TC03189

Appeal number: MAN/2008/01032

VALUE ADDED TAX – input tax – denial of right to deduct on grounds that the Appellant knew or should have known that the transaction was part of fraud by others – alleged MTIC – whether shown that the Appellant's transactions connected with fraudulent evasion of VAT – yes – whether Appellant "knew or should have known" of fraud – yes – valid refusal of right to deduct – appeal dismissed

FIRST-TIER TRIBUNAL
TAX CHAMBER

PHONEBITZ 2000 UK LIMITED **Appellant**

- and -

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

TRIBUNAL: JUDGE MISS JENNIFER BLEWITT
MR ALBAN HOLDEN

Sitting in public at Manchester on 7, 8, 9 and 11 October 2013

Mr Richard Gray, Counsel Instructed by Direct Access, for the Appellant

Miss Lucy Wilson-Barnes, Counsel instructed by HM Revenue and Customs, for the Respondents

DECISION

Introduction

1. This is an appeal against HMRC's decision contained in a letter to Phonebitz 2000 UK Ltd ("Phonebitz 2000") dated 18 July 2008 in which it refused payment of input tax in the sum of £144,112.50. The disputed input tax was incurred in two transactions in the Appellant's VAT period 06/06. HMRC contend as set out in its Statement of Case, that the transactions were connected with the fraudulent evasion of VAT and that the Appellant knew or should have known of this fact. The Appellant's case is that it did not know and had no means of knowing that its transactions were connected with such fraud.

Missing Trader Intra-Community Fraud: Legislation and Case law

2. There was no dispute between the parties as to the legislation and case law applicable to this appeal which can be summarised as follows: The legislation governing the right to deduct is contained within Sections 24 – 26 of the Value Added Tax Act 1994 and the VAT Regulations 1995 (SI 1995/2518). If a trader has incurred input tax which is properly allowable, he is entitled to set it against his output tax liability or to receive a repayment if the input tax credit due to him exceeds that liability. Evidence is required in support of a claim (Article 18 of the Sixth Directive and regulation 29 (2) of the VAT Regulations 1995).

3. That the onus and burden of proof in this type of case rests with HMRC was confirmed by Moses LJ in *Mobilx Ltd and The Commissioners for Her Majesty's Revenue and Customs, The Commissioners for Her Majesty's Revenue and Customs and Blue Sphere Global Ltd, Calltel Telecom Ltd & another and The Commissioners for Her Majesty's Revenue and Customs* [2010] EWCA Civ 517 ("*Mobilx*") (paragraph 81):

"It is plain that if HMRC wishes to assert that a trader's state of knowledge was such that his purchase is outwith the scope of the right to deduct it must prove that assertion."

4. A description of Missing Trader Intra-Community Fraud, hereinafter referred to as "MTIC fraud", can be found in *HMRC and Livewire & HMRC and Olympia Technology Ltd* [2009] EWHC 15 (Ch) at paragraph 1:

"…In its simplest form it is known as an acquisition fraud. A trader imports goods from another Member State. No VAT is payable on the import. He then sells on those goods to a domestic buyer and charges VAT. He dishonestly fails to account for the VAT to HMRC and disappears. The importer is labelled a "missing trader" or "defaulter".

5. In *Blue Sphere Global Ltd and The Commissioners for HM Revenue and Customs* [2009] EWHC 1150 (Ch) the Chancellor stated (at paragraphs 42 – 45):

"…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.*

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…to conceal the fraud committed by A in the dirty chain in its failure to account for the input tax received from B."

6. The cases of *Kittel v Belgium, Belgium v Recolta Recycling* [2008] STC 1537*("Kittel")* and *Mobilx Ltd (in administration) v HMRC* [2009] STC 1107 made clear that there is no discretion on the part of the Authorities to withhold any tax repayment where the objective criteria for compliance with the VAT regime are met. However where a trader does not comply with the objective criteria because there is a fraud, that trader cannot recover any tax.

7. The case of *Kittel* extended the concept of knowledge to include a trader who ought to have known that there was a fraud and the test was further clarified by Moses LJ in *Mobilx* at paragraph 24:

"The scope of VAT is identified in Art. 2 of the Sixth Directive. It applies, in addition to importation, to the supply of goods or services effected for consideration within the territory of the country by a taxable person acting as such. A taxable person is defined in Art. 4.1 as a person who carries out any of the economic activities specified in Art. 4.2. Art. 5 defines the supply of goods and Art. 6 the supply of services. The scope of VAT, the transactions to which it applies and the persons liable to the tax are all defined according to objective criteria of uniform application. The application of those objective criteria are essential to achieve:-

> *"the objectives of the common system of VAT of ensuring legal certainty and facilitating the measures necessary for the application of VAT by having regard, save in exceptional circumstances, to the objective character of the transaction*

concerned." (Kittel para 42, citing BLP Group [1995] ECR1/983 para 24.)

And at paragraph 30:

"...the Court made clear that the reason why fraud vitiates a transaction is not because it makes the transaction unlawful but rather because where a person commits fraud he will not be able to establish that the objective criteria which determine the scope of VAT and the right to deduct have been met."

8. At paragraph 72 Moses LJ also referred to a number of important questions:

"(1) Why was…a relatively small company with comparatively little history of dealing in mobile phones, approached with offers to buy and sell very substantial quantities of such phones?

(2) How likely in ordinary commercial circumstances would it be for a company in [the Appellant's] position to be requested to supply large quantities of particular types of mobile phone and to be able to find without difficulty a supplier able to provide exactly that type and quantity of phone?

(3) Was [the supplier] already making supplies direct to other EC countries? If so, he could have asked why [the supplier] was not making supplies direct, rather than selling to UK traders who in turn would sell to such other countries.

(4) Why are various people encouraging [the Appellant] to become involved in these transactions? What benefit might they be deriving by persuading [the Appellant] to do so? Why should they be inviting [the Appellant] to join in when they could do so instead and take the profit for themselves?"

9. We adopted the approach advocated by Christopher Clarke J in *Red 12 Trading Ltd v HMRC* [2009] EWHC 2563 (CH) that the purpose of having regard to the attendant circumstances and context of a transaction was in order to understand the true nature of the transaction, not to alter it (at paragraphs 109 – 111):

"Examining individual transactions on their merits does not, however, require them to be regarded in isolation without regard to their attendant circumstances and context. Nor does it require the tribunal to ignore compelling similarities between one transaction and another or preclude the drawing of inferences, where appropriate, from a pattern of transactions of which the individual transaction in question forms part, as to its true nature e.g. that it is part of a fraudulent scheme. The character of an individual transaction may be discerned from material other than the bare facts of the transaction itself, including circumstantial and 'similar fact' evidence. That is not to alter its character by reference to earlier or later transactions but to discern it.

To look only at the purchase in respect of which input tax was sought to be deducted would be wholly artificial. A sale of 1,000 mobile telephones may be entirely regular, or entirely regular so far as the taxpayer is (or ought to be) aware. If so, the fact that there is fraud somewhere else in the chain cannot disentitle the taxpayer to a return of

input tax. The same transaction may be viewed differently if it is the fourth in line of a chain of transactions all of which have identical percentage mark ups, made by a trader who has practically no capital as part of a huge and unexplained turnover with no left over stock, and mirrored by over 40 other similar chains in all of which the taxpayer has participated and in each of which there has been a defaulting trader. A tribunal could legitimately think it unlikely that the fact that all 46 of the transactions in issue can be traced to tax losses to HMRC is a result of innocent coincidence. Similarly, three suspicious involvements may pale into insignificance if the trader has been obviously honest in thousands.

Further 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".

10. Our approach to the issue was therefore to recognise that, while we must consider the merits of the individual transactions, we should not view the transactions in isolation as to do so would be an artificial exercise. We were conscious to ensure that in considering the knowledge of the Appellant, through the Company officers Mr Cavanagh and Mr McKenna, we only took account of information known to them during the relevant period; for that reason we were cautious when considering generic information and opinions provided by HMRC officers nor did we attach any significant weight to evidence established with the benefit of hindsight.

11. We followed the dicta of Briggs J in *Megtian Ltd v HMRC* [2010] STC 840 *("Megtian")* that there is no *"rigid prescription"* as to what HMRC must prove and we note the guidance of Moses LJ in *Mobilx* that the test should not be "over-refined":

"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…such circumstantial evidence…will often indicate that a trader has chosen to ignore the obvious explanation as to why he was presented with the opportunity to reap a large and predictable award over a short space of time." (paragraphs 75 and 84).

A Summary of the Parties and Evidence

12. Miss Wilson-Barnes of Counsel appeared on behalf of HMRC. Mr Gray of Counsel appeared on behalf of the Appellant. We were also provided with 39 lever arch files containing witness statements and documentary exhibits relied upon by both parties.

13. We heard evidence from the following witnesses:

- Mr Richard Saxon, an HMRC officer who took over responsibility for the decision to deny the Appellant's repayment claim following the retirement of HMRC officer Mr Blocksidge and incapacity of HMRC officer Ms Gordon;

- Mr Domhnart Lavery, an HMRC Officer who provided evidence relating to contra trader Intertrade;

- Mr Karl Cavanagh, a former director of the Appellant; and

- Mr Michael McKenna, director of the Appellant.

Issues

14. It was accepted on behalf of the Appellant that HMRC had established indirect fraudulent tax losses which were connected to the transactions forming the subject of this appeal. The only remaining issue for the Tribunal to determine is therefore whether the Appellant knew or should have known that its transactions were connected with fraud.

15. That the onus and burden of proof in this type of case rests with HMRC was confirmed by Moses LJ in *Mobilx* (paragraph 81):

"It is plain that if HMRC wishes to assert that a trader's state of knowledge was such that his purchase is outwith the scope of the right to deduct it must prove that assertion."

Undisputed Background Facts

16. Phonebitz 2000 was incorporated on 5 September 2002 and registered for VAT with effect from 1 December 2002. The main trading activity declared on the VAT1 signed by Mr Barry Cavanagh was "mobile phone retailer". The VAT1 also stated that the estimated turnover in the following 12 months was £60,000 and that it did not expect its purchases to regularly exceed the VAT on its taxable supplies nor did the Appellant expect to be buying from or selling to other EU Member States. The trading activity changed to the wholesale of mobile phones during March 2006, with the intention to trade UK - UK being notified to HMRC at a visit on 13 March 2006.

17. The company's registered office is at 52 Penny Lane, Liverpool which is the address of the Appellant's accountants Matthews Sutton & Co. The principal place of business during the relevant period was the retail premises at 511 West Derby Road, Liverpool. The principal trading activity since the date of registration has been retail of mobile phone handsets and accessories with miscellaneous activity such as sale of airtime, receipt of airtime connection fees and phone unlocking services. A second set of retail premises was opened on 18 December 2002 at Unit 125a Skelmersdale Shopping Centre, Skelmersdale. By letter dated 24 March 2006 the Appellant's accountants notified HMRC of a change to its principal place of business to Suite 14 Signature House, Rainhill, Merseyside.

18. The organisation of the Appellant is as follows:

Director	Appointment Date/Resignation Date
Michael Jeffery McKenna	5 June 2003 to 26 March 2004 6 March 2006 to present Company Secretary appointed on 8 August 2006
Peter Benbow	26 March 2004 to present
Karl Wayne Cavanagh	6 March 2006 to 30 September 2007
Barry Cavanagh	5 September 2002 to 5 June 2003
Form 10 Directors FD Ltd	5 September 2002 to 10 September 2002

19. Mr Karl Cavanagh had also previously been a director of Phonebitz 2000 Limited which was incorporated on 1 August 2001 and which traded in wholesale phones from 2002 to February 2003 whereafter, on 20 May 2004, the company went into creditors voluntary liquidation.

20. The Appellant carried out its first wholesale deal on 27 March 2006 and undertook 11 export deals in its VAT period 03/06. According to a transaction summary provided by the Appellant to HMRC, between 27 March 2006 and 30 March 2006 the value of the Appellant's 11 wholesale transactions was £7,386,897.50 as compared with its retail transactions of £42,420. On 29 June 2006 the Appellant sold 4800 mobile phones to the value of £889,350 in the two transactions which form the basis of the appeal. No further wholesale transactions took place after VAT period 06/06. The VAT Return submitted on or about 18 July 2006 for the 06/06 period was selected for in-depth verification due to the large repayment claim made. The Appellant was notified of the verification on 10 August 2006 and following completion of its enquiries, HMRC issued its decision letter by which it denied entitlement to the right to deduct input tax on 18 July 2008.

21. By its Notice of Appeal dated 31 July 2008 the Appellant appealed against HMRC's decision to withhold repayment of its input tax claim pertaining to the transactions in the 06/06 period. The grounds of appeal can be summarised as follows: all of the input tax denied by HMRC had been paid by the Appellant which had at all times carried on a genuine and honest business. The nature of the Appellant's trading was "back to back" and it would only purchase stock when a customer had been lined up. The Appellant would source stock quickly by contacting its suppliers first thing in the morning. The recording of IMEI numbers was not compulsory within the mobile phone industry during the relevant period and the Appellant had agreed with HMRC officer Mr Blocksidge that a scan of 10% of IMEI numbers would be undertaken due to time scales and costing. The Appellant did not know where the phones originated, only where its supplier was based. If it had known where its supplier had purchased

the phones it would not have needed to deal with its supplier. The Appellant did not, nor has it ever tried to enter into artificially contrived deals and it at no time had any knowledge of a scheme to defraud the Revenue.

Transactions connected to fraudulent tax losses

22. Although the Appellant did not dispute that the transactions forming the subject of this appeal were connected to fraudulent tax losses, it may assist the reader to give a brief summary of those transactions and their connections to fraud.

23. HMRC traced the chains of the two transactions carried out in 06/06 via a contra trader, Intertrade Worldwide Limited ("Intertrade"), to defaulting traders.

24. In both deals the Appellant bought from UK supplier Intertrade and sold the goods to Phone-C@nnected SARL ("Phone-C@nnected") which was based in France. Deal 1 took place on 28 June 2006 on which date Intertrade sold 3000 Samsung D600 mobile phones to the Appellant at £138.00 per phone, totalling £414,000 (excluding VAT of £72,450). Deal 2 also took place on 28 June 2006 on which date Intertrade sold 1800 Nokia 9300i mobile phones to the Appellant at £227.50 per phone totalling £409,500 (excluding VAT of £71,662.50).

25. In both deals, Mr Saxon noted that the Appellant's deal documents included Intertrade sales invoices with invoice numbers which differed to those which purported to relate to the deals but which contained the same number, make, model and price of the phones along with a credit note containing the same date which appeared to cancel out those sales invoices. No explanation had been provided to Mr Saxon as to the significance of the documents or reason for their production.

Intertrade

26. HMRC officer Mr Lavery provided a detailed witness statement in which he concluded that Intertrade acted as a contra-trader, that its transactions formed part of an overall scheme to defraud the Revenue and that features of Intertrade's conduct suggested that its directors were aware of such a scheme.

