



[2020] UKFTT 0027 (TC)

TC07533

VAT- MTIC- denial of input VAT- whether the appellant knew or ought to have known that the transactions were connected with fraud. Axel-Kittel v Belgium; Belgium v Recolta Recycling [2006] ECR I-6161, 30 Red 12 Trading Ltd v The Commissioners for Her Majesty's Revenue and Customs [2009] EWHC 2563 (Ch), Mobilix Ltd (In Administration) v HMRC; HMRC v Blue Sphere Global Ltd, Calltel Telecom Ltd and another v HMRC [2010] EWCA Civ 517, AC (Wholesale) Ltd v The Commissioners for Her Majesty's Revenue & Customs [2017] UKUT 191 (TCC) considered and applied.

**FIRST-TIER TRIBUNAL
TAX CHAMBER**

Appeal number: TC/2017/06998

BETWEEN

PYRAMID DISTRIBUTION LIMITED

Appellant

-and-

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

Respondents

**TRIBUNAL: JUDGE MALEK
MR JOHN ADRAIN**

**Sitting in public at Alexander House 14-22 Parsonage, Manchester M3 2JA between 4-15
November 2019**

Mr. Nigel Gibbon for the Appellant

**Mrs. Newstead-Taylor, counsel, instructed by the General Counsel and Solicitor to HM
Revenue and Customs, for the Respondents**

DECISION

INTRODUCTION

1. The Appellant appeals against the Respondents' decision, dated 05.05.17 ("the Decision"), denying the Appellant's right to deduct input tax in the sum £216,848.00 claimed in VAT periods 03/15, 06/15 and 09/15 on the grounds 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 of this fact.

BACKGROUND AND DRAMATIS PERSONAE

2. We are grateful to the Respondents for providing a useful dramatis personae which we rely upon below.

Pyramid Distribution Ltd	The Appellant
Mr. James Cooke	The Appellant's Director
Ms. Michelle Cooke	1. The Appellant's Company Secretary and Mr Cooke's sister.
Global Freight Systems ("GFS")	Freight Forwarder
Saikona	1. A company based in Lithuania. 2. Presence's Supplier in Deals 4 and 5.
Presence Network Ltd ("Presence")	An alleged defaulter.
Ren Tools (UK) Ltd ("Ren")	An alleged defaulter.
TLP Networks Ltd ("TLP")	An alleged buffer.
Global SFX Ltd ("Global")	An alleged buffer.
XG Concept Ltd ("XGC")	An alleged buffer.
Engage & Reward Ltd ("E&R")	1. An alleged buffer 2. Previously called Mistral Promotions and Marketing (UK) Ltd (111 1376 68).
Mistral Marketing Ltd (918 5302 26)	1. A company supplying iPhones and iPods back to back. 2. Mr Plunkett is the director. 3. On 26.5.13, entered into liquidation.
Mr. Richard Plunkett	1. The director of E & R. 2. A business associate of Mr Cooke.
East West Bridge Trading Ltd ("EWBT")	The Appellant's customer.

3. The background is not controversial and can be summarised as follows.

4. Mr Cooke is the Director of the Appellant and Ms Cooke is the Company Secretary.

5. The Appellant:

- (1) was incorporated on 19.10.2000,
- (2) was registered for VAT with effect from 06.11.2000,
- (3) carries on business as a retail and wholesale supplier of refurbished computer hardware, related products and software, and
- (4) submitted VAT returns for the VAT periods 03/15, 06/15 and 09/15 claiming repayments of £172,671.79, £166,087.48 and £235,417.72 respectively.

6. The Returns related, in part, to purchases of Mr Site software (Mr Site) from E & R; being a UK trader, and then the onward sales of Mr Site to EWBT; being a company allegedly based in Hong Kong, in a back to back transaction. The purchase transactions from E&R are detailed below:

<i>Deal Number</i>	<i>Invoice Date</i>	<i>Invoice Number</i>	<i>Supplier</i>	<i>Product</i>	<i>Net (£)</i>	<i>Vat (£):</i>	<i>Gross (£)</i>	<i>Customer</i>
1	21.01.15	53	E&R	Mr Site	208,239.12	41,647.82	249,886.94	EWBT
2	26.03.15	57	E&R	Mr Site	260,712	52,142.40	312,854.40	EWBT
3	29.05.15	59	E&R	Mr Site	€354,311.25	50,615.89	€425,173.50	EWBT
4	03.07.15	61	E&R	Mr Site	€139,574	20,082.58	€167,488.80	EWBT
5	25.09.15	89	E&R	Mr Site	261,800	52,360	314,160	EWBT

7. On 13.12.16, the Respondents informed the Appellant that, in their view, Deals 2, 3 and 4 commenced with a defaulting trader (Presence) resulting in a loss to the public revenue exceeding £116,171.

8. By letter dated 29 March 2017 the Respondents:

(1) notified the Appellant of their decision denying the Appellant the right to deduct input tax in respect of Deals 1 and 2 on the grounds 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 of this fact. The defaulting trader in Deal 1 was identified as Ren.

(2) assessed the amount of VAT due in the sum of £93,789.00.

9. Further information was provided by the Appellant which the Respondents considered, but concluded on 2 May 2017 that it did not alter their original decisions. These decisions culminated in a final decision dated 5 May 2017 (i.e. the Decision) which encompassed all five deals and which maintained the earlier decisions. The Decision was itself maintained on review and eventually appealed to this Tribunal on 5 September 2017.

THE GROUNDS OF APPEAL

10. The Appellant appeals the Decision and asks this Tribunal to discharge the assessments on the grounds that:

(1) the Respondent is required to prove, and has not done so, that there was fraudulent evasion of VAT.

(2) the Appellant neither knew nor ought to have known that the transactions were connected with the fraudulent evasion of VAT.

THE LAW

11. There is no dispute between the parties in relation to the applicable law which we summarise in Appendix 1.

THE ISSUES

12. The questions for our consideration are:

- (1) Is there a tax loss? (The tax loss question)
- (2) If so, does the tax loss result from fraudulent evasion? (The fraud question)
- (3) If there is fraudulent evasion, was the Appellant's transaction connected with the fraud? (The connection question)
- (4) If it was connected, did the Appellant know or should the Appellant have known that its transactions were connected with fraud? (The knowledge question)

13. The Respondents accept that the burden of proof is on them and that the standard of proof is the balance of probabilities.

14. The Appellant's position on the issues is set out in the Notice of Issues. The Appellant does not accept that:

- (1) In relation to all the transaction chains, any default by the specified defaulter was a fraudulent VAT default because the evidence served by the Respondents does not prove to the requisite standard that that was the case.
- (2) In relation to transaction 5, that the evidence served by the Respondents demonstrates to the requisite standard that the chain traces back to the alleged defaulter.
- (3) The evidence served by the Respondent demonstrates to the requisite standard that the Appellant knew or ought to have known that its transactions were connected with fraud (if, indeed, they were so connected.)

15. The Respondents position is that all four questions, detailed at paragraphs 12 above, should be answered in the affirmative and, consequently, that the right to deduct input VAT in relation to these transactions is lost.

THE EVIDENCE

16. We had documentary evidence contained in some 11 volumes and a bundle of authorities.

17. The Respondents relied upon witness statements produced by:

- (1) Officer Fazakerley
- (2) Officer Lahi
- (3) Officer Tosta
- (4) Officer Lewis
- (5) Officer Rogers
- (6) Officer Ramesh
- (7) Officer Stock , and
- (8) Officer Styles-Coles.

18. Officers Fazakerley, Lahi, Tosta, Lewis and Rogers gave oral evidence before us. Officer Ramesh did not attend, but her statement was adopted by Officer Stock who did give oral evidence. Each was cross examined by Mr. Gibbons on behalf of the Appellant and there was also an opportunity for us to ask questions.

19. Officer Styles-Coles' evidence was agreed and she was not required by the Appellant to give oral testimony.

20. Evidence on behalf of the Appellant was given by Mr. Cooke. He produced a witness statement which he adopted as his evidence in chief. He was cross examined by Mrs. Newstead-Taylor on behalf of the Respondent and we had an opportunity to ask him questions.

Respondent witnesses

21. The Respondents' witnesses provided evidence in relation to the companies and transactions in the deal chain which they conclude to be fraudulent. For ease of reference this deal chain and the transactions therein are summarised in Appendix 2.

Officer Fazakerley

22. Officer Fazakerley produced three witness statements and her evidence can be summarised as follows:

(1) She is a Higher Officer at HMRC and from 2013 to 2017 she was a member of the Missing Trader Intra Community (MTIC) team in the Fraud Investigation Service.

(2) The Appellant had been subject to monthly monitoring since 2011 and she became the responsible officer for the Appellant from September 2015. Monitoring includes regular visits, checking the credibility of transactions and discussing due diligence.

