient to override these warning signs. The status of TAP should not have persuaded WW, and would not have persuaded a reasonable business person that no further due diligence was required.

86. If WW was unaware that the deals were connected with fraud, that was based on a determined effort not to ascertain what was actually going on. The Tribunal cannot agree that it was "inconceivable that a business such as TAP would be involved in fraud". The Tribunal takes WW's lack of interest and failure to ask relevant questions about these transactions as an indication of their willingness to allow TAP to use WW for deals which they should have known were fraudulent.

87. The Tribunal has concluded that on the information available to WW, on the basis of what WW and Mr Hall did actually know, they should have considered it highly likely, that Deals 1 – 4 were connected with fraud and that this should have led to further due diligence being carried out. Whether this was not done due to naivety, stupidity, or willingly turning a blind eye, is not possible to be certain from Mr Hall's rather evasive evidence, but whatever the reason, the Tribunal has concluded that someone in WW's position aware of the circumstances of each of these deals and of the risk of fraud in this market, could and ought to have put himself in a position to know whether or not they were connected with fraud. The test in *Kittel* and *Mobilx* extends to intentionally failing to ascertain fraud, which is what we consider WW did.

Timing of release of goods – was there an export by WW?

88. Although this was not a point raised by either party, the Tribunal has considered whether the confusion about the time when title to the goods passed and lack of export documentation means that the phones were not in fact successfully exported when they were sold. In each of Deals 1- 4 the release notification was sent to the UK freight forwarder, instructing release of the goods before they left the UK. No CMRs were available for the deals, (other than in respect of Deal 4) therefore there was no evidence that the goods left the UK, a requirement for zero-rating. This should have

been apparent to the visiting officer and output tax would have been due on what would have been treated as UK sales rather than a denial of input tax under the MTIC fraud provisions. It is long past the time when this course of action is available so we have considered whether the failed exports affect what we are required to consider in this case. The Tribunal has considered whether this changes the nature of the fraud and therefore the knowledge with which WW needs to be fixed. We have concluded that it does not, since the fraud existed at top of the chain, and the fact that circle of MTIC exports was not completed does not mean that there is no fraud for WW to know about.

Costs

89. HMRC made an application for their costs if successful. In the absence of a request for the Value Added Tax Tribunal Rules 1986 to apply, Rule 10 of the Tribunal Rules applies and on that basis we order costs in favour of the Respondents to be assessed by the Tribunal if not agreed.

90. 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.

RACHEL SHORT
TRIBUNAL JUDGE

RELEASE DATE: 22 November 2013