27. Intertrade was incorporated on 25 February 2003 and registered for VAT on 1 March 2003 at the request of the director. The company went into creditor's voluntary liquidation on 21 June 2007. The director of the company was Mr Darley who was also an officer in the following companies: Americano Street Clothing Company Limited, Fargrove Limited, Humber Freight (London) Limited, Humber Freight Limited, Intertrade Worldwide (London) Limited, Stadium Safety Limited, Venus Global Limited. Mr Darley was disqualified from being a director of a company for 7 years on the grounds that he had misappropriated £532,898.00 of monies paid to Humber Freight by its customer to pay excise duty to HMRC. Mr Darley instead used the misappropriated funds to pay other company creditors and a personal liability of £14,893.00 less than two weeks before Humber Freight went into administration.

28. Despite the fact that Intertrade shared its principal place of business in Hull with its sister company Humber Freight Ltd, its method of trading (except when Intertrade

imported stone from India) was to hold stock within third party warehouses rather than use Humber Freight and use contractors to transport goods to its customer.

29. At a pre-registration visit by HMRC officers to Intertrade on 2 April 2003 it was established that the business had been set up with the primary intention of exporting tantalum to China with a secondary activity of dealing in soft drinks.

30. On 2 June 2003 HMRC officer Mr Mason established that the intended activities had never taken place but that dealing in alcohol was to be the principal activity. It subsequently transpired that the company traded in the wholesale of computer chips and mobile phones with a small amount of trade in alcohol and stone imported from India.

31. Intertrade's VAT return for the period ending 31 December 2005 was for the sales of approximately £3,000,000 and a net liability of £6,641.85. Purchases and sales in the period matched within 1% and the net liability was 0.2% of sales. The period 03/06 showed that sales had grown to £29,000,000 however the net liability reduced from £6,641.85 to a net repayment of £1,512.79. Similarly the period 06/06 showed another doubling of turnover to £62,000,000 with a net liability of £1,352.26.

32. HMRC undertook extended verifications of Intertrade's 03/06 and 06/06 returns. For the three months ending 30 June 2006 Intertrade declared that it had handled stock to a total value of £135,000,000 with the associated total VAT being £21,951,295.42 however the net liability was a claim for repayment of £1,352.66.

33. Despite a number of efforts by Mr Lavery to obtain from Intertrade all of its records for June 2006, it was not until 30 August 2007 after the appointment of a liquidator that additional deal packs, evidence of export and bank statements were produced. Mr Lavery noted that some documents remained outstanding such as CMRs. Nevertheless he was able to identify 30 deals where Intertrade acted as a broker, 1 deal where it acted as a buffer and 47 deals where it acted as an acquirer. Intertrade had 6 immediate EC customers and 4 immediate EC suppliers.

Broker Deals:

34. Of the 30 broker deals where Intertrade bought from the UK and sold to the EC generating a turnover in excess of £33,000,000 with associated input tax of £5,777,025, 25 were traced back to a tax loss. The remaining 5 could not be fully traced but were blocked at a trader who did not appear to be either a manufacturer or first acquirer into the UK. The deals involving a direct tax loss amounted to £30,175,583.91 with associated VAT of £5,280,727. The VAT associated with the blocked deals totalled £496,298.00. The 6 EC customers were Scorpion Electronics Sociedade Unpessoal LDA ("Scorpion"), Powertec Computer Components Sociedade Unpessoal LDA ("Powertec"), Kiara Trading International SARL ("Kiara"), Eurotronics International Aps ("Eurotronics"), FAF International SRL ("FAF") and Nano Infinity SARL ("Nano").

35. Scorpion traded from an address in a village near Faro, Portugal although the stock involved in the 1 deal with Intertrade was delivered to a warehouse in Belgium.

The Portuguese provided HMRC with the following information dated 29 November 2006 (which we note would not have been available to the Appellant):

- Scorpion is described as a "Non Declaring Conduit Company";
- Its head office was a private house in Portugal where the sole partner was staying when he created the firm'
- The company was registered for VAT with effect from 2 November 2005;
- The sole partner was Jose Luis Espada, a Spanish citizen living in Marbella, Spain;
- The Portuguese authorities were only able to contact the sole employee and not Mr Espada;
- The company had a rented office but no warehouse or other premises at which to receive goods;
- Scorpion had an FCIB bank account;
- Only one VAT declaration was ever made regarding the fourth quarter of 2005.

36. Powertec traded from an address in Faro, Portugal although all of the stock purchased from Intertrade in 13 deals was delivered to warehouses in France and Belgium. The value of its deals with Intertrade was £14,645,970 with the associated input tax of £2,547,159.77. The Portuguese tax authorities provided the following information dated 29 July 2006:

- Powertec is described as a "Non Declaring Conduit Company";
- It was registered for VAT with effect from 2 November 2005;
- The sole partner was Joakim Peter Broberg, a Swedish citizen, who gave his home address as the Swedish Embassy in Madrid, Spain;
- The Portuguese Officials were only able to contact the sole employee not Mr Broberg;
- Mr Broberg's representative was Bruno Farias Paulo and Fernando Jose Santos De Almeida was his accountant; both had connections to Scorpion and both companies began trading on the same day;
- Powertec had no premises in which to store goods and it employed only one member of staff;
- Powertec held an FCIB account;
- Powertec did not remit VAT declarations.

37. Kiara traded from an address in Coudekerque Branche, France. The value of its 3 deals with Intertrade was £1,770,740 with the associated input tax of £306,946.50. The stock it purchased was delivered to warehouses in Belgium. The French tax authorities provided the following information:

- All correspondence sent to Kiara was returned "not claimed";
- Kiara was unknown to any of the usual logistics centres;
- There is no evidence to substantiate the sales of goods to Kiara;
- The directors of the company were listed as Ferry Verhaegen and Gilles Poelvoorde.

38. A Dun & Bradstreet report also listed Gilles Poelvoorde as an executive of the company. Mr Poelvoorde was also listed on a Dun & Bradstreet profile as the chief executive of Phone-C@nnected. Mr Poelvoorde received a sentence of imprisonment for a term of 4 years after being convicted after trial together with 4 others of attempting to steal £229,000,000 from a London bank.

39. Eurotronics International APS were involved in 6 deals with Intertrade. It traded from an address in Copenhagen, Denmark. All of the stock purchased from Intertrade was delivered to warehouses in Belgium. The value of the deals was £6,717,036.75 with the associated input tax of £1,167,705.13. The Danish tax authorities provided the following information:

- Eurotronics is suspected of carousel fraud;
- Eurotronics declared no sales in Denmark;
- It held no known bank accounts in Denmark;
- Its director was resident in London.

40. FAF International, which traded from an address in Milan, Italy was involved in 3 deals with Intertrade. The stock purchased was delivered to warehouses in Belgium. The value of the deals was £2,140,288.75 with associated input tax of £371,079.45. The Italian tax authorities provided the following information dated 6 November 2006:

- The sole executive of FAF International was Mr Tommi Heikinpoika Neuvonen;
- FAF held an FCIB account and was the subject of an investigation by the Guardia di Finanza.

41. The office of Comando Generale Della Guardia Di Finanza Il Reparto provided the following information dated 16 October 2008:

- The competent Corps carried out a fiscal audit into FAF International in which "…it was ascertained that FAF is a company that is part of a whirling fraudulent mechanism, so called "carousel"…";

- Mr Neuvonen mainly managed the company from abroad;

- The company did not have a depot, warehouse or premises suitable for keeping goods nor did it use third parties for such operations;

- FAF International had no employees;

- Following the audit the records of the company were placed under seizure and the director was charged with fiscal fraud.

42. Nano was involved in 4 deals with Intertrade. It traded from an address in Paris although all of the stock it purchased from Intertrade was delivered to Belgium. The value of the deals was £5,790,204 with the associated input tax of £1,006,288.41. The French liaison department provided the following information dated 30 July 2008:

- Proceedings disclosed that Nano acted as "an invoicing agency embroiled in an MTIC scheme";

- The tax authorities concluded that the company was created just to issue bogus invoices in order to uphold their British suppliers to defraud the UK Revenue;

- Nano could not afford working plant, operating assets, storage facilities, truck fleet, office room or staff;

- Nano held an FCIB account;

- The accuracy of all of the transactions made by Nano has been denied by the French Tax Authorities who considered that the company had not been carrying on economic activity.

Acquisition Deals:

43. Intertrade conducted 47 acquisition deals. The goods were purchased from 4 suppliers; Kiara (14 deals), FAF International (5 deals), Nano (22 deals) and Hennar SA (6 deals).

44. Hennar traded from an address in Panama City, Panama but was registered for VAT in Germany. The value of its purchases from Intertrade was £1,544,550 with an associated output tax of £270,296.25. Documents attesting to the source of the goods and their movement into the UK were incomplete and CMRs indicated that the goods were moved from a warehouse in Belgium into the UK. The German tax authorities provided the following information dated 24 November 2006

- Hennar are suspect;

- The directors are all listed as being based in Panama City;
- The authorised representative resided in Netherlands;
- In 2006 the company did not produce provisional or actual declarations of VAT to the Federal Central Tax Office and the provisional declarations provided for 2005 show a turnover as "0.00". No EC sales lists were produced;
- The only information held by German authorities as to the company's trading activities come from references from other member states;
- The authorities worked on the basis that Hennar had its registered office in Panama in order to disguise carousel transactions;
- The competent tax authorities were intending to withdraw the company's VAT number retroactively.

Contra Chains

45. In 06/06 Intertrade conducted 47 deals in mobile phones or computer chips where the immediate supplier resided in other EU Member States and where the goods were supplied to UK registered companies. In each case the goods were supplied onwards either by Intertrade's customer or its customer's customer forming chains of transactions which ended with the supply back to companies in other member states. 6 customers acted as brokers: International Electrical Distributors Ltd, Buzz Talk Traders Ltd, Phonebitz 2000 UK Ltd, Chapter 6 Ltd, Swift Communications Ltd and Regent Commodities Ltd.

Defaulter Chains

46. Intertrade conducted 30 deals in 06/06 which involved the purchase of goods from within the UK and supply of those goods to wholesalers in other member states. The defaulting traders to whom a direct tax loss was traced were: the Taxable Person purporting to be Eutex Ltd ("Eutex"), Trader purporting to be 1st 4 Report Ltd ("1st 4 Report"), LTH Ltd ("LTH"), Zenith Sports (UK) Ltd t/a i-Connect Technologies ("Zenith") and Prestige 29 Ltd ("Prestige"). Although 5 of the 30 deals could not be traced beyond blockers, Mr Lavery concluded on the balance of probabilities that the nature of the blockers' trading makes it very probable that the deals in question would also trace back to a tax loss. The blocking traders were: P & M Transport & Communications Ltd ("P & M"), AC Enterprises (UK) Ltd ("AC Enterprises") and Universal Supplies t/a Easi Blaster ("Easi Blaster").

47. HMRC Officer Mr Doyle provided a witness statement setting out his involvement with 1st 4 Report which can be summarised as follows: On 16 October 2007 1st 4 Report was notified by letter that HMRC was satisfied that its transactions in 05/06 formed part of an overall scheme to defraud the Revenue and that its conduct demonstrated that it knew or should have known that this was the case. Its input tax claim in the sum of £2,275,000 relating to the purchases of mobile telephones in May

2006 was denied as a result. Subsequently HMRC found invoices for supplies from 1st 4 Reports to DBP Trading Ltd ("DBP") in transaction chains of a company called Demravale Ltd between March and June 2006. The invoices which included VAT totalling £10,939,033.70 did not resemble the layout of those issued by 1st 4 Report during the relevant period and 1st 4 Report denied having issued the invoices. In the absence of any evidence to the contrary no further action was taken by HMRC in respect of 1st 4 Report and a dummy VAT registration number was established to record an assessment of tax in the sum of £10,939,033.70 that the taxable person purporting to be 1st 4 Reports had failed to declare to HMRC. Three further assessments were raised against the taxable person purporting to be 1st 4 Reports on 12 February 2008, 9 June 2008 and 1 July 2008 in the sums of £244,801.38, £1,089,417.85 and £1,708,050.19 respectively.

48. HMRC Officer Mr Jones provided a witness statement in respect of AC Enterprises. The statement was not challenged and therefore we shall not repeat the same in any detail. Ac Enterprises is a trader which went missing and in doing so, Mr Jones concluded fraudulently failed to account for its VAT liability to HMRC. His reasons for so concluding are:

- That the vast majority of its sales in 05/06 were traced back to missing or defaulting traders;
- It made 3rd party payments despite being advised by HMRC against such action;
- It denied making 3rd party payments despite HMRC being in possession if evidence that such payments were made;
- It failed to respond to HMRC's enquiries into its 05/06 VAT return;
- It failed to follow HMRC's advice and verify VAT numbers via Redhill and there was no evidence that written contracts were used or insurance taken out to cover the goods.

49. AC Enterprises was assessed for VAT due on 3 transactions. The company has failed to correspond with HMRC regarding the assessment nor has it supplied any information to HMRC. It has failed to pay VAT due to HMRC in respect of transactions carried out in 05/06. Mr Jones concluded that the company is a missing trader and also acted as a blocker in that it obstructed HMRC in attempts to identify traders within its deal chains.

50. HMRC Officer Gellvear provided an unchallenged witness statement regarding Easiblaster which was incorporated on 22 November 1982. The business activities were described on the VAT1 as "sales of equipment". Easiblaster was involved in mobile phone deals with Intertrade in period 06/06 which were traced to tax losses in the sum of £190,238.93. HMRC made numerous requests to Easiblaster for deal paperwork however none was ever provided. HMRC treated Easiblaster as a missing trader and the company was de-registered for VAT purposes from 1 April 2007. Ms Gellvear was unable to trace the deals which form the subject of this appeal beyond

Easiblaster and consequently the true acquiring defaulter has not been traced. However, she concluded that Easiblaster acted as a "tactical blocker" in that it failed to provide its records to HMRC thereby denying HMRC the opportunity to verify its transaction chains. An assessment was raised by HMRC on 28 February 2008 denying the company's input tax claim in the sum of £2,252,496 for the period 06/06 as no documentary evidence to support the claim was provided. Ms Gellvear concluded that Easiblaster was a fraudulent trader for the following reasons:

- Turnover increased from £16,884,804 in the period 1 July 2005 to 31 December 2005 to £105,342,200 from 1 January 2006 to 30 June 2006;
- Easiblaster made 3rd party payments in earlier deals which indicated that VAT would go unpaid in the UK;
- Easiblaster has not queried or appealed the assessment raised against it;
- It failed to render its final VAT return;
- Easiblaster's associated business (by common directors) was AC Enterprises which has also had assessments raised against it and been de-registered;
- Easiblaster has disappeared from its principal place of business and attempts to contacts the directors have been unsuccessful;
- The directors Mr Wildon and Mr Marsh have been disqualified from holding the office of director for a period of 12 years. The Insolvency Service considered that both knowingly caused AC Enterprises to undertake a method of trading which involved it in MTIC fraud.