(3) She first visited the Appellant on 23 October 2015 when she met Mr. Cooke and Ms. Ranson (the Appellant's Finance Director at the time). From her notes of the meeting she recalls:

(a) that in response to a question about whether or not there had been any change to their usual business activity Mr. Cooke said that they had purchased 500 reconditioned mobile phones from E&R, but that these had been of poor quality and not as described so approximately 40% of these had been returned to E&R and they were awaiting a refund of approximately £30,000.

(b) Mr. Cooke said that there had not been any back to back deals.

(4) Following the receipt of detailed VAT reports and sales invoices for Mr Site (from E&R and to EWBT) Officers Fazakerley and D'Rozario visited the Appellant on 15 March 2016 and she recalls the following from her notes:

(a) Mr Cooke dealt with Richard Plunkett at E&R.

(b) Pyramid made a mark-up of about 4% on the sale of Mr. Site.

(c) EWBT had to pay up front before the goods were shipped. However, they had delayed making payment for the previous transactions and this had caused problems with having to store the goods before export. Mr Cooke said this had led to a 'falling out' and he no longer traded with them.

(d) Officer Fazakerley pointed out that invoice number 35178 showed that they (Pyramid) had charged VAT when they shouldn't have done as it was an export. Mr Cooke said they would have corrected that before the invoice was sent to the customer.

(e) Mr Cooke said the Mr Site deals were the only back to back trade that they had done. He said if they were considering doing back to back deals in future then they would inform the Respondents in advance.

(f) Mr Cooke confirmed that E&R had repaid them the £30,000 for the substandard mobile phones which they had returned to them (as mentioned in the visit report dated 23 October 2015).

(5) On 11 August 2016 Officer Fazakerley, together with Officer Healy, visited the Appellant. This time Officer Fazakerley's notes show the following questions put to Mr. Cooke and the responses that he made:

(a) Question 1 - How had he heard about Mr Site?

Answer- it is massive in Asia; they sell loads of it there.

(b) Question 2 - Had he tried to sell it in the UK?

Answer- no.

(c) Question 3 - What does Mr Site do?

Answer- it's just a website in a box (no further description given).

(d) Question 4 – I showed Mr Cooke invoice number 89 showing the names of the different Mr Site products and asked what the product code or version number was.

Answer- they are the only versions. When asked if he had checked he said no.

(e) Question 5 - What hardware is Mr Site compatible with?

Answer- He didn't know, had not looked into it and it did not interest him.

(f) Question 6 - Did he get a sample or demonstration CD?

Answer- he did not have a sample and had not seen it working.

(g) Question 7 - Had he approached any other suppliers?

Answer- Mr Cooke said 'no, you don't do that in this business, nobody would deal with you if you did. His supplier is trusted and he has known him for 15 years'. (This was in reference to E&R). This contradicts what Mr Cooke had previously told me about another product he dealt in.

(h) Question 8 - How did Pyramid advertise for a customer for Mr Site?

Answer- Mr Cooke said he had been offered the product, he then put out an email as he usually would.

(i) Question 9 - Were Pyramid still doing much trade with E&R?

Answer- No, E&R owed Pyramid approximately £4,000 from return of faulty goods (reconditioned mobile phones) and they had not paid the money back. Mr Cooke said he could not trade with them unless they pay on delivery. E&R were having problems because the director had been ill and was going through an expensive divorce. He would trade with them in the future if things changed.

(6) She identified the deal chain and concludes that Deal 1 leads back to Ren and deal 2-5 lead back to Presence. She also identifies the other parties in the transaction.

(7) Under the heading appellant's general awareness of MTIC fraud Officer Fazakerley says, in her statement, that the Appellant through Mr Cooke should have been fully aware of the risk associated with MTIC fraud by reason of the following:

(a) Warning letters about MTIC fraud were sent to the Appellant on 26 February 2007, 5 March 2009 and 17 December 2012.

(b) On 16 January 2008 a copy of VAT Notice 726 was given to Mr. Cooke.

(c) On 16 January 2008, 20 February 2009, 28 October 2010, 12 June 2013 and 29 October 2013 the Respondents' officers visited the Appellant and discussed:

(i) MTIC fraud, and

(ii) the need to conduct due diligence to verify the origin of the goods purchased.

(d) On 26 May 2011 the Appellant was placed under MTIC monitoring and was informed of this by letter which also set out that the common characteristics of MTIC fraud can be found on the Respondents' website.

(8) Under the heading 'Mr Site Software' Officer Fazakerley sets out the following in relation to the software:

(a) On around 30 January 2017 James Shulter and Adam Smith (directors of Paragon Internet Group Ltd) told officers of the Respondents that:

(i) They had acquired Mr. Site from the previous owner Beatrice Hatherley; and

(ii) prior to 2005 there was a boxed version of Mr Site which was sold into retailers such as Currys and PC World, but is now sold online normally on an individual basis.

(b) Following enquires made by the Respondents Beatrice Hatherley informed the Respondents that:

(i) they had designed Mr Site themselves and originally sold the product as a boxed version;

(ii) however the boxed version of Mr Site became unfashionable and it became costly to store;

(iii) so they sold the boxed versions of Mr Site in bulk to a company called Lilanch Ltd on 11 December 2014 at discounted rate of £1.50 per item with the total number of items being 11,268.

(c) On around 8 March 2017 the Respondents officers visited Lilanch and obtained the following information:

(i) Lilanch purchased the software from Mr Site and sold it to GSFx, one of the companies included in the deal chain.

(ii) Lilanch produced 3 sales invoices made out to GSFx. Invoice number 1455 dated 11 December 2014 described the goods as batteries and the quantity was 11,268. The quantity matched that on the Mr Site

sales invoice but when asked why the items sold were misrepresented no reason was given. The selling price was £2.50 and £2.75 per item.

(iii) Invoice 1458 also dated 11 December 2014 showed the quantity of Mr Site sold as 23,986. The description of the goods was Mr Site Pro, Mr Site Standard and Mr Site Beginner. The selling price was £2.35 per item.

(iv) Invoice number 1715 dated 03 June 2015 showed the quantity of 'Assorted Software' as 24,531. The unit price was £1.50.

(9) Under the heading due diligence on E&R Officer Fazakerley says the following in her statement:

(a) During a visit of 28 October 2010, when asked about what due diligence had been done on E&R the following answer was given: 'the relationship was struck up via Tony Croxley (TC) whom they had known for a long time through his previous business (Sense Wear and Chris Cross). After his previous clothing business had gone into liquidation he had set up Mistral. MC said no due diligence was needed because of the previous business relationship with TC. Pyramid's contact at Mistral was Richard Plunkett'.

(b) On 20 April 2017 Mr Cooke sent to Officer Fazakerley the following information from the due-diligence he had undertaken:

(i) Printed copy from Companies House showing the change of name of MPM to E&R. It was not possible to tell when this was obtained.

(ii) A photocopy of what appears to be a letter of self-promotion. It is not addressed to Pyramid nor mentions Pyramid within the text. There is a hand written note showing a date 30/06/14 saying 'checked VAT no on VIES all ok'.

(iii) A photocopied piece of paper showing bank details for E&R.

(iv) A photocopy of E&R VAT certificate.

(v) A photocopy of Richard Plunkett's driving licence.

(vi) A photocopy of Richard Plunkett's passport.

(vii) A copy of MPM's abbreviated company accounts for the period 1 December 2011 to 31 March 2013 which were sent to Companies House on 20 August 2013.

(viii) A copy of E&R's abbreviated company accounts for year ending 31 March 2015, it is not clear where these originated from but are available from Companies House and were submitted 21 December 2015 which was after all the deals took place. These accounts showed that E&R had fixed assets of £1,351, debtors of £306,261 and liabilities of £389,101.

(ix) A copy of the Annual Return dated 8 November 2014 which was received for filing at Companies house on 3 February 2015. It shows who the directors are and that Richard Plunkett is a shareholder.

(10) Under the heading 'due diligence on East West Bridge Trading' Officer Fazakerley says that the following was provided by the Appellant as evidence of its due diligence:

(a) An email of introduction dated 19 January 2015 to Mr Cooke from wang@eastwestbridgetradinglimited.com stating that they are looking for niche software and fast moving consumer goods.

(b) A copy of a certificate of incorporation in the Republic of Seychelles dated 4 March 2013 showing the company number as 120538.

(c) A certificate of incumbency from the Seychelles dated 10 April 2013 giving the name of the director as Wang Xiao Gang.

(d) A share certificate showing Wang Xiao Gang, the director, holding 1,000,000 shares. This gives the director's address as being in Hainan Province China. This is approximately 500km from the address of EWBT in Hong Kong.

(e) A photocopy of a passport in foreign language.

(f) A copy of a HSBC bank account statement listing transactions between 1 October 2013 and 8 November 2013 giving a closing balance of 1,909.31 USD. The last entry shows a charge for insufficient funds.

(g) A print out from a website for a company called East West Bridge Trading Limited. This shows the company registration number as 2204340, the date of incorporation 16 February 2015 and that shares are registered in Hong Kong. Neither of these match the Certificate of Incorporation. The address is also different from that on the invoices.

