TC02694

Appeal number: LON/2007/1127

VAT – MTIC fraud - repayment of input tax refused – whether tax loss caused by fraud – held yes - whether Appellant knew transactions connected with fraudulent evasion of VAT – held yes - whether Appellant should have known transactions connected with fraudulent evasion of VAT – held yes - appeal dismissed

FIRST-TIER TRIBUNAL
TAX CHAMBER

DIGIT THREE LIMITED

Appellant

- and -

THE COMMISSIONERS FOR HER MAJESTY'S REVENUE & CUSTOMS

Respondents

TRIBUNAL: JUDGE GREG SINFIELD
NIGEL COLLARD

Sitting in London on 8 - 12 October 2012

Andrew Young, counsel, instructed by Peter Smallwood, VAT consultant, for the Appellant

Adam Hiddleston and Ben Hayhurst, counsel, instructed by the General Counsel and Solicitor to HM Revenue and Customs, for the Respondents

DECISION

Introduction

1. The Appellant ("DTL") was a dealer in mobile phones. This appeal concerns input tax of £394,600.99 incurred by DTL on the purchase of four lots of mobile phones, two in June and two in July 2006, which were sold and despatched to buyers in the EU as zero-rated supplies. Some of the input tax claimed was allowed and the amount in dispute is £393,058.73.

2. HMRC formed the view that the transactions were part of a missing trader intra-community ("MTIC") fraud. A brief description of the type of MTIC fraud alleged/accepted to have occurred here was given by Lewison J in *HMRC v Livewire Telecom Ltd* [2009] EWHC 15 (Ch), [2009] STC 643 at [1] as follows:

> "A trader … imports goods from another Member State. No VAT is payable on the import. Typically the goods are high value low volume goods, such as computer chips or mobile phones. He then sells on those goods to a domestic buyer and charges VAT. He dishonestly fails to account for the VAT to HMRC and disappears. The domestic buyer sells on to an exporter at a price which includes VAT. The exporter exports the goods to another Member State. The export is zero-rated. So the exporter is, in theory, entitled to deduct the VAT that he paid from what would otherwise be his liability to account to HMRC for VAT on his turnover. If he has no output tax to offset against his entitlement to deduct, he is, in theory, entitled to a payment from HMRC. Thus HMRC directly parts with money. Sometimes the exported goods are re-imported and the process begins again. In this variant the fraud is known as a carousel fraud. There may be many intermediaries between the original importer and the ultimate exporter. These intermediaries are known as "buffers". The ultimate exporter is labelled a "broker". A chain of transactions in which one or more of the transactions is dishonest has conveniently been labelled a "dirty chain". Where HMRC investigate and find a dirty chain they refuse to repay the amount reclaimed by the ultimate exporter."

3. It is settled law (see Joined Cases C-439/04 and C-440/04 *Kittel v Belgian State* and *Belgian State v Recolta Recycling SPRL* [2006] ECR I-6161, [2008] STC 1537 ('*Kittel*')) that, where a taxable person knew or should have known that, in purchasing goods, he was taking part in a transaction connected with the fraudulent evasion of VAT, that taxable person loses the right to deduct input tax on those goods. In a decision letter dated 21 March 2007, HMRC refused DTL's claim to recover the input tax incurred on the purchase of the mobile phones in June and July 2006. The grounds for the refusal of the claim were that HMRC considered that DTL, through the controlling mind of its director Stephen Titheridge, knew that the transactions were connected with the fraudulent evasion of VAT or, alternatively, that Mr Titheridge should have known that they were so connected.

4. DTL accepts that all of its transactions in mobile phones, except for the two transactions involving V2 UK Limited ("V2") in July 2006, were connected with the fraudulent evasion of VAT. In relation to the two transactions in July 2006, DTL accepts that there were tax losses but not that they were connected with the fraudulent evasion of VAT. DTL contends that there is no evidence that V2 intended to defraud HMRC and, even if it so intended, an unsuccessful attempt to defraud does not engage *Kittel*.

5. Even if it is admitted (June 2006) or proved (July 2006) that the transactions were connected with the fraudulent evasion of VAT, DTL does not admit that its director, Mr Titheridge, knew or should have known that they were so connected.

6. Accordingly, there are only two issues in this appeal, namely:

> (1) Were the two transactions in July 2006 connected with the fraudulent evasion of VAT?
>
> (2) Did Mr Titheridge know or should he have known that the transactions in June and, subject to the first issue, July 2006 were connected with the fraudulent evasion of VAT?

7. For the reasons given below, we have concluded that the two transactions involving V2 UK Limited ("V2") in July 2006 were connected with the fraudulent evasion of VAT. We have also found that Mr Titheridge knew that the transactions in June and July 2006 were connected with the fraudulent evasion of VAT. Even if we are wrong in our conclusion that Mr Titheridge knew that the transactions were connected with fraud, we have no doubt that, taking account of all the circumstances, he should have known that the transactions were connected with the fraudulent evasion of VAT. Accordingly, our decision is that DTL's appeal is dismissed.

Right to deduct input tax

8. The Sixth Council Directive 77/388/EEC of 17 May 1977 on the harmonisation of the laws of Member States relating to turnover taxes - common system of value added tax: uniform basis of assessment, ("the Sixth VAT Directive"), which was the Directive in force at the time of the transactions that are the subject of this appeal. Article 17 of the Sixth VAT Directive provided that a taxable person has a right to deduct VAT which the taxable person has paid or is liable to pay in respect of goods and services supplied to the taxable person to the extent that the goods and services are used for the purposes (ie are cost components) of the taxable person's taxable transactions (ie supplies of goods and services other than exempt supplies) or transactions treated as such carried out in the course of an economic activity.