51. HMRC Officer Mr Siddle's witness statement detailed his involvement with investigations into the hijacking of Eutex. At a visit to Eutex by HMRC officers on 17 May 2006 it was established that the company had received bills from freight forwarders for the transport of goods about which it had no knowledge and correspondence from the provisional liquidator for a company called Ideas 2 Go Ltd. An invoice from Eutex was compared with one provided by a company called Dialhouse Electrics Limited which traded in wholesale quantities of mobile phones and computer chips. The layouts of the invoices were found to be entirely different as were the contact telephone and fax numbers provided. As a result of the investigations Mr Siddle was satisfied that Eutex had not undertaken the transactions involving mobile phones and computer chips and that its trading details had been hijacked. Mr Siddle concluded that the hijacking was a deliberate act to defraud the Revenue by the person purporting to be Eutex as no VAT liability for the sales was ever accounted for. Consequently a dummy VAT registration was set up on 26 March 2007 and 13 assessments raised against the taxable person purporting to be Eutex Limited including the amounts arising from 18 deals with Intertrade. To date the VAT liabilities remain outstanding.

52. HMRC Officer Hartell provided information pertaining to the defaulting trader LTH Limited which was incorporated in 23 March 2004. In May 2006, 21 months after becoming registered for VAT, it was established via information obtained from freight forwarders that LTH was not retailing children's clothes but dealing in goods which were commonly linked to MTIC fraud. On 17 May 2006 a visit to the business premises by HMRC revealed that an unrelated company had taken over the property and no forwarding address had been left for LTH. The company's VAT registration was cancelled with effect from 19 May 2006. A Mr Tilstone contacted HMRC on 22 May 2006 and advised that he had purchased the company for £100 on 17 March 2006 from a friend he played football with and that the business activity was buying camcorders, phones and computer chips from inside and outside the UK. HMRC advised Mr Tilstone that he would have to reapply to have the VAT registration instated. Mr Tilstone never contacted HMRC again. A VAT assessment was raised against LTH on 6 September 2006 in the sum of £921,022.70. which arose from the sale of phones which LTH had acquired from other EU Member States and sold in the UK and which had not been accounted for. The Notice of Assessment sent to Mr Tilstone's home address was returned with a covering letter stating that The Lyme Trust had moved into the premises in June 2006 and the previous residents had moved out. A number of further assessments were raised against LTH relating to undeclared sales by LTH, including those involving Intertrade, for which it failed to produce any trading documentation to HMRC. The company did not appeal against the assessments raised or the decision to de-register the company for VAT. On 27 September 2006 the National Asset and Security Team wrote to the trader advising him of the outstanding debt in the sum of £921,882.70; the letter was returned by the postal service. On 21 December 2006 HMRC was advised that a Winding Up Order dated 29 November 2006 had been made against LTH. The tax loss identified to date is £27,164,207.70. Mr Tilstone was disqualified as acting as a director with effect from 21 November 2008 for a period of 12 years on the basis that the Official Receiver concluded that he had caused LTH to trade in such a way as to involve the company in and put HMRC at risk of MTIC VAT fraud.

53. HMRC Officer Ms Tressler was responsible for verifying the VAT returns for P & M Transport in June 2006. The VAT1 declared the company's business activities as that of a haulage contractor and no purchases or sales to the EU would take place. The annual accounts filed at Companies House showed the following:

- Period 1 December 2002 to 30 November 2003 – trading turnover of £7,227;
- Period 1 December 2003 to 30 November 2004 – trading turnover £58,631;
- Period 1 December 2004 to 30 November 2005 – trading turnover £23,662;
- No annual accounts for tax periods ending 30 November 2006 and 30 November 2007 have been filed (during which period the company traded in mobile phones).

54. On 31 August 2005 the company director notified HMRC of a change of its principal place of business and its trading activities to dealing in transportation and

selling navigation systems, small screen televisions, iPods, flat screen televisions and CD radio equipment. On 7 April 2006 P & M's VAT return for the period 1/06 was submitted declaring sales of £33,000,344; a significant increase to the £1,237 declared sales in the previous VAT quarter. The company's VAT return for 04/06 declared sales of £172,802,736 and the VAT return for 07/06 showed declared sales of £9,574,917. Despite numerous requests for information pertaining to undisclosed transactions in 04/06 the director of P & M failed to provide the requested documentation; as a result HMRC raised an assessment on 16 August 2007 in the sum of £1,790,598 and the company's VAT number was blocked at Redhill from 8 May 2007. On 28 January 2008 Howes Percival, the solicitors appointed to undertake winding up proceedings against the company, wrote to the director requesting payment of the company's outstanding VAT debt of £2,504,310. On 3 September 2008 a Winding Up Order was made against P & M in the High Court of Justice. The company failed to pay its debt to HMRC of £5,225,030.67 and was de-registered from VAT with effect from 17 September 2008. On 28 October 2010 the director was disqualified from acting as a director or insolvency practitioner for a period of 13 years on the basis that "*during the period 1 November 2005 to 31 October 2006 Phillip Andrew Temme caused P & M Transport and Communications Ltd to undertake a method of trade which involved it in, and put Her Majesty's Revenue and Customs at risk of being subjected to Missing Trader Intra Community Value Added Tax fraud…*"

55. HMRC Officer Ms Hirons provided evidence regarding defaulting trader Prestige which was incorporated on 6 December 2004 and registered for VAT with effect from 1 June 2005, its main business activities described as bathroom and kitchen supplies. Prestige failed to declare any of its VAT liability for the period 1 November 2005 to 10 May 2006. On 10 May 2006 Ms Hirons visited the principal place of business whereupon she found an abandoned shop with the name "Bathroom Solutions" above it and a "To Let" sign. Prestige was de-registered with effect from 10 May 2006 as a missing trader, having failed to render and make payment of the outstanding VAT returns. As a result of information obtained via other traders, 8 assessments were raised against Prestige in the sum of £5,080,286 which included the transactions linked to Intertrade. Ms Hirons concluded that Prestige acted fraudulently in its wholesale supplies and that it entered into such transactions intending to defraud the Revenue by failing to declare and pay the VAT due to HMRC.

56. HMRC Officer Mr Patterson provided a witness statement detailing his involvement with defaulting trader Zenith which was incorporated on 14 December 2004 and registered for VAT from 1 August 2005 to 13 December 2006. At a visit by HMRC on 27 March 2006 the manager Mr Hussain and Director Miss Basharat stated that the main business activity was sportswear but that the company also intended entering the wholesale mobile phone market. At a further visit on 29 June 2006 Miss Basharat indicated that the main business activity was the wholesale supply of mobile phones and CPUs. Mr Patterson noted that the company's due diligence checks were poor, no inspection records were held and that the daybook showed sales of £122,000,000 with net inputs of £125,000,000 and a repayment due of £427,000. Following examination of the company's records a VAT liability was calculated in the sum of £122,238.00 (as amended) for period 05/06 and £19,967.88 for 08/06. An

assessment in that sum was notified to the company which was also informed that a loss of revenue exceeding £19,000,00.00 had been found in the transactions shown on the company's deal log. A visit to the principal place of business on 13 December 2006 established that the trader was no longer trading from the address and mail was returned to HMRC marked "gone away". Subsequent enquiries by Mr Patterson revealed that initially Zenith traded as a buffer, however each of its suppliers was a defaulting trader having failed to declare or pay the UK VAT due on their sales to Zenith. Zenith also acquired goods from the EC in the period 08/06 and additional assessments were raised to account for the output tax due. Zenith was the defaulting trader in two deals involving Intertrade on 21 June 2006. The trader repeatedly failed to respond to HMRC's attempts at contact and is considered missing. It is now in liquidation having failed to submit returns for 05/06, 08/06 and 09/06. The assessments have not been challenged and the liability remains outstanding. A debt in excess of £17,000,000 was written off as a result of liquidation and it was not considered practical to raise a further assessment in the sum of £345,398.46 for the deals involving Intertrade.

Findings on whether the tax loss was fraudulent and whether the Appellant's transactions connected with fraudulent VAT losses?

57. The evidence in respect of the defaulting traders, blockers and contra trader was not challenged by the Appellant; indeed we could not envisage how any serious challenge could have be made to such cogent evidence. We were wholly satisfied that Intertrade knowingly acted as a dishonest contra trader and that its transactions formed part of an overall scheme to defraud the Revenue. We found as a fact that Intertrade's 25 broker deals in what is commonly referred to as the "dirty chain" were accurately traced back to fraudulent tax losses which arose from the actions of 6 defaulting traders: Scorpion, Powertec, Kiara, Eurotronics, FAF and Nano. We found as a fact that the traders acting as "blockers": P & M, AC Enterprises and Easi Blaster had deliberately prevented HMRC from being able to verify the chains of the remaining 5 which could not be traced back to a tax loss; that said we were satisfied that the nature of the blockers' trading could lead us to infer on the balance of probabilities that those deals also traced back to a fraudulent tax loss.

58. We noted the unchallenged evidence of HMRC Officer Mr Humphries who reviewed the transaction chains of Intertrade and 8 other contra traders whose transactions he identified as being very similar to those of Intertrade (although we must note that the Appellant would have no knowledge of the other traders and we do not infer any such knowledge). The 9 traders have common EU suppliers, using only 10 suppliers between them. 9 of those EU suppliers also feature at the end of the transaction chains as the EU customers of the UK brokers. There are 35 broker traders which use only 11 EU customers between them. 8 of the 12 EU customers used by the contra traders in their broker transactions also feature as customers and suppliers in the acquisition transactions which provides a link between the acquisition transactions and the tax loss transactions entered into by the contra traders. Mr Humphries concluded that this pattern of transactions could not exist in genuine commercial trade and that none of the transactions appear to have any commercial substance. We were satisfied that Mr Humphries' evidence strengthened our findings that the transactions

were contrived as an overall scheme to defraud the Revenue. Whilst we noted Mr Humphries comment that the scheme could not operate successfully without each trader involved having some knowledge of it we did not attach any weight to this opinion and we considered the Appellant's knowledge or otherwise as a separate issue.

59. For the reasons set out above we were satisfied that the Appellant's transactions which form the subject of this appeal were connected to fraudulent tax losses via the contra trader Intertrade.

Did the Appellant know, or should it have known that the transactions in this appeal were connected to fraud?

60. The evidence we heard related mainly to this principal issue. Given the volume of evidence before us, both oral and documentary, the following is intended as a summary of the points raised however we should make clear that all of the evidence was carefully considered.

Evidence of HMRC

61. Mr Saxon's witness statement set out the Appellant's historical association with other businesses including those which bore the generic title of "Phonebitz" and the activities of which bore similarities to the Appellant Company by trading in mobile phones.

Phonebitz 2000 Limited ("P2000")

62. P2000 was incorporated on 1 August 2001 and its registered address was 52 Penny Lane, Liverpool; the address of its accountant Matthews Sutton & Co Ltd. The business was registered for VAT with effect from 20 October 2000 as a partnership between Karl Wayne Cavanagh and Michael McKenna. The VAT number was subsequently transferred from the partnership to the limited company which was later de-registered for VAT on 8 July 2004 following entry into Creditors Voluntary Liquidation on 20 May 2004 leaving a VAT debt to HMRC of £368,916.61. The Company was dissolved on 10 March 2010. The business activity was described as "Accessories and phones" with an expected annual turnover of £48,000.

63. At visits by HMRC on 11 and 30 July 2001 it was established that Mr Cavanagh had previously been employed by various mobile phone companies including The Mobile Phone Store and The Phone People. A visit to P2000 on 30 May 2002 established that the company had commenced trading in the wholesale back to back supplies of bulk quantities of phones from 10 April 2002 in addition to selling mobile phones via its retail outlets.

64. Visits to the business during the latter part of 2002 confirmed that the principal business continued to be wholesaling in mobile phones within the UK and the turnover in VAT quarter 10/02 had increased to £73,000,000. In February 2003 the company ceased wholesaling mobile phones, instead continuing the wholesale business via another associated company, Phonebitz 2003 Limited.

65. On 6 May 2004 HMRC issued unpaid VAT demand letters to the company's registered office and principal place of business in respect of an outstanding debt of £234,282.71. The company entered into Creditors Voluntary Liquidation on 21 May 2004 and HMRC's insolvency claim for a VAT debt of £368,916.61 was ultimately written off.

Harringtons Exports Limited (formerly Phonebitz 2003 Limited) ("Harringtons/P2003")

66. Harringtons/P2003 was incorporated on 19 August 1996, registered for VAT on 26 September 2002 and de-registered on 3 December 2007. The company directors were Christopher Ash and David Ross and the sole shareholder was Fairfax Gerrard Holdings Ltd, of which Mr Ash and Mr Ross were also company officers.

67. Harringtons/P2003 started trading in February 2003; its deals were arranged by P2000 in that P2000 sourced the stock and negotiated the deals undertaken by Harringtons/P2003. The net profit of the deals undertaken was passed by Harringtons/P2003 to P2000 in the form of commission earned for arranging the deals.

Phonebitz 2000 Export Ltd ("P2000E")

68. P2000E was incorporated on 13 December 2002, registered for VAT on 29 January 2003 and de-registered on 11 November 2003. The Company was dissolved on 14 September 2004. The connection to the Appellant was via the director Mr Adam Nicholson and Company Secretary Mr Howard Nicholson who were known to Mr Cavanagh through The Phone People (of which they were company officers) and a common address with P2000. There is no evidence to show that P200E ever carried out any transactions in its intended business activity of exporting mobile phones.

Liverpool Freight Co Limited

69. Mr McKenna and Mr Cavanagh were directors of the Liverpool Freight Co Limited which was incorporated on 18 April 2006 and dissolved on 20 August 2008. There is no record of the company having been registered for VAT or having ever traded. A third director was Mr Numan Malik who was appointed on 18 April 2006, the same date as Mr McKenna and Mr Cavanagh, and who was also a director of Swift Communications Limited ("Swift"). Swift was registered for VAT from 1 June 2002 to 30 September 2003; its principal trading activity was the bulk wholesale of mobile phones. Its VAT returns for periods 04/06 to 09/06 inclusive have been subjected to extended verification and input claims for 04/06 and 05/06 in the sums of £1,599,541.13 and £1,943,905.52 respectively have been denied on the grounds that the transactions were connected to fraud and Swift knew or should have known of this fact.

Broadpark Estates Limited ("Broadpark")

70. Mr Cavanagh was appointed director of Broadpark on 29 July 2002 and Mr McKenna was appointed as company secretary on the same date. Its VAT application was refused as it did not commence trading and was dissolved on 19 February 2008.

71. Mr Saxon included within his written evidence details of Mr Cavanagh's previous convictions which he explained in oral evidence was part of his evidence gathering process and simply designed to provide a full background. We should note at this point that we disregarded this evidence due to age of the convictions and the fact that we took the view that they were irrelevant to the issue before us.

Mark Up

72. Mr Saxon referred to the mark ups achieved in the 2 transactions in this appeal. He noted that despite the fact that the deals involved 2 different models of phones with purchase prices of £138 and £227.50, the mark ups achieved by the Appellant on its sales of 7.97% and 8.02% were remarkably similar. He also queried why Intertrade had been unable to achieve such a mark up by seeking an EU customer given that it had experience of dealing with the EU.

