[2016] UKFTT 159 (TC)

TC04945

Appeal number: MAN/2008/0901

VAT – MTIC – whether trader entitled to recover input tax –timing of contra trades - whether the appellant knew or should have known that its transactions were connected with a fraudulent evasion of VAT by a contra trader – yes – appeal dismissed

FIRST-TIER TRIBUNAL
TAX CHAMBER

GRADE ONE TRADING LIMITED (in liquidation) **Appellant**

- and -

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

TRIBUNAL: JUDGE ANNE SCOTT, LLB, NP
MEMBER: TERENCE BAYLISS, FFA

Sitting in public at Birmingham Magistrates Court, Birmingham on Monday 5 October to Tuesday 13 October 2015

Having heard Timothy Brown, of Counsel, instructed by Moore Stephens for the appellant and James Puzey, of Counsel, instructed by the General Counsel and Solicitor to HM Revenue and Customs, for the respondents.

DECISION

Introduction

1. The appeal is brought by the appellant against the decision of the respondents ("HMRC"), which expression is used for convenience to include HMRC's predecessor HM Customs & Excise, dated 18 June 2008 ("the decision") denying the appellant the right to deduct input tax claimed on the appellant's VAT return for the period 03/06 in a total of £966,085.20.

2. That sum reflects the amounts in dispute in respect of three deals, namely

   (a) £397,665.63 for invoice number 933 ("deal 1"),

   (b) £523,325.25 on invoice number 940 ("deal 2"), and

   (c) £45,094.32 on invoice number 943 ("deal 3").

3. In respect of deals 1 and 3 HMRC denied the input tax only where the appellant had made onward supplies outwith the UK ("broker deals"). The input tax was not denied where the appellant made onward supplies to UK based customers ("buffer deals").

4. HMRC's grounds for the decision were stated to be that the input tax was incurred by the appellant in transactions connected with the fraudulent evasion of VAT and the appellant knew or should have known that fact.

5. In respect of the three denied deals in the VAT period 03/06 HMRC assert that they have traced the chain of transactions, via a contra trader Cmart Trading Limited ("Cmart"), to defaulting traders and therefore tax losses. They accept that the appellant's transactions do not trace back directly to a defaulting trader ie there is no UK missing trader at the beginning of the appellant's three deal chains.

6. Although the decision relates to 2006, it was made on 18 June 2008 and Grade One Trading Limited had gone into liquidation on 3 January 2008. At all times the appellant has been, and is, the company Grade One Trading Limited (in liquidation) and it is not litigation at the instance of the liquidator.

7. Originally this had been a consolidated appeal involving a similar appeal in respect of the period 06/06 in the sum of £489,013.88. By letter dated 8 March 2011, the liquidator of the appellant withdrew the appellant's appeal against the decision (also dated 18 June 2008) in respect of the period 06/06. No explanation was given for the withdrawal. HMRC argued that since that appeal had been withdrawn it was therefore "an established fact" that the appellant's trading in that period was connected to fraud through the mechanism of contra trading. We do not accept that assertion. There could have been many reasons for the withdrawal.

8. We are obliged to both Counsel for the concise delineation of the issues and detailed references to the bundles.

Evidence

9. HMRC Officers who gave oral evidence were: Graham Taylor, Jane Humphrey, Terence Mendes, Michael Everett and Gavan Wafer.

10. The 20 HMRC Officers whose evidence was not challenged and therefore were not required to give evidence, were: Andrew Adamson, Olultoyin Alabi, Sarah Alan, Christopher Baker, Mathew Bycroft, Michael Downer, Susan Hirons, Nigel Humphries, Paul Johnson, Robert Lamb, Andrew Letherby, Andrew Monk, Richard Meynell, Stephen Nealey, Roger Murphy, Daniel Outram, Barry Patterson, Julie Sadler, and Gavin Stock.

11. Mr Delroy Keith Haughton ("Mr Haughton"), the controlling mind of the appellant at all material times, produced two witness statements with exhibits and gave oral evidence for the appellant.

12. We had 55 bundles of evidence, three other bundles and one bundle of authorities.

13. There were nine authorities cited:

(i) *Axel Kittel v Belgium* C-439/04; *Belgium v Recolta Recycling* C-440/04 [2006] ("*Kittel*")

(ii) *Mobilx Ltd and Others v The Commissioners for HMRC* [2010] EWCA Civ 517 "(*Mobilx*")

(iii) *Emblaze Mobility Solutions Ltd v The Commissioners for Her Majesty's Revenue and Customs* (VAT) [2010] UKFTT 410 (TC) ("*Emblaze*")

(iv) *Powa (Jersey) Ltd v HMRC* [2012] UKUT 50 (TCC) ("*Powa*")

(v) *Red 12 Trading Ltd v HMRC* [2009] EWHC 2563 ("*Red 12*")

(vi) *Optigen Ltd and others v Customs and Excise Commissioners* (Joined Cases C-354/03, C-355/03, C-484/03 ("*Bond House*")

(vii) *Fonecomp Limited v HMRC* (2015) EWCA Civ 39 ("*Fonecomp*")

(viii) *The Hira Company Ltd v HMRC* (2011) UKFTT 450 ("*Hira*")

(ix) *Staatssecretaris van Financien v Schoenimport 'Italmoda' Mariano Previti vof, and Turbu.com BV* (Joined Cases C-131/13, C-163/13 and C-164/13).

The legal framework

14. There was no dispute as to the applicable law and the contra-trade construct was well known and understood by both parties and, no doubt, to the majority of readers of this decision. Therefore, we do not set out the legal principles at length.

MTIC fraud – a brief explanation

15. As we indicate above HMRC contend that all the transactions entered into by the appellants, on which they based their claims to deduct input tax, form part of what is described as "Missing Trader Intra-Community" ("MTIC") fraud. The "classic way" in which the fraud works was described by Christopher Clarke J in *Red 12* (at paragraphs 2 and 5) as follows:

> "2….Trader A imports goods, commonly computer chips and mobile telephones, into the United Kingdom from the European Union ("EU"). Such an importation does not require the importer to pay any VAT on the goods. A then sells the goods to B, charging VAT on the transaction. B pays the VAT to A, for which A is bound to account to HMRC. There are then a series of sales from B to C to E (or more). These sales are accounted for in the ordinary way. Thus C will pay B an amount which includes VAT. B will account to HMRC for the VAT it has received from C, but will claim to deduct (as an input tax) the output tax that A has charged to B. The same will happen, *mutatis mutandis*, as between C and D. The company at the end of the chain – E – will then export the goods to a purchaser in the EU. Exports are zero-rated for tax purposes, so trader E will receive no VAT. He will have paid input tax but because the goods have been exported he is entitled to claim it back from HMRC. The chains in question may be quite long. The deals giving rise to them may be effected within a single day. Often none of the traders themselves take delivery of the goods which are held by freight forwarders…
>
> 5. A jargon has developed to describe the participants in the fraud. The importer is known as 'the defaulter'. The intermediate traders between the defaulter and the exporter are known as 'buffers' because they serve to hide the link between the importer and the exporter, and are often numbered 'buffer 1, buffer 2 etc'. The company which exports the goods is known as 'the broker'."

16. For simplicity, but without thereby prejudging the issue, we shall adopt the same terminology of "defaulter(s)" (sometimes also known as "missing traders"), "buffers" and "brokers".

17. Some MTIC appeals involve a variation on the typical transaction, as described above by Christopher Clarke J, and that is known as contra-trading. It is that with which we are concerned in this appeal.

18. Christopher Clarke J goes on to describe contra trading and its implications at paragraphs 7 to 10 which read as follows:

> "7. There are variants of the plain vanilla version of the fraud. In one version ('carousel fraud') the goods that have been exported by the broker are subsequently re-imported, either by the original importer, or a different one, and continue down the same or another chain. Another variant is called 'contra trading', the details of which are explained in paragraphs 9 and 10 of the judgment of Burton J in **R (on the application of Just Fabulous (UK) Ltd) v HMRC** [2008] STC 2123. Goods are sold in a chain ('the dirty chain') through one or more buffer companies to (in the end) the broker ('Broker 1') which exports them, thus generating a claim for repayment. Broker 1 then acquires (actually or purportedly) goods, not necessarily of the same type, but of equivalent value from an EU trader and sells them, usually through one or more buffer companies, to Broker 2 in the UK for a mark up. The effect is that Broker 1 has no claim for repayment of input VAT on the sale to it under the dirty chain, because any such claim is matched by the VAT accountable to HMRC in respect of the sale to UK Broker 2. On the contrary a small sum may be due to HMRC from Broker 1. The suspicions of HMRC are, by this means, hopefully not aroused. Broker 2 then exports the goods and claims back the total VAT. The overall effect is the same as in the classic version of the fraud; but the exercise has the effect that the party claiming the repayment is not Broker 1 but Broker 2, who is, apparently, part of a chain without a missing trader ("the clean chain"). Broker 2 is party to the fraud.
>
> 8. HMRC will have records of whatever returns have been made to them by companies registered for VAT and will know what has been accounted to them and what has not. Using those records and information provided by VAT registered companies they are able to trace a chain of transactions in respect of which output tax received has been accounted for and claims to deduct input tax have been made. They can, thus, trace back from exporter E to

(say) importer A. But at some stage the trail is likely to go cold. In the classic version of the fraud it will do so when HMRC gets to A because A and its documents have disappeared. HMRC will know that A has defaulted on its obligations in respect of VAT since it will not have received any of the output tax paid by B to A (as accounted for by B).

9. However, HMRC may not be in a position to know whether A is in fact the importer or whether there may have been earlier companies in the chain, either as purchasers or transferees, such that its full length was (say) Y – Z – A – B etc. In that example there will have been a defaulter (A), who will not have accounted to HMRC for VAT, but there will also have been an importer (Y). Whether or not Y or Z are liable to account for VAT may depend on the exact nature of the dealings between Y, Z and A, between whom money may not have changed hands.

10. In a chain of transactions between traders all of whom are honest each trader will account to HMRC for the output tax received (in respect of which the trader acts, broadly speaking, as agent for HMRC: **Elida Gibbs Ltd v Customs & Excise Comrs** [1997] QB 499), less any input tax incurred, which he will claim from HMRC. He will, ordinarily, need most of the money received from his sales to pay his supplier and the VAT due. The full extent of any chain will be patent. Where there is dishonesty the position is different. It is in the interests of those who seek to defraud HMRC of VAT to hide the full extent of any chain by the use of buffer companies. Such persons lack any interest in seeing that they, or the companies through whom they operate, are able to account to HMRC for all the VAT that they should."

Fonecomp

19. As both parties are aware the Court of Appeal has clarified the law in regard to contra-trading in *Fonecomp* which sets out very clearly the position in regard to the right to credit for input tax and/or repayment and analyses a number of the cases in this arena.

20. At paragraph 33 *Fonecomp* makes it explicit that:

(a) paragraph 62 of *Mobilx* is good law and that reads:

"62. The principle of legal certainty provides no warrant for restricting the connection, which must be established, to a fraudulent evasion which immediately precedes a trader's purchase. If the circumstances of that purchase are such that a person knows or should know that his purchase is or will be connected with fraudulent evasion, it cannot matter a jot that that evasion precedes or follows that purchase. That trader's knowledge brings him within the category of participant. He is a participant whatever the stage at which the evasion occurs.", and

(b) the conclusion of Hildyard J *in Edgeskill Limited v HMRC*[1] at paragraph 124 is also endorsed and that reads:

"124. In short, nothing in *Mahagében*, or perhaps I should add for comprehensiveness, *T□th, Bonik,* or any other CJEU authority cited, including *Hardimpex KFT* case [C-444/12], LVK-56 [case C-643/11] and *Forvards V SIA* case [C-563/11] … involves any departure from or restriction of the *Kittel* principles as interpreted in *Mobilx*. As indicated above, that analysis is binding at this level, and I could only depart from it if I was persuaded that subsequent cases cast such doubt as to merit a reference to the CJEU: I have not been so persuaded."

21. The Court went on to consider what constituted a connection between the fraud and the transaction for which the trader seeks to exercise the right to deduct and concluded that:

"43. Under the *jurisprudence* of the CJEU it is for the national court to determine if there was a connection on the facts, and this question is to be determined on the objective evidence and without reference to the trader's knowledge.

[1] [2014] UKUT 38 (TCC)

> 44. Furthermore in my judgment, there is nothing in *Kittel* which would lead to the conclusion that HMRC has to show that the transaction provides tangible assistance in carrying out the fraud. … Furthermore, … there is no warrant for reading in a requirement that, in a contra-trading case, the connection can be established only by inclusion of details of the transaction in question in a VAT return."

22. At paragraph 46, Arden LJ pointed out that the Court of Appeal had considered the extent of knowledge required by the *Kittel* principle in great detail in *Mobilx* and she endorsed Moses LJ in that case at paragraphs 59 and 60 which read as follows:-

> "59 - The test in *Kittel* is simple and should not be over-refined. It embraces not only those who know of the connection but those who 'should have known'. Thus it includes those who should have known from the circumstances which surround their transactions that they were connected to fraudulent evasion. If a trader should have known that the only reasonable explanation for the transaction in which he was involved was that it was connected with fraud and it turns out that the transaction was connected with fraudulent evasion of VAT then he should have known of that fact. He may properly be regarded as a participant for the reasons explained in *Kittel*.
>
> 60 – The true principle to be derived from *Kittel* does not extend to circumstances in which a taxable person should have known that by his purchase it was more likely than not that his transaction was connected with fraudulent evasion. But a trader may be regarded as a participant where he should have known that the only reasonable explanation for the circumstances in which his purchase took place was that it was a transaction connected with such fraudulent evasion."

23. The next issue was the determination as to what degree of knowledge of the fraud the trader must have in order to be liable to be a participant in it. At paragraph 49, Arden LJ endorsed the test set out by Briggs J in *Megtian Ltd v HMRC*[2] at paragraph 37 and that reads:-

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

24. At paragraph 51 Arden LJ stated:-

> "51. However, in my judgment, the holding of Moses LJ does not mean that the trader has to have the means of knowing how the fraud that actually took place occurred. He has simply to know, or have the means of knowing, that fraud has occurred, or will occur, at some point in some transactions to which his transaction is connected. The participant does not need to know how the fraud was carried out in order to have this knowledge. This is apparent from [56] and [61] of *Kittel* … Paragraph 61 of *Kittel* formulates the requirement of knowledge as knowledge on the part of the trader that 'by his purchase he was participating in a transaction connected with fraudulent evasion of VAT'. It follows that the trader does not need to know the specific details of the fraud".