9. The Court of Justice of the European Communities ("the ECJ") has determined that there is an exception to the right to deduct. In *Kittel*, the ECJ held at [54] – [59]:

> "54. As the Court has already observed, preventing tax evasion, avoidance and abuse is an objective recognised and encouraged by the Sixth Directive … Community Law cannot be relied on for abusive or fraudulent ends …

> 55. Where the tax authorities find that the right to deduct has been exercised fraudulently, they are permitted to claim repayment of the deducted sums retrospectively … It is a matter for the national court to refuse to allow the right to deduct where it is established, on the basis of objective evidence, that that right is being relied on for fraudulent ends.
>
> 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'."

10. At [61], the ECJ summarised the position as follows:

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

11. Relevant to the Tribunal's considerations in this regard are the steps, if any, that the Appellant took to protect itself. At [51] of *Kittel*, the ECJ stated;

> "…traders who take every precaution which could reasonably be required of them to ensure that their transactions are not connected with fraud, must be able to rely on the legality of those transactions without the risk of losing their right to deduct the input VAT…"

12. In *Mobilx Limited and others v HMRC* [2010] EWCA CIV 517, [2010] STC 1436 ('*Mobilx*') the Court of Appeal considered the proper interpretation and application of the ECJ's decision in *Kittel*. Moses LJ, with whom Carnwath LJ and Sir John Chadwick agreed, held at [52];

> "If a taxpayer has the means at his disposal of knowing that by his purchase he is participating in a transaction connected with the fraudulent

> evasion of VAT he loses his right to deduct, not as a penalty for negligence, but because the objective criteria for the scope of that right are not met. … A trader who fails to deploy the means of knowledge available to him does not satisfy the objective criteria which must be met before his right to deduct arises."

13. Moses LJ considered the extent of knowledge that was required at [53] – [60]. He concluded at [59]:

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

14. Moses LJ went on to add at [75] (in respect of the appeal by Blue Sphere Global Limited);

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

15. The Court of Justice of the European Union ("CJEU") recently reaffirmed the position in Case C-285/11 *Bonik EOOD v Direktor na Direktsia 'Obzhalvane i upravlenie na izpalnenieto' – Varna pri Tsentralno upravlenie na Natsionalnata agentsia za prihodite* [2012] ECR I-0000 ("*Bonik*") issued on 6 December 2012. *Bonik* did not concern an MTIC fraud but was a case where there was no evidence that the goods purportedly supplied had actually existed. The CJEU, having referred to *Kittel*, stated at [37] - [40]:

> "37. It is therefore for the national courts and judicial authorities to refuse the right of deduction, if it is shown, in the light of objective factors, that that right is being relied on for fraudulent or abusive ends.
>
> 38. That is the position where a tax fraud is committed by the taxable person himself. In such a case, the objective criteria which form the basis of the concepts of 'supply of goods or services effected by a taxable person acting as such' and 'economic activity' are not met.
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> 39. By the same token, a taxable person who knew, or should have known, that, by his purchase, he was taking part in a transaction connected with VAT fraud must, for the purposes of Directive 2006/112, be regarded as a participant in that fraud, whether or not he profits from

> the resale of the goods or the use of the services in the context of the taxable transactions subsequently carried out by him.
>
> 40. It follows that a taxable person cannot be refused the right of deduction unless it is established on the basis of objective factors that that taxable person – to whom the supply of goods or services, on the basis of which the right of deduction is claimed, was made – knew or should have known that, through the acquisition of those goods or services, he was participating in a transaction connected with VAT fraud committed by the supplier or by another trader acting upstream or downstream in the chain of supply of those goods or services."

Burden and standard of proof

16. The CJEU in *Bonik* confirmed that the tax authorities bear the burden of proof in MTIC cases at [43] where the Court said:

> "Consequently, since the refusal of the right of deduction is an exception to the application of the fundamental principle constituted by that right, it is incumbent upon the competent tax authorities to establish, to the requisite legal standard, the objective evidence needed to substantiate the conclusion that the taxable person knew, or should have known, that the transaction relied on as a basis for the right of deduction was connected with fraud committed by the supplier or by another trader acting upstream or downstream in the chain of supply."

17. We consider that the standard of proof to be applied in this case is, notwithstanding the seriousness of the allegations, the ordinary civil standard of proof, namely, whether the alleged misconduct more probably occurred than not - see *Re B (Children) (Care Proceedings: Standard of Proof)* [2008] UKHL 35, [2009] AC 11 per Lord Hoffmann at [13] and *In Re S-B (Children) (Care Proceedings: Standard of Proof)* (2010) 1 AC 678 at [10] - [13].

Evidence

18. Witness statements, together with exhibits in 15 bundles to which both parties referred, were produced by Mr Mark Thompson, Ms Vivien Parsons, Mr Gordon Smith, Mr Graham Taylor, Mr Jonathan Read, Mr Huw Griffiths, Mr Terence Mendes, Mr Andrew Letherby and Mr John Fletcher on behalf of HMRC. The witness statements of Ms Parsons, Mr Taylor, Mr Griffiths and Mr Mendes were admitted. We heard evidence from Mr Thompson, Mr Smith, Mr Letherby and Mr Fletcher. Their witness statements stood as evidence in chief and they were cross-examined by Mr Andrew Young, who appeared for DTL.