73. In oral evidence to the Tribunal Mr Saxon retracted the word "remarkable" but maintained that the mark up received on both deals of different values was consistent which he felt was a relevant factor.

Time of Trade

74. Mr Saxon noted that both of the Appellant's wholesale deals took place at the end of the VAT quarter; both deals involved the purchase of goods on 28 June 2006 and sale of those goods on 29 June 2006. The Appellant's transactions in 03/06 followed a similar pattern in that its 11 transactions took place between 27 March 2006 and 31 March 2006. The Appellant did not carry out any wholesale transactions in the remainder of the VAT periods and Mr Saxon queried why this was if the Appellant had actively sought to trade in an open market.

75. In oral evidence to the Tribunal Mr Saxon explained that the profit gained from one period had not been used as working capital in the sense of being used in other transactions to generate business but rather was used for transactions which took place at the end of each VAT quarter. He accepted that he had not considered Counsel's argument that it made commercial sense to use capital over a shorter period however he did not agree with the point.

76. Mr Saxon told the Tribunal that he recalled being told by Mr Cavanagh in May 2006 that the Company's Lloyds TSB account had been frozen, at the time when repayment had been made by HMRC to the Appellant in respect of its 03/06 transactions.

IMEI Numbers

77. There was no evidence that the Appellant directly instructed the freight forwarder Ontime Logistics to conduct any IMEI checks on its behalf in respect of the

deals in this appeal. The inspection requests and reports produced by the Appellant originated from its supplier Intertrade.

78. The Appellant's failure to obtain IMEI numbers is contrary to the recommendation in the Code of Conduct within the Memorandum of Understanding which was signed by Mr McKenna in October 2002. Mr Saxon stated that having signed the MoU he would have expected the Appellant to observe the recommendations contained therein and that the Appellant would have had a greater knowledge of the reasons why IMEI numbers were important as a result.

79. A list of a 10% inspection of IMEI numbers which related to deal 1 (Samsung D600 phones) was obtained by Intertrade from Ontime Logistics prior to the supply of goods to the Appellant. Mr Saxon queried how and when this report came to be in the Appellant's possession, it having been served on HMRC in these proceedings as part of its List of Documents. Having checked the list, HMRC found the following:

- 2 handsets had previously been examined by HMRC at Heathrow Airport on 15 March 2006;
- 2 handsets were reported as stolen on 9 November 2005 and 10 May 2006 respectively which predates the sale to and by the Appellant;
- 2 handsets were reported as stolen on 28 July 2006 and 6 October 2006 which post dates the sale by the Appellant;
- 22 handsets were identified on the Central Equipment Information Register (maintained by the operating networks) as having had their IMEI numbers blocked by the networks as lost or stolen prior to their sale by the Appellant;
- 9 handsets on the Central Equipment Information Register showed the IMEI numbers as blocked by the networks after the sale by the Appellant.

80. HMRC wrote to the Appellant on 26 February 2007 setting out the findings from the NEMESIS checks and requesting a response to the fact that some of the allegedly "new" phones it was trading had been blocked prior to their sale by the Appellant. The Appellant replied on 7 March 2007, stating that the Appellant was concerned by HMRC's findings and intended to investigate the matter fully. A further response was received from the Appellant on 21 May 2007 in which it stated that it was *"unable to comment on the statement as we have no way of knowing it is correct or not."*

81. In oral evidence Mr Saxon was unable to assist as to whether the information subsequently revealed by HMRC's NEMESIS checks would have been available at the time of the back to back transactions undertaken by the Appellant however he noted that the Appellant had not responded to HMRC's letter of 26 February 2007 which raised the issue.

82. Mr Saxon concluded in his written evidence that the fact that the Appellant and its predecessor chose not to make general IMEI checks in its wholesale trade to

establish the provenance of the stock it traded unseen via remote logistical warehouses is indicative of contrivance and knowledge of such on the part of the Appellant.

83. In oral evidence Mr Saxon agreed that the scanning and retention of IMEI numbers was not compulsory at the relevant time however he explained that HMRC recommended such action to help traders protect themselves. He stated that a large number of traders did not maintain IMEI numbers which was part of the due diligence HMRC expected traders to complete, although a failure to do so would not, of itself, lead to a repayment claim being denied.

FCIB

84. Mr Saxon noted that all of the parties in the Appellant's chains of transactions, namely Kiara, Intertrade, the Appellant and Phone-C@nnected, operated offshore FCIB accounts. He queried why the Appellant opened an account solely for use in its wholesale deals when it already held an account with Lloyds TSB.

85. In his oral evidence, Mr Saxon accepted that, at the relevant time, UK banks had concerns about money laundering issues and that banks had been refusing accounts to small wholesaler traders in *"MTIC liable goods"* (transcript 7/10/13 page 59). He did not recall any conversations with the Appellant regarding difficulties it had experienced with major UK high street banks, although he accepted that it may have been mentioned and that the Appellant had told him that it's application for an FCIB account was pending.

86. Mr Saxon explained that he had not told the directors of the Appellant company that an FCIB account would attract suspicion from HMRC, stating that it was a matter for the directors which bank they chose to use. He denied that HMRC had used entrapment by allowing the Appellant to use the FCIB and he did not agree that HMRC had *"scared off"* UK high street banks (transcript 7/10/13 page 174 and 176) which effectively *"corralled"* traders into the FCIB.

87. HMRC Officer Ms Verna Gellvear provided an unchallenged witness statement detailing her analysis of data from the FCIB record systems Bankmaster Plus and Datastore which respectively showed the flow of money between traders and documents presented by account holders in support of their application to open an account. Ms Gelvear concluded the following:

> (a) Payment transaction chains were traced in respect of the two deals subject to this appeal and both deals have payment transaction chains that are constructed in a circular manner;
>
> (b) The deals under appeal appeal have payment transaction chains that are identical in terms of FCIB account presence and sequence. Such consistency of circularity of monies could only occur if the transaction chains were contrived;
>
> (c) All 20 of Intertrade's deals in tax loss chains which were sampled by Ms Gellvear were constructed in a similar circular manner;

(d) All 20 of the said deals have similar FCIB account presence and sequence and such consistency of circularity could only occur if the transaction chains were contrived;

(e) In the Appellant's transaction chains (which do not show a tax loss) GFSM appear to make a paper loss as the amounts it paid to start the transaction chains is greater than the amounts received back by it. However in Intertrade's tax loss deal chains GFSM receive back more than the amount it paid to start the deal. The increase in monies would appear to be the UK tax loss in the deals;

(f) GFSM made the first payment in all the payment transaction chains of the Appellant and Intertrade. After a series of FCIB intra account transactions, often occurring on the same day, the last payment transaction is made back to GFSM.

88. HMRC Officer Ms Farzana Malik provided an unchallenged witness statement detailing her analysis of data held on the FCIB's Dutch and Paris Servers which provided narrative for each payment transaction, information on account usernames, timings of payments, log in and log off times for each username and the IP address for each payment. Ms Malik analysed both of the Appellant's deals relevant to this appeal and 3 Intertrade deals for a more detailed analysis.

89. In respect of the Appellant's first deal Ms Malik provided the following information:

(a) The first payment in Deal 1 was made at 11:51:03 on 14 July 2006 by GFSM to Scorpion Electronics. The final payment was made by Estocom Distribution OU ("Estocom") to GFSM at 12:48:03 on the same day;

(b) GFSM's payments were made from a sub-account entitled "GBP Account";

(c) All payments in the chain for Deal 1 were completed in less than 1 hour;

(d) The first payment in Deal 2 was made at 11:54:07 on 14July 2006 by GFSM which received the last payment made by Estocom at 12:48:03;

(e) All payments in the chain for Deal 2 were also completed in less than 1 hour;

(f) The username against the Appellant's payments is proper to the account signatory Peter Benbow;

(g) The 2 UK traders in the chains are the Appellant and Intertrade. The remaining accounts in the chain have primary addresses in France, Portugal, Estonia and Hong Kong.

90. Ms Malik concluded that the following features were indicative of contrivance and complicity by the parties involved in the deal chains:

(a) The timings of payments whereby a trader paid a supplier within minutes of receipt of funds from its customer and for this to occur throughout an entire supply chain and repeated in every deal chain examined;

(b) The speed at which payments through the chains occurred regardless of whether payments took place several weeks after the invoice dates, as in the Appellant's deals, or a few days later as in Intertrade's deals. The speed at which payments were made did not appear to be hampered by the presence in every chain of companies based in Hong Kong and the EU;

(c) Common reference numbers; Ms Malik noted that if the deals were carried out at arm's length there would be no reason for GFSM in Hong Kong to use the same payment reference in its narrative as 2 purportedly independent UK companies when the payment passed through an intermediary account which did not use the same reference in its narrative;

(d) Accounts which appeared in several chains and in the same position within each chain;

(e) Split payments shown in several deal chains where payments were frequently made on the same date rather than by instalments at regular and agreed intervals and which continued down the deal chains in the same manner as received. Ms Malik formed the view that this indicated a lack of discretion on the part of the traders in the chains as to how or when payments were to be made within the overall scheme to defraud.

GFSM Loan

91. Global Financial Services Management ("GFSM") is a company registered in the British Virgin Islands, which operated an FCIB account registered at an address in Hong Kong.

92. GFSM provided the Appellant with a loan totalling £1,010,000 via 3 instalments of £500,000 on 30 March 2006, £400,000 on 3 April 2006 and £110,000 on 4 April 2006. A loan agreement between the two companies was provided by the Appellant entitled "Conditional Joint Venture Loan Agreement" which is signed by Mr Cavanagh, Mr McKenna and GFSM. The document is undated and it remains unclear to HMRC why it indicates a loan of £1,000,000 leaving a discrepancy between the document and bank transfers of £10,000.

93. Mr Saxon noted that the loan appeared to fund the VAT which was then reclaimed by the Appellant on its 03/06 return. On 5 June 2006 the Appellant obtained its refund in the sum of £1,243,000 described in the account as "B/O PHONEBITZ 2000 UK LTD FOR RECLAIM PAYMENT". On the same day the Appellant's account shows a debit payment out in the sum of £1,100,000 described as "loan payment for March 2006." Mr Saxon notes that GFSM who provided the loan also appear at the start and end of the money flows in both the Appellant's transactions under appeal and Intertrade's connected transaction chains.

94. HMRC Officer Mr Everett provided an unchallenged witness statement regarding the Appellant's loan agreement with GFSM. He noted that the agreement is described as a "conditional joint venture loan agreement" between the "lender" GFSM at Suite K11, Tsimshatsui Centre East Wing, 66 Mody Road, Hong Kong and the client "Phonebitz 2000 UK Ltd. Mr Everett highlighted that the title of the agreement appears unusual in that the term "joint venture" suggests a share of profit or control however neither such feature is apparent from the terms of the agreement. Also the term "conditional" appears to be redundant as the agreement fails to state what, if any, conditional arrangements are in place.

95. The agreement is not dated by the Appellant and is fronted by a letter headed aKMB, Verification, Consultancy, Validation which is also undated.

96. The total charge of interest is £100,000 for seventy days which represents £521,000 per annum and a rate of 52%. Mr Everett notes that the interest rate appears high but that this may have been reflective of the degree of risk taken by the lender.

97. Mr Everett noted that the agreement does not appear to be drafted in the professional terms expected for an investment of £1,000,000; a penalty charge is misspelt as "penelty" and client declaration is misspelt as "client decleration." Other than the first page there are no page numbers on the agreement which increased the risk of possible omissions or inclusions by either party and the first page is number "page 2 of 2".

98. Mr Everett queried why the Appellant chose a Hong Kong based lender when the transactions were EU based and the owner and director of GFSM is a UK national living in Spain.

99. The agreement under *"Client Declaration to Global Financial Services Management Limited"* states *"Title: I understand that Global Financial Services Management Ltd hold title over the goods and will release title at their discretion"*. Mr Everett comments that the statement is unclear in that it fails to identify the goods to which it refers. He also noted that if GFSM held title to the goods rather than the Appellant then questions are raised as to who purchased the goods and who sold the goods; issues which he would have expected to be clarified within the agreement.

100. The Client Declaration also stated *"Default: I understand that defaulting on the payment will result I legal action being carried out against the company"* however the agreement fails to identify which company it is referring to and what is meant by *"the payment"*.

101. Clause 3.3 of the agreement states *"Lender shall employ a comprehensive due diligence procedure that shall cover such aspects as identity theft, insolvency and suitability for funding"* however no evidence to demonstrate that GFSM or aKMB undertook any due diligence was provided to Mr Everett.

102. The same clause also states *"All funding in Client is to be secured against assets such as, but not limited to, stock, capital and where applicable, by Directors Personal Guarantee"*. Mr Everett saw no evidence of a Directors Personal Guarantee and based

on the Appellant's VAT returns and accounts rendered to Companies House it is doubtful whether it was in a position to offer much by way of security.

103. Mr Everett highlighted Clause 3.6 which states *"Client will be responsible for all its billing and collection from its customers. Lender reserves the right to verify the methods for billing and collection in its sole discretion. Lender is authorised to receive payments on behalf of Client."* He concluded that it is unusual in that it allows GFSM to receive 3rd party payments of any unspecified sum from any 3rd party proper to the Appellant for an unspecified period of time.

104. The same clause contained terms which Mr Everett noted appeared unprofessionally drafted and which were unclear, for example *"Lender is not acknowledge guarantee or damages claims to client."*

105. Clause 6.1 states *"This agreement shall become effective on the Effective date and shall continue for a minimum initial term of one (1) year (Initial Term). Following the term of this Agreement shall continue in effect until termination at any time, by either party, upon eighty (80) days prior written notice to the other party"* which Mr Everett noted appears inconsistent to the repayable due date of 70 days from the effective date which is set out on the agreement. Clause 1.2 states *"Effective date shall mean the date both parties shall have signed this agreement if said dates are different, then the earlier of the two dates shall be the effective date hereto"*. Mr Everett notes that the agreement is neither signed nor dated and allows the lender to make available the loan amount of £1,000,000 for a period of one year which increases the risk to the lender if the profitability or forecasts of the client within that one year period are not fulfilled.

106. Clause 6.1 also states *"Following the term this agreement shall continue in effect until termination at any time, by either party, upon 80 days prior written notice to the other party"* which appears to contradict both the repayable due date of 70 days and the minimum initial term of 1 year.

107. Clause 14 headed *"Entire Agreement"* is neither signed nor dated by GFSM or the Appellant which would invalidate the agreement. Mr Everett also noted that the Appellant's financial statements for the year ending 30 September 2006 show authorised shares of 100 with a nominal value of £1 meaning that it obtained a loan of £1,000,000 from a foreign-based lender despite the 2 directors owning only £100 of share capital.

Lack of Written Contracts

108. Mr Saxon noted that the Appellant has not produced any written contracts with either its customers or supplier. He queried how the Appellant would address issues such as the exchange or return of stock by any party should it be found to be faulty or not as described and relied on this as indicative of the Appellant's knowledge that the deals were contrived.