25. Lastly in the conclusion at paragraph 54 it is made explicit the CJEU case law does not require that a trader either knows the details of the fraud or of the connection between its transactions and the fraudulent evasion of VAT.

Burden of Proof

26. There was no dispute that the burden of proof rests on HMRC. HMRC suggested that the appellant was arguing that that was at a high standard because all innocent possibilities have

[2] [2010] EWHC 18 (Ch)

to be discounted. We agree with Lady Hale at paragraph 34 in *S-B Children* that the simple civil standard applies and that is on the balance of probabilities:

> "34. This issue shows quite clearly that there is no necessary connection between the seriousness of an allegation and the improbability that it has taken place. The test is the balance of probabilities, nothing more and nothing less."

27. It is not disputed that the matters that HMRC must prove are:

(1) Was there a VAT loss?

(2) If so, was it occasioned by fraud?

(3) If so, were the appellant's transactions connected with the fraudulent VAT loss?

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

28. The appellant has conceded that

(a) Mr Haughton was aware of MTIC fraud in the market,

(b) The transactions are as set out in the deal chains,

(c) There was a fraudulent default of VAT and therefore tax losses exist in Cmart's deal chains where it is argued that it acted as a contra trader,

(d) Those tax losses were the result of a deliberate attempt to defraud the Revenue.

29. The issues for the Tribunal are:-

(i) Is there a link between Cmart's sales to the appellant between 24 February and 1 March 2006 and Cmart's purchases in itsfive tax loss chains on 8 and 13 March 2006, and

(ii) If that is established, did the appellant know or should it have known that its transactions were connected with fraud.

30. Although academic logic dictates that, in the first instance, we should consider whether or not there is a link between the appellant's transactions and Cmart's contra-trading at the end of period 03/06, in practical terms it is only by looking at the totality of the evidence that one can discern whether or not such a link exists. Of course, there is no direct evidence and realistically nor could there be.

31. It is not enough that the circumstances of the appellant's transactions might reasonably have lead the appellant to suspect a connection with a fraud and nor is it enough that the appellant should have known that it was more likely than not that the transactions were connected with fraud.

32. The test is whether on the balance of probability the *only* reasonable explanation for the circumstances in which the transactions took place is the connection with fraudulent evasion.

33. We agree with the Upper Tribunal in *GSM Export (UK) Ltd (in administration)*, *Sprint Cellular Division Ltd (in administration) v HMRC*[3] when it confirmed that the requirement as to the taxpayer's state of mind squarely remains "knew or should have known" and that the

[3] 2014 UKUT 0529 (TCC)

reference to the "only reasonable explanation" is merely a way in which HMRC can demonstrate the extent of the taxpayer's knowledge, that is to say that he knew or should have known of the connection with fraud.

34. We agree with Mr Brown that in analysing the "wide range of factors" referred to by Judge Poole in *Hira,* care must be taken to avoid imputing the appellant with knowledge of matters that are only appreciable with the benefit of hindsight. That is what we have done.

35. We have no hesitation in agreeing with Mr Brown that the numerous expressions of opinion in the HMRC Officers' witness statements should be excluded. In *Megantic Services Ltd v HMRC*[4] the Tribunal (Judge Berner and Judge Walters QC) observed:

> *"(15)… an expression of a view…is not a matter of fact but a matter of opinion. It is merely a view of a witness on a matter on which the tribunal itself must reach its own conclusion, and as such is of no value as evidence. Such evidence may rightly be excluded on that basis. In most cases, however, we would not see it as necessary, or indeed proportionate, for a forensic exercise to be undertaken, either by the parties or by the tribunal, to identify any such matters in each witness statement and for the tribunal formally to direct that they be excluded…".*

36. Further, we are bound by, and agree with Mrs Justice Proudman in *HMRC v Sunico*[5] and in that case she stated at paragraph 29:

> "29. Accordingly, and in the absence of any expert evidence, much in this case turns upon my assessment of the documentary evidence in the light of the parties' respective analysis of it. As I have already noted, to the extent that the witnesses expressed their opinions on the documents they discussed I have discounted their evidence."

We have adopted such an approach in the present case in respect of the opinions, comments and conclusions drawn by witnesses of fact.

37. Lastly, we observe, that although undoubtedly the legal burden rests on HMRC to prove that the transactions were connected with fraud, we agree entirely with Judge Barlow at paragraph 48 of *Megtian v HMRC*[6] where he states:

> "48. The legal burden of proof does not alter throughout the proceedings. However, the evidential burden shifts. Once a party has produced enough evidence to satisfy the legal burden the other party is obliged, not because of any rule of law but in order to succeed in the appeal, to produce evidence to refute the other party's case so far as possible."

Overview of the appellant's disputed deals in 03/06 including the unchallenged elements

38. In period 03/06, in three transactions, the appellant had purchased goods to a total value, including VAT, of £9,859,717.93 from Cmart Trading Limited ("Cmart"), a UK company. The appellant then sold some of those goods to Costa Rental & Management S.L. ("Costa") in Spain.

39. In all three deals, Cmart had purchased the goods from a Portuguese company, Silverpound Lda ("Silver") on 24 February 2006. When exporting the goods to Costa, the

[4] [2013] UKFTT 492

[5] 2013 EWHC 941 (CH)

[6] 2008 UKUAT V 20894

appellant instructed IMEX Logistics Limited ("IMEX"), the freight forwarder utilised by Cmart, to ship the goods on hold to Boston Freight Limited ("Boston") in Belgium.

40. All of the companies to which we refer including in particular Silver, Cmart, Costa and the appellant operated First Curaçao International Bank **(**"FCIB") bank accounts.

41. In order to trace the movement of funds HMRC traced the payments in not only the broker deals but also in some of the sales in the UK, where possible.

42. HMRC have only challenged the recovery of VAT in relation to the sales to Costa. The sales to UK companies by the appellant were not challenged by HMRC.

Deal 1

43. On 24 February 2006, Cmart purchased from Silver 57,250 units of Espeed–DDR2 at a unit price of £92.50. All of those units had been offered to the appellant the day previously (and there had apparently been a previous stock offer of 4,750 units which the appellant was instructed to ignore) and the deal then split into four chains:

(a) On 24 February 2006, Cmart sold 12,000 units to a UK company, Bluewire Connections Limited ("Bluewire) at a unit price of £92.75, which in turn sold those 12,000 units on the same day at a unit price of £95.50 to the French company SNN s.a.r.l.("SNN").

(b) On 24 February 2006, Cmart sold 45,250 units to the appellant at a unit price of £92.75 and the appellant sold 24,500 units on the same day to Costa at a unit price of £96.20 (invoice 933).

(c) On 24 February 2006, the appellant also sold 18,000 units at a unit price of £92.90 to a UK company Euro Trade (Wholesale) Ltd ("Eurotrade") and on that day Eurotrade sold those units to a Swedish company known to them as AXT Telecommunication ("AXT") at a unit price of £ 94.40.

(d) On 28 February 2006, the appellant sold the remaining 2,750 units to Eurotrade at the same price and Eurotrade sold those 2,750 units to a Romanian company Andrevias S.R.L. ("Andrevias") on 2 March 2006 at a unit price of £94.40.

Deal 2

44. On 28 February 2006, the appellant faxed Cmart accepting a stock offer dated 27 February 2006. On 1 March 2006, the appellant issued a purchase order for those 10,035 units of E-AUZ software training zone at a unit price of £298 and sold them that day to Costa at a unit price of £309 (invoice 940).

Deal 3

45. On 28 February 2006, the appellant, having purchased 15,268 units of E-AUZ Quark Xpress software from Cmart (which issued an undated invoice) on purchase order 2168 (and also on the same fax as in Deal 2) at a unit price of £78.85, sold 12,000 units to Matrix Europe Limited ("Matrix") at a unit price of £79. Matrix had issued two purchase orders for 7,000 and 5,000 units respectively. On the same day Matrix then sold 7,000 at a unit price of £83.70 plus £0.05 and 5,000 at the same price to Andrevias. Cmart only released the goods to the appellant on 13 March 2006 by which time the goods had been transported elsewhere. Bizarrely, there is a second release instruction three days later.

46. On 6 March 2006, the appellant sold the remaining 3,268 units to Costa at a unit price of £81.75 (invoice 943) having received a purchase order dated 5 March 2006.

Overview of Cmart's deals in 03/06

47. In period 03/06 Cmart did not trade in January but thereafter it undertook 11 deals (11 purchases but 12 sales) generating a net turnover of £27,321,367.50. Six were as a buffer and five were as a broker. The buffer deals were all purchases from Silver. The first three purchases, on 24 February 2006, involved onward sales to UK brokers, being the appellant and Bluewire (with the appellant selling on in buffer deals to Matrix and Eurotrade). The detail of those deals is as set out in the preceding paragraphs.

48. Cmart's broker despatch transactions involved five UK purchases from Panache Accessories Ltd ("Panache") which had acquired the goods via a UK supply chain, each of which started with a fraudulent defaulting trader and ended with sales to AXT. Three of those deals were dated 8 March 2006 and two 13 March 2006. The total of the tax losses which have been traced is £2,498,825.

49. The goods in these tax loss chains were allegedly shipped to the UK from Boston Freight Limited, sold through a chain of five traders and shipped out of the UK within 24 hours in each case.

8 March 2006 deals

50. The three deals on 8 March 2006 were identical and the chain was:-

AXT (SE) < Cmart < Panache < AE Resources Ltd < Wireless Warehouse Limited < Zoom Products Ltd < Spolka Zoo (PL) (being the EU supplier). The fraudulent defaulter identified in those deal chains is Zoom Products Limited. In each case the goods passed from Boston in Belgium to the UK freight forwarder Advance Solutions and then the goods were shipped back to the EU to the freight forwarder Entrepots Surete in France.

51. The tax loss of £1,794,275 in the 8 March 2006 deals has been traced back to the assessment for in excess of £35 million which is unpaid by Zoom Products Limited which was compulsory deregistered for VAT on 15 March 2006 and placed into liquidation on 13 December 2006.

13 March 2006 deals

52. The two deals on 13 March 2006 followed an almost identical deal chain, to that on 8 March 2006, namely:-

AXT (SE) < Cmart < Panache < AE Resources Ltd < Deepend Trading Limited < Roble Comm Limited t/a Linkss 4 U Limited. The fraudulent defaulter identified in these deal chains is Roble Comm Limited (being the EU supplier).

53. The shipping and freight forwarding routes were identical to those in the deals on 8 March 2006.

54. The tax loss of £704,550 in the 13 March 2006 deals has been traced back to the assessment for almost £19 million raised on Roble Comm Limited on 10 May 2006. That

remains unpaid and Roble Comm Limited was compulsory deregistered for VAT on 24 March 2006.

24 March 2006 deals

55. Cmart made three more acquisitions from Silver on 24 March 2006 selling the goods to Anthony Irish t/a TIS Associates ("TIS") and the goods were then dispatched to AXT all on the same day. That resulted in a repayment claim for Cmart for period 03/06 of a mere £18,098.

Arguments

The appellant's principal arguments

56. The appellant disputes:-

(a) That its transactions were part of an orchestrated fraud, on the basis that:-

i. There were no tax losses in its transactions; and

ii. The appellant's supplier Cmart was neither a defaulting trader nor a contra-trader during the relevant period. However, the further arguments are that

(1) whilst it is not in dispute that Cmart's broker transactions were connected to fraud, the first of those was only on 8 March 2006, one week after the appellant's final purchase from it;

(2) since the only documentation relating to the broker transactions is dated 8 March 2006, there is no evidence that Cmart deliberately intended to enter into broker transactions on or before 1 March 2006, (being the date of the last sale to the appellant);

(3) it is asserted that the contra transactions (ie those deliberately entered into so as to reduce the VAT liability to a level so as to disguise its activities from HMRC) did not take place until 24 March 2006 being the final three transactions. The appellant asserts that the mark up was so low in those transactions that they lacked credibility and if the intention throughout had been to act as a contra trader in period 03/06 Cmart would not have waited until the last week of the period,

and

(b) That the appellant knew or ought to have known that its transactions were connected to fraud.

57. There was nothing to directly link the appellant with the traders in Cmart's contra chains.

58. Furthermore, the appellant also asserts that if its transactions were connected to fraud and it knew or ought to have known of it, then the denial of input tax pursuant to the *Kittel* principle requires that all or none of the input tax incurred in the purchases should be denied; not just where the tainted goods were supplied onwards to non-UK traders.

59. Whilst the appellant conceded that there was fraud in Cmart's broker deal chains, it was argued that it may be that that was "acquisition" fraud (where a defaulting trader "walks off" with the VAT it has received indirectly from an innocent broker without accounting for or paying VAT to HMRC) and not carousel or MTIC fraud.

60. Since in February 2006 HMRC did not believe that Cmart was definitely involved in fraud then the appellant could not have known.

HMRC's arguments other than that this was an archetypal MTIC fraud

61. HMRC argue that the appellant's disputed transactions and Cmart's transactions during the period 03/06 were all a contrived fraud including both the tax loss and non-tax loss chains. There is no dirty or clean chain as such. There is an interdependence between the funds for the tax loss and the non-tax loss chains.

62. Secondly, HMRC argue that the *Kittel* principle does not require that the entirety of the appellant's input tax be denied. At that time, HMRC had inadequate resources to investigate all repayment claims and their policy was to focus on dispatch or broker transactions. Policy is not a matter for the Tribunal.

The Principal Dramatis Personae and their role (apart from the appellant and its officers)

Cmart

Background

63. Cmart was a UK Company, which applied for VAT registration on 5 March 2005, having been incorporated on 16 December 2004. The business activity is described as "distributor of furniture, gifts, crafts….". The expected turnover was given as £100,000 with no EC trading. In response to an enquiry from HMRC, on 30 March 2005, Mr Bashir, the sole director, gave further information about the products that would be sold which were household items and that did not include either software or mobile telephones.

64. The credit report obtained by the appellant dated 23 January 2006 shows the only director as being Ahjaz Bashir and that Khadam Hussain was the company secretary. (He appeared to be a director of an associated company Cmart Peepul Trading Limited). Mr Hussain resigned in approximately May 2006. Although apparently not a Director of the company he described himself in correspondence as Finance Director/Company Secretary.