19. Unlike the other witnesses for HMRC, Mr Fletcher is not an HMRC officer but a director of KPMG LLP. Mr Fletcher produced three witness statements in relation to the authorised distribution market in mobile phones and the grey (ie unauthorised) distribution market in mobile phones. Mr Young submitted that Mr Fletcher's evidence should be excluded because it was not relevant to the issue which the

Tribunal had to decide. Mr Young stated that Mr Titheridge had accepted that, save in relation to the V2 transactions, there had been an overall scheme to defraud VAT and there had been tax losses. Mr Young said that the critical issue in this case was Mr Titheridge's state of mind and Mr Fletcher's evidence had nothing to say about that. Mr Young further submitted that Mr Fletcher's evidence should be excluded as he was not independent, because KPMG advised an anti-grey market alliance of mobile phone companies. We decided not to exclude the evidence of Mr Fletcher as it was potentially relevant to the question of whether the V2 transactions were connected to fraud. We also considered that any questions about Mr Fletcher's independence or expertise could be dealt with in cross-examination and would go to the weight that we should give to his evidence but did not warrant its exclusion.

20. A witness statement was also produced by Mr Roderick Stone, an officer of HMRC with considerable experience of MTIC investigations but who had not been involved in the investigation in this case. Mr Young objected to Mr Stone's evidence as being merely general background and not of any specific relevance to the issues for the Tribunal in this case. We agreed that the evidence of Mr Stone seemed to consist of general comments and that as the Tribunal was familiar with the background to MTIC fraud generally such evidence added nothing of specific relevance and should be excluded in this case.

21. The only witness for DTL was Mr Titheridge who produced two witness statements which stood as evidence in chief. Mr Titheridge was cross-examined for some six and a half hours by Mr Adam Hiddleston who appeared with Mr Ben Hayhurst for HMRC.

22. On the basis of the evidence, we find the material facts relating to DTL's input tax claim to be as set out below.

Background

23. Mr Titheridge spent 22 years in the Royal Navy Fleet Air Arm, achieving the rank of Chief Petty Officer. He left the Navy in September 2002 and, after taking a course at Chippenham College, became a technical author for a company in Weymouth which produced technical documentation in the fields of aerospace, engineering and defence.

24. In early 2004, Mr Titheridge was experiencing marital difficulties. Mr Titheridge agreed with his wife that they would divorce. He decided to move to the Portsmouth area to be nearer his elderly parents.

25. Mr Titheridge had kept in touch with a friend, Mr Ian Tuppen, who he had known at college. Mr Tuppen was a director of Kingswood Trading Services Limited ("KTS"), based in Portsmouth. KTS traded in mobile phones. Mr Tuppen was keen to help Mr Titheridge.

26. Mr Tuppen introduced Mr Titheridge to Mr Damian Maginn, a director of Katian Limited ("Katian"). Like KTS, Katian traded in mobile phones. Mr Tuppen

suggested that Mr Titheridge could make a short term loan to Katian to finance its business and earn a decent return.

27. On 18 May 2004, Mr Titheridge made a loan of £30,000 to Katian. Mr Titheridge stated in his witness statement that the source of the loan was a joint bank account that he held with his wife at that time and that the funds had been obtained by way of a secured loan on the family home. In cross-examination, Mr Titheridge was asked why £50,000 in cash was paid into the joint account with his wife, followed a few days later by a payment by cheque for £30,000 which was agreed to be paid to Katian. Mr Titheridge stated that his wife had arranged to borrow the £50,000 and that he had only assumed that it had come from the bank. He said he had not really thought about it and guessed that the money had come from his wife's father. Mr Titheridge could not explain why his wife would have arranged to borrow £50,000 when he had only wanted £30,000. Mr Titheridge said that he had absolutely no idea what happened to the balance of £20,000.

28. Mr Titheridge thought that he would earn a good return of around 12% on the loan. Mr Titheridge said that it sounded like a good opportunity although he did not ask what deal Katian would use the money for or why Mr Maginn approached him rather than a bank. The loan agreement was produced during the hearing. It was a one page letter, dated 17 May 2004, that stated that the loan was unsecured and that no interest would be payable by Katian. Mr Titheridge could not explain why the letter said that no interest would be payable. The letter also stated that the loan would be repayable on 30 days' notice in writing. Mr Titheridge stated in evidence that he was not ready to start trading in mobile phones in May 2004 because he did not have a lot of knowledge. Mr Titheridge said that, when he was ready to make his first trade, he would be repaid the money, with some interest, so he could use it to trade. He said he trusted Mr Maginn (and Mr Tuppen as well) and he was prepared to take a risk.

29. Around the same time, ie May 2004, Mr Tuppen suggested to Mr Titheridge that he could make some money by importing and exporting commodities such as mobile phones. Mr Tuppen helped Mr Titheridge by suggesting what he should do.

30. DTL was incorporated on 1 June 2004. Mr Titheridge was its sole director. Mr Titheridge registered DTL for VAT with effect from 1 January 2005. On the application to register for VAT, Mr Titheridge gave his parents' house in Stubbington, Fareham as the principal place of business of DTL. At a later date, he changed the address of DTL's place of business to his home address. He said that he came to realise that there were too many distractions at home and, although it was useful to have post sent to his home address, he worked at the offices of KTS on an almost daily basis.

31. On 4 April 2005, HMRC sent DTL a 'Redhill' awareness letter detailing the problems regarding MTIC fraud and procedures for checking the VAT status of potential suppliers and customers. On 8 April 2005, Mr Titheridge attended the Portsmouth VAT office and was interviewed by HMRC officer Peter Stubbs who issued him with Public Notice 726 on Joint and Several Liability. Mr Titheridge was

shown a note of the meeting. Mr Stubbs's note of the meeting records that DTL had been in contact with only two suppliers, namely Katian and KTS, and the only potential customer was Roma Import Export. Mr Titheridge said in evidence that, other than providing a copy of the Notice 726, Mr Stubbs did not offer any advice or give any warnings about trading in mobile phones.

32. Mr Titheridge left the company in Weymouth where he had been working as a technical author around the end of May 2005.