109. In oral evidence Mr Saxon explained his concerns about the lack of written contracts (transcript 7/10/13 page 180):

"…how does a customer know that the phones that he is going to be provided would match exactly his requirements, such as model, specification, language, whether they had two pin plugs or three pin plugs…"

General Awareness of MTIC Fraud

110. HMRC contended that the Appellant had a good general awareness of MTIC fraud in the mobile phone industry long before it carried out the deals which form the subject of this appeal.

111. During a visit to the associated company P2000 on 30 May 2002 and 18 June 2002 Mr Cavanagh confirmed that the company had received a letter from Redhill VAT Office which instructed the company to validate VAT numbers via Redhill and provide monthly transactions lists of sales and purchases from 1 May 2002. Mr Cavanagh confirmed to HMRC at the visit that the company verified all VAT numbers of customers and suppliers, he also stated that it was his practice to meet with the principal of any new supplier prior to trading.

112. On 16 October 2002 Mr McKenna on behalf of P2000 signed the Memorandum of Understanding between HM Customs and Excise and the Mobile Phone Industry ("MoU") which incorporated a Code of Conduct for the Mobile Phone Industry. The purpose of the MoU was to identify actions that could be taken in the industry to minimise the level of VAT fraud in the sector.

113. At a further visit by Mr Saxon to P2000 on 12 November 2002 a discussion took place between HMRC, Mr Cavanagh and Mr McKenna regarding a business called "Phone Bitz" which had purchased stock from a missing trader, although we note that there was no evidence that P2000 was ever involved in the deals in question. At the same meeting it was noted that the company had verified traders using HMRC's National Advice Centre rather than Redhill and P2000 agreed to always use Redhill in future. Advice was also given by Mr Saxon as to how to ensure that the terms of the MoU were addressed when dealing with new suppliers and customers.

114. In respect of P2003, both Mr Cavanagh and Mr McKenna were aware that HMRC had denied P2003 the right to input tax totalling £1,074,474.80 for VAT periods 10/03 and 11/03 on the grounds that the transactions in those periods were connected to tax losses and devoid of economic substance. HMRC also discussed the issue with Mr McKenna and Mr Cavanagh at a visit on 13 March 2006. Although Mr Saxon noted that the input tax was subsequently repaid to P2003, he relied on the initial denial as evidence of the Appellant's awareness of MTIC fraud and the fact that input tax repayments could be denied by HMRC.

115. At a visit to the Appellant Company on 13 March 2006 Mr Saxon discussed HMRC's concerns about tax losses and connections to MTIC fraud. He outlined the requirement to undertake due diligence checks and the significance of Redhill checks, 3rd party payments, stock inspections and retention of records. The directors were also referred to the guidance set out in Public Notice 726, a copy of which they already held. On the same date a letter reiterating the discussions was sent to the Appellant as

was a letter from Redhill which advised the Appellant of the continuing and significant problems HMRC were experiencing with MTIC fraud.

116. Mr Saxon formed the view that the Appellant was aware of the prevalence of fraud within the mobile phone sector and as such was under a duty to mitigate the risk of entering into transactions tainted with such fraud.

Commercial Checks

117. The due diligence carried out by the Appellant on its supplier and customer was sent to HMRC by its accountant Matthews Sutton & Co on 6 March 2007.

Checks on Intertrade

118. Trade references provided for Intertrade were Adworksuk.com Limited and Hawk Logistics Limited. Adworksuk.com was registered for VAT from 1 June 2004 to 30 January 2007 and became insolvent on 10 June 2009. The company was a wholesaler of mobile phones which subsequently (and we note after the relevant period with which we are concerned) had its right to input tax refused on the grounds that its transactions were connected to fraud and that it either knew or should have known of the fact. Mr Saxon noted that there is no evidence that the Appellant ever sought a reference from Hawk Precision Logistics.

119. A copy of Intertrade's VAT registration certificate was obtained by the Appellant. Mr Saxon noted that it showed the trade classification as "Wine, Beer, Spirits and Alcoholic Bevs" and that there is no evidence that the Appellant queried this classification prior to trading with Intertrade.

120. The bank account details on the VAT certificate do not appear on the bank details summary provided by Intertrade and again, Mr Saxon noted that this did not appear to have been queried by the Appellant.

121. Two copies of Europa VAT validation responses were provided dated 31 March 2006 and 29 June 2006, each confirming that Intertrade's VAT number was valid. The purchases of goods from Intertrade took place on 29 March 2006 and 28 June 2006, both of which pre dated the dates of the respective validations. Mr Saxon formed the view that in such circumstances the reports have no merit if intended as due diligence. A request to verify the VAT number of Intertrade at Redhill was responded to on 24 April 2006 which Mr Saxon noted was out of the date range for both the March and June deals.

122. The Redhill VAT validation request made by the Appellant in respect of Intertrade and the Europa website check were dated 29 June 2006, the day after Intertrade had invoiced for the goods.

123. The signed Intertrade supplier declaration forms for both deals were received by the Appellant by fax on 30 June 2006, 2 days after the goods had been invoiced which Mr Saxon concluded rendered the declarations meaningless.

124. A Check Sure report on Intertrade dated 18 April 2006 was provided by the Appellant. Intertrade was assessed as "average risk" and the report advised treating the company with "a degree of caution". Mr Saxon highlighted that the report post-dated the Appellant's first deals with Intertrade in March 2006 and that no action appeared to have been taken by the Appellant in respect of the warning given prior to carrying out the June 2006 deals. The report also indicated that Intertrade had a credit limit of £500 yet the Appellant undertook high value deals with Intertrade without carrying out any further checks.

125. The Appellant undertook site visits to Intertrade on 4 April 2006 and 13 July 2006. Mr Saxon noted that the first visit took place 6 days after the first deals with Intertrade on 29 March 2006 and the visit on 13 July 2006 post dates the June deals by 15 days.

126. A Trade Application Form signed by Mr Benbow is dated 30 March 2006 which again post-dated the first deals with Intertrade.

Checks on Phone-C@nnected

127. Phone-C@nnected provided the Appellant with trade references including Digi Trading GmbH, Santech Ltd, Waterfire Limited and Warehouses Pro-Logic and MDL S.A.R.L. There is no evidence that the Appellant requested references from any of the names referees.

128. A photograph purporting to be the premises of Phone-C@nnected was provided by the Appellant. Mr Saxon noted that it is unclear when the photograph was taken and there is nothing shown in the photograph to identify that the premises are those of the company.

129. The Appellant visited Phone-C@nnected on 11 April 2006 and copies of travel tickets to Paris and Barcelona together with a hotel bill were provided. The documents were dated between 11 and 13 April 2006. A further visit took pace on 19 July 2006. Mr Saxon questioned the timings of the visits; the April visit took place after the Appellant had already traded with Phone-C@nnected in 6 deals commencing on 27 March 2006. Mr Saxon formed the view that a site visit in April would have served no purpose and was intended as "window dressing." Even if the visit was intended to support future transactions, Mr Saxon concluded that no further deals were carried out with Phone-C@nnected until some 10 weeks later. The later visit took place after the deals which form the basis of this appeal had taken place and 4 days after payment was received. As no further transactions took place between the Appellant and Phone-C@nnected, Mr Saxon concluded that there was no meaningful purpose in the visit and the motivation for it was unclear.

130. The Redhill VAT validation request made by the Appellant in respect of Phone-C@nnected and the Europa website check were dated 29 June 2006, the day after Intertrade had invoiced for the goods.

131. The Appellant provided a number of documents in support of its due diligence which were in French. Mr Saxon noted that no English translation was provided nor was there any evidence of the Appellant seeking a translated copy.

132. In oral evidence Mr Saxon accepted that responses from Redhill were subject to delay and that the Europa checks showed an attempt by the Appellant to verify its trading partners although he queried the timings of the checks. He also accepted that he had no knowledge of any due diligence checks undertaken by the Appellant on the telephone.

133. Mr Saxon concluded that the due diligence checks carried out by the Appellant on both Intertrade and Phone-C@nnected were inadequate and untimely. Site visits took place after the trading relationship had already commenced and the Appellant had therefore already been exposed to potential risks. Mr Saxon formed the view that the due diligence undertaken by the Appellant was no more than "window dressing" designed to satisfy HMRC that checks were carried out.

134. Ms Melanie Hamilton, a member of the Chartered Institute of Management Accountants ("CIMA") and operational accountant within HMRC, provided an unchallenged witness statement in which she reviewed the Appellant's due diligence procedures from an accountant's view. Ms Hamilton notes that 2 of the Appellant's directors in the 06/06 period, Mr Cavanagh and Mr Jeffrey, were signatories to the MoU which listed a set of suggested due diligence checks to be undertaken. At that time both were also directors of P2000 Limited and as a result of HMRC correspondence sent to the companies regarding MTIC fraud and due diligence, combined with its involvement with the MoU, Ms Hamilton concluded that the Appellant should have been very aware of due diligence requirements.

135. Ms Hamilton examined the documents provided by the Appellant and highlighted the following features:

(a) Timing:

The dates contained on the due diligence documents are within days of the Appellant's transactions with its trading partners which indicates that the Appellant accepted the potential trading risk before the due diligence procedures were completed.

(b) Translation:

Some of the documents supplied by the Appellant are in French and there was no accompanying evidence of an English translation of request for one.

(c) Credit checks:

There is no evidence that the recommendation in the Checksure report on Intertrade that the company "should be treated with a degree of caution" was acted upon.

(d) Trade Classification:

The Appellant did not seek an explanation as to why Intertrade's Trade classification was listed as *"Wine, Beer, Spirits and Alcoholic Beverages"* on the company's Certificate of Registration for VAT or why its activities changed, as stated on its letter of introduction, to *"…a specialist company in the source and supply of electrical goods and new sim-free mobile handsets…"*

(e) Trade References:

There is no evidence that trade references were sought from the companies named by Intertrade.

136. Ms Hamilton concluded that the due diligence checks undertaken by the Appellant were superficial; although checks were undertaken to a certain level, it did not reflect the level of the value of trading and there was little evidence that appropriate due diligence was undertaken prior to the Appellant entering into the relevant transactions.

Insurance

137. Mr Saxon was satisfied that the Appellant insured the goods it purchased however he queried why the Appellant had delayed in providing HMRC with the documents. He also noted that there was no evidence that the goods were insured whilst held in storage at the UK freight forwarder's premises in the UK prior to being shipped or at the warehouse in France. This was highlighted to the Appellant in HMRC's decision letter dated 18 July 2008 to which the Appellant did not respond.

138. The Appellant provided the insurance policy as part of its List of Documents served in these proceedings. Mr Saxon noted the delay in providing this document and made the following observations: the covering letter is dated 11 September 2006 which suggests that the document was provided almost 6 months after the policy was taken out and almost 3 months after the transactions relevant to this appeal had taken place. The policy specifies the principal insured party as "Phonebitz 2000 Limited" as opposed to Phonebitz 2000 UK Limited. The period of cover clause states *"12 months open cover to accept all transits and/or risks as detailed in the cover wording, commencing on or after 27 March 2006. SUBJECT TO NO KNOWN OR REPORTED LOSS AS AT 13:08 HRS 31 MARCH 2006"* which suggests that although the policy was stated to take effect from 27 March 2006, the insurance came into force at 13:08 on 31 March 2006 and was backdated. If such was the case, the Appellant's goods in its March 2006 deals which totalled £6,349,335 were uninsured at the time the consignments were actually shipped.

139. The Appellant also produced as part of its List of Documents a letter dated 3 April 2006 from the Appellant to Ontime Logistics which requested that Ontime confirm conveyances will be completed in accordance with security clauses as specified in an attached "Security Conditions" schedule which was signed by Ontime but which is headed "Security Conditions that will be complied with when shipping goods for Svenson Commodities Ltd and their customers." Mr Saxon queried how the Appellant came into possession of a document, which appears to relate to a wholly separate company, Svenson but which was faxed to the Appellant.

Lack of Financial Risk, Payment and Anomalies

140. Mr Saxon noted the lack of any financial risk to the Appellant in the transactions in this appeal as both deals were structured so that the Appellant did not have to pay for its purchases until it was paid by its customer.

141. Phone-C@nnected paid the Appellant in 2 instalments (£447,000 and £442,350) on 14 July 2006. On receipt of the funds the Appellant paid its supplier Intertrade in 2 instalments (£486,450 and £481,162.50). Mr Saxon noted that by the time of payment the goods had already been shipped to the Appellant's customer putting them beyond the Appellant's physical control 16 days prior to payment and authorised release of the goods by Intertrade. He queried how the Intertrade could have exercised any control over the goods should it have needed to between 29 June and 14 July 2006.

142. The CMR notes issued by Ontime Logistics indicated that the goods in both deals departed from its warehouse on the same vehicle on 28 June 2006 however the Eurotunnel vehicle tracking report showed the vehicle checking in at the Folkestone Terminal at 18:45 hours on 29 June 2006. Mr Saxon noted that this information suggests that the goods were in transit between Kent and Folkestone for approximately 24 hours prior to departing from the UK.

143. The Phone-C@nnected purchase orders are dated 29 June 2006 and indicate they were faxed to "Phonebitz LTD" on 30 June 2006; the day after the Appellant had sold the goods by invoice to Phone-C@nnected and shipped the goods out of the UK.

144. The terms on the Intertrade invoices to the Appellant state "Immediate Payment". The Appellant apparently breached the terms without consequence as payment was not made until 14 July 2006.

145. The Appellant's sales invoices in both deals are dated 29 June 2006, the day after the goods appear to have been shipped from Ontime Logistics to Phone-C@nnected.

146. The Appellant's Notices to Inspect Goods issued to Ontime Logistics for both deals provide no detail as to what type of inspection is required. The invoice from Ontime Logistics for deal 1 shows a charge of £30 excluding VAT for the inspection service, which Mr Saxon noted in a consignment of 3000 phones equates to only 1 pence per phone.

147. Mr Saxon noted that the Appellant provided no evidence of written terms or conditions nor did it produce any contracts between it and its trading partners and queried how the Appellant would protect itself should the goods have been found to be faulty or damaged.

The Appellant's Evidence

148. We should note at this point that the Appellant provided the following witness statements:

- Karl Cavanagh dated 1 August 2011;
- Michael McKenna dated 1 August 2011;
- Karl Cavanagh dated 18 October 2011;
- Michael McKenna dated 18 October 2011; and
- Karl Cavanagh dated 18 May 2012.

149. The witness statements predated Counsel Mr Gray's involvement in the case and in those circumstances we were prepared to accept that the oral evidence would go beyond the scope of matters addressed in the witness statements. We did not draw any adverse inferences against the Appellant where this occurred having recognised that had time permitted additional statements may have been served.