65. Mr Bashir resigned as a Director on 19 January 2006 and sold the business in its entirety, but not including stock, to a friend Kasim Haq for £5,000. Mr Haq was appointed as the sole director on 25 January 2006 and told HMRC that he started work with the company a few weeks later. He confirmed that he had inherited the HMRC file including all warning or deregistration "Veto" letters. He had not known Mr Hussain prior to the purchase.

66. The first two VAT returns for 06/05 and 09/05 showed minimal trading but in period 12/05 the net sales figure declared was £35,092,502. The net VAT paid to HMRC was £5,047.01. They were all buffer deals.

67. Between 16 October and 16 November 2005 Cmart had purchased approximately £8 million of goods from Xellance International Trading Company ("Xellance") but had made payment therefor to third parties (contrary to explicit HMRC advice). Xellance had not accounted for the VAT amounting to £4 million on the sales to Cmart and others and Xellance was deregistered for VAT with effect from 22 November 2005. The Veto letter was issued to Cmart on 23 November 2005.

68. Cmart received a total of 21 Veto letters from HMRC, at least eight of which were issued before the deals with the appellant. It is the case that those letters, and all other Veto letters issued to any trader did not state why the companies in question were no longer registered for VAT. Those letters simply state that the trader has been deregistered and that therefore any deals after the date of deregistration may be subjected to verification.

Miscellaneous

69. The trading activities of Cmart continued and period 06/06 was selected for extended verification. After investigation a decision to deny input tax of almost £2 million was taken on 26 March 2008. That decision was never appealed, the company officers have disappeared and the company was deregistered for VAT purposes.

70. In period 03/06 the margins achieved by Cmart, where it acts as broker in the transaction chains where there are tax losses, range between 20p and 50p per unit and between 20p and 25p in the contra chains. By contrast, the other broker traders in the contra chains achieved margins between £1.90 and £11 per unit.

71. The margin per unit achieved by the participants in the acquisition deal chains is very consistent with the broker achieving a very large margin and the buffers far less regardless of the type or quantity of goods involved.

72. All of the transactions were routed through the FCIB bank account.

73. Mr Bashir's name frequently appears as the signatory on printed correspondence after Mr Haq purchased the company.

Costa

74. Costa Rental & Management, S.L. was incorporated in Spain on 23 June 2003 and according to the legal documentation produced, on 1 June 2005 the original shareholder Francisco Jiménez Macias sold to Maxwell Ian Perry his entire shareholding for €3010 being the sum that he had subscribed. The company address in the sale agreement was given as Centro Comercial Cristamar, Local 16 A, Nueva Andalucia, Marbella, Spain ("Cristamar").

75. Mr Maxwell Perry applied for and opened an FCIB account on 15 June 2005 in the slightly different name Costa Rental Management S.L. The registered address given, which should have been the address in the incorporation agreements was not. It was similar to that given in the previous paragraph but in Puerto Banus, Marbella 29660 not Nueva Andalucia, Marbella 29660. However, we are aware that Puerto Banus is simply a suburb of Nueva Andalucia.

76. From the legal documentation we can see that the previous address, presumably from incorporation, was Centro Comercial Costa Sol, Local numero 3, Estepona, Malaga. That was the address that the appellant used in, for example, release instructions and invoices. The CMRs use that address.

77. The postal address for that FCIB account was identical to that for Silver and had the address Centro Comercial Plaza, 15/1 North Tower, Neuva Andalucia, Marbella, Spain 29660 ("15/1"). The telephone number for that was a Spanish number and the email was costarental@walla.com. The "walla" email accounts are Israeli accounts.

78. A number of officers exhibited the response from the Spanish Tax Authority. That disclosed that the sole proprietor until 29 June 2005 was Mr Perry, living in Estepona, Malaga, Spain. Accordingly, Mr Perry was a director for less than one month. The sole proprietor since 29 June 2005 was Francisco Jiménez Macias, also living in Estepona, Malaga, and he was the owner and manager not only of Costa but also of 68 other businesses including Hierro Holdings SP SL ("Hierro") which features as one of the conduits in the FCIB tracing exercise.

79. Costa was registered for VAT on 1 July 2005 and deregistered as a missing trader in 2006. Its business activity was described as the sale of buildings.

Boston Freight Limited ("Boston")

80. The goods despatched by the appellant were apparently sent to the premises of Boston Freight in Belgium. Marshall Boston, the owner of the company, has been convicted of conspiracy to cheat the Public Revenue in respect of the trade in mobile phones undertaken by Future Communications (UK) Limited and Unique Distribution Limited (ie MTIC fraud). Officer Humphrey's unchallenged evidence was that in early 2006, their premises were visited and Mr Boston stated that no goods were ever delivered and stored at the premises as no storage facilities existed. However, HMRC have advanced no argument that the goods, in this appeal, did not exist.

Euro Trade (Wholesale) Limited ("Eurotrade")

81. This was a UK company. Eurotrade was not denied input tax on its purchases because its purchases were not subject to verification. HMRC had finite resources and did not at that time investigate Eurotrade's transactions. Eurotrade's transactions in subsequent periods were subject to investigation and input tax of £1,204,567.92 was denied for a number of VAT periods.

Matrix Europe Limited ("Matrix")

82. This was a UK company and the denial by HMRC of input tax of in excess of £3.7 million was upheld by the Tribunal in 2011.

IMEX Logistics Limited

83. This was the UK based freight forwarder utilised by the appellant and Cmart in all of the transactions.

Silver

84. Silverpound Trading Lda ("Silver") was incorporated in Portugal on 15 June 2005 with Paula Teresa Burnett as its sole director. Its own documentation, such as purchase orders etc shows it trading as Silver Pound LDA. It used the address Avda.25 de Abril, 217-3-A, Cascais, Portugal on documentation.

85. It applied for, and obtained, an FCIB account in the name of Silver Pound Trading Lda on 27 September 2005. The registered address was Avda 25 de Abril but the address given for correspondence was 15/1. That is precisely the same address as Costa and others (see below).

86. Mrs Burnett stated to FCIB that her home address was the Marbella address. We note that the telephone number given to FCIB was the Portuguese number on the company documentation. The email address was silverpound@walla.com. Of course, this is another Israeli email account.

87. Officer Murphy exhibited two responses (October 2006 and April 2007) from the Portuguese Tax Authority and those disclosed that the "head office" was in a residential building. The trader was in a multicultural control organised by the German authorities and the company was deregistered on 29 September 2006 since it was impossible to contact and there was deemed to be an inadequate structure to carry out an activity. By the time of the second response the authorities had noted that on the Trade Register the company had allegedly changed address in Cascais but had not informed the authority.

88. The Officers' unchallenged evidence in regard to Silver disclosed that an investigation, involving both civil and criminal investigation officers of HMRC, had established that Silver had been recipients of fictitious consignments of goods from a UK based broker trader in another contra-trading scheme. Export documentation had been fabricated by cloning the details of legitimate movements of freight. The freight companies and drivers concerned established that the corresponding job files for the specific vehicles purportedly involved in the phantom shipments reveal totally different cargo and destinations. In March 2006, Silver had paid in excess of £4.5 million for mobile handsets that were never delivered.

89. Officer Humphries' evidence in regard to period 06/06 established that Costa had been a supplier to Silver.

90. Silver was deregistered for VAT on 29 September 2006.

AXT Bygg o Telekommunikation, *also known as AXT Telecom and AXT Telecommunications ("AXT")*

91. A number of officers, including Officer Humphrey in her second witness statement gave unchallenged evidence about the company. AXT was registered in Sweden with effect from 30 November 2004 and deregistered with effect from 9 May 2007. On 6 February 2007 the controlling mind of AXT, Anthony Ruoro, was found guilty in a criminal trial. He had operated from a small rented flat, had failed to keep proper records and had never declared any VAT. He informed the police that AXT had passed all logistic invoices direct to the supplier and that AXT had made no payments itself. AXT's customer paid the supplier to AXT and AXT were paid a small amount per unit. No goods were ever delivered to AXT or entered Sweden.

92. AXT was a direct customer of Cmart in its own broker deals. AE Resources Limited who were a buffer in each of the five broker deals had been a direct supplier to AXT in January 2006 and in the quarter to 31 March 2006 had supplied goods to the value of £3,711,000 to AXT. It was also a customer of Eurotrade and TIS.

Panache Accessories Limited ("Panache")

93. This is a company registered for VAT in the UK. It also features in the deal chains for 06/06.

SNN s.a.r.l

94. The unchallenged evidence was that this French company was run from Spain, the authorities believed it to be a conduit company for carousel fraud, the main address was an accommodation address, VAT returns were filed irregularly with only two declarations in 2005 paid and the rest were nil returns or not filed. It was deregistered as a missing trader on 1 July 2006.

Andrevias SRL

95. The Romanian authorities stated that it was a missing trader in carousel transactions and since the establishment of the company in August 2004 it had not accounted for or declared any revenues from any activities. In March 2006 it hired a storage facility in a free zone in Romania and on 20 March 2006 allegedly 600 boxes containing 12,000 units of E-auz software accompanied by two invoices for a total value of £1,005,000 from Matrix were presented. The goods were then allegedly re-exported to Matrix on the basis that the wrong goods had been delivered but the delivery was apparently made to the Netherlands not the UK. At all times the goods had allegedly remained in the free zone. The owner of the company denied that he had had any transactions with Matrix and it was suggested that perhaps the company had been hijacked.

Anthony Irish t/a TIS Associates.

96. On 29 August 2007, input tax in the sum of £1,759,813.13 was denied in respect of nine deals with Cmart including the three with which we are concerned. That decision was not appealed, the trader was declared bankrupt and is missing.

A man called Russell

97. Officer Everett had investigated the FCIB data in regard to companies and their personnel. His findings included:

(a) *Caliche International Limited* ("Caliche") - the director, signatory and beneficial owner of the company is Christopher Stephen Russell, an Irish citizen born 25 August 1950 residing at Camino del Pinar, 10 Marbella 29600 Spain. His passport was issued in Ireland on 3 April 2000. His email contact address is steve@cemsa.com. The company was nominally based in the Seychelles but the postal address for FCIB purposes was in Gibraltar.

(b) *Kingsart International Limited* ("Kingsart") – the beneficial owner and primary contact is named as Stephen C Russell, an Irish citizen born 25 August 1950 residing at Camino del Pinar, 10 Marbella 29600 Spain. His passport is in the name Stephen Christopher Russell and was issued in Madrid on 13 July 2004 but a supporting BBVA bank document shows the name as Christopher Stephen Russell. His email contact address is steve@cemsa.com. The permanent address for this company was given as The Ocean Centre, Harper City, No. 5 Tsimshatsui, Kowloon, Hong Kong.

(c) *Complementos De Exportacion Multifuncionales SA* ("CEMSA") was owned by Christopher Russell and was based in Marbella. CEMSA has not traded directly with the appellant but HMRC have traced 222 broker deals by UK traders to CEMSA.

Caliche and Kingsart - Corporate "Loans"

98. Caliche lent the appellant £760,000 and that is discussed at greater length below.

99. Quite apart from that, Officer Everett spoke to and exhibited almost identical agreements from Caliche to other entities where VAT repayments have also been denied following extended verification and where appeals have not been pursued, namely

(a) Adam Associates Limited dated 6 February 2006 for £3 million with VAT denied of £1,533,486 for period 03/06

(b) Crest Telecom Limited dated 27 January 2006 for £475,200 with VAT denied of £1,434,802 for periods ending 04/06 and 07/06

(c) Tradeline Europe Limited dated 9 May 2006 for £500,000 with VAT denied of £1,825,512.50 in periods 04 and 05/06.

100. He had also identified two other companies, namely Q-Tech LLC (Dubai based) and Kingsart making very substantial loans in 2005 and 2006 to numerous other companies in the same trading sector where the terms of the agreements were very similar. In some cases they used the very unusual italic font and again after extended verification, the borrowers were denied very large VAT repayments.

101.Amongst those loans, were loans of £791,000 on 18 April 2006 to AE Resources Ltd, £2 million to Eurotrade on 11 May 2006 and £750,000 to MT Phoenix Limited on 16 March 2006.

102.AE Resources Ltd was a direct supplier to the appellant in November and December 2005, to Cmart in April and June 2006 and to AXT in January 2006. It supplied Panache in Cmart's tax loss chains. Eurotrade was a customer of the appellant not only in the deals with which we are concerned but also in January, March and April 2006. MT Phoenix featured in the appellant's deal chains dated 27 January 2006.

103. Officer Mendes established that Kingsart made an "Investment Loan" of £690,000 to TIS on 5 June 2006 which helped fund the payment to Cmart on 6 June 2006 in respect of one of the 24 March 2006 sales with which we are concerned.

Baddesley Holdings Limited ("Baddesley")

104.Officer Mendes established that the funds lent by both Caliche and Kingsart, in the deals in which we are interested, had ultimately been sourced from Baddesley Holdings Limited ("Baddesley") a Hong Kong company which has a permanent address in Hong Kong. However, the mailing address is exactly the same mailing address as that for Costa and Silver, namely Cristamar. It too has an Israeli email address. The beneficial owner, a Briton, lived in Spain.

Background to the appellant and its officers

2001-April 2002

105.The appellant was registered for VAT on a voluntary basis with effect from 2 January 2001 having been incorporated in November 2000. Mr Haughton had been the sole director since 30 November 2000 until liquidation. His wife, Elsa Delores Haughton, was the company secretary. They were the sole shareholders owning one share each.

106.Mr Haughton alleges that his wife had little knowledge of the appellant's dealings; she runs an associated retail mobile phone business from the same premises. That had been hived off into a separate company in 2001. However, we note from a letter to HMRC dated 26 April 2007, that he stated that his wife was a signatory on the appellant's FCIB bank account. There is no doubt that he was the controlling mind of the appellant at all material times.

107.The appellant's accountant, Abacus, confirmed to HMRC that Mr and Mrs Haughton had always been paid "£400 gross/net" per month and that their son Calvin had received £1,000 per month at all material times. Mr Haughton confirmed that and that his son worked in the retail company. We noted that he told the investigating officers in Operation Sponsor in 2002 (see below) that he earned £1,500 per month plus expenses but we only have accounts for 2005 and 2006. Those accounts are consistent with £400 per month.

108.The VAT 1, being the application to be registered for VAT signed by Mr Haughton, indicated no EC trade and a turnover of £60,000 in respect of financial advisory service. The business activity was formally changed to telecommunications and accessories in August 2001.

109.Initially Mr Haughton had presented to the Tribunal as having had little understanding of the detail of the VAT regime but he altered his stance when questioned about his professional advisors and his own financial experience. Both when interviewed under caution and in his oral evidence (the latter being somewhat equivocal) he conceded that he had been professionally advised when registering for VAT. In general, financial services would be exempt from VAT and Mr Haughton was unable to explain satisfactorily why he had registered for VAT.