33. Mr Tuppen offered Mr Titheridge a job with KTS. On 3 June 2005, Mr Titheridge became an employee of KTS and worked as a general aide to Mr Tuppen. Mr Titheridge's duties included acting as a chauffeur and carrying out other tasks as and when asked to do so. Mr Titheridge drove Mr Tuppen to some business meetings but he said that he remained in the car while Mr Tuppen attended the meetings.

34. Mr Titheridge said that he took the job with KTS because he had no experience of trading in mobile phones or any other items and he hoped to learn something from Mr Tuppen. Mr Titheridge said that he was keen to get into an area where he could make some money. Mr Titheridge knew that Mr Tuppen traded in mobile phones as well as other items and had been very successful in his life. The idea was that Mr Tuppen was going to help Mr Titheridge get into the trading business. Prior to his transactions with DTL, Mr Titheridge had no involvement in and had no experience of trading in mobile phones. Mr Tuppen allowed Mr Titheridge to use a desk in his office at KTS from the time that he started working there. Mr Titheridge said that, despite working for him and being in his office, he did not know who Mr Tuppen's suppliers or other customers were and never asked him. Mr Titheridge said that he tried to build a customer base by targeting as many customers as he could from phone trader websites and sending out DTL's details although it was entirely unclear from his evidence when he started to do this.

35. Mr Titheridge opened an account with the First Curaçao International Bank ("FCIB"). Mr Titheridge said that the reason he opened the FCIB account was because Mr Tuppen told him that the way forward if he wanted to trade was to have an FCIB account.

Trading history

36. On 13 June 2005, ten days after Mr Titheridge started work with KTS, DTL completed its first transaction in mobile phones. The sale was to Roma Import Export in Italy. DTL's supplier for this transaction was Katian. The transaction was later traced by HMRC to a defaulting trader.

37. This was the only time that Katian acted as supplier to DTL. Mr Titheridge said that he had sent DTL's details to a number of companies that he had contacted through phone trading websites such as International Computer Brokers and International Phone Traders.

38. Mr Titheridge continued as an employee of KTS until 31 January 2006. During the period of his employment, Mr Titheridge was paid just over £23,000. At the same

time, DTL was trading in mobile phones. Apart from the first transaction, DTL bought all of its mobile phones from KTS.

39. In July 2005, DTL submitted a VAT return claiming a repayment of £40,476.63 for the 3 month period ending 06/05 relating to the goods purchased from Katian for sale to Roma Import Export, which was the only output transaction during the period. The repayment was authorised on 22 July 2005. DTL subsequently applied and was allowed to use monthly accounting periods because it was engaged in export transactions.

40. Mr Titheridge said in evidence that, when he started trading, he was not sure whether he was going to trade in phones or computer parts or something else. He said that it was not until August 2005 that he decided to concentrate his efforts on mobile phones. Mr Titheridge originally said that DTL set out to establish a small customer base by way of advertising on the ICB website in August 2004. In evidence, he corrected that to August 2005 but that was after he had already traded with Roma Import Export and a considerable time after the meeting on 8 April 2005, where Mr Titheridge had told HMRC officer Stubbs that the only potential customer at that time was Roma Import Export. Mr Titheridge said that he found Roma Import Export on the internet. We note that Roma Import Export had been a customer of Katian.

41. DTL entered into three further transactions with Roma Import Export in August and September 2005. DTL's supplier in those transactions (and all subsequent transactions) was KTS. Mr Titheridge said that KTS could always supply him and it was easier to deal with just one company.

42. In September 2005, DTL submitted a VAT return claiming a repayment of £55,285.05 for period 08/05 relating to the goods purchased from KTS for sale to Roma Import Export which was the only output transaction during the period. The repayment was authorised on 26 September.

43. In October 2005, DTL submitted a VAT return claiming a repayment of £93,129.15 for period 09/05 during which DTL made two exports. The repayment was authorised on 10 November.

44. In October, November and December 2005 and January 2006, DTL sold mobile phones to La Parisienne du Commerce on five occasions.

45. In November 2005, DTL submitted a VAT return claiming a repayment of £63,806.32 for period 10/05. DTL made only one export during the period. The repayment was authorised on 8 December.

46. In December 2005, DTL submitted a VAT return claiming a repayment of £119,392.14 for period 11/05. DTL made only one export during the period. The repayment was authorised but the date of authorisation is unknown.

47. In February 2006, DTL entered into a transaction with D Jensen Trading AB. This was DTL's only transaction with that company.

48. In January, March and April 2006, DTL sold three consignments of mobile phones to France Affaires International.

49. On 25 April 2006, DTL received a letter from HMRC stating that six deals that DTL had entered into in June, August, September, October and December 2005 traced back to defaulting traders, resulting in a tax loss in excess of £330,000. The letter stressed the need for DTL to check the integrity of the supply chains and that heed be taken of any indications that VAT was not being accounted for.

50. In March, May and June 2006, DTL sold mobile phones to 2 Trade BVBA, a Belgian company, on five occasions. The last two transactions in June 2006, deals J1 and J2, are the subject of this appeal.

51. On 15 June 2006, DTL sent KTS, its supplier, a 'supplier declaration' form 119 that DTL had composed and, on the same day, completed a customer declaration form 120 about its customer, 2 Trade. Both of the documents referred to a number of checks and undertakings designed to guard against MTIC fraud.

52. On 18 July 2006, HMRC sent DTL a letter stating that DTL's 06/06 VAT return would be subject to extended verification. The letter also reiterated the problems with MTIC fraud. This letter was sent nine days before deals JY1 and JY2 were conducted.

53. In July 2006, DTL sold two consignments of mobile phones to Allimpex Handels, a German company. These transactions, deals JY1 and JY2, are also the subject of this appeal.