(h) An email from Mr Cooke to Ms Cooke dated 19 January 2015 saying 'can you check these'.

(i) An email dated 19 January 2015 to HMRC Validation Unit enquiring how to validate East West Bridge Trading (Seychelles). On 30 January 2015 the Validation Unit replied to say they were unable to validate companies outside the EU and suggested contacting the VAT General Enquiries Line, alternatively there may be companies on the internet that offer information services for global companies.

(11) Officer Fazakerley says that during her visit to the Appellant's premises on 11 March 2016 Mr Cooke did not say that he had inspected the Mr Site product.

(12) Officer Fazakerley, in her statements, also offers her views on why she thinks that the scheme of trading is contrived and sites factors such as delay, deal documentation (or lack of), transport and storage, insurance, payment, terms and conditions and comparison of sales value. Whilst it is useful to know how an experienced officer such as Mrs Fazakerley approaches the matter that is before us; we should, on these issues, prefer to make up our own minds. As such these issues are discussed later in our decision.

23. Officer Fazakerley was cross examined on behalf of the Appellant. During cross examination Officer Fazakerley accepted that in the meeting of 11 August 2016 when she asked question 5 (what hardware is Mr Site compatible with?) the question was about hardware and not software. Accordingly, Mr. Site could possibly be compatible with any hardware. She also accepted that Mr Cooke's answer to question 7 (had he approached any other suppliers?) may not have been contradictory in light of the further explanation provided by Mr. Cooke about

moving to suppliers who might still be the beneficiary of bonus schemes from the manufacturers. However, she had made her evaluation based upon the information that she had at the time.

24. In relation to the information provided by Paragon Officer Fazakerley conceded that Paragon only sold online and that there was no facility for it to wholesale on line. As such it was accepted by Officer Fazakerley that the comparison between the Mr Site product available online and the boxed version was not comparing like with like.

25. When cross examined about the due diligence carried out by the Appellant Officer Fazakerley accepted that it was not unreasonable for the Appellant not to extend its checks on its suppliers and purchasers to those further up or down the supply chain. She further accepted that a supplier may not want to answer, and may not answer, questions which might reveal who its supplier was for commercial reasons.

26. Officer Fazakerley was further cross examined on her views on the adequacy of due diligence, the commerciality of the transactions and promptness of payment. As we have indicated earlier these are matters on which we would prefer to make up our own minds.

27. Our overall impression of Officer Fazakerley was that she was an honest, straight forward and reliable witness. There was no attempt by her to “*gild the Lilly*” and she made appropriate concessions during cross examination when it was necessary for her to do so.

Officer Lewis

28. Officer Lewis gave evidence in relation to Ren, the defaulting trader in Deal 1. His evidence can be summarised as follows:

- (1) He has been with the Respondents since 2007 and worked as a member of the specialist investigation team into MTIC fraud between April 2007 and January 2012.
- (2) Ren was incorporated on 27.11.13 and its first director on incorporation was Mohammed Ikhlaiq who resigned on 25.11.14. Mohammed Ashfaq Hussain was then appointed as director until 01.12.14. Vitoria Bogdan, a Romanian national, was appointed as director and remained as such until Ren’s dissolution on 23.08.16.
- (3) Ren became VAT registered on 2.12.13 and described itself in VAT1 as a ‘Hard metal tipped tools (manufacture)’, estimated its turnover as £200,000 p.a. and did not declare any EC trade.
- (4) Ren acquired the Mr Site software and then on 26.01.15 sold the software to TLP at a cost of £198,943.48 plus VAT of £39,788.70. Ren failed to account for the VAT in respect of the sale.
- (5) Ren’s final return for the period 01.12.14 to 26.02.15 showed sales of £17,831,969, purchases of £17,976,376 and a repayment of £3,515.45.
- (6) He conducted an unannounced visit on 26.02.15 and spoke with an employee who advised that the director was Mr Hussain, despite the fact that Mr Hussain had resigned on 01.12.14. He was unable to contact Mr Hussain or Miss Bogdan. Accordingly, Ren was given a “7 day letter” requiring Ren to contact HMRC within 7 days or deregistration would follow.
- (7) On the same day he also visited Ren’s second registered address, 205 Fairgate House. This was a serviced office block. The list of the businesses present within the building did not list either Ren or Ren’s agent.
- (8) Ren did not make contact and, consequently, on 06.03.15 Ren was de-registered as a missing trader with effect from 26.02.15.

(9) On 11.05.15, Ren was notified that its final VAT return had been selected for verification. Ren was asked to provide the business records that substantiated the figures in the VAT return. Ren was advised that, in default, the Input Tax would be reduced to nil. A reminder letter was sent on 27.05.15.

(10) On 11.06.15, following no response from Ren, Officer Lewis denied the input tax of £3,562,878.47 claimed in the final VAT return and adjusted the net VAT due from Ren to £3,562,878.

(11) Ren did not challenge the decision, seek a reconsideration or appeal the decision. It has never made any payment in respect of the liability and its VAT debt pre-dissolution on 23.08.16 was £3,571,664.55.

(12) He concludes that Ren appears to have disappeared from its declared principal place of business, he has been unable to locate the directors who have made no contact, he was told that the directors were not there when he had visited the premises and he had received mail returned as undelivered indicating that 'attendee gone away'.

29. When cross examined Officer Lewis was asked if there were any additional indicators of fraud. He responded by saying that Ren had moved into trading in high risk commodities, there were missing VAT returns and after he had visited and spoken to a director that director subsequently resigned.

30. Our impression of Officer Lewis was that he was an honest and credible witness.

Officer Lahi

31. Officer Lahi's evidence can be summarised as follows:

(1) She has been with the Respondents since September 1991 and has been in the MTIC team since April 2012.

(2) Her statement relates to E&R (the company from whom the Appellant purchased Mr Site). The company has undergone a number of changes of name over the years.

(3) On 15.04.13 Richard Plunkett was appointed as director of E&R.

(4) It is fair to say that the Respondents had numerous concerns about E&R's due diligence.

(5) On 10.09.13 E&R was placed on continuous monitoring.

(6) E&R had longstanding and unpaid VAT debts.

(7) E&R bought Mr Site from XG, a UK based company, and sold to it the Appellant, again a UK based company. The transaction was carried out in Euros.

(8) On 29.09.16, E&R was de-registered for VAT with effect from 30.09.16 and its VAT registration was cancelled on 10.11.16.

32. During the course of cross examination Officer Lahi was asked why a transaction in euros might arouse suspicion. She replied that this was not in itself suspicious, but might become so when both the companies are based in the UK. She accepted that there might be many reasons why a director might not contest deregistration, but that directors were known to change company names and companies in order to avoid detection in a fraudulent chain.

33. We found Officer Lahi to be a reliable and credible witness.

Officer Tosta

34. Officer Tosta's evidence can be summarised as follows:

(1) He has been with the Respondents since April 2001 and is currently a member of the FIS team which covers investigations into MTIC fraud.

(2) His statement concerns itself with Global, an alleged “buffer” in the chain, which registered for VAT on or around 21 June 2006.

(3) Khalid Hussain was appointed as a director of Global on or around 15 May 2006 and remained so throughout all relevant periods. On 22.03.18, he received an 11 year directors disqualification undertaking for causing or allowing Global to participate in transactions connected with the fraudulent evasion of VAT- such connections being something which he either knew or should have known about.

(4) Mohammed Urfan was Global’s director from 22.06.07 - 01.08.07. On 05.01.11, he received a 14-year directors’ disqualification for causing Stonewhite Digital Limited to be involved in MTIC fraud.

(5) A visit on 16.04.15 identified that Global’s trade had numerous MTIC indicators. Specifically, (i) Global’s turnover and purchases had increased dramatically, (ii) goods were not stored at the business premises but at a freight forwarder, (iii) Global did not have insurance believing the goods were insured by the freight forwarder, (iv) full inspections were not conducted on the goods and (v) Global did not use HMRC’s validation unit for due diligence.

(6) 40 of Global’s transactions carried out from 08.05.14 to 03.02.15 lead back to tax losses totalling £607,131.

(7) On 14.07.15, Global was found to have been involved in the sale of carouselled goods, namely Go-Pro cameras, supplied by Askos. Despite this, Global continued to trade with Askos who were Global’s main supplier at 26.08.15.

(8) Global’s deal sheets for 01-31.08.15 did not include the sale and purchase of Mr Site (Deal 5).

(9) Global failed to provide business records upon request.

(10) On 12.02.16, tax loss letters were issued to Global in the total amount of £1,548,989.

(11) On 23.02.16, Global was compulsorily de-registered under the abuse principle.

(12) On 06.09.16, the Respondents issued a penalty against Global in the sum of £329,386.55 for a deliberate inaccuracy. On 24.10.16, a personal liability notice in the sum of £329,368 was issued to Khalid Hussain.

(13) On 22.09.16, Global entered voluntary liquidation owing VAT in the sum of £1,001,952.89.