110.Mr Haughton previously, and at least until 2005, was a sole trader as GFS aka Globe Financial Services as a mortgage advisor and licensed credit broker. He was registered with the FSA. He stated that when setting up the appellant he had contemplated moving into property sales but there was no other evidence in that regard.

HMRC visits and contact (the dates of all visits are in italics*)*

111. At the first VAT visit on *26 March 2001*, Mr Haughton was very vague about the business, stated that there had not been any trade (albeit the Officers observed that there were indications of trading), but that it would be telecommunications. He said that the business had been funded by his capital but no evidence was produced.

112.By *26 April 2001*, at the next visit it was evident that the business was then a retail mobile phone outlet with no wholesale trade. The Officers explained carousel fraud and the need to verify VAT numbers.

113.The appellant was again visited on *13 September 2001* when it was clear that Mr Haughton wished to embark on wholesale deals in mobile phones. There was discussion and warnings about possible problems with third party payments, acquisition of goods from the EC, verification of VAT numbers and the need to ensure that suppliers were *bona fide*.

114.The visit on *22 October 2001* covered possible issues including a customer who operated with no bank account, no payments to UK wholesalers (therefore suggesting chains), and the

fact that the appellant had never made payment direct to the supplier and had no knowledge as to how the supplier was paid.

115.On *16 and 17 April 2002* Officers visited to uplift transaction bundles for the Law Enforcement Officers.

116.On 17 April 2002, four Veto letters were issued to the appellant. Mr Haughton confirmed to the Tribunal that he viewed those letters as being warnings from HMRC about various traders.

May 2002 to December 2005

Operation Sponsor

117.On 9 May 2002, Mr Haughton was arrested and interviewed that day, the following day and again on 26 November 2002 in connection with suspicion of fraudulent evasion of VAT in the period May 2001 to March 2002.

118.It was alleged that the appellant had made 173 purchases of mobile phones from eight traders, seven of whom were hijacked entities and the eighth was a missing trader. None of those entities accounted for VAT on their sales to the appellant causing a loss to public revenue of £10,672,542. The appellant had made payments of £74,598,620 in respect of those purchases to overseas bank accounts and paid £2,112,684 to apparently unrelated third parties. The appellant did not pay any funds to the hijacked traders themselves.

119.In the course of those interviews Mr Haughton described forming the appellant with the intention of initially trading in the retail supply of mobile phones and then he moved into the wholesale side. Although his first transaction was £639,000 and in less than a year he had moved to a turnover of £87 million, he said that he needed no capital since his customers funded it. "Quite simply, I'm actually using other people's money to buy and sell stock, so it's not as if I physically need to have that kind of funds available to me 'cause as I'm selling the stock on the actual customers are physically paying for it'".

120.The Officers had ascertained that he had sometimes verified the VAT number after the first transaction and he confirmed that he did not always go through verification prior to commencing business.

121.The interviewing officers made it explicit to Mr Haughton that the major problem was that the fraud with which they were concerned involved a loss of in excess of £5 million of VAT. There were a "recurrent chain of companies" and within those chains money could be moved offshore and indeed the appellant had made payments to offshore companies and that would be construed as money laundering.

122.On 16 July 2003, a summons to appear at the Magistrates Court to answer charges of money laundering contrary to the Criminal Justice Act 1988 and Cheating the Public Revenue contrary to the Common Law was served on Mr Haughton but in September 2006 he was formally acquitted because the charges were not pursued due to concerns as to the reliability of evidence obtained from the freight forwarder. Obviously, Mr Haughton is entirely innocent of any criminal activity in relation to those matters.

HMRC's continuing contact and visits

123.On *27 June 2002*, Officers visited and uplifted information about all transactions and visiting and monitoring ceased as a result of the legal process.

124.On *10 March 2003*, Officers visited and uplifted information but also reiterated the departmental requirements in regard to verification of VAT numbers and again on *24 March 2003*.

125.On *10 April 2003*, Officers visited and discussed the new legislation and advised on Joint and Several Liability and missing traders.

126.On *2 May* and *10 June 2003,* during visits, there were further discussions about the need for appropriate checks including Redhill. At the earlier visit there was also a discussion about the implications of *Bond House*.

127.On 16 October 2003, HMRC wrote to the appellant stressing the incidence of significant VAT fraud and issuing a requirement under Schedule 11 Value Added Tax Act 1994, for the submission of information including "…immediate notification of any new supplier or one with whom you have not traded with for a month – date/time/means of first contact: business name, VAT number, name of person(s) representing the new supplier, address(es), phone and fax numbers: goods – unit value & total proposed deal: method and route of delivery: bank account" .

128.On *21 October 2003* Officer Taylor visited the appellant and discussed IMEI numbers, inspections, verification, insurance, visiting customers and checks, joint and several liability and third party payments were all discussed. Mr Haughton made it clear that he did not accept the advice about third party payments and the need for commercial checks. Officer Taylor observed that a copy of Notice 726 was hanging on the office wall.

129.On 27 October 2003, he followed that up with a letter confirming the issues with third party payments and also issued a "Redhill letter" enclosing a further copy of Notice 726. The "Redhill letter" briefly explains MTIC fraud and sets out the type of information that traders should send to Redhill when seeking verification of VAT numbers. The terms of that letter and relevant excerpts of that Notice are annexed at Appendix 1.

130.On 15 September, 7 October and 3 and 23 November 2004, 20 December 2005 and 16 February 2006, the appellant received six Veto letters. The first of those was in respect of a trader called The Agency GB Limited (see following paragraph) and the penultimate, Almafra Trading SL ("Almafra") (see HMRC Investigation 2005 below).

131.There were routine visits on *4 October 2004* and on *7 February 2005*. At the former visit the deregistration of The Agency GB Limited was discussed. At the latter visit, the Officers enquired in more detail about The Agency GB Limited. Mr Haughton confirmed that the appellant was a creditor to the extent of £147,000 for goods, which had never been received, because The Agency GB Limited had made third party payments and the goods had not been released to them by their supplier.

132.At a visit on *14 June 2005*, although he stated that he no longer made third party payments, Mr Haughton stated that he saw no problem with them.

HMRC Investigation 2005 and Almafra

133.At a meeting on *24 May 2005* that HMRC arranged with Mr Haughton, with some difficulty, Officers Nealey and Taylor questioned sales invoice 784 in respect of the sale of tools purchased from a UK trader to Almafra in Spain in period 03/05. Mr Haughton had never seen the tools, he conceded that Almafra had not enquired about the specification and quality of the tools, he had done no market research or research about the tools, he had shipped them on hold to a warehouse in Spain releasing the tools to the customer 11 days before he received full payment and his due diligence amounted only to checking the Vat registration on Europa.

134.He was wholly unable to explain the discrepancy whereby the travel documentation showed that the goods had apparently arrived in Spain a day after the tools had allegedly been inspected in Spain and released to the customer. In any event the Officers established that the timing of the ferries in each direction meant that it was impossible for the goods to have been transported from Calais to Madrid.

135.There were also a number of other problems as to whether the tools were genuine, if not whether they were part of a fraudulent consignment, whether they had ever been exported and whether Mr Haughton had adequate records of inspections and other relevant documentation. One aspect that is clear is that all of the parties in this deal both received and made full payment.

136.On 18 July 2005 HMRC wrote to the appellant pointing out that the verification of the 03/05 VAT claim was not random and was based on concerns about fraud "…occurring by way of defaulting traders or unjustified claims arising from zero rated supplies between EU member states."

137.The appellant was represented by Dass, Solicitors. On 12 December 2005, having written to Dass and the appellant with a detailed explanation on 25 November 2005, an assessment in the sum of £36,956.52 (plus penalties and interest) was raised against the appellant on the basis that the export evidence was untenable. Although that was appealed, the appeal was subsequently withdrawn.

January 2006 visit

138.On *9 January 2006*, Officers visited and enquired in detail about five further transactions with Almafra in period 09/05 where key problem areas were that:

(a) the original CMRs were not date stamped on arrival into UK freight forwarder,

(b) no freight ticket had been supplied to confirm how goods arrived into the UK,

(c) there was no evidence of any release notification,

(d) there was a lack of knowledge of some of the products.

139.The transactions on 09/05 were entered into after the appellant knew that the transaction with Almafra in 03/05 was subject to extended verification. By the time of this visit, of course, the appellant also knew that Almafra had been deregistered for VAT.

140.Due diligence for new customers was discussed and Mr Haughton produced First Report Credit Checks which often showed as inconclusive or high risk and that was discussed. The Officers identified payment discrepancies between customers and suppliers. They stressed the need to verify customers and suppliers immediately prior to each and every deal since

Mr Haughton was not doing so. He said that he considered that to be "over the top". The risks were again explained to him and he conceded that he understood why it was recommended.

141.Officer Nealey wrote to the appellant on 13 January 2006 confirming the tenor of the discussions including the need for due diligence and Redhill checks and requesting outstanding information. He also identified the need for freight forwarders to date stamp the CMRs.

2006

142.From incorporation until the end of 2005 the appellant had traded primarily as a wholesaling buffer buying and selling in the UK. Its turnover fluctuated from a few million pounds up to approximately £20 million but always with a relatively modest VAT liability. Although the appellant was purchasing in large quantities, the mark-ups on the buffer deals were relatively small. At the beginning of 2006, the turnover leapt from approximately £20 million a quarter to £70 million in the period 03/06 and stayed at approximately that level in period 06/06. The appellant's returns for the periods 03/06 and 06/06 were selected for extended verification.

143. In period 03/06, apart from the three disputed deals with which we are concerned and the associated buffer deals with Eurotrade and Matrix, HMRC adduced uncontested evidence to the effect that numerous other of the appellant's 86 deals in the period had been traced to fraudulent tax losses. Ultimately in closing submissions for the appellant, it was argued that of the approximately 80 deals in the period, "around half" are not alleged to be tainted by transactions involving contra traders or to have started with defaulting traders. We had, and accepted, the evidence of Officer Taylor to the effect that he did not know of any deals that had been traced to a situation where there had been full accounting for tax. He did not know how many deals had actually been traced. We also note that the loss to the Exchequer in period 03/06 in buffer deals involving the appellant where there has been tracing exceeds £5 million.

144.By letter dated 18 June 2008, the appellant was denied input tax in relation to purchases undertaken in period 06/06 in the sum of £489,013.88. Those transactions were traced to purchases from a contra-trader, namely Blackstar Limited.

The 2007 meeting

145.On 29 March 2007, at an interview with Officers Grant and Turner, in the presence of his solicitor, Mr Haughton confirmed that he had read Notice 726. Mr Haughton explained that stock would be offered to him by suppliers and he would then contact his customers. He could not recall if the appellant had ever purchased from an authorised distributor. He retained no stock and he did not usually see the goods himself. The transportation was arranged by the freight forwarder and the inspection was undertaken by the freight forwarder. Title to the goods was only transferred once payment for the goods had been made. He said that he had met the directors of Cmart and Costa and had visited IMEX.

146.He said that he had undertaken checks on the freight forwarders. He said that he had visited IMEX and had conducted Companies House and VAT certificate checks on Boston Freight.

Loan from Caliche

147.As we indicate above, the appellant obtained financial support in the form of a loan from Caliche in the sum of £760,000. The loan agreement was dated 7 March 2006. The draw down of funds was on 7 May 2008.

148.Following the 2007 meeting, Mr Haughton had written to HMRC stating:

> "2. The VAT input tax for 2005/2006 was financed by means of a Corporate Investment Business Loan.
> 3. The purpose of the loan was to finance the VAT input tax.
> 4. There have been no other private investment."

We comment in detail on that loan below.

First Curaçao International Bank ("FCIB")

149.Most readers of this decision will be very familiar with FCIB.

150.The appellant has banked with FCIB since 2004 and Mr Haughton stated, at the 2007 meeting that he had used it for all of his trading.

151.Officer Mendes' evidence was compelling and he explained the results of his tracing exercise commendably clearly. It is both lengthy and complicated. There are, however, a few key core findings.

Circularity

152. His analysis identified that regardless as to whether the chain was a contra transaction or a VAT loss transaction, the funds commenced with one of three money conduits and in every transaction the funds returned to one of those companies. The traced transactions flowed in very quick succession in every instance.

153.Those three companies are Total Profit Limited ("Total"), Full-Moon Holdings Limited ("Full Moon") and Baddesley.

154.Full Moon is a Seychelles company but based in Cyprus with a hotmail email account. Total and Baddesley are Hong Kong companies.

155.In those conduits there are a few companies through which funds other than those identified in the deals passed. Prosafe LDA and Hierro share the same address at 15/1 as Costa, Silver and Baddesley. Further, the address for Svensome Inversiones SL ("Svensome") is the other address used by Costa at Cristamar.

156. In all three of the appellant's denied deals the funds that allowed trades were provided by, and returned to, Total via a number of companies. In addition, the funding for all of the 57,250 units traded by Cmart in deal 1 (not just those in the appellant's denied deal) were also furnished by, and returned to, Total. Obviously that includes not only Cmart's deals but also the appellant's buffer deals. The funds passed through six traders in every case except the one where AXT received funding from Globalni to enable it to pay Eurotrade for the 20,750 Espeed DDR2 which it had bought from the appellant. That chain involved seven traders apart from Total.

Loans

157.In all three deals the appellant received funds exclusive of VAT and paid Cmart inclusive of VAT. The difference is £761,698.01. As at 7 May 2006, the appellant owed Cmart £615,751.56 and Caliche paid the appellant £760,000 that day at 20:06:01. The appellant promptly paid Cmart at 21:06:01. Officer Mendes has established that the loan from Caliche originated at 19:39:01 from Baddesley via Svensome to Caliche. All four transactions therefore took place within 1 hour and twenty-seven minutes.

158.Further those funds were then promptly returned to Baddesley within the hour in the chain for Cmart's 8 March 2006 purchase from Panache and sale to AXT.

159.Baddesley also provided the funding for the loan from Kingsart to TIS (see paragraph 102 above) paying Kingsart £696,900 on 5 June 2006 at 20:57:02 and TIS was paid £690,000 on the same day at 21:06:06.

Interdependence of funds for tax loss and non tax loss chains

160. Quite apart from the loans emanating from Baddesley, the tracing of the movement of funds in the three tax loss chains show that the funds flowed from Full Moon and Baddesley and returned to Baddesley in the first tax loss chain. In the second, the funds flowed from Full Moon and Total and returned to Total and in the last the funds started with and returned to Total.