Disputed transactions

54. The transactions which gave rise to this appeal took place in June and July 2006. They were the last transactions carried out by DTL. DTL has not traded since the input tax incurred on the purchase of the mobile phones which were the subject of the transactions was withheld by HMRC.

55. All of the traders, including DTL, in the four supply chains involving the disputed goods had accounts with the FCIB and used them to make payments pursuant to the transactions. The transactions and the flow of payments for the transactions have been traced by the analysis of information obtained by HMRC from servers of the FCIB. This banking evidence was not disputed by DTL.

56. The two transactions which took place in June 2006 (J1 and J2 respectively) involved the purchase of mobile phones by DTL from KTS and the onward sale and dispatch of the phones by DTL to 2 Trade. The supply of the phones by DTL was zero rated because the phones were despatched to 2 Trade which was registered for VAT in Belgium. In relation to both deal J1 and deal J2, the monies used to pay for the goods started and ended with a Portuguese trader, Worldcall LDA ("Worldcall").

57. In J1, the monies left Worldcall's bank account and transferred through eight traders, including DTL, before returning to Worldcall's account 2 hours and

21 minutes later. DTL paid its supplier, KTS, VAT (ie the input tax claimed in this appeal). VAT was paid up the chain until it reached RS Sales Agency. RS Sales Agency should have retained the VAT and accounted to HMRC for it but the banking evidence shows that RS Sales Agency paid the gross amount (ie including the VAT) that it had received from its customer, Highbeam UK Limited ("Highbeam"), to Worldcall save for just under £1,700. RS Sales Agency never accounted to HMRC for the VAT. DTL made a profit of £32,775 (or £11.50 per unit) on the J1 transaction. KTS made a profit of £8,550 (or £3 per unit) on the J1 transaction.

58. In J2, the monies left Worldcall's bank account and transferred through nine traders, including DTL, before returning to Worldcall's account 1 hour and 48 minutes later. DTL paid its supplier, KTS, VAT (ie the input tax claimed in this appeal). VAT was paid up the chain until it reached RS Sales Agency. RS Sales Agency should have retained the VAT and accounted to HMRC for it but the banking evidence shows that RS Sales Agency paid the gross amount (ie including the VAT) that it had received from its customer, Highbeam, to Worldcall save for £940. RS Sales Agency never accounted to HMRC for the VAT. DTL made a profit of £20,000 (or £12.50 per unit) on the J2 transaction. KTS made a profit of £5,600 (or £3.50 per unit) on the J2 transaction.

59. The two transactions which took place in July 2006 (JY1 and JY2 respectively) involved the purchase of mobile phones by DTL from KTS and the onward sale and dispatch of the phones by DTL to Allimpex. The supply of the phones by DTL was zero rated because the phones were despatched to Allimpex which was registered for VAT in Germany. Both JY1 and JY2 took place on the same day and involved the same parties at all stages of the chain.

60. In both JY1 and JY2, the monies left the bank account of Bespoke International LLC, based in Dubai, and transferred through ten traders, including DTL, before ending in the account of Talkount SL, which was based in Estonia.

61. It took three days for the money to transfer between Bespoke International LLC and Talkount SL, although it only took 3 hours and 31 minutes in JY1 and 3 hours and 21 minutes in JY2 for the monies to transfer from Bespoke International LLC through eight of the ten traders to V2. V2 should have accounted to HMRC for the VAT but it did not do so and we discuss this further below. DTL made a profit of £41,737.50 (or £13.25 per unit) on the JY1 and JY2 transactions. KTS made a profit of £25,200 (or £8 per unit) on the JY1 and JY2 transactions.

62. HMRC submits that both RS Sales Agency and V2 fraudulently defaulted on their liability to account for output tax on their sales of the mobile phones. DTL accepts that its J1 and J2 transactions were connected with fraud and that there were tax losses arising from that fraud. DTL does not accept that there were tax losses connected to fraud in relation to the JY1 and JY2 transactions with V2. In relation to V2, DTL submits that there is no evidence that the company would have defaulted if its FCIB account had not been frozen. In relation to all the disputed transactions, DTL maintains that Mr Titheridge did not know that the transactions were connected with fraud and it cannot be said that he ought to have known of the fraud.

63. In relation to the J1 and J2 transactions, Mr Titheridge's evidence was that he was contacted by 2 Trade by fax. He then checked that the stock required was still available from KTS. Mr Titheridge said that he had visited the premises of 2 Trade in April 2006, after his first transaction with them in March, as part of his due diligence. Mr Titheridge checked the validity of 2 Trade's VAT number on the Europa website on 14 June 2006 which was the day before the J1 transaction. Mr Titheridge also telephoned the HMRC National Advice Service to check the validity of the VAT registration number of 2 Trade on 28 June 2006 which was the same day as the J2 transaction.

64. In relation to the JY1 and JY2 transactions, Mr Titheridge's evidence was that he was contacted by Allimpex on his mobile phone. He then checked that the stock required was still available from KTS. Mr Titheridge checked the validity of Allimpex's VAT number on the Europa website on 27 July 2006 which was the day of the JY1 and JY2 transactions.

65. Mr Titheridge said that, based on his knowledge at the time of the transactions, he did not think there was anything unusual in the way in which the transactions were carried out.

Were JY1 and JY2 transactions connected with fraudulent evasion of VAT?

66. There was no dispute that V2 never accounted for the VAT that it received in the course of the JY1 and JY2 transactions. There was also no dispute that deals JY1 and JY2 were part of a wider overall scheme to evade VAT fraudulently. In opening, Mr Young stated that DTL accepted that some of its transactions were connected with fraud and that there were tax losses but it did not accept that there were tax losses connected with fraud in respect of V2. DTL's case, put by Mr Young in his cross-examination of Mr Smith, was that the real cause of V2's inability to pay the VAT was certain actions taken by HMRC, namely the issue of certain assessments and a notice of a direction under Regulation 25 VAT Regulations 1995. In addition, at the time that V2 was due to pay the VAT, its FCIB account had been frozen.