35. He orally confirmed that Global did not have any storage facilities of their own but used a warehouse, had goods in its possession for a few days, did not carry out inspections (and the bank statements showed no payments in relation to inspections), did not think it consistent with Global business model to hold stock for any length of time and that Global would be paid by its buyer before paying its supplier.

36. In cross examination Officer Tosta accepted that Global may not have put every transaction through its “books” and that it was possible that there was a transcription error on the invoices from Lilanch to Global [pages 2/322 and 2/323] such that the invoice relating to batteries actually referred to Mr Site and vice versa.

37. We found Officer Tosta to be a reliable and honest witness.

Officer Stock

38. Officer Stock adopted the witness statement of Officer Ramesh. Their evidence can be summarised as follows:

- (1) Officer Ramesh' statement concerns itself with Presence, the default trader in Deals 2-5.
- (2) Presence was incorporated on 14.12.05 and VAT registered on 01.06.06.
- (3) On 25.09.14, Joshua Hendry was appointed director of Presence. Mr Graham Hendry was reappointed as a director on 1 January 2015.
- (4) In a visit to the principle place of business on 05.11.14 and upon speaking to Mr Joshua Hendry the officers noted that: (i) the only proposed trading partner was on continuous monitoring, (ii) it was unclear what role Presence plays as part of the transaction chain and (iii) it was unclear what value Presence brings.
- (5) Presence acquired the Mr Site software VAT free from the EU and sold it on to Global charging VAT.
- (6) On 02.03.15, Presence was placed on the MTIC monitoring project.
- (7) On 13.03.15, Presence was placed on monthly VAT returns and failed to file returns for 03/15 through to 11/15.
- (8) A visit on 16.03.15, identified that Presence had (i) no contracts in place with its trading partners, (ii) no contingency plans if a provider / supplier fell through, (iii) Messrs Graham and Joshua Hendry had little understanding of the technical aspect of the trade, (iv) no due diligence was undertaken, (v) Presence had no commercial use in the chain.
- (9) A visit on 18.09.15 identified that (i) Presence did not carry out an inspection of the goods, (ii) Presence is paid by its customer first and then pays its supplier, (iii) Presence carried out no research on products prior to sourcing, (iv) Presence did not have supporting documentation to ratify the deals, (v) Presence's bank statements appear to have been altered (vi) there is a risk that the entire VOIP aspect of the business was fabricated as Presence had no capacity to run VOIP and no payment for the service could be evidenced, (vii) Due diligence was a mere tick box exercise, (viii) Graham Hendry was a puppet director.
- (10) On 17.11.15, Presence could not be found at either its place of business or registered address. The address provided for Presence's accountants was false.
- (11) On numerous occasions Presence failed to provide complete business records when requested to do so.
- (12) Assessments were raised in respect of Deals 2, 3 and 4:
 - (a) On 24.02.17 Presence was assessed for £49,814.40.
 - (b) On 16.10.15, Presence was assessed for £47,656.40.
 - (c) On 24.02.17, Presence was assessed for £19,324.85.
- (13) The assessments remain unpaid and have not been appealed. On 16.05.16, Presence was wound up owing the Respondents £390,030.88.

Officer Rogers

39. Officer Rogers' evidence was agreed by the parties so she was not required to give oral evidence. Her evidence dealt with TLP in the deal chain and shows that TLP was deregistered for VAT on 2 April 2015 and was struck of the company register on 24 May 2016.

Officer Coles

40. Likewise, Officer Cole's evidence was also agreed and so she was not required to give oral evidence. Her evidence dealt with XG in the deal chain and shows that XG was compulsorily deregistered on 31 July 2016.

Appellant's evidence

41. The Appellant relied upon the evidence given by its director, Mr Cooke. He produced a witness statement and gave oral evidence. A summary of his evidence is as follows:

(1) Mr. Cooke is the sole director of the Appellant and is the sole shareholder with voting rights.

(2) The Appellant operates a simple IT distribution model. It has two sides to the business: (1) purchasing computer hardware in volume and then distributing through its database of customers and (2) the purchase and resale of computer software.

(3) The "back to back" business began in around 2011/12 and the Appellant always stuck to products that he knew. Between May 2011 and November 2016 the Appellant conducted some 85 or so "back to back" transactions.

(4) There are many suppliers to the business and these include Richard Plunkett (in his various guises – E& R and Mistral). Mr. Cooke has known and dealt with Mr. Plunkett for some 15 years and the Appellant has completed thousands of transactions with him.

(5) In respect of the present transactions the terms were that the Appellant would take delivery of the goods to complete a full inspection and once the Appellant had been paid by its customer it would pay E&R.

(6) It is the Appellant's policy to:

- (a) never ship any goods for export without advance payment,
- (b) fully inspect all goods,
- (c) conduct due diligence on all trading partners,
- (d) check how customers and suppliers located the Appellant,
- (e) complete credit checks where possible,
- (f) use Google Earth to check the location, and
- (g) visit companies where possible.

(7) In respect of the 5 transactions concerning this appeal the Appellant put out a "broadcast" on Broker Bin (a platform where members can buy, sell and research new and used IT related hardware).

(8) On 19 January 2015 Mr Wang of EWBT contacted Mr. Cooke by telephone. Mr. Wang was responding to the broadcast advertising. He seemed to be knowledgeable about the software market. He sold software into large retail customers around Asia. He said that the Chinese market is huge for self-build websites. He was aware of the Appellant in the UK.

(9) Afterwards most of Mr. Cooke's communication with Mr. Wang was by email because it was difficult for Mr. Cooke to understand Mr Wang (as his first language was not English) and because the time difference meant that he was difficult to get hold off.

(10) Transaction 1 started with an email of "formal introduction" sent by Mr. Wang on 19 January 2015 and the subsequent emails confirm the details. Mr. Wang wanted the goods to be shipped to his "freighter" in Singapore. He did not quite understand the process it having to be explained to him by Mr. Cooke that he first needed to send through a purchase order. Mr. Cooke sent Mr. Wang a copy of the Appellant's terms and conditions, but he cannot now see which email they were attached to. There was some delay in receiving payment, but this was eventually received on 4 February 2015 and the goods dispatched on 13 February 2015. On the same day Mr. Cooke asked Mr. Wang for bank details in order to make a partial refund because when the goods had arrived at the Appellant's warehouse there were only 1926 pieces, a shortfall on the order.

(11) Transaction 2 started on 12 March 2015 with Mr. Cooke being offered more Mr. Site software by Mr. Plunkett. Mr. Cooke contacted Mr. Wang by email the same day. The email chain shows the details of the correspondence, but it is fair to say that there was delay in Mr. Wang sending payment which resulted in Mr. Cooke becoming frustrated. The money eventually arrived on 23 April 2015 and the goods were shipped on or around 27 April 2015 to the same address as the previous goods.

(12) Transaction 3 started towards the end of May 2015 with Mr Plunkett offering Mr. Cooke more Mr. Site software which Mr. Cooke offered to Mr. Wang on 28 May 2015. This time Mr. Cooke quoted in Euros because Mr. Plunkett had asked for payment in Euros. Mr. Wang was happy to pay in Euros. This time Mr. Wang asked to amend his order so as to reduce it. Rather than split the stock Mr. Cooke offered a 1% discount which Mr. Wang accepted. There was a delay in payment once again and payment was eventually completed on 10 June 2015. The goods were eventually shipped by the Appellant to Mr. Wang's "freighter" in Dubai.

(13) Transaction 4 commenced around 30 June 2015 when Mr. Cooke offered Mr. Wang 545 units of Mr Site Seller and 609 units of Mr. Site Pro with these units already having been offered to him by Mr. Plunkett. Again Mr Wang wished to purchase and again there were difficulties with payment that caused delay. This time payment was received on around 31 July 2015 and the goods were duly shipped at around the same time.

(14) Transaction 5 commenced 29 July 2015. This time Mr Cooke was wary and said that he might be able to get some more Mr Site software, but would need 100% confirmation that he would get paid. On 30 August 2015 Mr. Wang emailed to say that he wanted to know the price, that payment would be made in GBP and that he would send a purchase order. Again there was delay caused by lack of payment by Mr. Wang and Mr. Cooke expressed his frustration, as shown by the email chain. Payment was eventually received in full on 27 October 2015 and the goods shipped on 28 October 2015. By this time Mr. Cooke had had enough and he decided not to do anymore business with Mr. Wang.

(15) Mr. Cooke conducted due diligence on EWBT and the documents received for the latter are as set out at paragraph 22(10) of this judgment. He was not totally happy with this and therefore asked Ms. Cooke to seek help from HMRC by making a request for validation. Whilst still not happy with the due diligence Mr. Cooke decided that because

the commercial risk had been ameliorated with a payment upfront being sought he should trade with EWBT.

(16)The due diligence that Mr. Cooke said was conducted on E&R is set out at paragraph 21(9) above. Mr. Cooke accepts in his statement that his due diligence of E&R was minimal; although he did attempt to row back somewhat from his original pronouncement saying that perhaps he had been a little unfair on himself.