161. In oral evidence Officer Mendes clarified his written evidence and made it explicit that the funds furnished to the appellant via the loan on 7 May 2006 were promptly utilised by Cmart to make payment in the first tax loss chain.

162. He explained the tracing exercises and clarified his conclusion in his witness statement that he had established an interdependence.

Insurance

163.Mr Haughton stated in his witness statement that:

> "The documents received from Greetek International were considered to be sufficient evidence of the cover effected on behalf of the company. Greetek was supplied with copies of the invoices issued by the company so it was aware of the goods being transported, the period in which they would be shipped and their destination".

He exhibited the documentation provided from the agent, Greetek International ("Greetek").

164.There was some evidence of insurance for the goods in deals 1 and 2 but not deal 3. Repeated requests had been made to the appellant to produce the insurance policies from the Turkish company Gokturkler Sigorta Ltd STi but nothing has been forthcoming. All that was produced from that source were the two "Policy Schedules" which specified the period of insurance, the type of goods, the premium and the agent, Greetek.

Deal 1

165.The appellant has produced only the policy schedule which states that the period of cover was "24/2/06 to 27/2/06" and the premium was £3,300. There were two consignments of

12,250 units each valued at £1.2 million. There is no doubt, that the two premiums of £3,300 were paid. However, in this instance, unlike deal 2, we do not have copies of the terms and conditions. However, we expect that they would be similar. The CMR has the same deficiencies as in deal 2. The goods were in Stoke on 26 February 2006 and the Eurotunnel transport ticket is for embarkation on 27 February 2006 at 00:34 for one passenger only.

Deal 2

166.Greetek was paid £8,525 through FCIB on 7 April 2006 for insurance of the goods to a maximum value of £3.1 million. The Policy Schedule produced by the appellant made it explicit that the period of insurance was "3/3/06 to 5/3/06" yet the CMR shows that the goods were in Stoke on 5 March 2006 and the Eurotunnel ticket shows check-in on the following day at 03:13 for one passenger. Therefore it was not within the period of cover.

167. Secondly, the terms for that cover set out in a fax from Greetek dated 3 March 2006 are very clear:

> "Our terms for this consignment are:
> a) Copy of invoice
> b) If goods are to be transported on one vehicle that vehicle is to be double-manned
> c) Cover will be maximum14 hours of goods in transit from collection in the UK and our cover will cease upon delivery to Boston Freight, Belgium
> d) CMR's to have time and date of collection in box no 20 on the CMR form
> e) CMR's to also have time and date of delivery in box 17 on the CMR form
> f) We will require the transport companies details
> g) We will also require copies of the driver and co-drivers' driving licences".

168.The vehicle was not double manned and therefore the co driver's driving licence could not have been provided. The time of collection was not in box 20 and the time and date of delivery were not in box 17.

Deal 3

169.There was no insurance for deal 3 and Mr Haughton explained that was because he had made a commercial decision that because the value was only £267,000 he did not need insurance. We comment on that below.

DISCUSSION

170. The Tribunal's function is not to conduct a review of whether HMRC's decision was reasonably made in the light of the material held by HMRC at the time the decision was made. Rather, the Tribunal's function is to determine whether the *Kittel* test is satisfied, on the basis of the evidence presented to us.

171. We have no difficulty in accepting Mr Brown's argument based on paragraph 36 of *Turbu* that it is possible that some traders in a "supply chain may not even be aware that they are participating in a fraud and may be acting in good faith." Indeed, that was our starting point since it was the appellant's argument from the outset that he was an innocent dupe and a "victim of the alleged fraudulent practices of others".

172. There is no single determining factor. We have weighed all of the evidence in the balance and although we did only hear oral evidence from a few HMRC Officers we have also carefully read all of the unchallenged evidence, including the evidence that was served in

relation to period 06/06 and to which no objection was taken. We reiterate that we have excluded opinion evidence and when assessing knowledge and means of knowledge we have only taken into account those matters which should or could have been known to Mr Haughton so obviously he cannot have known about the information provided by other tax authorities or in the course of other prosecutions. We also had the benefit of hearing from Mr Haughton.

173.Mr Haughton's occupation for many years has been as an Independent Mortgage Advisor and Licensed Credit Broker, and that should have meant that he would have been more aware than most of the need to take appropriate measures to ensure the *bona fides* of those with whom he traded and to avoid exposure to money laundering and similar issues.

174.Some of his evidence can only be described as startling and, indeed incredible. In the words of a well-known song - we start at the very beginning.

175.In response to cross examination relating to the discovery by HMRC at the first VAT visit on 26 March 2001 that the business would not be financial services but telecommunications he stated that the Officer concerned had "In effect …gave me the idea of the wholesale market…". He went on to say that the Officer had advised him in the course of a number of visits.

176.Mr Puzey put it to him that it was "extraordinary" and that he had "…never heard of a VAT officer giving out business advice. Was that really happening?" We find that Mr Haughton's response "Well he did. He advised me on the wholesale market and in effect that was my first introduction…" to be wholly incredible.

177.Mr Haughton was quite clear that he had decided to enter into the wholesale mobile phone industry, as to which he had known nothing previously, because the VAT visiting officers had warned him about the extent of fraud and carousel fraud and that had made him interested in the area. After further questioning he confirmed that the Officer had told him that there was a problem with fraud in the mobile industry and although fraud was "rife" he had decided to go into that business because "Due diligence, um, within your, um, transaction, people you talk to etc."

178.We accept without reservation the contemporaneous record by HMRC officers of the visits, as described earlier, when they record frequently the warnings given to the appellant about fraud. It simply is not the case that they encouraged the appellant to enter the trade. We also note that the appellant only formally told HMRC about his change to wholesale trading some months later when he had already embarked on the trades which led to Operation Sponsor.

179.He explained that after Operation Sponsor he "…became more prudent in terms of my due diligence and I would look to visit most companies that I was looking to deal with…".

Due Diligence

180.Before commenting in detail about due diligence we draw attention to two quotations from the evidence obtained in Operation Sponsor. Mr Haughton described his trading model as follows:

> "When I actually have a supplier supply me the phones I then check with the freight forwarders and in most instances make, see where the phones are. I then pass that information on to my customers. Its up

> to them to check and make sure that the phones are there and actually ready to be released to them and then they would actually pay me, the funds would be released or the phones would be released, they would pay me and then I actually pay my suppliers … The release is authorised by my actual suppliers who I am actually buying off … They would authorise that release to the freight forwarder … I then send a further release note to the freight forwarders to release it to X, Y, Z company."

He confirmed to this Tribunal that his trading model had not changed albeit he did confirm that he did not himself see the goods in most instances.

181. He also stated that:

> "When I'm dealing with anybody in business I deal with them formally…in business things have got to be done properly."

182. In his witness statements he said very little about due diligence but produced in the Bundle due diligence for both Cmart and Costa. Of course, he had also previously produced documentation to HMRC which they exhibited.

Cmart

183. In his oral evidence (as opposed to previously), Mr Haughton freely admitted that prior to these transactions in 03/06 he had never traded previously with Cmart. He was very clear in his witness statement that the appellant had

> "…placed much reliance on the representations made in the supplier's declaration signed by Cmart. In addition, it placed some reliance upon the following:
>
> - The trade protocol questionnaire completed by Mr Kasim Haq
> - HMRC's confirmation that Cmart's VAT number was valid
> - A visit undertaken to Cmart's premises - photographs taken during the visit are exhibited
>
> Since the company would not be making loans to Cmart, no reliance was placed on its credit rating assessed by others".

184. Before commenting on those limited areas we comment on the generality of the due diligence. In the appellant's Bundle there was the due diligence produced to the appellant by fax from Cmart on 16 December 2005 and a number of other documents and those, considered with HMRC's exhibits, raise a number of obvious questions.

185. The fax started with a letter of introduction from Cmart which stated in the first sentence: "We are wholesalers and distributors of general goods". It was signed by Mr A Bashir. However, in the due diligence previously produced to, and exhibited by, HMRC there was an introductory letter faxed to the appellant on 13 March 2006 in identical terms other than it stated in the first sentence "We are an Import and Export company of general goods". It was signed by Mr K Haq. Both letters indicated that Cmart wished to increase their supplier data base and having allegedly viewed the appellant's details on the internet they were interested in the products supplied. Neither letter was addressed to the appellant or Mr Haughton personally. By 13 March 2006, of course, the appellant had purchased many £millions of goods from Cmart so no introduction was necessary and we have had no explanation as to why an exporting company would be selling within the UK.

186. That fax enclosed the copy VAT registration certificate which shows the trade classification as being wholesale of furniture and the certificate is dated 15 April, effective

25 February 2005, so the company had not been trading for long and not, it would appear, in the goods in which the appellant traded. That should have concerned Mr Haughton.

187. That introductory letter also encloses a copy certificate of incorporation, bank details for HSBC, and a copy of a previous fax to an unknown individual but dated 21 September 2005 giving details of the FCIB account.

188. The other items in the appellant's Bundle include an invoice dated 28 February 2006 for rental for the month of April 2006 which, is of course after the relevant dates with which we are concerned. That invoice is addressed to "C Mart Trading" which is the wrong name for Cmart and suggests that it is not incorporated. Secondly the rental for the premises was the tiny sum of £250 and it had apparently been paid in cash but the "receipt" element is undated. That should all have been of concern. That also contrasted with the BT bill to "C Mart Trading Ltd" dated 5 January 2006 which showed an outstanding sum of £227.59. Both bills should have raised the question as to the actual name of Cmart.

189. There is also an unsigned Trade Application form from the appellant to Cmart. This was a company with which the appellant wished to transact for very large amounts and yet the spelling is obviously deficient. Declaration is spelt in bold " Decelration".

190. The equivalent trade application from Cmart to the appellant was included and was also in the due diligence produced to HMRC. It was sent to the appellant by fax on 27 February 2006 which was after the first dates with which we are concerned (the copy in the appellant's bundle did not have the full date disclosed on it) and the main activity was "CPUs and mobiles". It shows the directors/partners/proprietors as being Messrs Haq and Hussain.

191. Surprisingly, item 12 in the appellant's Bundle is an undated letter from Mr Haughton to Mr Bashir at Cmart stating:

> "Dear Mr A Bashir
>
> Please find enclosed correspondence from HM Revenue & Customs.
> Whilst trying to confirm your VAT number:
>
> Yours truly
>
> Keith Haughton."

192. There is no response from Cmart. At item 13 there is enclosed a letter from HMRC (which may have been the enclosure) dated 10 January 2006 stating that Redhill could not confirm that Cmart had a valid VAT registration. There are also two other HMRC letters one of which is dated 30 December 2005 (which may also have been the enclosure) again stating that there was no VAT certificate for Cmart and one dated 4 April 2006, which is after the dates with which we are concerned, confirming Cmart's VAT registration.

193. Apart from two undated photographs of Cmart's small office and a street map there was included a four page online credit report dated 23 January 2006 which shows the only director as being Ahjaz Bashir and that Khadam Hussain was the company secretary and it does not reflect the resignation of Mr Bashir four days previously or, obviously, the appointment of Mr Haq two days later. That report showed that the company had only been incorporated on 16 December 2004 and under the headings "Credit Rating, Risk Indicator and

Credit rating" it states "The company has been assigned a Credit Rating of £0. There is insufficient data to assign a current Credit Rating Score is not available". Furthermore it goes on to say that there is no profit and loss information filed and no balance sheet information available. That credit report should have raised a large number of concerns.

194.However, the Bundle also includes the trade protocol which makes it explicit that Mr Haq had bought the business.

195.Mr Haq had partially completed that trade protocol questionnaire. It did not include answers on the date of incorporation or how long the company had been actively trading. It did not give the principal trader's mobile phone number. It did indicate that the principal trader, Mr Haq, had been trading in that industry for six months having bought the business. He did not keep a record of daily stock offer and request prices but he did say that he did not make third party payments. He did not obtain credit checks on suppliers or customers premises and nor did he get copies of his counter-party directors home utility bills. There was no answer to whether or not he knew the suppliers or the customers' history in trade. He confirmed that he did not physically inspect the stock in which he traded but relied on freight company checks.

196.The copy produced by the appellant as an exhibit to the witness statement was clearly dated 21 February 2006. The copy previously produced to HMRC had been altered in that the date had obviously previously been 26 February (in different script) and had been changed to 21 February 2006, but everything else including other alterations was identical. There would therefore be some considerable doubt as to which, or whether either, is an original.

197.That trade protocol should have rung immediate alarm bells for any prudent businessman. If Mr Haughton thought he was dealing with Mr Bashir in December 2005, Mr Haq could not have been trading for six months. Of course he could have been trading in a related industry but a reasonable businessman should have made enquiries. It is also clear that he was not doing due diligence and that should have been a matter of concern to Mr Haughton.

198.It should have been even more alarming in the context where in December 2005 and January 2006, HMRC had indicated that they could not verify Cmart's VAT registration numbers. There are no trade references and no other information to verify Mr Haq's, and therefore Cmart's credentials.

199.As we indicated, Mr Haughton stated that "some" reliance was placed on the trade protocol. We find that, quite apart from the issues arising from the discrepancies in the dates, little or no reliance should have been placed upon it without further enquiry and that did not happen.

200.Greater reliance was apparently placed upon the suppliers declarations. In fact, there are a number of signed suppliers declarations by Cmart and that is in itself is surprising. The appellant exhibited two of them, one in each of the exhibits for deals 1 and 3. The former was signed by Mr Hussain and dated 24 February 2006 but did not identify either a purchase order or invoice and indicated that the VAT certificate had been checked on 23 February 2006. The latter was signed by Mr Haq and was dated 28 February 2006 but although the box for verification of the VAT certificate was ticked, no date was inserted.

201.On examining the HMRC exhibits, we identified another declaration for deal 1 (since it identified the purchase order and invoice) and it was also signed by Mr Hussain. The surprise is that the date on which the VAT certificate was allegedly checked was not the same and was 25 February 2006. There is yet another version of that with the same date but it did not have the purchase order or invoice on it. We also found another declaration faxed to the appellant on 28 February 2006, signed and dated by Mr Haq but with absolutely no other information inserted on the form.

202.Quite apart from the discrepancies in, and unexplained multiplicities of, the supplier declarations, they are simply self-certifying statements. What was their value at the time to the appellant? Obviously they must be considered in the context of the rest of the evidence. If one considers the declaration dated 28 February 2006, by that time, firstly significant deals had been concluded and more to the point the appellant had by then seen other documentation from Cmart.