67. Mr Young sought to rely on the decision of the First-tier Tribunal in *My Secrets v HMRC* [2011] UKFTT 72 (TC) ("*My Secrets*"). In that case, in which Mr Smith was also a witness, the Tribunal concluded that HMRC had not proved that V2 intended fraudulently to evade VAT in respect of three transactions (not being the JY1 and JY2 transactions). The Tribunal in *My Secrets* found at [42]-[44] that:

> "42. On 21 August 2006, HMRC issued a regulation 25 direction which instructed the company to immediately make an early VAT return. This was not complied with but a return was made for the 08/06 quarter declaring a VAT output tax liability of £985,064.70. This included the VAT liability for the July 2006 sales of phones to the Appellant which were the subject of this appeal. This sum remains unpaid.
>
> 43. At a meeting between Officer Smith and Nadeem Ahmed [the director of V2] on 1 September 2006, Mr Ahmed complained that V2's FCIB account

which had a balance of £1,325,625.61 had been frozen. V2 by this time had also issued credit notes in respect of transactions for which they had not been paid. This resulted in an assessment being raised by HMRC on the basis that in the absence of any indication from other purchasers that they were not pursuing the debt it was simply an attempt to evade a VAT liability which was due.

44. On cross-examination Mr Smith confirmed that the three deals with which the Appellant was involved were submitted on a single VAT return which showed a VAT liability of £985,064.70. However he could not accept the net liability shown on the return because of the credit notes issued which he believed were intended to artificially reduce the amount of VAT due."

68. The Tribunal set out its conclusion on this point at [290] as follows:

"We find that Mr Ahmed of V2 did not deliberately avoid paying the amount of VAT on the return which included the Appellant's transactions. He stated that he had some £1.3 million in his [FCIB] bank account which was true but that the account was frozen which was also true. We are unable to come to the conclusion that he would never have paid the VAT had the account not been frozen."

69. Mr Young submitted that there was no evidence that the losses were attributable to any fraud by V2. He further submitted that, even if there had been an attempt to defraud HMRC by V2, an attempt could not engage *Kittel*. Mr Young contended that it is relevant to consider whether V2 would have been able to meet its VAT liability but for the intervention of HMRC or the freezing of its FCIB account. In our view, that is tantamount to saying that it is necessary for the fraud to have caused an actual loss, ie to have been successful, in order for input tax on a connected transaction to be denied. Mr Young did not shrink from this. We reject both of Mr Young's submissions for the reasons set out below.

70. First, we must decide whether HMRC have proved, on the balance of probabilities, that V2 intended fraudulently to evade VAT on the JY1 and JY2 transactions at the time that the transactions took place.

71. In relation to the *My Secrets* decision, it was accepted by Mr Young that we are not bound by the decision of another First-tier Tribunal and also that HMRC had revisited their evidence and "beefed it up a bit". For those reasons, we disregard the findings of the Tribunal in *My Secrets* and look at the evidence produced in this case afresh.

72. As already stated, there was no dispute that V2 defaulted on its obligation to account for the VAT that it received in the course of the JY1 and JY2 transactions. In assessing V2's intention in relation to the JY1 and JY2 transactions, it is appropriate to have regard to its trading history and other transactions which were dealt with in the evidence of Mr Smith.

73. Mr Smith was the assurance officer who monitored V2 when HMRC first became aware that it was trading in mobile phones. V2 was originally a retail

clothing business with premises in Blackburn. In February 2006, V2 started trading in mobile phones. On a visit on 21 February 2006, Mr Nadeem Ahmed, the director of V2, told Mr Smith that he wanted to diversify into wholesale trading in mobile phones because the retail clothing business was not good. He stated that his intention was to trade with UK registered suppliers and customers only. In fact V2 went on to acquire mobile phones from suppliers in the EU. Mr Smith gave Mr Ahmed Notice 726 and other materials relating to MTIC fraud.

74. In the period of approximately six months during which it traded in mobile phones, V2's turnover in that trade was £416,038,327.49 including VAT of £61,909,016.86. Mr Smith said in evidence that, in his opinion, most of V2's trade in mobile phones, if not all of it, was connected to fraud. V2 acted as a buffer in 477 deals and a broker in one transaction. All of V2's broker and buffer deals can be traced back to a defaulting trader. In V2's only broker deal, the goods were sold to 2 Trade in Belgium which was also DTL's customer in the J1 and J2 transactions. Mr Young for DTL did not contradict the evidence in relation to V2's broker and buffer deals but focussed on what he called the trigger that caused the alleged tax loss in relation to the JY1 and JY2 transactions.

75. On 26 July 2006, V2 switched from being a buffer trader to being an acquiring trader. From 26 July 2006, V2 conducted 32 acquisition deals before ceasing to trade on 3 August 2006. In all 32 deals V2 was supplied by Polish trader Techbase Consulting ("Techbase"). V2's FCIB bank account showed that V2 was paid by its customer and, in turn, paid its supplier in 13 of the acquisition deals. Deals JY1 and JY2 were included in these 13 deals.

76. On 14 August 2006, HMRC became aware that V2 was undertaking acquisition deals. Mr Smith said that HMRC knew from experience with similar traders that when a business, like V2, suddenly became an acquirer, its net tax liability could quickly increase significantly.

77. On 16 August 2006, V2 opened an account with Worldwide Currencies Limited ("WCL"), a currency exchange service. On the same day, V2 informed WCL that they were to receive substantial funds from the FCIB.