(17)The shipments made to EWBT were adequately insured and each delivery inspected.

(18)Mr. Cooke can only know about 3 people in any supply chain: his customer, himself and his supplier. He did not ask Mr. Plunkett about his supplier because he didn't think Mr. Plunkett would give him that information because armed with that information he could cut out Mr. Plunkett.

(19)Mr Cooke did not see the need for formal written contracts for each transaction because he felt that a purchase order, pro-forma invoice and the terms and conditions are as good as a formal contract. Formal contracts would complicate his business and slow down the transactions where speed was crucial.

(20)The Appellant had been on HMRC's monitoring scheme since 26 May 2010, but was removed on 19 July 2019.

42. Mr. Cooke was cross examined over a period of two days by Mrs. Newstead-Taylor and his key responses can be summarised as follows:

(1) He accepted that the "back to back" business was an addition and not the core business. The margins were low (1-4%) for "back to back" compared with 25% for hardware and 10% for software in standard transactions (the "bread and butter" side of the business). "Back to back" deals would have to be done in volume to make a decent profit. Speed was important, but more so was the fact that you don't lose the deal.

(2) There was a cost involved in storing stock and you do not want to be sat on stock.

(3) The Appellant does not verify VAT numbers on the 'bread and butter' side of the trade because it is commercially impossible. There are over five hundred suppliers and four thousand buyers. However, he always verified the "back to back" deals. This was later amended to 99% of the time when it was pointed out to him that no verification had been conducted for Melon Telecom Ltd at the time of the deal and that the Appellant appeared to have been trading with Early Markets Ltd before a VAT verification had been received from HMRC. Mistral was likewise not verified until after trading had commenced.

(4) There was no note on the CRM or anywhere else of his discussions with Mr. Plunkett who first contacted him about the Mr Site stock.

(5) Mr. Wang's first contact was in response to a broadcast about Mr. Site. It was a general broadcast with only 4 lines on Mr. Site.

(6) It did not concern Mr. Cooke that EWBT was incorporated in the Seychelles. He did not check where Mr. Wang lived and did not get any document translated.

(7) He accepted that he was not happy about the due diligence on EWBT, but it was Michelle's job to check and it was right that he did not wait for a response from HMRC's verification unit before commencing with the transaction.

(8) He did not just carry out “tick-box” due diligence on his suppliers and customers. Proper credit should be given for how well he knew the supplier / customer and the length of trading history was important.

(9) There were no negotiations with Mr. Wang because he was happy with the price being paid for Mr. Site.

(10)The Appellant would still have continued with the deals if a credit check had been carried out on E&R because of the long standing relationship with Mr. Plunkett.

(11)In deal 4 Mr. Cooke accepts that he placed a purchase order with E&R before he had secured an order from Mr. Wang. He explained that he might have “jumped the gun” and might have been under pressure from his supplier.

(12)Mr. Cooke accepts that he never offered the Mr. Site software to anyone else other than EWBT.

(13)Mr. Cooke was not concerned on learning that the difficulty with payment was that Mr. Wang was waiting on the bank to do a compliance check for the third time.

(14)Mr. Cook accepted that the charge made by the Appellant to EWBT for transit insurance bore no relationship to the cost of the insurance to the Appellant. Mr. Cooke says he was simply trying to make some money.

43. In answers to questions from us Mr. Cooke confirmed that he had learnt that the software was available from E&R, that he had made a broadcast on Broker Bin, Mr Wang was the only purchaser although there had been many who had asked questions, he did not retain details of these other enquiries, and E&R could have subscribed themselves to Broker Bin but that Mr. Plunkett was more comfortable with the Appellant and that Mr. Plunkett was a one man band.

44. When asked for details of the initial and subsequent conversations with Mr. Wang Mr. Cooke said that:

(1) This was the only telephone conversation that he had had with Mr Wang, he spoke to him on Mr Wang’s mobile phone, there were no further telephone calls and specifically, he did not think to contact Mr Wang on the phone to chase him regarding the delayed payments for the Mr Site software.

(2) Mr Wang explained his business background in computer software and consumer electronics and referred to EWBT being his trading company.

(3) He did not know where Mr Wang was when he was speaking with him.

45. Mr. Cooke’s evidence was not, in all parts, satisfactory. On a number of occasions he was forced to say that matters could be explained by an email that was not before us or by “Michelle” who did not appear to give evidence. In addition he was forced to row back on his testimony on more than one occasion. Our overall impression was that where Mr. Cooke’s evidence was directly contradicted by some documentary evidence or the evidence of other witnesses we should prefer the latter over Mr. Cooke’s evidence.

FINDINGS AND DISCUSSION

46. We have already set out above what we perceive to be the issues in this case. There is no dispute between the parties on the applicable law and there is no controversy as to the approach that we are required to take.

The tax loss question

47. The Appellant takes no real issue with the Respondent in relation to the tax loss question. Nonetheless, HMRC must prove that there has been a loss to the exchequer. HMRC identifies Ren and Presence as tax defaulters. In the case of Ren we have considered the evidence provided by Officer Lewis from which it is clear that there is an ultimate loss to the exchequer in the sum of £3,571,664.55. In the case of Presence we considered the evidence provided by Officers Ramesh and Stock from which it was equally clear that there was loss to the Exchequer in the sum of £390,030.88.

48. In each case we have no hesitation in concluding that there was a tax loss to the Commissioners and accordingly answer the first question in the affirmative.

The fraud question

49. The next question for us to consider is whether or not the tax loss resulted from a fraudulent evasion of tax. We accept the Appellant's contention that it is not enough for the Respondents to show that there has been a tax loss. The Respondents must also show that the loss was a result of fraudulent evasion. Neither is it sufficient for the Respondents to show that they 'suspect' fraudulent evasion of tax. The Respondents must show, on the balance of probabilities, that there was an actual fraudulent evasion of tax. We do not understand the Respondents to be arguing contrary to these propositions.

50. The Respondents identify two fraudulent defaulters: Ren and Presence. The Appellant says that in each case the Respondents have failed to discharge the burden upon them to show, on the balance of probabilities, that Ren and Presence had engaged in fraudulent evasion. We respectfully disagree.

51. In relation to Ren, after considering Officer Lewis' evidence, we agree with his conclusion that Ren was fraudulent in its wholesaling of multiple commodities and thereby engaged in the fraudulent evasion of VAT. In particular we note that Ren essentially "went missing" – its directors having failed to provide business records or make any form of contact and ultimately failed to challenge a substantial VAT assessment made in default. We have already commented on the veracity of Officer Lewis' evidence and have no hesitation in holding that, on the balance of probabilities, Ren was engaged in fraudulent evasion. Whilst it may be argued, as it was on behalf of the Appellant, that the tax loss flowed from a failure to produce documents and not necessarily as a result of fraud; this is to take too myopic a view. Of course one of the reasons why the assessment arose was because there was a failure to produce documents. However, the wider picture reveals that the failure to produce documents was part of the scheme of fraud.

52. In the case of Presence we agree with the conclusions reached by Officers Ramesh and Stock. This is because we agree, on the evidence before us, that Mr. Hendry was likely to have been a "puppet" director who had little understanding of the business and failed to carry out appropriate due diligence on customer and/or suppliers, that Presence failed to inspect goods and to provide business records, added little of value to the chain, that its bank statement appears to have been altered and that it gave false information about who its accountants were. In our view it matters little whether the Respondents chose to issue penalties or Personal Liability Notices ("PLNs") against the directors. There may be many reasons (oversight, commercial or policy) as to why penalties and PLNs were not issued in this case. However, there is nothing to suggest that there was any doubt in the minds of the relevant officers as to whether or not Presence had engaged in fraudulent evasion.

53. We have already set out our views on the veracity of Officer Stock's evidence and we have no hesitation in concluding that, on the balance of probabilities, Presence was involved in fraudulent evasion.

The connection question

54. As set out above the Respondent must show that the Appellant's transactions, in each case, were connected to the fraud. Officer Fazakerley was responsible for identifying the deal chain in relation to the five transactions before us. As set out above she gave evidence before us and this part of her evidence was not challenged by the Appellant. We found her to be a credible, honest and competent witness. In addition Mrs. Newstead-Taylor took us, document by document, through the transactions that are said to form the chain.

55. Officer Fazakerley's evidence was, and the documents showed that, Deal 1 could be traced directly to Ren. In the same fashion and for the same reason Deals 2, 3 and 4 could be traced directly to Presence. Having assessed the evidence given by Officer Fazakerley and considered the documents before us we conclude that Deals 1,2,3 and 4 are connected to the fraud(s) identified above. The deal chain is set out in Appendix 2.

56. In relation to deal 5, the Appellant contends that the evidence served by the Respondent fails to demonstrate to the requisite standard that the chain traces back to Presence. The matters relied upon by the Respondent to demonstrate that Deal 5 can be traced back to Presence are as follows:

(1) The email chain obtained from Global Freight shows that Deal 5 involved Mr Site software that passed through a chain identical to those in Deals 2, 3 and 4 in that it involved the same 5 businesses in the same places in the chain.