203.The documentation emanating from Cmart to the appellant sometimes carried Mr Bashir's name and sometimes carried Mr Hussain or Mr Haq's name. That conflict in the various names on the paperwork showing Mr Bashir allegedly in the business after he had sold it and left, should have been a matter for major concern. A prime example is the stock offer for deal 1. That is dated 23 February and reads "Further to our telephone conversation today…" and it is signed by Mr Bashir. If the trade protocol was indeed dated 21 February 2006 then Mr Haughton (who had confirmed that only he dealt with the business) must have known that Mr Bashir no longer had anything to do with the business.

204.Mr Haughton was very vague about who precisely he had met in connection with Cmart other than that he had visited the premises.

205.In oral evidence, Mr Haughton confirmed that his dealings had "probably" been with Mr Haq. That assertion was far from persuasive.

206.Further in terms of documentation, the pro forma and invoices received from Cmart, including Cmart's invoice dated 24 February 2006, state at the foot "WHOLESALE & REATIL OF ALL TYPES OF HOUSEHOLD GOODS". Quite apart from the spelling error which should have caused some degree of alarm, the goods in question were not household goods. Indeed, what Mr Haughton patently erroneously thought was software was in fact integrated silicone chips which are random access memory for computers.

207.In summary, we find that Mr Haughton should reasonably have been expected to have been very concerned about Cmart and its ability to fund its own large purchases.

Costa

208.Mr Haughton had produced as exhibits to his witness statement a fax from Spain dated 27 October 2005 comprising an introductory letter from Mr Perry, an undated trading application signed by Mr Perry which stated that Costa had commenced trading in 2005, copy fiscal identification card dated 7 July 2005 for "Costa Renta & Management SL" with the Nueva Andalucia address, copy electronic VAT query number dated 3 October 2005, a copy of the banking details for FCIB in the name "Costa Rental Management SL" and a Europa verification of Costa's VAT number dated 3 October 2005. There was also exhibited a fax dated 24 February 2006 which bore the trading address and confirmed that address, Redhill confirmation of the VAT number (and the correct name) dated 11 November 2005 and

Europa validations dated 9 November 2005 and 23 February 2005. The VAT registration indicated that Costa was involved in building sales.

209.There was no reference to any of these in his witness statement, however, the witness statement referenced the HMRC officers statement which referred to and exhibited these documents with the exception of the trade application form.

210.The introductory letter had the registered address for the company in Puerto Banus printed on it and what appeared to be a sticker with the trading address.

211.On 20 July 2006, Mr Haughton had also produced to HMRC a copy of Mr Perry's passport, the undated trade application form from Mr Perry and a document in Spanish dated 29 June 2005 for Costa Rental & Management S.L.

212.The oral evidence did not clarify that at all. When Mr Haughton was cross-examined, the Tribunal and Mr Haughton had been made aware of the evidence that Mr Perry had sold his interest in Costa in 2005. Mr Haughton said that he had met the company personnel from Costa at a hotel down the road from their offices. He could not remember when that had been. They had given him business cards and no proof of identity. Mr Haughton stated that he had dealt with a Spanish gentleman and someone else. He could not recall who and said that they were probably Spanish. That does not sit well with his oral evidence that "I would speak to Costa Rental very frequently chasing actual payment.".

213. He was adamant that he had not dealt with Mr Perry. Quite why he had produced the copy passport to HMRC as evidence of his due diligence is therefore a mystery. It did not add to his credibility.

214.In summary, Mr Haughton does not appear to have checked which of the trading names used might be correct or what Mr Perry's role might have been. The due diligence for Costa, as a newly formed trading entity, can have given little or no comfort to the appellant in regard to its ability to fund purchases totalling £5,724,874. Further, since he conceded that Costa should have paid the appellant as soon as the goods had been inspected yet did not do so for approximately a month, that should have been a matter of major concern. Apparently it was not. That very much points to knowledge of contrivance and fraud.

Freight forwarders

215.There was no evidence of detailed due diligence. Mr Haughton did state that at some unspecified stage he had visited IMEX but his evidence was that he used the freight forwarders used by his supplier and he accepted that if that was where the goods were stored by his supplier then that would suffice. We find that to be absolutely extraordinary. Quite apart from the obvious point that any businessman storing millions of pounds worth of goods should reasonably wish to know that they were in secure premises, the freight forwarders were "recommended" to him by a trader with whom he had never dealt. A prudent businessman would want to know where the premises were, who was involved, how they operated and their financial stability.

216.Furthermore, and crucially, unlike many other traders in this sector Mr Haughton had first hand, presumably very painful, knowledge of just how unreliable freight forwarders might be. Firstly, he knew that the criminal proceedings against him in Operation Sponsor were dropped because the freight forwarder evidence had been found to be unreliable because

of possible complicity in the alleged fraud. Furthermore in the investigation in 2005, one of the reasons the assessment was raised against the appellant was because, again, the information from the freight forwarder was not consistent with what was factually physically possible.

217.Lastly, in the context of the evidence in regard to freight forwarders, Mr Haughton's evidence about his *modus operandi* (see paragraph 180 above) where he said that he checked with the freight forwarder as to whether they had possession of the goods does not in any way sit with the very conflicting evidence as to the location of the goods in deal 1 (see paragraph 242 below).

218.To put it very mildly, Mr Haughton should have been very much on his guard as to the very real possibility of problems with freight forwarders in that industry, yet he made almost no enquiry and had no written contractual arrangements.

Relevance of Due Diligence

219.Whilst due diligence is by no means an overriding factor in determining knowledge of fraud, nevertheless the very sparse due diligence in these deals is, as HMRC argue, revealing. Although Mr Haughton wrote to HMRC on 7 August 2006 stating that the appellant had been dealing with Costa Rental for "about a year", that was patently not the case and in his oral evidence Mr Haughton confirmed that the first deals with both Cmart and Costa were those with which we are concerned.

220.In our estimation, the evidence of the reality of Mr Haughton's direct relationships with his trading counterparties, by his own account, was not only unconvincing but flimsy in the extreme. We do not accept that he could have fairly relied upon the due diligence that he did to discharge his duty of responsible enquiry. What do we mean by that? There are numerous examples in addition to those cited above.

221.The appellant accepts that Mr Haughton was aware of MTIC fraud because of Operation Sponsor. However, he denied that he knew or should have known that there was extensive fraud in the market. We have listed the numerous warnings given to him by HMRC both orally and in writing. The long interviews under caution in Operation Sponsor can have left Mr Haughton in absolutely no doubt about the severity and extent of MTIC fraud. He was explicitly told that officers believed that he was involved in the fraud, that what he described as "normal business practices" were not viewed as such particularly since he had conceded that he had been given warnings about EU trade and yet he was dealing with European traders. Undoubtedly, he must have been very aware of the risks of MTIC fraud, the warning signs and the indications of such fraud. Indeed, in the course of the extensive interviews, and he was professionally advised throughout, he made the following statements:

> (i) "rogue traders…traders going missing…You know, if any European companies were asking me to, like buy stock and what have you, just to be careful…"
> (ii) "As stated, when I'm actually looking to deal with a company I check with yourselves, the VAT offices if the company is a valid company and then I will actually trade with them. I have on occasions actually gone through Experian just to check out the company…".
>
> (iii) Q "Would it be your normal business practice to go through that verification process prior to commencing business?"
>
> A "Not always"

(iv) It was then put to him that the late verification was because he knew that he was dealing with missing traders and that he denied. Subsequently it was again put to him that on numerous occasions he had "…bought from the European Union, …paid the European Union direct and …installed a missing trader in order to claim back …VAT". He replied "No".

(v) It was suggested to him that "…almost a hundred percent of your stock comes from missing traders?" and that the "…chances of you innocently trading with all these missing traders happening randomly, as opposed to being part of some organised scheme…is very small" . Again his answer was "No".

222.His explanation in cross examination was that following Operation Sponsor, the change that he made to his business was that: "I started more due diligence in terms of visiting and speaking with customers, suppliers, to be more reassured who I was dealing with." That is of course relative but was not borne out by the evidence. He never visited Costa's premises and he did not know who he dealt with in Costa. The failure to verify the identity of the personnel in Costa is extraordinary and begs the question as why he had produced information about, and from, Mr Perry as part of his due diligence. That should have been irrelevant.

223.Further, although he had been explicitly warned in Operation Sponsor that his business model was not normal business practice, apparently, the only change he made was to visit and speak to his counterparties. His own evidence was to the effect that he had not taken the VAT Officer's explicit advice not to make third party payments and was still doing so in October 2003 and that he never made any checks on the third parties. Further, he confirmed to the Tribunal that notwithstanding the fact that he had had a copy of Notice 726 on his office wall as long ago as 2003, he had never asked his suppliers how they financed their purchases and as far as customers were concerned he simply checked with them their method of payment such as bank transfer. He conceded that the record of the HMRC visit on 9 January 2006, immediately before the deals with which we are concerned, was accurate and that at that stage he still was not verifying customers and suppliers immediately prior to each and every deal.

224.It is often observed in MTIC appeals, correctly, that there should not be undue reliance on due diligence, or the lack of it. We agree. However it is one of very many relevant "circumstances" which must be considered not least because it was a matter which was or should have been within the appellant's control.

225.It should have been a matter of importance to Mr Haughton to know that Cmart was financially sound and in turn had title to the goods. Title would only be obtained by payment or obtaining credit for the goods to the value of the transaction. It is evident that no enquiries were made about Cmart as to whether or not it was able to obtain credit or make payments without having first been paid itself. That is even more startling in the context of the two reports from HMRC in December 2005 and January 2006 that Cmart's VAT registration could not be confirmed and where the total invoice value was £9,859,718.34 with total input tax of £1,468,993.

226.In our view the appellant's compliance with Notice 726, and fundamentally its overall duty of responsible enquiry in connection with the transactions which it undertook was very far from adequate for an honest trader doing business in that market based on a genuine commercial relationship with its business counterparties.

227.We found that, at best, Mr Haughton had a cavalier attitude to due diligence, that he did not make the basic checks that would be expected and that the due diligence that appears to have been conducted was superficial and ineffective by any commercial standard. Further, although we have taken that documentation at face value, for the reasons given, there are considerable doubts as to whether some of those documents such as the supplier declarations and the trade protocol were actually produced in the format or on the dates alleged.

228.We conclude that the due diligence, such as it was, was designed to provide a fictitious smokescreen of conscientious conduct, when in reality it would appear to have been ignored and was treated by the appellant as a defence to HMRC's possible claims of knowing involvement.

Deal documentation

229. When evaluating whether this was an acquisition fraud or whether Cmart was engaged in MTIC and contra trading from the outset, it was very relevant to look at the documentation. In any event it is, of course, one of the "circumstances" which we are bound to consider.

230.The deal documentation has some very curious features.

231.The names of the parties on invoices, purchase orders and faxes varies considerably. Rarely is the correct or full name utilised by any party. There are numerous basic spelling mistakes in headed paper such as for Cmart and TIS which might have suggested to anyone that the firms in question were unlikely to be *bona fide* and conducting multi million pound deals.

Documentation that the appellant would have seen or instigated and which therefore point to knowledge or means of knowledge of fraud

232.The appellant's own headed paper is in three different formats with two different names (Grade One Trading Ltd and Gradeone Trading Limited) and each format has a different email address. Accordingly, for example Cmart had two different email addresses for the appellant as did IMEX.

233.Numerous documents including the instructions from the appellant to the freight forwarder to allocate goods, to inspect goods, ship on hold and release goods are undated. Mr Haughton's explanation that those were "an oversight" does not sit well with his assertion that things had to be done properly in business.

234.The appellant's instructions to the freight forwarder to allocate and the release note in deal 1, although typewritten, carry dates handwritten but in differing handwriting and format (24/2/06 and 30-3-06). That struck us as being unusual since it was Mr Haughton who conducted all of the deals and issued all instructions and he stated that the appellant had no other employees.

235.The appellant's instructions to IMEX for inspection did not specify the quantity of the goods. Indeed there is exceptionally little specification in any of the documents.

236.The pro forma invoices from Cmart for deals 1 and 3 dated 24 February and 1 March 2006 carry Mr Bashir's reference. The stock offer dated 23 February 2006 carried

Mr Bashir's name and referred to a telephone conversation that day (see the following paragraphs). That cannot have happened if he had sold the company.

237.The pro forma invoice for deal 1 is for 42,250 units instead of 45,250.

238.Much of the documentation from Costa was undated.

239. There is almost no specification of the goods involved in any of the deals but for example Quarke is also spelt Quark and the specification, if it can be called such, or the description, of the E-AUZ goods varies considerably.

240. In our view the documentation seen by the appellant is defective in numerous aspects and certainly point to at least means of knowledge of fraud, if not knowledge.

Documentation that the appellant would not have seen but that points to organised fraud

Cmart and Silver

241.Although Silver was a Portuguese company the purchase order and invoice for deal 1 carried the name Silver Pound Trading Limited which it simply could not be. There are other examples.

242.In the exhibits to the Officers' witness statements (we do not differentiate between Officers since numerous items were exhibited repeatedly) there are the following:

(a) Silver wrote to Cmart on 23 February 2006 offering the 57,250 Espeed and stating that if Cmart are interested they should fax their purchase order.

(b) Cmart then faxed "Silver Pound Trading Ltd" on 24 February 2006 referring to a telephone conversation and asking for that stock to be delivered to IMEX. That fax is signed by Mr Bashir.

(c) However, Cmart had written to IMEX on 23 February 2006 confirming a telephone conversation and stating that the 57,250 Espeed units would be arriving from Silver on 24 February 2006. That letter is also signed by Mr Bashir.

(d) There is produced a CMR for Silver showing that 2,750 of the Espeed left Portugal on 24 February 2006.

(e) Curiously, there is another fax from, purportedly Mr Hussein, but signed by Mr Haq dated 24 February 2006 to IMEX this time referring to a telephone conversation and stating that the goods would arrive via Gino Freight "sometime today" The company in question is Gina Logistica S.L. on the CMR. It is highly unlikely that the goods could arrive from Portugal within a matter of hours and in any event Cmart had indicated that the goods would be coming from Spain.

(f) A stock allocation (to the appellant) was sent to IMEX by Cmart signed by Mr Bashir on 23 February 2006 before the alleged sale to the appellant, and more pertinently the stock offer to Cmart dated that same day stated that the stock was located at IMEX yet it was still in Portugal.