150. For that reason we will only briefly summarise the evidence contained in the written statements.

151. Mr Cavanagh's first witness statement set out his background in the telecommunications sector since 1995 when he began work with the Mobile Phone Store (O2) where he was promoted to store manager after 8 months and area manager after a further 12 months. Mr Cavanagh was head-hunted by The Pocket Phone Shop in 1997 followed by subsequent moves to Phones 4 U and The Mobile Phone Store by which point he had developed considerable knowledge of the trade and made contact with numerous companies which bought and sold mobile phones on a wholesale basis.

152. In August 2000 Mr Cavanagh set up Phonebitz 2000 Ltd with Mr McKenna. The witness statements of both Mr Cavanagh and Mr McKenna dated 1 August 2011 set out that it was decided to split the retail and wholesale sides of the business, which led to the Appellant Company being formed in late 2000, initially to take control of the retail side.

153. Whilst both Mr Cavanagh and Mr McKenna were fully aware of MTIC issues they do not fully understand how such fraud takes place nor do they understand how HMRC could verify a repayment in excess of £1,000,000 involving Intertrade in April 2006 yet refuse a repayment involving the same company 3 months later.

154. The witness statements of Mr Cavanagh and Mr McKenna dated 18 October 2011 can be summarised as follows: it is acknowledged that in respect of MTIC fraud HMRC regularly informed traders in the mobile phone sector to be vigilant and the Appellant had a good awareness of such fraud. The Appellant carried out transactions with 20 different companies which had valid VAT registrations.

155. The Appellant accepted any references in respect of its suppliers unless it was *"obviously fictitious or unreliable"*. As regards Adworksuk.com, the company's VAT number was de-registered 7 months after the relevant transaction and therefore could not have been known to the Appellant.

156. Although Intertrade's registration certificate confirmed the trade classification as *"wine, beer, spirits and alcoholic beverages"*, the document is dated 19 July 2005 and the Appellant had no reason to doubt that Intertrade had diversified. The Checksure report dated 18 April 2006 confirmed the company's activities as *"alcoholic and other drinks, wholesale other electronic parts equipment."*

157. It is commercially unviable for a request to be made to Redhill every time a transaction takes place and the Appellant had, on a number of occasions, sought advice from HMRC as to how long a validation letter could be regarded as valid. HMRC Officer Blocksidge refused to put a time limit however he told the Appellant that the Europa website could be used for validations as an alternative given the delays encountered at Redhill which could exceed 4 months. The Appellant made a number of requests to Redhill validate the VAT numbers of its supplier and customers and used the Europa website as an additional check.

158. The Appellant visited its customers and freight forwarder and believed it had carried out due diligence to an acceptable standard. HMRC has ignored some of the checks made, such as requests to Redhill for validation of VAT numbers.

159. The Appellant was unaware of any issue regarding the FCIB which was one of the few banks that did not submit to the pressure applied by HMRC which resulted in many UK banks freezing the assets of companies believed to be involved in MTIC fraud.

160. Mr Malik is known to the Appellant as they all support Liverpool FC; Liverpool Freight Company was designed to use the letters "LFC" as an advertising gimmick however the company never traded and Mr Malik's other business dealings were unknown to Mr Cavanagh and Mr McKenna.

161. Intertrade paid Ontime to scan 10% of the IMEI numbers in both deals with the Appellant however due to an error by Ontime IMEI numbers were only provided in respect of one deal. It was for Intertrade to decide whether to conduct IMEI scans; the Appellant chose not to as it was not cost effective and a trader cannot access information as to whether the phones had been stolen, blocked or misused. The IMEI report from Intertrade was provided to Mr Saxon 9 months after the deals had taken place.

162. The agreed terms were payment on delivery and all contracts were verbal. The Appellant was unaware of any other traders in the chain beyond his own supplier and customer.

FCIB

163. In oral evidence Mr Cavanagh explained that the reason an account had been opened with the FCIB was that they had experienced difficulties with Lloyds TSB after a repayment received from HMRC following verification of the Appellant's 03/06 transactions was frozen. It took approximately 28 days to have the funds released which had led to the Appellant applying to open an FCIB account.

164. He stated that the application to FCIB had only been made once all other avenues had been exhausted, namely making applications between January and May 2006 to at least 5 UK banks, although Mr Cavanagh subsequently accepted that his memory was not accurate as to timings as documents showed that the FCIB application had been made on 23 January 2006.

Memorandum of Understanding and IMEI numbers

165. Mr Cavanagh clarified in his oral evidence that he was aware of the MoU signed by Mr McKenna which stated:

"Major distributors who were signatories to the Memorandum of Understanding have agreed they will adhere to the following procedures when purchasing mobile phones from a new supplier or supplying mobile phones to a new customer…Will the IMEI numbers of each phone be shown on invoices?"

As to whether he realised from the MoU the importance of IMEI numbers Mr Cavanagh stated (transcript 8 October 2013 page 43): *"I can't really answer that one…If we could get them, we would get them"*. He subsequently explained that the MoU was (transcript 9 October 2013 page 5): *"scrapped when joint and several liability came in in 2003"*.

166. As to the reason why IMEI numbers were not obtained by the Appellant, Mr Cavanagh explained that there was no legal obligation to do so nor did he think such an expense was cost effective. He explained that the Appellant requested a list of IMEI numbers obtained by Intertrade as a result of a request from HMRC.

167. Mr McKenna stated in his oral evidence to the Tribunal that he was aware of the importance of record keeping and he recalled signing the MoU. As regards IMEI numbers Mr McKenna stated (transcript 9 October 2013 page 112):

"We were under the impression, w asked many time, what were we supposed to be taking down as IMEIs…and we were given no answer…we asked different officers."

168. Mr McKenna took the view that HMRC bore some responsibility for the Appellant failing to obtain IMEI numbers as *"they're the representatives"* (transcript 9 October 2013 page 112) and stated that he did not believe it was cost effective to carry out the process.

Due Diligence

169. Mr Cavanagh explained in oral evidence that he and Mr McKenna carried out due diligence jointly. As to the fact that the documents produced in these proceedings showed that the Appellant did not have a validation for Intertrade's VAT number until 31 March 2006, after it had already traded with the company, Mr Cavanagh stated (transcript 8 October 2013 page 50): *"all I can say is that when we received paperwork we will have done it"*. He stated that there may have been an earlier validation, although subsequently went on to agree that the document dated 31 March

2006 which had been produced by the Appellant's accountants appeared to be the first attempt to verify the VAT number.

170. Mr Cavanagh accepted that Intertrade's letter of introduction had been received by the Appellant at 15:43 on 28 March 2006; the afternoon before the Appellant carried out its first trade with the company. He agreed that if the documents were the first set of documents received by the Appellant, it gave little time to carry out checks on the company before it entered into a deal worth almost £8,000,000 with Intertrade. Mr Cavanagh could not recall whether any other documents were received by the Appellant from Intertrade prior to those dated 28 March 2006.

171. As to whether trade references were taken up in respect of Intertrade Mr Cavanagh stated (transcript 8 October 2013 page 60):

"A. Not in writing, no.

Q. It was not taken up at all, Mr Cavanagh, was it?

A. That's your opinion.

Q. Matthew Sutton & Co. have written including the due diligence checks carried out by Phonebitz and there is no mention whatsoever in the covering letter of references having been taken up orally, is there?

A. Not by Matthew Sutton, no.

Q….Is not the reality that they were never taken up…

A.No

…

Q. So when were these references taken up orally then?

A.Possibly when we got the paperwork.

Q. Which paperwork?

A.Documents when we'd spoken to them.

Q. When did you speak to them?

A.I can't remember. It's a long time ago.

Q…I would suggest to you that the finer detail of making inquiries in a high risk area of business is not something you would be likely to forget. Do you agree with that?

A.No

Q. So who made these phone calls then?

A.It would have been me.

Q. …Was it you?

A. Yes.

Q. Can you explain how the phone calls went?

A. I probably rang Hawkes and asked them if they'd heard of the company…I'd have spoken to a few of the traders, had they heard anything of this company, had they heard anything bad about them, good…"

172. Mr Cavanagh explained that he did not carry out any financial checks on prospective trading partners as: *"we weren't asking for credit. We were dealing with stock"* (transcript 8 October 2013 page 63) and therefore he was not interested in whether the company from which the Appellant purchased over £1,000,000 stock had assets. He agreed that either Intertrade must have owned the goods itself or it was provided with credit but stated that Intertrade's credit worthiness was irrelevant because *"it is different in the mobile phone trade…you have a product and obviously it's physical and you move it on"* (transcript 8 October 2013 page 64). He was not concerned that the Checksure documents obtained on 18 April 2006 in respect of Intertrade showed a credit limit of only £500 or that the report recommended that the company be treated with a degree of caution as *"all mobile phone traders are basically under that assumption"* (transcript 8 October 2013 page 66). Mr Cavanagh stated that he had not looked at the financial data attached to the report nor had he considered the fact that a company which appeared to have a profit and loss account of £9,000 had supplied the Appellant with almost £2,000,000 of goods as *"we were dealing with the physical stock…whoever they got their credit from, it's not down to me"* (transcript 8 October 2013 page 66). He stated that Intertrade's financial standing was *"nothing to do with me"* (transcript 8 October 2013 page 66).

173. The trade application form which formed part of Intertrade's introduction pack was faxed to the Appellant on 28 March 2006, completed by Mr Benbow and sent back on 30 March 2006, the day after the Appellant's first deal with the company. Mr Cavanagh agreed that that the documents showed that Intertrade was prepared to supply goods to the Appellant before it had received notification of the identity of any trade references. He stated that this did not appear unusual to him *"in the mobile phone world"* (transcript 8 October 2013 page 71).

174. Mr Cavanagh agreed that visits to Intertrade and Phone-C@nnected took place after the Appellant's first deals with the companies and that the Swift Communications was not one of the Appellant's trading partners. He was unable to explain why Swift had been named as a trade reference, stating that it was possibly an error, nor could he explain why the trade application form indicated that company visits had taken place when, at the time the application was filled out, the visits had not taken place. The trade application form also indicated that IMEI numbers were obtained and retained by the Appellant although Mr Cavanagh accepted in his oral

evidence that the this was not the case and that the application form was possibly misleading in that regard.

175. In respect of the visit to Intertrade on 4 April 2006 Mr Cavanagh stated that (transcript 8 October 2013 page 82): *"basically we went down to see the premises, also to meet everyone else there. Also basically to see what else that they traded in, and just basically make sure that the company was there at that said address"*. The second visit on 13 July 2006 was *"basically just to make sure that the company is still there, that they are still trading, that they haven't moved offices"* (transcript 8 October 2013 page 84). Mr Cavanagh was asked about the documents obtained in respect of Intertrade (transcript 8 October 2013 page 87):

"Q. You see, looking at all of this documentation, and perhaps leaving aside the visits because they did not take place until after the deals had in fact taken place, I suggest to you, Mr Cavanagh, that this information provided by Intertrade in fact told you very little about Intertrade's background, its commercial standing. Simply a lot of documents, and there is a VAT certificate which was not, it appears, accurate in terms of its trade classification, and references which you say were taken but there is no evidence of that. It did not tell you anything about Intertrade, did it, in substance?

A. Told us where it was."

176. As regards Ontime Logistics, Mr Cavanagh could not recall when the documents exhibited by the Appellant such as the VAT certificate and Certificate of Incorporation were obtained by the Appellant. He believed that he had been present at a visit to Ontime with Mr McKenna on 10 April 2006 which post dated the Appellant's first involvement with the company and pre-dated the use of Ontime in its deals on 28 June 2006. Mr Cavanagh stated that the purpose of the visit was to make sure that the company was still at the address and look at the set up of the company. The visit report filled in by the Appellant recorded a leaving time of 14:45 on 5 April and arrival time at Ontime at 15:45. Ms Wilson Barnes queried how Mr Cavanagh and Mr McKenna had made the trip from Liverpool to Kent in such a short space of time, to which Mr Cavanagh responded that they may have been in the area visiting other suppliers and traders in the industry although he subsequently added that one of the times could have been a typing error. A further visit to Ontime was carried out on 18 July 2006 which Mr Cavanagh stated was due diligence to check that the company was still at its premises.

177. The documents produced by the Appellant in these proceedings in respect of Phone-C@nnected indicated that the introductory documents were received from the company by the Appellant on the day of its first deal which Mr Cavanagh agreed, if the fax timings on the documents were correct, allowed little time for the Appellant to carry out any checks on the company. When asked if he had any reason to doubt the timings on the documents Mr Cavanagh replied (transcript 8 October 2013 page 106): *"Who knows…I am not saying anything, am I…I am just saying because the timing of the date could have been out"* although he had no recollection of the timescale within which the Appellant was first introduced to Phone-C@nnected and when it decided to trade with the company. Mr Cavanagh recalled having telephoned Phone-C@nnected

prior to receiving the introductory pack and that he had obtained the company's details either off an email or a website.

178. It was put to Mr Cavanagh that the introductory letter was written in terms of Phone-C@nnected as a supplier rather than a customer and when asked why he believed the company might have been interested in purchasing from the Appellant he stated ((transcript 8 October 2013 page 113): *"You can always buy and sell to different customers, or the same customer. They will always have a demand…basically I would always offer, even if someone sells you something. I would always offer stock."*

179. Mr Cavanagh was asked about the Appellant's introduction letter to Phone-C@nnected which was signed by him and which stated:

"I would like to introduce ourselves to your company as wholesale distributors in the mobile phone industry. Due to the ever changing world of mobile communication I am pleased to say some things stay the same here at Phonebitz, like high standards, competitive pricing structure…"

Although at the time the letter was sent by the Appellant it had not carried out any wholesale deals Mr Cavanagh did not agree that the tenor of the letter was misleading and explained that *"basically it is about advertising your business"* (transcript 8 October 2013 page 115) although he agreed that it gave the impression that the Appellant had already engaged in wholesale distribution.

180. Mr Cavanagh accepted that the Appellant had not carried out any credit checks on Phone-C@nnected or taken up trade references at the time it entered into a deal worth in excess of £2,000,000. Mr Cavanagh did not agree that this type of trading lacked commercial legitimacy, stating that the Appellant continues to trade in such a manner. At visits to Phone-C@nnected Mr Cavanagh stated that there were discussions regarding stock, logistics and moving the business forward.

181. Mr Cavanagh agreed that the Appellant knew nothing about Phone-C@nnected's financial position but believed sufficient due diligence had been carried out. He stated that the stock sent to Phone-C@nnected remained under the Appellant's control and if the company had not paid he would have had it returned.

182. Mr McKenna agreed in his oral evidence that the Appellant had very little time in which to carry out checks on new trading partners in March 2006 given the time at which the introduction packs from Intertrade and Phone-C@nnected were received. He did not recall having made any checks himself nor did he have any knowledge about Intertrade's history of trading in mobile phones save for the fact that that a change in the company's trade classification was pending at the relevant time. Mr McKenna stated that no written trade references were obtained by the Appellant and that he personally had not sought any other form of reference.

183. Mr McKenna did not agree that financial information about Phone-C@nnected was relevant despite the high value of the Appellant's first deal with the company. He

stated that he had not considered the type of commercial financial check which should be carried out on the Appellant's suppliers and customers.