(2) Whilst no assessment was raised for Deal 5, Officer Ramesh's evidence, as adopted by Officer Stock, confirms that this was because the evidence now relied upon was not available at the time and "*...had that evidence been available, it is likely an assessment would have been raised.*"

57. The Appellant says that the emails which the Respondents rely upon, show that the goods, which were kept at a warehouse owned by a freight forwarder, were released by the parties in the chain to each other. This, it says, is not good enough.

58. The Respondents encourage us to look at the totality of the deals (and their characteristics) together with the surrounding circumstances in accordance with the principles set down in *Red*. In our judgment whilst we would have likely agreed that the emails by themselves might have been insufficient, when we stand back, look at all the circumstances and apply the *Red* principle it is clear to us that the Respondents have discharged the burden upon them. Accordingly, we find that, on the balance of probabilities, Deal 5 was connected with the fraud that we identify above.

59. We have come to these conclusions despite Mr. Gibbon's valiant efforts to persuade us that there was a break in the connection chain. He argued that the documents showed that Global could have had Mr. Site stock that did not come from Ren or Presence and that Mr. Tosta had failed to trace the onward movement of this stock. Accordingly, the Mr. Site stock that passed through the Appellant's hands may not be connected with the tax fraud perpetrated by Ren and/ or Presence. Mr Gibbon, quite properly, put his argument as being no higher than that it might be a 'possibility' that the stock did not come from Ren or Presence. That might be enough were the Respondents required to prove their case "beyond all reasonable doubt" (and even then we would have reservations), but in the instant case the Respondents are only required to prove their case on the balance of probabilities. Another way to ask the question is whether it is more likely than not that the relevant transactions (deals 1-5) are connected with the fraud perpetrated by Ren and/or Presence. When one examines the surrounding evidence (in particular relating to Global's model – no warehouse, generally possession of goods for only a few days, no inspections) the answer becomes clear. The evidence suggests that it is

more likely than not that the transactions are connected to the frauds identified. Mr. Gibbon's argument exposes no more than a possibility that the transactions were not so connected- and that is not, in itself, enough.

The knowledge question

60. The Respondents' contention are twofold. They contend that the Appellant either:
- (1) knew that the only reasonable explanation for the circumstances in which the Mr Site transactions took place was that they were transactions connected with the fraudulent evasion of VAT, or
 - (2) ought to have known that the only reasonable explanation for the circumstances in which the Mr Site transactions took place was that they were transactions connected with the fraudulent evasion of VAT.
61. The Appellant does not accept that the evidence relied upon demonstrates to the requisite standard that it knew or ought to have known that its transactions were connected with fraud.
62. The Appellant was, through Mr. Cooke, clearly aware of MTIC fraud generally and the need to conduct verification and due diligence on its suppliers and customers to establish their legitimacy and credibility. In addition the Appellant was aware of the "indicators" of such fraud which were disseminated by the Respondents to businesses that might be affected by means of notices and mail. We do not understand the Appellant to be seriously arguing to the contrary.
63. The Respondents makes a number of criticisms of the Appellant. However, the most telling is the complete absence of meaningful due diligence carried out on EWBT. Mr. Cooke says that he does not regard due diligence as a tick box exercise and that, by implication, he places much greater weight on other more subjective factors. If that is his general approach then we would have expected him to try and learn a lot more about Mr. Wang and his business. Mr. Cooke only had one conversation with Mr. Wang and he was unable to provide us with any meaningful detail. Even allowing for the passage of time we would have expected him to have recalled more than he volunteered. According to his evidence, Mr Cooke did not seek to ascertain, for example, how long Mr. Wang had been in business for, what the size of the business was, how many employees or offices there were, what Mr. Wang's actual role was, and perhaps who else they might have in common as trading partners. After all it was this sort of detail that was going to give him a "feel" for his customer and comfort in the absence of a 'check box' approach.
64. The documentation provided by Mr Wang is woefully inadequate. The bank statement is two years out of date and nowhere identifies the account holder. It is no answer to say that this means that the bank account must have been open for at least two years and, therefore, this shows some longevity of trading. The point is that the bank account may have been closed just under two years ago and Mr. Cooke would have been none the wiser. Mr. Cooke says that he conducts Google Earth checks on his suppliers. In this case the distance between where Mr. Wang is said to live and where EWBT is said to be based is such that it ought to at least have raised a question in Mr. Cooke's mind. As must have the facts that the ID document provided was in a foreign language and not translated, the share certificate appears to be unsigned and the company details provided in the certificate of incorporation appear to be at odds with those on EWBT website.
65. Mr Cooke did, apparently, have some concerns as he says in his statement that he was not entirely happy with the due diligence; yet he did nothing to address those concerns. These concerns must have been accentuated during the course of his dealings with Mr. Wang when he was told that delays in payment were due to issues with "compliance documents". It must

have occurred to Mr. Cooke that the bank may have had the same concerns that he did and that he ought, at the very least, to revisit the documentation that he had been provided with.

66. It is no answer to say that EWBT were paying upfront and therefore there was no commercial risk. The requirement to carry out due diligence is not, in this case, to protect the Appellant from commercial risk (i.e. risk against non-payment), but also to protect against financial / legal risk (i.e. the risk of a denial of a claim for input VAT). If a company in the Appellant's position does not carry out adequate due diligence then, as Mr. Cooke knew or ought to have known, it risks becoming associated with the evasion of VAT and consequently being denied a claim or claims for repayment of input VAT. The purpose of the due diligence is two-fold and mitigating the risk of non-payment by asking for payment upfront is no answer to the need to verify the purchaser in order to avoid the later denial of a VAT input claim.

67. When it comes to the due diligence on E&R we think that there is less that the Appellant can be criticised for. It is true to say that some of the items collected (passport and letter of introduction) were not required. Equally, of course, the Appellant might have been criticised for not collecting basic ID documentation. A credit check may, of course, have revealed that E&R was in financial difficulty and incapable of engaging in such large deals and, in particular, be in a financial position to wait for payment. The answer that Mr. Cooke gave in his evidence was that he would likely have carried on with the transaction even if the credit check came back negative on the basis of his longstanding relationship with Mr. Plunkett. However, what stands out for us is that Mr. Cooke uses the platform Broker Bin to advertise the sale of Mr. Site. This is a platform that Mr. Plunkett (and therefore E&R) was presumably aware of and could presumably have accessed. Instead Mr Plunkett (via E&R) chooses to sell through the Appellant and deprives himself of a further 1-4% margin whilst still having to wait just as long for payment. When this was pointed out to him Mr. Cooke said that Mr. Plunkett might have preferred to deal with the Appellant and that Mr. Plunkett was a "one man band". From the evidence that was before us we had not understood Mr. Plunkett to be a "one man band", but understood that the businesses that he was involved in were substantial. If Mr. Plunkett was truly a "one man band" then there must have been questions in Mr. Cooke's mind as to how he could make such valuable deals with, presumably, substantial suppliers on terms which require these suppliers to wait for significant periods of time for payment. Alternatively, in our judgment, Mr. Cooke must have wondered why Mr. Plunkett was content to forego a 1-4% margin on the deals so that Mr Cooke ought to have been left wondering whether or not the deal was too good to be true.

68. Mr. Cooke is also criticised for his lack of knowledge about the Mr. Site software and the market for it. To some extent we accept Mr. Cooke's explanation -If he only ordered the product after he was reasonably certain that he had a buyer (signified by the receipt of a purchase order) and was not at risk of holding unwanted stock (because he could return it to E&R if not sold) then he might be forgiven for not taking too much of an interest in whether or not Mr. Wang could resell it in "Asia". However, once there is doubt as to whether or not Mr. Wang will actually pay for the consignment the decision not to explore and understand the market and seek alternative customers is inexplicable. Mr. Cooke explained that seeking new customers would have meant going back to square one. However, our understanding of the process was that this simply meant sending out another "broadcast" on Broker Bin or an email using the Appellant's sales database at little additional cost or effort. It may well be the case that Mr. Wang would have become aware of the broadcast (in the same way that he picked up the original), but that does not mean that he would become alert to the fact that his consignment was now being offered for sale or that he would cancel his order as a result. In the first place he can hardly expect the Appellant to sit on his order indefinitely and to find that his consignment was up for sale might well have spurred him into action (rather like the threat of

storage costs). Secondly, our understanding of the original broadcast was that it was in general broad terms and did not specify quantities so that a repeat of it would not have caused Mr. Wang to think that it was his particular consignment that was being offered for sale. It seems to us that either there was a limited market for the software (in which case it made sense to persevere with Mr. Wang as he might be the “only game in town”) or there was a larger market that the Appellant inexplicably failed to explore. In the case of the former it was, of course, incumbent on Mr. Cooke to exercise greater caution as the lack of a market for the software is an indicator of MTIC fraud (see VAT Notice 726).