(g) Furthermore, Cmart faxed the appellant on 23 February 2006 referring to a telephone conversation, with the fax signed by Mr Bashir, offering the 57,250 units stating that they were at IMEX.

(h) The inspection instruction for the 57,250 units from Cmart to IMEX was dated 24 February but the inspection report, also dated that day was for 45,250 units being the amount sold to the appellant.

(i) The supplier declaration from Silver for Cmart described Silver as "Silver Pound Trading Ltd" and was dated 25 February 2006.

(j) There is a letter from Silver to Cmart dated 20 March 2006 which states:

> "Dear Sirs
>
> Would you please accept the below mentioned stock in two consignments:
>
> 57,250 ESPEED DDR2 1GB 533 MHZ
>
> One of 55,000 and the other one day later of 2,750.
>
> *Regards"*

As can be seen the 2,750 units were dispatched separately but apparently on 24 February 2006.

(k) A number of documents are undated including, in particular, release instruction from Silver to IMEX including the 57,250 units but also including the goods included in deal 2.

(l) Curiously there are two release notes from Cmart to IMEX in relation to the 15,268 units in deal 3. The first is from Mr Haq authorising the release of the stock to the appellant from Silver and is dated 13 March 2006. The second purports to be signed again by Mr Haq although it states in the box at the top that it is from Mr Hussein at Cmart and is a simple authorisation dated 16 March 2006.

Bluewire

243. There are some anomalies in the paperwork relating to the transaction between Bluewire and SNN.

244. On 24 February 2006, SNN faxed Bluewire addressed "to whom it may concern" requesting a copy of the inspection report for the 12,000 units.

245. SNN faxed Bluewire on 24 February 2006 at 18:09 with a purchase order stipulating delivery to Boston on 25 February 2006. In fact, we can see from the documentation, for what it is worth, that that did not happen. On 24 February 2006 Bluewire instructed IMEX to "ship on hold" the 12,000 units by road transport. The CMR are not complete but it would appear that allegedly the goods were transported in two shipments of 6,000 each and apparently were still in Stoke on 26 February 2006. There are exhibited one euro tunnel ticket for 27 February 2006 at 03:53 and one ferry ticket for Dover-Dunkirk at 01:01 on 22 February 2006. None of that is consistent. There was produced an nsurance certificate which states "insurance in respect of goods shipped on 24/02/06".

246. The IMEX invoice for freight charges for export to Belgium for 24,500 Espeed was £1,300 for the appellant. The inspection report was £500. The invoice to Bluewire dated 8 March 2006 for only 12,000 Espeed was a freight charge of £2,600 and an inspection charge of £500.

Matrix

247. The invoice to Andrevias states that payment terms are "1 day from date of invoice" yet the purchase order specified seven days after the invoice date.

248.Very bizarrely, the supplier's declaration by the appellant is dated at the top "28/01/06" but is signed by Mr Haughton on 2 March 2006 for a deal purportedly dated 28 February 2006 and where the declaration states that the deal is contingent thereupon. Bluntly, it does not make sense.

Summary

249.In our view, almost nothing has been done in accordance with what we would be expecting in "normal commercial practice". The deal documentation in all of the deals including the disputed deals is not only poor, lacking in specification, lacking dates and of little commercial value if litigation were to ensue but, even if it reflected the alleged agreement between the various parties, there are inherent inconsistencies that mean that, in our view, the only reasonable explanation for the documentation is that it was produced for HMRC and not for the parties.

Loan from Caliche

250.Mr Brown quite correctly and appropriately challenged Officer Everett about the breadth of his experience in looking at multi million pound loans. The Officer is not an expert. However, this is a specialist Tribunal and we bring extensive international experience of sourcing, negotiating, appraising and, indeed, advising on loans worth £millions in a number of different currencies and subject to various and sometimes very interesting jurisdictions. There is nothing about what purports to be a loan in this instance that withstands such scrutiny. Bluntly, for the reasons set out below, we find that it was clearly no more than a pre-ordained mechanism to inject funds into "*the system*" at an appropriate juncture.

251.The "loan" document is variously described as "Mercantile Agreement" and "Investment Agreement". It goes on to state that the "Investment amount" can be recalled on three months' notice in the form of a repayment as set out in the agreement. However, inconsistently, it goes on to state that the company is obliged to repay, in a lump sum, after three years from the date of investment or as agreed by the parties.

252.It also states that "In lieu of the investment amount, THE INVESTOR will share in the net profits of THE COMPANY to the extent of 50%. Hence no interest shall be paid to THE INVESTOR on the investment amount". There is no definition of the term "net profit" in the document. There is reference to an "auditor's report" with the company appointing the auditor of the appellant's financial documentation, which failing the Investor can do so at the company's expense. There is no reference to security for what amounts to the loan, no timetable for payment of the share of the profits, if any and none of the terms we would expect to see even in a basic loan agreement.

253.We consider that this agreement is couched in quite extraordinary terms. Some of it is arrant nonsense such as the provision that if either party dies or becomes incapacitated, "obligations will be passed on to their legal heirs". That is impossible since both parties are corporate entities; the fact that there is reference to the directors of the two companies representing the companies as they claim to have legal authority does not alter that.

254.Simply put, in no sense of the words do we consider the document to be remotely "commercial" or "at arms length". Given his financial experience that should have been blindingly obvious to Mr Haughton.

255.Mr Haughton's explanation of the circumstances surrounding the loan tested our credulity yet further. Even if it could be accepted, which it most certainly is not, that the loan documentation was "commercial", his account of the "negotiation" thereof and the actual intended implementation thereof is bizarre. Mr Puzey aptly put it to him at an early stage that his account was "extraordinary and quite unbelievable" yet his further explanations did nothing to assist him.

256.Prior to the hearing the only information proffered by the appellant in regard to the loan was the statement that it had funded the VAT payment in 2005-2006 and that the level of return at 50% of the net profit was very significant because of the appellant's inability to provide security.

257.At the point at which Caliche must have been negotiating the loan to the appellant, if indeed there were any negotiations, the most recent available accounts for the appellant were the annual accounts for the year to 31 March 2005 which were signed on 6 January 2006. That showed a turnover of £18,176,683 which was a 5.16% drop in turnover from 2004. The accounts disclosed a 13.4% drop in gross profit, a 20.32% drop in pre-tax profit and a 15.7% drop in profit after tax. The issued share capital was precisely two £1 shares. The fixed assets were £1,372 with net current assets of £30,531. There was approximately £2.5 million each in trade creditors and debtors. An operating profit of £4,560 on such a huge turnover cannot have been an attractive prospect.

258. In his oral evidence, Mr Haughton explained that the 50% of the net profits due to be paid to Caliche would be paid in respect of each of the transactions for which the loan facility had been utilised. Since it was not disputed that the funds had been drawn down and utilised instantly to fund the outstanding VAT on the transactions with Cmart, he then said that Caliche would be entitled to 50% of the net profit on that particular transaction and that that should have been paid once the appellant received its funds from Costa. The gross profit for the appellant was approximately £84,000.

259. Mr Haughton had anticipated that the transport costs and a percentage of the general overheads would be deducted and then the 50% net profit remitted to Caliche. (On the evidence provided there is little evidence that the additional overheads incurred by the appellant in exporting the goods (freight for example) accounted for more than a relatively very small proportion of the mark-up).

260.Since the funding was mainly intended to help with the export market the appellant would be liable to pay only 50% of the net profits on export deals. He went on to say that notwithstanding the terms of the agreement it had been agreed that the capital would be repaid "as I went along". He agreed that there would be an element of Caliche both profit sharing and also having the capital repaid. That did not sit well with his later explanation that the intention was that Caliche would help him expand his export business on a transaction by transaction basis.

261.His explanation of the provenance of the loan was even more surprising. Mr Haughton should have been experienced in assessing risk, analysing financial information and documentation and the world of finance generally. In that context it is absolutely startling

that he was able to say that he had never spoken to or met Mr Russell, the man behind Caliche, he did not know who he had dealt with, he did not know whether he had been approached by fax or at the CeBit exhibition or exactly how the loan had been arranged. He confirmed that the loan had been negotiated shortly before it was signed on 7 March 2006.

262. When pressed he said that all that he could recall is that he had spoken to "them", that they had said that they were a reputable company and he had taken them at their word. All negotiations had been done by fax, email or telephone. Therefore, it could not have been at the conference. Only the agreement has been produced and there is no evidence of any negotiations.

263. He stated that he was able to draw down the loan as required but he could not explain why he had been able to draw down the money on 7 May 2006. His only argument was that he had not drawn down the money earlier because he assumed that Caliche would still have been doing their due diligence. That simply does not make sense since they had signed the agreement some two months earlier.

FCIB

264. A key feature of MTIC fraud is that mechanisms exist for money and goods to be returned to the originator, and for the profit arising from the VAT evaded to be shared after the buffers and contra-traders have been paid their mark-ups.

265. We find that, at a distance, with a number of companies interposed, Total and Baddesley funded the appellant's deals and that the interdependence of the tax loss and non tax loss chains has been comprehensively established by HMRC.

266. Mr Haughton was asked about how he came to move the loan funds and indeed all other funds identified in these deals very shortly after receipt. He could not explain why some transactions took place within minutes and most within half an hour or an hour. His explanation that he regularly checked his bank accounts and that it was simply "coincidence" was simply not credible.

267. We accept that the appellant may not have been aware of the circularity of the money flows in the transaction chains. However, for the payment patterns revealed by the analysis of Officer Mendes to have been maintained, the appellant must have been involved in the chains: the appellant must have been told when to expect to receive payment from Costa and when to make payment to Cmart. That points to actual knowledge of a connection with fraud.

268. The argument advanced was that the appellant was an innocent dupe utilised by those who organise the activity in order to commit VAT fraud without its knowledge and therefore it is unsurprising that the flow of money followed the same pattern. We disagree. On the contrary those perpetrating the fraud must have organised precisely who did what and when. We found Mr Haughton's evidence in regard to the movement of funds wholly unconvincing. We do not accept his argument that it was simply "coincidence" that payments were made by him and others in very quick succession.

269. We find that the circularity of the funds in the FCIB accounts means that there is no genuine underlying economically justifiable reason for the transactions to exist.

270. We note with interest that all of the payments analysed by Officer Mendes were made in sterling regardless of the domicile of the paying and recipient companies. Given that a number of the companies were EU companies it is even more surprising that the transactions were conducted in sterling. We agree with HMRC's argument that the inference to be drawn is that the deals were all centred around the UK with the purpose being to defraud the UK Revenue.

271. We agree with HMRC that the chance that the circularity of money is being established in this way without there being in place an overall scheme to defraud the Revenue is remote to the point of being nil.

Insurance

272. For the reasons outlined above, we do not consider that there was adequate or effective insurance in place even although premiums were paid in two of the deals. Following the problems with Almafra, Officer Nealey had explicitly warned Mr Haughton to ensure that the CMRs were date stamped (see paragraph 141 above). We do not accept the arguments of the appellant that the appellant had no control over the lorry drivers or receiving warehouses as to whether the date and time were recorded on the CMR as required by the insurance documentation. That could and should have been stipulated as an essential requirement. A prudent businessman would have ensured that that was the case.

273. The lack of insurance for deal 3 was surprising. Mr Haughton had produced evidence of his own indemnity insurance for 2003/04 for claims aggregating a total of £500,000. Whilst we understand that insurance was mandatory for his mortgage business, that does not sit well with his assertion that goods worth £267,000 were not worth insuring since his transactions in the mortgage field must have been of approximately that order.

274. We find that the evidence, such as it was, in regard to insurance was a smokescreen just like much of the other documentation.

The relevance of the abandoned appeal for 06/06, Operation Sponsor and the 2005 investigation

275. As we indicate at paragraph 7 above, we do not accept that because there was no appeal of the period 06/06 disallowance that as a matter of fact the appellant's trading was connected to fraud through contra trading. HMRC's argument is that the transactions in period 03/06 were not an isolated matter but rather a part of a continuum that had started in 2001 when the appellant was purchasing from hijacked traders and carried on until the middle of 2006.

276. We had uncontested evidence in regard to all of these matters and we have read it all. The earlier matters both point unequivocally to the appellant having a very detailed understanding of MTIC fraud and, that being the case, Mr Haughton should have taken great care to consider all of his dealings. He did not. The evidence in regard to period 06/06 shows a similar pattern and indeed many of the same companies are identified in those transactions.

277. In his witness statement Mr Haughton stated that

> "…despite the intense scrutiny that the company was under, as far as I recall from late 2002 until late 2006, on no occasion was the company advised that tax losses had been identified in its transaction chain. The company drew considerable assurance from this fact".

That is quite simply not true. In the interviews in regard to Operation Sponsor it was made absolutely explicit to the appellant that there were substantial tax losses in its transaction chains. Furthermore in the HMRC investigation in 2005 they were again made aware of that position.

278.Mr Haughton was at pains to stress that he had a genuine knowledge of, and trust in, those with whom he did business. The history of his business dealings shows that that trust has been abused over six years and in regard to numerous parties with whom he did business. It all points to Mr Haughton being far from an innocent dupe.

Other factors

279. There were no written contracts between the appellant and Cmart and Costa despite the high values of the goods being purchased and sold. There was therefore no refund or return policy and matters such as payment and delivery terms were not the subject of any formal agreement. Mr Haughton's suggestion that it was all a matter of verbal agreement did not advance matters since by his own admission he neither paid Cmart nor did Costa pay him within what he alleged were the verbally agreed terms being once the goods had been inspected and therefore before they left the UK. That is very surprising given the very large sums of money involved.

280.Cmart certainly appears to have permitted the despatch of the goods sold to the appellant out of the UK prior to receiving payment and more pertinently it released the goods to the appellant on 30 March 2006 notwithstanding the fact that the appellant still owed it in excess of £600,000.

281.In regard to release of goods, Mr Haughton states that "it is inconceivable that Cmart did not give IMEX authority to ship the goods on the basis of Grade One's instructions". Mr Haughton's experience with The Agency UK Limited should have been a painful "wake up call" to ensure that a supplier had title. He should have been very alert to the potential risks. On the balance of probability, there was no perceived risk.

282. In his oral evidence Mr Haughton confirmed that he had never made any enquiry of his suppliers as to how they were financing their purchases and, as far as his customers were concerned, he would only ask them about their mechanism for payment such as bank transfers. As we indicate above, since he had obtained no trade or bank references in regard to either Cmart or Costa and the credit rating which he did have for Cmart was zero, that begs the question as to why he did not make more extensive enquiries as to whether or not Cmart could afford to purchase the goods which it then sold to the appellant or whether Costa would be able to pay for the goods which it then bought from the appellant. It would be ordinary commercial prudence to make appropriate enquiry in that regard. It is even more important in the context of an industry which was rife with fraud.