78. On 21 August, Mr Smith issued a Regulation 25 direction notice to V2. The Regulation 25 direction divided V2's three month 08/06 accounting period into two parts and required separate VAT returns for each. The first shorter period was 1 June to 21 August 2006 and the return was required to be submitted and VAT due paid by 22 August. The second shorter period was 22 August to 31 August 2006 and the return and payment of VAT due were required by 1 September 2006. Mr Smith said that he issued the Regulation 25 direction notice to V2 in order to reduce the risk of the tax liability increasing and to establish that V2 had the funds to pay the VAT that it owed.

79. On the same day that the Regulation 25 direction notice was issued, V2's accountant wrote to HMRC stating that "my client has asked me to make you aware that the funds sufficient to pay the VAT due per the made return are currently on

deposit so that payment can be as early as possible". In fact, V2 failed to furnish a completed return on 22 August as required by the Regulation 25 direction. On 24 August, HMRC assessed V2 for £2,270,903 VAT.

80. On 30 August 2006, Mr Ahmed tried without success to transfer all the funds in V2's FCIB account to V2's account with the Bank of Scotland in the UK. A note in Mr Ahmed's handwriting records a telephone conversation with someone at the FCIB as follows:

> "No third party payments. Need account number, bank and sort code. Back log currently taking a substantial amount of time. Will request varification [sic] on some transaction. Until we provide all the relevant information funds will not be transferred."

81. Mr Ahmed also sent an email to the FCIB

> "… could you please let us know what information you require in order to except [sic] the wire transfer, please note this request is being made prior to the last date of wire transfer, as there is a backlog of your system can you please confirm acceptance after the 31st August 2006. These funds are needed urgently to satisfy an outstanding amount which is due to the HMCE [sic], we are most willing to provide any necessary information as well as the HMCE VAT calculation request".

82. On 1 September 2006, Mr Smith visited V2 and was given a VAT return dated that day for the whole 8/06 period declaring net tax due as £985,064.70. The declared amount related to a number of buffer deals and the 13 acquisition deals where the monies had been transferred which included the JY1 and JY2 transactions. Mr Smith recorded that the following matters were mentioned during the visit:

> "Money – Mr Ahmed complained that this was still locked in FCIB. He gave me a print of the account balance (£1,325,625.61), an email dated 30/8/06 from him to FCIB and a handwritten note of a telephone conversation between Mr Ahmed and someone at the bank that afternoon.
>
> Customers – many are in the same position as V2 and so cannot pay what is owed. Mr Ahmed gave me copies of credit notes and pro-forma invoices (requesting payment) issued to customers who had not yet paid."

83. V2's actual liability for the period ending 08/06 based on the value of invoices issued and received was £2,235,739.02. V2 justified only declaring £985,064.70 in its VAT return for the period by issuing credit notes in relation to 16 deals for which V2 had not been paid (12 acquisition deals and 4 buffer deals). Mr Ahmed told Mr Smith that he issued the credit notes because he had not been paid by his customers. Mr Smith did not accept the credit notes were effective in those circumstances as the customers had not agreed that the deals should be cancelled. V2 did not issue credit notes in relation to the JY1 and JY2 transactions. V2 received payment from its customer and paid its supplier Techbase in relation to the JY1 and JY2 transactions which were included in the VAT return.

84. On 5 September 2006, V2 unsuccessfully attempted to transfer almost the entire balance of £1.3 million from its FCIB bank account to its account with WCL.

85. At this time, V2's account with the Bank of Scotland had over £80,000 in it. During the preceding three months or so, V2 had transferred over £445,000 from its FCIB account to its Bank of Scotland account. Despite having £80,000 in available funds, V2 did not pay and has never paid any of its VAT liability shown on the return for period 08/06.

86. It is clear from the trading history of V2 described above and the characteristics of the transactions that V2's transactions in period 08/06, including the JY1 and JY2 transactions, were part of a scheme to evade VAT fraudulently. All of V2's transactions in mobile phones before it became an acquirer traced to a defaulting trader. In such circumstances, we consider that it is highly improbable that V2 had no knowledge or means of knowledge of or involvement in the MTIC frauds. We did not understand Mr Young to contend otherwise. That being so, we consider it highly probable that the knowledge or involvement continued when V2 entered into the acquisition transactions. In addition, we agree with Mr Smith's view that the fact that the credit note deals, each purportedly worth hundreds of thousands of pounds, simply evaporated subsequently demonstrates that they were contrived and not genuinely commercial.

87. In the 32 acquisition deals, V2 was in the position of a defaulting trader. In order to work, the fraud required V2 to evade its output tax liability. If V2 accounted for the VAT then the arrangements would not produce a profit for the person organising the fraud. We consider that the fact that V2 occupied such a key position in the fraudulent scheme which would only succeed if V2 defaulted is strong evidence that V2 intended to default.

88. We regard the fact that V2 tried to empty its FCIB account on two occasions as indicating that V2 did not intend to pay the VAT that was due. On neither occasion did V2 request that payment should be made to HMRC. The first attempt was a request for a payment of £1.3 million to V2's Bank of Scotland account purportedly in order to meet its liability to HMRC. As V2 submitted a return showing that its liability was only £985,064.70 and as its liability in the absence of credit notes was £2,235,739.02, we conclude that settling its liability with HMRC was not the real reason for requesting the transfer of £1.3 million.