69. The Respondent also makes a number of other criticisms::

(1) The Appellant places a purchase order with E&R before receiving a purchase order from EWBT. This is contrary to the way the deal is supposed to be structured, but might be explained away as an error made in the “heat” of the deal.

(2) The Appellant transacts in Euros with E&R when both companies are based in the UK. There may be nothing wrong with companies doing this, but no plausible explanation is offered by the Appellant as to why this happened. It would seem to involve additional administration (conversion of currency) and introduce exchange rate risk. The latter of which meant that on at least one occasion the price had to be re-quoted. All this adds, ultimately, to greater cost which needs to be absorbed into very tight margins.

(3) To a greater or lesser extent, there are significant delays in payment and therefore in the transactions completing, in all deals. We wholly accept the Appellant’s argument that if the deals had completed like clockwork the Respondents would have seized upon this as evidence that the transactions were contrived. However, during all the apparent frustration at the delay, as evidenced by the email trails, Mr. Cooke never once seeks to pick up the telephone to Mr. Wang to try and resolve matters. Of course there are time differences and there might be problems with language which may make such a call difficult; but Mr. Cooke and Mr. Wang had managed to speak in the first instance and there is nothing to suggest that a second call would not be possible. If Mr. Wang was avoiding Mr. Cooke (as seems to be suggested in one email) then that is (a) more reason to try calling instead of just emailing again and (b) good reason for Mr. Cooke’s suspicions to be aroused.

(4) The Appellant is criticised for lack of or inadequate insurance. This might well have been the case, but we accept that the Appellant thought that he had sufficient insurance cover and that he did all that could reasonably be asked of him by notifying his broker as to his insurance requirements. We accept, on the balance of probabilities and given the email provided by the insurance broker that the consignments were insured. Mr. Cooke accepts that one or more of the consignments might have been slightly underinsured, but he considers that to be a commercial risk worth taking. The difficulty for Mr. Cooke arises from the fact that the amount that the Appellant charges EWBT for insurance fluctuates significantly from transaction to transaction and bore no relationship to the actual cost of insurance. Mr. Cooke’s explanation was that he saw this as a way of making more money. In essence what is being said is that this was a way for the Appellant to make more money by deceiving its purchaser about the true cost of insurance. An admission to engaging in deception of this type damaged Mr. Cooke’s credibility in our eyes.

70. For the sake of completeness we should set out the arguments made by the Respondents that we do not find convincing and our reasons for so finding:

(1) We do not accept that the deals were not in the Appellant’s usual business. They involved the sale, “back to back”, of software which did form part the Appellant’s business – albeit a much smaller part of the whole.

(2) We do not think that any meaningful criticism can be made of the Appellant for not having any excess stock because Mr. Cooke says, which we largely accept, that he would only send a purchase order to E&R once he had a purchase order himself.

(3) We accept Mr. Cooke’s explanation that the same people may be involved in the chain for multiple transactions relating to the same product. In the commercial world relationships are “sticky”. Once parties have found reliable purchasers or suppliers it makes little sense to move to someone else – in essence “better the devil you know”.

(4) The Respondents criticise the Appellant for not entering into contracts to deal with the transactions. The Appellant says that to do so would mean that the deals would take too long to complete and it would not make commercial sense to have lawyers involved in each transaction. The Appellant simply relied upon its terms and conditions. It is doubtful whether the Appellant could, as a matter of law, rely upon its terms and conditions given the way in which the transactions unfolded. However, we are satisfied with Mr. Cooke’s explanation that he thought that he was relying upon them. We are further satisfied with his explanation that in commercial dealings with customers a supplier may not rely upon its strict legal rights (as to termination or right to interest) in order to maintain or better business relationships.

(5) On balance, we accept Mr. Cooke’s evidence that the Mr. Site software consignments purchased by the Appellant were inspected by the Appellant when they arrived at the Appellant’s warehouse. The only criticism that the Respondents offer is that inspection is mentioned for the first time in the Appellant’s witness statement. This in itself is not, in our view, enough to displace the evidence provided by Mr. Cooke. Further, no meaningful criticism can be made of the Appellant with regards to the delivery of the consignments being to places other than the principle place of business of the purchaser. This, unlike payments to third parties, is not a factor highlighted by Notice 726 and in an era of “drop shipping” represents commercial reality for many purchasers and suppliers.

71. We did not understand there to be any difference between the parties as to the approach that we ought to adopt in considering the knowledge question. However, for the avoidance of doubt, we understand the Appellant to be saying that it has and has offered an explanation for the circumstances of the transactions other than a connection with fraud – namely that it entered into the transactions in the normal course of its business. Our understanding of the relevant case law is that in these circumstances it is not enough for the Respondents to show that, on the balance of probabilities, the transactions were connected with fraud, but also that the only reasonable explanation for the transactions is that they were so connected (see for example AC (Wholesale) UK Ltd). That is the approach we have adopted.

72. Taking all of the above factors into account and applying the relevant tests identified in this judgment, we conclude that, on the balance of probabilities, the Appellant ought to have known that the only reasonable explanation for the circumstances of the transactions was that the transactions were connected with fraud. In coming to this conclusion we place particular reliance upon the matters set out in paragraphs 63-68 above. The criticisms of the Appellant that are to be found at paragraph 69 of this judgement are in themselves less telling, however these taken together with those set out in paragraphs 63-68, provide further support for our conclusion.

73. We have not found it necessary, in this judgment, to dissect whether the knowledge attributable to the Appellant was actual (in this case Nelsonian “blind eye” knowledge) or apparent (i.e. the Appellant ought to have known). We have concluded that the Appellant ought to have known and did not feel it necessary to go on to consider its actual knowledge.

CONCLUSIONS

74. For the reasons set out above we dismiss this appeal.

75. We should also like to, publically, thank both Mrs. Newstead-Taylor and Mr. Gibbons for the practical and helpful way in which they conducted this lengthy hearing before us.

RIGHT TO APPLY FOR PERMISSION TO APPEAL

76. 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.

ASIF MALEK

TRIBUNAL JUDGE

RELEASE DATE: 15 JANUARY 2020

APPENDIX 1: THE LAW

Statute & Statutory Instruments

Articles 167 and 168 of Council Directive 2006/112/EC provide:

- “167 - A right of deduction shall arise at the time the deductible tax becomes chargeable.*
- 168 - In so far as the goods and services are used for the purposes of the taxed transactions of a taxable person, the taxable person shall be entitled, in the Member State in which he carries out these transactions, to deduct the following from the VAT he is liable to pay:*
- (a) The VAT due or paid in that Member State in respect of supplies to him of goods or services, carried out or to be carried out by another taxable person...”*

Council Directive 2006/112/EC is given effect in domestic law by the Value Added Tax Act 1994 (“VATA”) and regulations made under it.

The relevant provisions concerning the right of a registered person to deduct input tax from output tax and to be paid or reimbursed the difference are Ss. 24, 25 & 26 VATA and Regulation 29 of the VAT Regulations 1995:

“24 Input tax and output tax.

- (1) Subject to the following provisions of this section, “input tax”, in relation to a taxable person, means the following tax, that is to say—*
- (a) VAT on the supply to him of any goods or services;*
- (b) VAT on the acquisition by him from another member State of any goods; and*
- (c) VAT paid or payable by him on the importation of any goods from a place outside the member States, being (in each case) goods or services used or to be used for the purpose of any business carried on or to be carried on by him.*
- ...
- (6) Regulations may provide—*
- (a) for VAT on the supply of goods or services to a taxable person, VAT on the acquisition of goods by a taxable person from other member States and VAT paid or payable by a taxable person on the importation of goods from places outside the member States to be treated as his input tax only if and to the extent that the charge to VAT is evidenced and quantified by reference to such documents as may be specified in the regulations or the Commissioners may direct either generally or in particular cases or classes of cases;*

25 Payment by reference to accounting periods and credit for input tax against output tax.

(1) A taxable person shall—

(a) in respect of supplies made by him, and

(b) in respect of the acquisition by him from other member States of any goods, account for and pay VAT by reference to such periods (in this Act referred to as “prescribed accounting periods”) at such time and in such manner as may be determined by or under regulations and regulations may make different provision for different circumstances.

(2) Subject to the provisions of this section, he is entitled at the end of each prescribed accounting period to credit for so much of his input tax as is allowable under section 26, and then to deduct that amount from any output tax that is due from him.

26 Input tax allowable under section 25.

(1) The amount of input tax for which a taxable person is entitled to credit at the end of any period shall be so much of the input tax for the period (that is input tax on supplies, acquisitions and importations in the period) as is allowable by or under regulations as being attributable to supplies within subsection (2) below.

(2) The supplies within this subsection are the following supplies made or to be made by the taxable person in the course or furtherance of his business—

(a) taxable supplies;

(b) supplies outside the United Kingdom which would be taxable supplies if made in the United Kingdom;

(c) such other supplies outside the United Kingdom and such exempt supplies as the Treasury may by order specify for the purposes of this subsection....”