283.In summary the appellant exported goods to a very substantial value without having made payment or given any security for payment. The appellant was able to release the goods to Costa without having first made payment in full to Cmart. We agree with HMRC that the lack of the appellant's title to goods that it released to Costa coupled with the apparent lack of concern as to who in fact had title at any given point and time is compelling evidence that Mr Haughton knew that the appellant was being drawn into transactions involving the evasion of VAT. Even if he did not know then at the very least it should have put any reasonable businessman on notice that he was not involved in legitimate trade.

284.Mr Brown argued for the appellant, and we agree with, Judge Wallace in *Emblaze* where he stated at paragraph 225 that: "From a commercial point all that Global needed to know was that a customer was willing to pay a price which gave Global a profit." However, that is by no means the whole story since of course, as is explicit in paragraph 59 of *Mobilix*, we must look at "the circumstances which surround their transactions". Whilst a trader does not need to know why the customer makes a purchase nevertheless in the real world in order to make a sale, both purchaser and seller need to know what is involved.

285. Mr Haughton said that he relied entirely on Cmart for the description of the goods and he agreed to buy the goods on that basis. Quite how he was then able to sell on to Costa, Eurotrade and Matrix is not clear since from the outset HMRC have been asking for details of the various goods involved in these transactions and nothing has been forthcoming. Even in the hearing he did not know what it was that he had been dealing in. It seems inherently unlikely that there was any detailed information provided.

286. When asked about why he had made a £84,525 mark up on the sale to Costa in deal 1 as opposed to a mark up of a mere £2,700 on the sale to Eurotrade for only a slightly smaller amount, his response was simply "It was a very good deal". It is the responsibility of any reasonable and legitimate trader to question the nature of the transactions in assessing whether there is a connection to fraud. In this case the deals which fell into the appellant's lap were quite clearly too good to be true.

287. We agree with and had regard to the comments of Judge Bishopp in *Calltel Telecom Ltd v HMRC*[7]

"(52)…it is, we think, possible that a trader could have the means of knowing that, by his participation, he is assisting a fraud. Much will depend on the facts, but an obvious example might be the offer of an easy purchase and sale generating a conspicuously generous profit for no evident reason. A trader receiving such an offer would be well advised to ask why it had been made; if he did not he would be likely to fail the test set out at paragraph 51 of the judgment in Kittel*".*

That is precisely the position in which the appellant found itself yet it proceeded with the deals.

288. The financial figures for the appellant are startling for a business not involved in MTIC fraud. Wholesale trading started in March/April 2001 and in a period of 12 weeks a turnover of in excess of £4 million was achieved, rising to £12.8 million by August 2001. In his interview for Operation Sponsor he attributed that to luck. According to the appellant's accounts there was a sevenfold increase in turnover over the two years ending March 2005 and 2006.

289. The turnover grew rapidly for the period 03/06 with a 270% increase in trading and in 06/06 a 167% increase in trading. Neither is indicative of normal commercial organic growth.

290. The mark up achieved by the appellant in all three of the deals with which we are concerned is virtually identical (a difference of only 0.04% overall), even although there were different products, quantities and unit prices. That did not sit well with Mr Haughton's assertion at the 2007 meeting that "what you can negotiate from your customer prices today could be different tomorrow" or his argument in cross examination that it was simply a coincidence.

[7] [2007] UKVAT V20266

291.It was argued for the appellant that if the purchase in deal 1 had been contrived then the appellant would have purchased the full amount of 57,250 units and supplied the full amount to Costa. Similarly in deal 3, had it been contrived, then the full 15,268 units would have been sold to Costa. We find little merit in that argument. Had the full amounts been bought and sold that would have been a more compelling indicator of fraud but the converse does not hold good. As an example, splitting the deals may have been a device to shield the appellant from HMRC enquiry.

Mr Haughton's evidence

292.We accept that in this instance we are dealing with events spanning approximately six years and the majority of that occurred more than 10 years ago. Of course, one would expect a degree of failure in memory, both that of the appellant and institutional memory, due to the elapse of time but

(a) there is a great deal of contemporaneous evidence, and

(b) most of HMRC's evidence (although some of it was replaced) was served in 2011 and 2012.

Mr Haughton has had ample opportunity to refresh his memory and/or state what he did not know and when and to produce supplementary evidence. He has been interviewed under caution on a number of occasions and he has been professionally advised by numerous advisers over many years. He must have had a very good understanding of what was involved in a hearing of this sort.

293.Mr Haughton did not attend all of the hearing but he listened intently to the evidence of Officers Turner and Humphrey, making notes and it was quite clear to us from his oral evidence that he had due cognisance of what had been said. He is an articulate and intelligent man who handled cross-examination deftly even if, on occasion, the answers surprised all present.

294.For the reasons set out above, we found Mr Haughton to be a witness almost totally lacking in credibility and on occasion, such as in regard to the loan from Caliche and the movement of funds, his testimony was wholly incredible.

Joint and Several Liability

295.Officers Taylor and Humphrey were asked whether, and if not why not, HMRC had invoked the joint and several liability provisions. Those provisions were not invoked in this instance but the appellant had certainly been warned about the possibility of being subject to those measures. The law is clear. Section 77 A Value Added Tax Act 1994 took effect from 10 April 2003 and the amendment thereto on 1 April 2007 but both stipulate that those provisions only apply to goods where the unpaid VAT relates to the supply of those goods. That is not the case in a contra-trade, as is alleged here.

No disallowance of input tax on UK Trades

296.The argument was that it is a misapplication of the *Kittel* principle to only disallow the right to deduct "in respect of a purchase" of only part of that purchase being the portion which relates to the onward export. HMRC argued that it was not discriminatory, to disallow the

input tax on only part of the transaction and referred to and relied on Ross J in *Powa* at paragraph 60:

> "60. As to non-discrimination, this appeal concerns the decision by HMRC that the objective criteria determining the right to deduct input tax were not met as regards these claims for repayment by PJL (the appellants). If that is the case, PJL were not entitled to such repayments, irrespective of the position of anyone else … Furthermore, whether or not HMRC could have applied a similar approach to the traders who served as buffers in the chains (who would generally not be making a repayment claim to HMRC but simply crediting the input tax against the output tax received) does not affect that conclusion; and whether HMRC should have pursued those traders for an account of the output tax received, is a question of policy regarding the effective enforcement of the VAT regime, with no doubt limited resources. Accordingly, I consider that the principle of non-discrimination is not engaged".

297. We are bound by, and agree with that.

298.The HMRC officers were very clear that they were only able to, and did only, concentrate resource on export deals at that time. Of course, we agree that paragraphs 56, 59, and 61 of *Kittel* refer to a "purchase". In the interests of clarity, we set out the terms of paragraph 61 which read:

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

299. In *Mobilix,* Moses LJ, having analysed *Kittel,* stated at paragraph 58:

> "58. As I have endeavoured to emphasise, the essence of the approach of the court in *Kittel* was to provide a means of depriving those who participate in a transaction connected with fraudulent evasion of VAT by extending the category of participants and, thus, of those whose transactions do not meet the objective criteria which determine the scope of the right to deduct."

In paragraph 61, he went on to state that if a trader is such a "participant" then " …he will not be entitled to deduct". The emphasis in both *Kittel* and *Mobilix* is on entitlement to deduct not on what the national court or the taxing authority must allow or not in respect of deduction.

300. We do not find that the *Kittel* principle has been misapplied. In our view it would be entirely illogical if the *Kittel* principle, which extended the category of participant, could be defeated simply because HMRC did not include the buffer trades in the disallowance.

301. We find that the appellant is fortunate that the disallowance was limited in that manner.

Was Cmart a contra trader or intending to be such for period 03/06?

302.It was, and is, accepted that Cmart had not engaged in contra-trading before February 2006. In any event the contra-trading was a new construct to HMRC, and that construct only really evolved in 2006. Mr Brown for the appellant advanced an ingenious argument that Cmart only decided to engage in contra-trading at the end of the period and because they had never previously done so it must be assumed that that was a late change. We might possibly have found that argument more persuasive if the ownership of Cmart had not changed prior to the deals with which we are concerned.

303.Mr Brown submitted that the Tribunal should conclude that Cmart's transactions with TIS were an after-thought and therefore at the time of the appellant's last transaction, the appellant could not have known nor should it have known of the connection to fraud.

304. We rejected this submission for the following reasons. Firstly, we find that it is wholly unsurprising that the transactions with TIS were at the end of the period since the whole purpose was to reduce the VAT repayment.

305. We did not accept that the relevant invoice(s) had to be created prior to the appellant's transactions. In our view the invoices could be created at any time and still form part of the fraudulent scheme to defraud (whether in the direct supply chains or via contra-trading) and we found support for this proposition in *Mobilx* at [62]:

> "The principle of legal certainty provides no warrant for restricting the connection, which must be established, to a fraudulent evasion which immediately precedes a trader's purchase. If the circumstances of that purchase are such that a person knows or should know that his purchase is or will be connected with fraudulent evasion, it cannot matter a jot that that evasion precedes or follows that purchase. That trader's knowledge brings him within the category of participant. He is a participant whatever the stage at which the evasion occurs."

Conclusions

306.For the reasons set out above, we found the evidence in respect of the defaulting traders and Cmart's and the appellant's transaction chains cogent and compelling. We have set out at considerable length our findings in this matter since although some features commonly found MTIC trading such as same day back to back transactions and exact matching of quantities are not always present in all of the deals which we were considering, it is only by looking at the totality of the evidence that HMRC's argument about a continuum of trading could properly be explored.

307.Our findings demonstrate that fraud was rife throughout the deal chains. The goods could have been sold more profitably had they remained in the European mainland and the unexplained very close trading and other relationships between a number of the parties (such as AXT, Cmart, Costa, Silver and Baddesley) point to there being no commercial rationale for the goods ever entering the UK.

308.We are satisfied that HMRC had established fraudulent tax losses and that there was an orchestrated scheme for the fraudulent evasion of VAT connected with the transactions which form the subject of this appeal. In doing so, as we indicate, we rejected the appellant's submission that the issue of timing in respect of the contra-trading transactions meant that the necessary connection had not been established.

309.We are wholly satisfied that HMRC had accurately traced the appellant's chains of supply to tax losses caused by defaulting traders via Cmart acting as a contra-trader. We found as a fact that Cmart knowingly acted as a dishonest contra trader and that all of its transactions in period 03/06 formed part of that overall scheme to defraud the Revenue.

310.We find that this was certainly not acquisition fraud and that it matched the description of MTIC or carousel fraud.

311.We concluded that in respect of the periods under appeal the appellant knew that the transactions were connected with the fraudulent evasion of VAT. We reached this conclusion

not only as a result of our finding that the evidence of Mr Haughton was untruthful but also after consideration of the nature and features of the transactions and all other relevant circumstances. Even if we had not found Mr Haughton's evidence unreliable we were satisfied that we would have reached the same conclusion on actual knowledge by inferences drawn from the evidence. We were also satisfied that the factors set out above would at the very minimum support a finding of means of knowledge.

312. In summary, in our view, and to a standard of proof of at least reasonable probability, if not higher, the only reasonable explanation for the appellant's role in these patently pre-planned transactions was that it had known precisely what it was doing and when. What it did was to participate in pre-planned transactions inherently connected to VAT fraud.

313. Accordingly, we find that HMRC has proved that the appellant's means of knowledge and indeed actual knowledge was such that the transactions fell outside the scope of the right to deduct input tax. Therefore, we found that the decision of HMRC to deny the appellant's input tax was correct and is upheld.

314. The appeal is dismissed.

Costs

315. On 31 January 2013, the Tribunal Directed that pursuant to paragraph 7 of Schedule 3 of the Transfer of Tribunal Functions and Revenue and Customs Appeal Order 2009 SI 2009/56, Regulation 29 (Awards and Directions as to Costs) of the VAT Tribunal Rules 1986 SI 1986/590 shall apply to the current proceedings in relation to the costs incurred prior to 1 April 2009. The Tribunal also Directed that for the avoidance of doubt, in relation to the costs incurred after 31 March 2009, Rule 10 of the Tribunal Procedure (First-tier Tribunal) (Tax Chamber) Rules 2009 SI 2009/273 shall apply.

316. We see no reason here why costs should not follow the event, as is usually the case, and we therefore direct that the appellant is to pay HMRC the costs of, incidental to and consequent upon the appeal, to be the subject of detailed assessment if not agreed.

317. 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.

ANNE SCOTT
TRIBUNAL JUDGE

RELEASE DATE: 7 March 2016

APPENDIX 1

Dear Sir/Madam

Missing Trader Intra-Community (MTIC) VAT fraud constitutes one of the most costly current forms of VAT fraud within the EU. It is a serious problem for the UK and is Customs' top VAT fraud priority. As you may be aware I am a Tax Operations Manager with responsibility for this area of work.

Amongst the commodities involved are computer equipment, mobile phones, ancillary items and any other goods. The current estimate of the VAT loss from this type of fraud in the UK alone is between £1.7 and £2.6 billion per annum.

Customs and Excise are still experiencing certain problems with businesses in your trade sector offering commodities regularly involved in Missing Grader Intra Community (MTIC) VAT fraud. As part of our local controls you may previously have been verifying the VAT status of new or potential Customers/Suppliers with your local office.

However, with effect from today's date, verification of the VAT status of new Customers/Suppliers should instead be faxed to **Redhill VAT Office**. However, if you do not have fax facility please contact us by telephone or E-Mail: Marie.Haynesperks@hmce.gsi.gov.uk

The fax numbers at Redhill VAT Office are: 01737 734605 or 01737 734600. The telephone number at Redhill is 01737 734612.

If know, the information provided should include the following:

- The name of the new or potential Customer/Supplier.
- Their VAT registration number.
- Their contact numbers (including telephone number, fax number, e-mail address and mobile numbers if known).
- The Directors and/or responsible members.
- Whether they are buying or selling goods.
- The nature of the goods.
- The quantities of the goods.
- The value of the goods.
- Their bank sort code and account number.
- We would also require you to continue forwarding, on a monthly basis, a purchase and sales listing with the identifying VAT Registration Numbers against the suppliers/customers to Redhill Vat office."

I look forward to your continued assistance in this matter.

Yours