184. Mr McKenna could not recall visits undertaken to suppliers and customers with any clarity. In respect of the visit to Ontime his recollection differed to that of Mr Cavanagh as he believed that the time of 14:45 contained on the visit report referred to their arrival time and 15:45 was when they left.

GFSM Loan

185. Mr Cavanagh was asked about the Global Financial Services Account application form which he had signed together with Mr McKenna and Mr Benbow on 20 March 2006. He recalled that the company was advertised online and that a consultant had visited the Appellant although he could not recall when or the name of the person from GFSM who visited. Mr Cavanagh confirmed that no personal guarantees were given by himself, Mr McKenna or Mr Benbow in respect of the unsecured loan. When asked whether he was surprised that within a space of 2 weeks the Appellant, a company of modest financial standing, was able to obtain an unsecured loan for £1,000,000 Mr Cavanagh replied: "I don't know" (transcript 8 October 2013 page 135) and clarified that it was a facility for the Appellant to fund its VAT. He agreed that there was no joint venture between GFSM and the Appellant and did not know why the loan document was headed as such.

186. Mr Cavanagh was cross-examined as to the terms of the loan which set out that GFSM retained title over the goods and *"will release title at their discretion"*. He understood *"the goods"* referred to the mobile phones but provided no further explanation. He understood that GFSM *"were a funder of what we wanted for the VAT element of our deals"* (transcript 8 October 2013 page 139) but maintained that he was unaware at the relevant time that the GFSM had funded the deals with the monies being returned to it. He did not view the loan as too good to be true and stated that due to the lack of funding available from UK banks the Appellant had to source finance from elsewhere.

187. Mr McKenna did not know why the loan agreement was entitled "joint venture loan agreement" nor did he understand what the term meant although he thought he had understood the document when he had read it. He could not explain how GFSM would hold title over goods which, at the time of entering into the agreement with GFSM, had not yet been purchased. Mr McKenna could not recall what information GFSM had requested from the Appellant prior to offering the loan.

Redhill

188. Mr Cavanagh stated in oral evidence that responses from Redhill would generally take *"anywhere from 2 days to a week, the worst case a couple of months"* (transcript 8/10/13 page 30) and that HMRC Officer Mr Blocksidge had told the Appellant that it was acceptable to verify VAT numbers via the Europa website if Redhill was delayed.

189. In oral evidence Mr Cavanagh stated that he would try to make checks with Redhill and Europa at least once a month. He subsequently stated in respect of a transaction in March 2006 with Proinserco (transcript 8 October 2013 page 57):

"Q. The company did not seem to be very enthusiastic about Redhill. It looks as if the deal was carried out a day before the fax was even sent to Redhill. Do you agree with that?

A.That's what it's saying.

Q. Which…does not suggest that the company particularly cared about whether it made checks to Redhill in good time for the transactions.

A. No I wouldn't say that.

Q. Have you any explanation for why it would appear that a deal was carried out before the check was even made?

A. The deal could have run into the next day, something could have been happening in the shop. I have no explanation for that."

Trading and Roles

190. In oral evidence Mr Cavanagh stated that he and Mr McKenna were involved in the wholesale side of the business, with Mr Cavanagh taking the greater role of the two. He subsequently stated that the work *"was done between us but one would do paperwork, one would do phone and one would do other stuff"* (transcript 8 October 2013 page 148). The companies with which the Appellant traded in the transactions which form the basis of this appeal had not previously traded with the Appellant on the retail side of its business.

191. Mr Cavanagh agreed that the deals in which the Appellant was involved only arose at the end of the VAT quarter but that this had not aroused his suspicion as the Appellant had previously turned down deals *"because we had too much on our plate"* (transcript 8 October 2013 page 146).

192. As to how the deals arose, Mr Cavanagh explained that the Appellant received an offer of stock from Intertrade late in the afternoon on 28 June 2006 whereafter he would have called Phone-C@nnected to see if it wanted the stock. Phone-C@nnected confirmed the following morning that it would take the stock between 9:30 and 11:00am.

193. There were no written contracts but as far as he recalled, following commitment from Phone-C@nnected Mr Cavanagh telephoned Intertrade to confirm purchase of the stock. Mr Cavanagh understood a contract came into existence *"if you're agreeing to buy something, when you do the deal you've bought it"* (transcript 8 October 2013 page 153). The purpose of an invoice was a request for monies and the purchase order was to confirm purchase of the stock. The commitment was made to buy the stock by both sending the purchase order and confirming it in conversation. The supplier

declaration was part of the Appellant's due diligence as *"…obviously with HMRC going on about third party payments we didn't want to get embroiled in anything like that, and obviously it's another paperwork to say that…this is us, that's them…at the end of the day it's just a – it's a piece of paperwork we had to put in"* (transcript 8 October 2013 page 157 and 159). There was no rule as to when the supplier declaration was required; if it wasn't signed in a day or two the supplier would be chased for the document. It was put to Mr Cavanagh that by the time the Appellant received the supplier declaration form back from Intertrade the goods had already been shipped out of the UK and he agreed that it had no impact on whether the Appellant entered into a deal or shipped the goods *"because the deal was already done"* (transcript 8 October page 160).

194. Mr Cavanagh was unsure as to why Ontime had been instructed to inspect the goods and provided a report dated 28 June 2006, at which point the Appellant had not entered into the deal. He explained that the deal had lapsed over 2 days and that he may have asked Ontime to backdate the report although he could not be sure.

195. Mr Cavanagh could not explain why the CMR documents indicated that instructions had been given on 28 June 2006 to ship the goods out of the UK when the deal had not, at that point, been entered into. He was asked about the term contained on the documents *"ship to hold"* which he clarified should have read *"ship on hold"*. He stated that *"that's how the deals were done, ship on hold"* (transcript 8 October 2013 page 173) but agreed he had no way of knowing whether Ontime Logistics structured deals in that way or that it understood the reference *"ship to hold"*.

196. Mr Cavanagh agreed that the Appellant had not asked Ontime to check the specification of the phones or inform the Appellant whether the goods were the correct specification.

197. Mr McKenna told us that he *"didn't generally deal with the day to day dealings if the transactions"* (transcript 9 October 2013 page 81) and that generally Mr Cavanagh as *"front of house"* (transcript 9 October 2013 page 90) would speak to trading partners on the telephone. He could not recall how the Appellant came into contact with Intertrade or Phone-C@nnected but most information gathered by the Appellant came from *"…websites or back of magazines…"* (transcript 9 October page 88).

Title, Payment and Insurance

198. Mr Cavanagh explained that he believed Intertrade held title to the goods but had not given any thought as to how Intertrade had obtained title. He stated that he believed the Appellant took ownership of the goods *"when they were shipped"* (transcript 9 October 2013 page 67).

199. He agreed that Intertrade's invoice terms mandated immediate payment but stated that the term *"may be generically put on there"* (transcript 8 October 2013 page 184). He did not believe the payment term applied to the Appellant as the goods were shipped on hold and explained that conversations had taken place with Intertrade

prior to the deals taking place in which terms for payment were addressed. Mr Cavanagh explained *"in the industry as soon as you get paid, you would pay down your supplier, even if you didn't have the funds yourself…they can ask for immediate payment but we didn't have the funds at the time"* (transcript 8 October 2013 page 187).

200. Mr Cavanagh explained that he had not noticed the term on Phone-C@nnected's purchase order which specified that *"the stock must be owned by the supplier"* however he was not concerned by the fact that the Appellant did not own the goods.

201. Mr Cavanagh was asked why the goods were shipped out of the UK on 28 June 2006when there was no documentary evidence from Phone-C@nnected showing such a request or specifying a delivery date to which he replied *"…I have no answer for that one because I'm stuck"* (transcript 8 October 2013 page 191). Mr Cavanagh could not recall the specific details of any telephone conversations with Phone-C@nnected regarding payment but believed that Mr Giles Poelvaarde had experienced *"a banking issue or something had gone on in his family"* (transcript 8 October 2013 page 197). Phone-C@nnected returned by fax dated 5 July 2006 a letter from the Appellant requesting signed confirmation of receipt of the stock in good order. No mention of payment which remained outstanding was made in the letter from the Appellant however Mr Cavanagh stated that he had chased payment via telephone. He explained that Intertrade was either content to wait for payment or could have pulled the stock back as Intertrade still had control. When asked how Intertrade would have known where the goods were, Mr Cavanagh clarified that *"I assume they would have spoke to Ontime"* (transcript 8 October 2013 page 203).

202. Mr Cavanagh explained that the insurance taken out to cover the goods was billed by reference to deals which had taken place and the date of 31 March 2006 shown on the document may have referred to the date on which the Appellant notified the insurance company about deals which had been undertaken.

Inspection Anomalies

203. Mr Cavanagh could not explain the discrepancy between the price structure information provided by Ontime, which quoted 75p per item to be inspected and £30 per rewrapped pallet, as compared with an invoice from the company which charged 1p per item inspected and made no charge for rewrapping nor did he recall noticing the anomaly at the relevant time.

Submissions

204. We were assisted by Counsel who provided us with written submissions and supplemental oral submissions for which we were grateful.

205. On behalf of HMRC Ms Wilson Barnes submitted that where there is a dispute the evidence of HMRC should be preferred to that of Mr Cavanagh and Mr McKenna who were untruthful witnesses. Mr Cavanagh was evasive, particularly in respect of timings and contents of conversations with trading partners and when challenged

about the lack of evidence as to communication having taken place he insisted that conversations had taken place and he could recall their substance.

206. Both Mr McKenna and Mr Cavanagh gave unsustainable reasons as to why IMEI numbers were not obtained, namely the lack of legal obligation to do so and cost effectiveness, despite the express commitment set out in the MoU. Neither witness had a clear recollection of the transactions which form the basis of this appeal, receipt of the loan from GFSM or application to join FCIB despite the fact that these would no doubt have been memorable events leading to the Appellant's first wholesale export deals; for example the evidence of Mr Cavanagh repeatedly used speculative terms such as "I would have".

207. The Tribunal was invited to find that the Appellant failed to obtain trade references in respect of Intertrade and Phone-C@nnected either in writing or orally and no discussions took place with Ontime as to the meaning or effect of "ship to hold". Furthermore the Tribunal should reject Mr Cavanagh's oral evidence that he chased payment from Phone-C@nnected.

208. The Tribunal can infer that the Appellant was aware of the connection to fraud, or in the alternative it should have known, from the following features:

- The unexplained shift between 13 March 2006 and 27 March 2007 from intended UK to UK deals to export deals;
- The speed and ease at which the Appellant obtained a loan in the sum of £1,000,000 from GFSM despite being in a position whereby it was unable to repay such a loan;
- The lack of understanding as to the terms of the "joint venture agreement" with GFSM and the fact that the loan was expressly intended to fund the VAT;
- That the Appellant opened an offshore account to effect the transactions;
- The lack of any financial information obtained in respect of the Appellant's customer about which little else was known and despite which the Appellant was willing to ship valuable goods to it;
- The lack of concern as to Intertrade's poor credit rating and lack of capital;
- The inaccurate and misleading information provided by the Appellant to Intertrade on the trade application form and which was only sent back to Intertrade after the first transaction in March 2006 had been completed;
- The limited time available for the Appellant to undertake due diligence on Intertrade and Phone-C@nnected prior to its first deals in March 2006;

- The inference that the Appellant knew Intertrade was importing the goods and lack of commercial rationale for the goods then being exported by the Appellant;

- The absence of any clear explanation as to why Phone-C@nnected introduced itself as a supplier but went on to purchase goods as a customer;

- The ease at which transactions were carried out and significant resultant profit combined with the Appellant's ability to match stock offers with requirements within such a short space of time;

- The absence of formal written contracts and evidence of negotiation;

209. Many factors indicate that the transactions were contrived including the circular flow of monies within FCIB accounts over a short time period and breaches of terms such as that of Intertrade which required immediate payment. Furthermore the Mr Cavanagh's evidence as to the purpose and meaning of paperwork such as invoices and purchase orders was vague and contradictory and from which it can be inferred that the documents were effectively meaningless.

210. The evidence demonstrates that the deals were orchestrated for the purpose of defrauding the Revenue and the Appellant either knew or should have known that each of its transactions were connected to fraud.

211. On behalf of the Appellant, Mr Gray submitted that there was nothing suspicious in the Appellant trading in back to back wholesale deals and that HMRC's reliance on the Appellant's associated companies is irrelevant and prejudicial.

212. The mark ups made in the two deals in this appeal were different from which it can be inferred that they were commercial transactions where price was negotiated. Similarly HMRC's reliance on uplift in turnover is misplaced as the distinct sides of the business, namely retail and wholesale, are incomparable.

213. The VAT element of the Appellant's March 2006 deals was funded by the GFSM loan. It would not make commercial sense to have a substantial amount of money "out" for a significant period of time as one of the main issues in any business is cash flow and the agreement with GFSM stipulated a time period over which penalty fees are payable. For the same reason it made no commercial sense for the Appellant to pay out monies for a substantial period of time in the 06/06 quarter which was one of the reasons why the deals were undertaken at the end of the quarter. The other reason was that the Appellant's account at Lloyds had been frozen which meant that the funds could not be accessed throughout May and into June 2006.

214. The loan agreement was a matter for GFSM; any risk taken was a matter for the lender and for which the borrower cannot be held responsible. The loan enabled the Appellant to carry out its deals in March 2006, the profit from which allowed it to

enter into the transactions in 06/06. In that respect there was no funding by GFSM for the deals in this appeal and the amount reclaimed was comparatively small.

215. Information obtained from tax authorities in the EU could not have been known to the Appellant at the relevant time and has only come to light as a result of full investigations with the benefit of hindsight.

216. It is accepted that the Appellant did not obtain IMEI numbers however this was not compulsory until after the date of the transactions in this appeal. Furthermore there is no evidence that at the relevant time the Appellant could have accessed information such as that available to HMRC on NEMESIS. HMRC have attempted to transfer an onus of absolute necessity of obtaining IMEI numbers where no such obligation existed. The MoU was not a legal document but rather an understanding between the signatories. It is accepted that Mr Cavanagh and Mr McKenna were aware of the prevalence of MTIC fraud however the Tribunal should note that the terms of the MoU were not mandatory and advice sought by the Appellant from HMRC was often not given.

217. The FCIB account was not used as a vehicle for fraud nor to hide payments in the overall scheme of trading; the Appellant made clear to HMRC that it kept its retail and wholesale accounts separate. The Appellant made full and frank disclosure to HMRC regarding its application to open an account and were not informed that HMRC viewed the FCIB with suspicion. There is no evidence that all traders who used FCIB accounts were acting fraudulently. The Appellant's evidence that banks faced pressure from HMRC, as a result of which the Appellant had its account at Lloyds frozen and was unsuccessful in opening an account at other high street banks, should be accepted and is confirmed by the evidence of HMRC officer Mr Stone. The Appellant also informed HMRC that it expected to move into export deals; the opportunity to do so came about in a short space of time due to the fast pace of the industry and the Appellant cannot be criticised for exploiting the opportunity.