“Claims for input tax

Reg 29. —

(1) Subject to paragraph (2) below, and save as the Commissioners may otherwise allow or direct either generally or specially, a person claiming deduction of input tax under section 25(2) of the Act shall do so on a return made by him for the prescribed accounting period in which the VAT became chargeable.

(2) At the time of claiming deduction of input tax in accordance with paragraph (1) above, a person shall, if the claim is in respect of—

(a) a supply from another taxable person, hold the document which is required to be provided under regulation 13;...

provided that where the Commissioners so direct, either generally or in relation to particular cases or classes of cases, a claimant shall hold, instead of the document or

invoice (as the case may require) specified in sub-paragraph (a), (b), (c), (d), (e) or (f) above, such other documentary evidence of the charge to VAT as the Commissioners may direct....”

European Caselaw:

The right to refuse repayment of input tax arises from a series of decisions of the ECJ.

In *Halifax plc v Customs and Excise Commissioners* (Case C-255/02) [2006] STC 919 the Court of Justice found that where tax is evaded by the taxable person himself the criteria of supplies and economic activity will not be met and, accordingly, there would not be a right to deduct input tax in relation to the transactions concerned (“the Halifax Principle.”)

In *Optigen Ltd v Commissioners for Customs and Excise* [2006] Ch 218 @ 47 & 51-52 (“*Optigen*”) it was held that transactions, not themselves vitiated by VAT fraud, did meet the criteria of supplies and economic activity regardless of the possible fraudulent nature of another transaction, prior or subsequent, in the supply chain of which the taxable person had no knowledge and no means of knowledge and, accordingly, there would be a right to deduct input tax in relation to the transactions concerned (“the Optigen Principle.”)

In *Axel-Kittel v Belgium; Belgium v Recolta Recycling* [2006] ECR I-6161; [2008] STC 1537 @ 51-61 (“*Kittel*”) the Court of Justice considered the middle ground between the Halifax Principle and the Optigen Principle; being the situation where the taxpayer himself was not seeking to evade tax, but did have knowledge or means of knowledge of a fraud by someone else. The Court of Justice said:

“...56 In the same way, a taxable person who knew or should have known that, by his purchase, he was taking part in a transaction connected with fraudulent evasion of VAT must, for the purposes of the Sixth Directive, be regarded as a participant in that fraud, irrespective of whether or not he profited by the resale of the goods.

57 That is because in such a situation the taxable person aids the perpetrators of the fraud and becomes their accomplice.

58 In addition, such an interpretation, by making it more difficult to carry out fraudulent transactions, is apt to prevent them.

59 Therefore, it is for the referring court to refuse entitlement, to the right to deduct where it is ascertained, having regard to objective factors, that the taxable person knew or should have known that, by his purchase, he was participating in a transaction connected with fraudulent evasion of VAT, and to do so even where the transaction in question meets the objective criteria which form the basis of the concepts of ‘supply of goods effected by a taxable person acting as such’ and ‘economic activity’...”

In summary, the Court of Justice held that where, having regard to objective factors, the taxable person knew or should have known that he was participating in a transaction connected with the fraudulent evasion of VAT there would not be a right to deduct input tax in relation to the transactions concerned even where the criteria of supplies and economic activity were met (“the Kittel principle.”)

English Caselaw

The Kittel principle has been discussed in a number of English authorities and, in particular, consideration has been given to the knowledge or means of knowledge test.

In *Megtian Limited (In Administration) v the Commissioners for Her Majesty's Revenue and Customs* [2010] EWHC 18 (Ch) @ paras 33 – 38 Mr Justice Briggs clarified the decision of Lewison J in *HMRC v Livewire and Olympia* [2009] EWHC 15 02 – 106 (“*Livewire*”) and stated that it is not necessary to demonstrate knowledge or means of knowledge of the detail of the fraud:

“33. Mr Patchett-Joyce’s submission under Ground 3 was that, in the light of Livewire, it was necessary in any case where a disallowance of input tax was to be made good as against the broker at the foot of the clean chain in a contra-trading case to demonstrate, and for the Tribunal on appeal to find, that the broker knew or ought to have known specifically of one or other of those two aspects of the underlying fraud....”

34. I disagree. I do not read Lewison J’s analysis of the issue as to what must be shown that the broker knew or ought to have known in a contra-trading case as amounting to a rigid prescription that, as a matter of law, such an analysis must be performed in every contra-trading case, such that it will be defective unless it identifies one or other of the alternative frauds as being that which the broker knew or ought to have known.

35. In the first place, Lewison J was, as he made very clear, addressing the question what had to be demonstrated against an honest broker who was not a dishonest co-conspirator in the tax fraud. In the present case, the Tribunal’s conclusion, after hearing oral evidence from and cross-examination of Mr Andreou, Megtian’s shareholder and principal manager, was that Megtian knew that the transactions on which it based its claim were connected with fraud: see paragraph 112 of the Decision. Participation in a transaction which the broker knows is connected with a tax fraud is a dishonest participation in that fraud: see below.

36. Secondly, Lewison J acknowledged that in many if not most cases of contra-trading, the clean chain and the dirty chain were likely to be part of a single overall scheme to defraud the Revenue. As he put it, at paragraph 109: “Indeed it seems to me that the whole concept of contra-trading (which is HMRC’s own coinage) necessarily assumes that to be so.”

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

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

Arden LJ confirmed this in *Fonecomp Ltd v The Commissioners for Her Majesty's Revenue & Customs* [2015] EWCA Civ 39 @ paragraphs 45 -52.

Red 12 Trading Ltd v The Commissioners for Her Majesty's Revenue and Customs [2009] EWHC 2563 (Ch) at paras 109 – 111 (“*Red 12*”) stated that:

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

The Court of Appeal in *Mobilix Ltd (In Administration) v HMRC; HMRC v Blue Sphere Global Ltd,; Calltel Telecom Ltd and another v HMRC* [2010] EWCA Civ 517 (“*Mobilix*”) considered the question of knowledge and held that:

“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 if it turns out that the transaction was connected with fraudulent evasion of VAT then he should have known of that fact. He may properly be regarded as a participant for the reasons explained in Kittel.

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.

61. Such an approach does not infringe the principle of legal certainty. It is difficult to see how an argument to the contrary can be mounted in the light of the decision of the court in Kittel. The route it adopted was designed to avoid any such infringement. A trader who decides to participate in a transaction connected to fraudulent evasion, despite knowledge of that connection, is making an informed choice; he knows where he stands and knows before he enters into the transaction that if found out, he will not be entitled to deduct input tax. The extension of that principle to a taxable person who has the means of knowledge but chooses not to deploy it, similarly, does not infringe that principle. If he has the means of knowledge available and chooses not to deploy it he knows that, if found out, he will not be entitled to deduct. If he chooses to ignore obvious inferences from the facts and circumstances in which he has been trading, he will not be entitled to deduct.

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.”

In *AC (Wholesale) Ltd v The Commissioners for Her Majesty's Revenue & Customs* [2017] UKUT 191 (TCC) @ paragraph 27 the Upper Tribunal (“UT”) stated that “...the ‘only reasonable explanation’ test is simply one way of showing that a person should have known that transactions were connected to fraud.” The Upper Tribunal went on to state that:

“29 It is, to us, inconceivable that Moses LJ's example of an application of part of that test, the 'no other reasonable explanation', would lead to the test becoming more complicated and more difficult to apply in practice. That, in our view, would be the consequence of applying the interpretation urged upon us by Mr. Brown. In effect, HMRC would be required to devote time and resources to considering what possible reasonable explanations, other than a connection with fraud, might be put forward by an appellant and then adduce evidence and argument to counter them even where the appellant has not sought to rely on such explanations. That would be an unreasonable and unjustified evidential burden on HMRC. Accordingly, we do not consider that HMRC are required to eliminate all possible reasonable explanations other than fraud before the FTT is entitled to conclude that the appellant should have known that the transactions were connected to fraud.

*30 Of course, we accept (as, we understand, does HMRC) that where the appellant asserts that there is an explanation (or several explanations) for the circumstances of a transaction other than a connection with fraud then it may be necessary for HMRC to show that the only reasonable explanation was fraud. As is clear from *Davis & Dann*, the FTT's task in such a case is to have regard to all the circumstances, both individually and cumulatively, and then decide whether HMRC have proved that the appellant should have known of the connection with fraud. In assessing the overall picture, the FTT may consider whether the only reasonable conclusion was that the purchases were connected with fraud. Whether the circumstances of the transactions can reasonably be regarded as having an explanation other than a connection with fraud or the existence of such a connection is the only reasonable explanation is a question of fact and evaluation that must be decided on the evidence in the particular case. It does not make the elimination of all possible explanations the test which remains, simply, did the person claiming the right to deduct input tax know that, by his purchase, he was participating in a transaction connected with fraudulent evasion of VAT or should he have known of such a connection.”*

APPENDIX 2: THE DEALS