218. There is no evidence that the Appellant's customer requested the exact amount sold; they may have requested more and been sent less by the Appellant.

219. There were generally no written contracts in the industry due to the need for expedition.

220. The Appellant cannot be expected to know the source or ultimate destination of the goods; it was only aware of its immediate trading partners. Regarding its due diligence on Intertrade, the lack of documents cannot be criticised in such a fast moving industry as that of the mobile phone sector. Mr Cavanagh gave evidence that many telephone calls were made in place of documentary checks and following successful transactions in March 2006 the Appellant continue to foster good relations with its trading partners. It is conceded that many of the due diligence documents produced by the Appellant post date the first transactions with Intertrade and Phone-C@nnected in March 2006 but the Appellant took the view that the relationships were moving forward and any concerns were alleviated following visits to the relevant parties.

221. As regards financial checks on the Appellant's trading partners there was no reason for checks to be made in respect of Intertrade, which supplied the goods. Furthermore traders in the mobile phone industry generally had low credit ratings. Mr Cavanagh believed that the important point was retaining control of the goods, which he did via "ship on hold" instructions.

222. Taking into account the evidence given by Mr Cavanagh and Mr McKenna, it cannot be said that the Appellant either knew or should have known that its transactions in 06/06 were connected to fraud.

The Decision

Findings of fact on whether the Appellant knew, or should have known, that its transactions were connected to fraud.

231. We have considered the law, oral and written evidence and submissions of Counsel carefully in reaching the following findings of fact.

Credibility of witnesses

223. We found Mr Saxon was a credible witness who was, not least by his concessions, reasonable in his approach to this case and the issues he raised. To the contrary Mr Cavanagh's evidence was evasive and unconvincing. Mr McKenna was extremely vague in his evidence and, even allowing for the passage of time that has elapsed since the transactions in question took place, we found him to be an unconvincing witness.

Associated Companies

224. We were satisfied that through P2000 and P2003 Ltd Mr Cavanagh and Mr McKenna had significant experience of the mobile phone industry including the problems associated with the trade such as MTIC fraud. We did not accept the evidence of Mr Cavanagh and Mr McKenna that although they knew of fraud within the industry they were not aware of the mechanics of such fraud; we found as a fact that both men had experience of wholesaling mobile phones, albeit within the UK, and had utilised this knowledge when the Appellant entered into wholesale export deals.

225. We did not find the Appellant's connection to P200E or Broadpark relevant in assisting us to determine the issue of knowledge in this case. As regards Mr Cavanagh and Mr McKenna's connection to the Liverpool Freight Company we concluded that the only relevance of such a connection was the link to Swift Communications via its director Mr Malik who was also a director of LFC. We noted that the Appellant had used Swift Communications as a trade reference but had not in fact traded with the company which in our view demonstrated the close ties the Appellant had with Mr Malik to such an extent that the Appellant was confident to provide him as a referee.

226. We were quite satisfied that the Appellant, through Mr Cavanagh and Mr McKenna, was aware of the general prevalence and characteristics of fraud within the

industry, and it was against this background that we assessed the nature of the Appellant's trading.

Mark Ups

227. There were only 2 transactions in this appeal and we concluded that they were insufficient to support a finding that there was a pattern in the Appellant's mark ups. That said, we noted that the Appellant was aware of the price at which he bought and sold the goods and we queried why the Appellant failed to question why it was able to make significant profits without adding value to the products or why Intertrade did not seek to retain such profits for itself. We concluded that a reasonable businessman in the Appellant's position would have asked such questions and that the Appellant's failure to do so was indicative of the fact that it either knew or turned a blind eye to the fact that its transactions were connected to fraud.

Timing of Deals

228. We considered Counsel Mr Gray's submission that to conduct transactions at the end of the VAT quarter made commercial sense for the Appellant as it meant funds were not tied up for a significant period of time, however we noted that this was not the evidence given by Mr Cavanagh who explained that it was a result of the Appellant's funds being frozen by Lloyds.

229. Whilst we accepted that this was the case, there was no evidence that the funds were frozen until the point at which the deals in 06/06 arose nor was there any oral or documentary evidence, in period 06/06 or 03/06, to demonstrate that the Appellant had made any attempt to source deals other than those it carried out. We also noted the apparent ease with which the Appellant began exporting goods seemingly without using any of the contacts made during his earlier employment in the mobile phone trade.

IMEI Numbers

230. There was no dispute that the Appellant made no provision for IMEI numbers to be obtained for its 06/06 transactions. The list of IMEI numbers provided to HMRC in respect of one deal was obtained from Intertrade and we noted that the Appellant only sought this information in response to a request from HMRC after the transactions had been completed. In those circumstances we were satisfied that the list of IMEI numbers served no purpose for the Appellant.

231. We accepted Mr Cavanagh's evidence that there was no legal obligation on traders to obtain IMEI numbers however we balanced against this the fact that the Appellant was experienced in the mobile phone trade and, in addition to the verbal and written warnings given to it by HMRC, it had signed the MoU which expressly addressed the issue of IMEI numbers.

232. We noted Mr McKenna's evidence that the MoU was of some age at the time of the relevant transactions, however in our view any reasonable businessman would have followed the advice and guidance set out therein which was designed to provide

protection to traders within the industry. Mr McKenna sought to persuade the Tribunal that the Appellant had sought advice from HMRC regarding IMEI numbers without success however we found his evidence, which lacked any detail, unpersuasive. We also queried why advice had been sought when the views of both Mr Cavanagh and Mr McKenna were clear from their oral evidence, namely that obtaining IMEI numbers was not cost effective and as it was not compulsory the Appellant chose not to do so.

233. We accepted that the Appellant did not have access to the NEMESIS database and therefore would not have been aware of the results of the scans detailed in HMRC's evidence however there was no credible explanation as to why the numbers were not obtained. We rejected Mr McKenna's evidence that HMRC bore a degree of responsibility on the matter; we formed the view that this was an attempt to transfer an obligation onto HMRC on an issue which was ultimately for a trader to decide.

234. We also noted that the Appellant's evidence as to the cost-effectiveness of obtaining IMEI numbers was not borne out by the evidence when the cost was compared to the value of the deals and profit made, a factor which was to a degree conceded by Mr Cavanagh. For that reason we rejected the evidence as unsustainable and we concluded that the Appellant made the deliberate decision not to obtain IMEI numbers, contrary to the advice it had been given by HMRC, and that its failure to heed such advice was not the action of a reasonable businessman. We were satisfied that the Appellant's blatant disregard for the MoU was indicative of its awareness that the deals were contrived.

FCIB

235. We did not accept that opening an FCIB account was, of itself, indicative of any knowledge of fraud on the part of the Appellant; at the relevant time there was no reason for the Appellant to know of the subsequent closure of the bank and we accepted that Mr Saxon had not informed the Appellant of HMRC's suspicions of traders with FCIB accounts. We did however note that the evidence given by Mr Cavanagh as to how the Appellant came to open an FCIB account was vague and inaccurate in respect of the dates upon which he said the Appellant had approached UK banks.

236. We found that the circularity of funds in the transaction chains demonstrated by HMRC's analysis of the FCIB servers was clear evidence of contrivance and although we did not attribute knowledge of the wider scheme to the Appellant we were satisfied that the timings of payments, in particular those of the Appellant, Phone-C@nnected and Intertrade, indicated a close connection between the parties. We were satisfied that it was, at the very least, unusual in the normal course of business to see such short intervals between payments between purportedly independent traders in different areas.

GFSM Loan

237. We found as a fact that both Mr Cavanagh and Mr McKenna displayed a clear lack of understanding as to the title of the loan from GFSM as a "joint venture agreement" nor had they sought clarification of it. Furthermore both showed little understanding or awareness of the terms of the loan, in particular GFSM's purported ownership of goods not yet purchased.

238. Given the short period over which the loan was secured, taken together with the vague evidence given by Mr Cavanagh and Mr McKenna as to how it was obtained and the fact that Mr Cavanagh accepted that the loan was intended to fund the VAT on the Appellant's 03/06 deals (a matter which was, by inference from the terms of the loan, known to GFSM) we were satisfied that any reasonable businessman would have been put on notice that the loan was not a legitimate, arms length agreement.

239. The unprofessional manner in which the agreement was drafted, which included such basic errors as spelling mistakes, must have been obvious to the Appellant. We found that this was further evidence of the fact that the loan was neither commercial nor legitimate.

Lack of Written Contracts and Title

240. We did not accept the submission that there were generally no written contracts in the industry due to the need for expedition; there was no evidence to support this contention nor was such evidence given by Mr Cavanagh or Mr McKenna. We found as a fact that the lack of written agreements regarding matters such as responsibility for returns of faulty goods was implausible for a legitimate trader seeking to minimise his exposure to risk. The terms set out on invoices, such as Intertrade's requirement for immediate payment, were ignored and there was no evidence to support Mr Cavanagh's assertion that terms were agreed orally. In our view, any legitimate business involved in transactions of such high value would have recorded any terms agreed in order to protect itself.

241. The oral evidence as to title from Mr Cavanagh was implausible and inconsistent. He contended that Intertrade held title to the goods despite being unaware as to whether Intertrade had actually funded the goods and he subsequently stated that he believed the Appellant took ownership of the goods when they were shipped which contradicted his earlier statement that Intertrade owned and retained control of the goods.

242. In our view legal title is an issue crucial to any trader and a reasonable businessman would ensure that it was clear which party had legal title to the goods and at what point legal title passed.

243. We were satisfied that the lack of formal contracts was indicative of the contrived nature of the deals whereby issues such as faulty goods and legal title would never be in issue. We found the oral evidence of Mr Cavanagh unconvincing and in our view the evidence laid bare the lack of commerciality of the trade in which the Appellant was engaged.

Manner of Trade, Insurance and Payment

244. The transactions took place on a back to back basis and there was no evidence, oral or documentary, to indicate that Appellant was ever left with unsold stock. Whilst we found that this corroborated the fact that the deals were contrived as part of a scheme, we were not satisfied that this fact, of itself, was sufficient to indicate that the Appellant knew or should have known that the transactions were contrived.

245. As regards the chains of supply, the Appellant was aware that the chain included Intertrade, Phone-C@nnected and itself. That the Appellant failed to consider where the goods came from beyond its supplier or where the goods ended up was, in our view, a feature which indicated knowledge of the contrivance or, at the very least turning a blind eye to a feature which in our view any legitimate trader would have considered.

246. The evidence regarding Phone-C@nnected's delayed payment to the Appellant was untenable. Mr Cavanagh asserted that there was a reason behind the late payment but was vague as to what that reason was, stating (transcript 9 October 2013 page 24) *"it was either a banking issue or some other issue personally, can't really recollect"* which given the value of the transaction was implausible. We also rejected Mr Cavanagh's evidence that he chased the payment on the telephone on the basis that it did not tally with the documentary evidence in the form of a letter from the Appellant to Phone-C@nnected requesting confirmation that the goods were in order and which made no mention of the late payment. We concluded that the issue of late payment was of no concern to the Appellant as it was fully aware of the contrived nature of the transactions and in reality the Appellant knew there was no risk of not being paid.

247. We also noted that at the time of payment by Phone-C@nnected the goods had already been shipped out of the UK. The evidence also demonstrated that the goods were shipped prior to the evidence being completed and, on the oral evidence of Mr Cavanagh, before the Appellant had been offered or sold the goods. We queried why any trader would ship goods prior to any confirmation of purchase and why Ontime Logistics were assumed to have understood and acted upon the erroneous terms on the Appellant's instructions to "ship to hold". Even accepting that the goods were shipped on hold, the reality was that the Appellant, and Intertrade to whom the goods still purportedly belonged, had lost physical control of the goods, which were deposited in a warehouse in France about which the Appellant knew nothing. When viewed together with the vague evidence and anomalies shown on the inspection documents as to the type of inspection to be carried out and the amount charged to the Appellant as compared with the Ontime's price list (for which there was no explanation from the Appellant) we were satisfied that the only reasonable explanation was that the Appellant was fully aware that the deals were contrived.

Due Diligence

248. The due diligence carried out by the Appellant lacked any substance. The time at which both Intertrade and Phone-C@nnected sent introduction packs to the Appellant prior to its first deals left insufficient time to conduct any meaningful

checks and the VAT number validations took were carried out after the relevant deals had already taken place. The signed supplier declaration form from Intertrade was received after the transaction had been conducted which in our view rendered it meaningless.

249. Whilst we accepted that the Appellant had made a number of VAT number validations, either via HMRC's Redhill office or on the Europa website, such a check was, in our view, limited in terms of the information it actually provided to the Appellant.

250. Similarly visits to trading partners took place after the companies had already traded and the evidence from both Mr Cavanagh and Mr McKenna as to the purpose of the visits was vague and unconvincing.

251. We were satisfied that the lack of any checks as to the financial standing of Phone-C@nnected, upon which the Appellant was reliant for payment, demonstrated that the Appellant was aware there was no risk of non-payment. We noted that the Checksure warnings in respect of Intertrade were wholly ignored and the only reasonable explanation for such behaviour by the Appellant was that it was aware that the deals were contrived.

252. No written trade references were taken up and Mr McKenna accepted in oral evidence that he had not sought any oral references and that he had no knowledge as to the background of Intertrade. There was no evidence from Mr Cavanagh as to the type of information he had obtained on the Appellant's supplier and customer or from whom the information had been obtained and we were satisfied that Mr Cavanagh's evidence that oral references were sought was untruthful.

253. We agreed with the unchallenged evidence of HMRC officer Ms Hamilton that the checks undertaken by the Appellant were superficial and did not reflect the value of its trading. We concluded that the due diligence undertaken provided the Appellant with limited information from which it would not have been able to reasonably assess the legitimacy of the companies with which it traded and we were satisfied that this was indicative of the Appellant's awareness of the contrived nature of its transactions.

Conclusion

254. We were satisfied HMRC had established fraudulent tax losses and that there was an orchestrated scheme for the fraudulent evasion of VAT connected with both of the transactions which form the subject of this appeal.

255. We were careful not to focus unduly on the issue of due diligence, and we took into account all of the surrounding circumstances in reaching our decision that the Appellant, through Mr Cavanagh and Mr McKenna, knew that both of its transactions were part of an artificial scheme. In doing so, the only conclusion we could reach was that the Appellant had actual knowledge that the transactions were connected to fraud for the reasons set out above.

256. We found that some reasons carried more weight than others and we did not base our decision solely on one reason but rather the cumulative effect of our findings viewed in totality.

257. We concluded that in respect of the period under appeal the Appellant knew that, by its purchases, it was taking part in transactions connected with the fraudulent evasion of VAT or that the factors identified above, from which we inferred the Appellant's actual knowledge, would at the very least support a finding of means of knowledge.

258. The appeal is dismissed.

Costs

259. We direct that the Appellant is to pay HMRC costs of, incidental to and consequent upon the appeal, to be the subject of detailed assessment if not agreed.

260. 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.

MISS JENNIFER BLEWITT
TRIBUNAL JUDGE

RELEASE DATE: 6 January 2014