89. The second attempt to transfer money was to V2's account with WCL. In that case, the money moved out of V2's FCIB account but was stopped before it was credited to the account with WCL and returned. Mr Ahmed had never told HMRC about the WCL account. Mr Young suggested to Mr Smith that that was because Mr Ahmed had never been asked about it. Mr Smith agreed that he had not asked Mr Ahmed about other accounts but said that he had several meetings with Mr Ahmed and that he expected to be told about significant matters relating to the VAT liability. We agree that it is suspicious that Mr Ahmed tried to move the money to an account which HMRC did not know about. We were puzzled that V2 should try to move the money to WCL at a time when V2 clearly knew that the FCIB account was frozen but

there is no doubt that V2 requested the transfer and we note that the money was debited from the FCIB account although later returned by the FCIB.

90. We find, on the balance of probabilities, that V2 did not intend to account to HMRC for the VAT relating to the JY1 and JY2 transactions but to evade that VAT fraudulently. We reach that conclusion having regard to

(1) V2's trading history;

(2) the contrived and artificial nature of the deals;

(3) V2's position in the fraudulent scheme which depended on V2 defaulting;

(4) V2's failure to comply with the Regulation 25 direction and provide a return by 22 August 2006;

(5) V2's attempted use of credit notes to reduce the amount of VAT for which it was liable to account and the fact that those deals simply evaporated;

(6) the fact that V2 made no attempt to pay any part of its VAT liability despite having some £80,000 available; and

(7) V2's attempts to empty its FCIB account.

91. Having found that V2 more probably than not intended to evade the VAT relating to the JY1 and JY2 transactions, we now consider Mr Young's submission that an attempt does not engage *Kittel*. Our view is that an attempt to evade VAT fraudulently brings the *Kittel* principle into play. This can be clearly seen from the CJEU's comments in Joined Cases C-354/03, C-355/03 and C-484/03 *Optigen Limited, Fulcrum Electronics Limited and Bond House Systems Limited v Commissioners of Customs and Excise* [2006] ECR I-483 ("*Optigen*"). At [55], the CJEU concluded that (emphasis supplied):

> "… transactions …, which are not themselves vitiated by VAT fraud, constitute supplies of goods or services effected by a taxable person acting as such and an economic activity within the meaning of Articles 2(1), 4 and 5(1) of the Sixth Directive, where they fulfil the objective criteria on which the definitions of those terms are based, regardless of the *intention* of a trader other than the taxable person concerned involved in the same chain of supply and/or the *possible* fraudulent nature of another transaction in the chain, prior or subsequent to the transaction carried out by that taxable person, of which that taxable person had no knowledge and no means of knowledge. The right to deduct input VAT of a taxable person who carries out such transactions cannot be affected by the fact that in the chain of supply of which those transactions form part another prior or subsequent transaction is vitiated by VAT fraud, without that taxable person knowing or having any means of knowing."

92. In our view, it is not necessary for the intended fraud to be successful before a participant loses the right to deduct input VAT. To put the proposition positively, a

person, who has the requisite knowledge of an intended VAT fraud by another person, loses the right to deduct input VAT incurred on transactions connected with the intended fraud. *Optigen*, *Kittel* and *Bonik* show that the right to input tax recovery is lost where there is knowledge or means of knowledge of a connection with the fraudulent evasion of VAT. Paragraph [55] of *Optigen* shows that an intention to commit VAT fraud is sufficient to vitiate a transaction entered into by the fraudster. Such fraudulent intention also nullifies the right of another person in the chain to recover input VAT where the other person knows or has the means of knowing of the intention to commit fraud or the possible fraudulent nature of another transaction elsewhere in the chain. The fact that the intention was subsequently frustrated by supervening events is of no consequence.

93. In our view, if Mr Titheridge knew or should have known that the July transactions were connected with fraud, the fact that V2 was unable to obtain the money because its FCIB bank account had been frozen or pay its VAT liabilities because of other actions by HMRC so the fraud was unsuccessful does not mean that DTL was entitled to deduct its input VAT. We consider that the CJEU cases provide no authority for the proposition that the intended fraud must result in tax actually being lost before the right to deduct input tax can be denied. In our view, the CJEU in *Optigen* made clear that a person, who has the requisite knowledge of an intended VAT fraud by another person, loses the right to deduct input VAT incurred on transactions connected with the intended fraud.

94. In conclusion on this point, we find that V2 did not intend to account for VAT arising from the JY1 and JY2 transactions. It follows that the JY1 and JY2 transactions were connected with fraud. In our view, the fact that V2's FCIB account was frozen and thus V2 would not have been able to pay the VAT, even if it had wanted to, does not mean that the tax loss was not connected with fraud.

Did Mr Titheridge know or should he have known that the transactions were connected with fraud?

95. We now turn to consider whether DTL knew or should have known that, when it entered into the J1, J2, JY1 and JY2 transactions, it was participating in transactions which were connected with the fraudulent evasion of VAT? Mr Young told us that Mr Titheridge had come to accept that all of the transactions entered into by DTL were the subject of an overarching fraudulent design. In closing, Mr Young said that Mr Titheridge now realised that he had been manipulated by Mr Tuppen, who he had believed to be a friend. Mr Young said that Mr Tuppen has a degree of notoriety in MTIC matters (as a cursory search of the First-tier Tribunal's decisions reveals). The question for this tribunal is not whether Mr Titheridge was manipulated into entering into transactions connected with the fraudulent evasion of VAT but whether he knew, or should have known, that the transactions were connected with the fraudulent evasion of VAT. For the purposes of this question, it is the state of mind of Mr Titheridge at the time of the transactions that is relevant.

96. As Moses LJ made clear in *Mobilx* at [59], 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. It is clear from this observation that the scope of constructive knowledge is not limited to what the taxpayer could have found out about the particular fraud by making further enquiries; it is wider than that and encompasses the inferences that the taxpayer should have drawn from all the information at his disposal at the relevant time.

97. On the basis of the evidence and for the reasons set out below, we have concluded, on the balance of probabilities, that Mr Titheridge knew that the J1, J2, JY1 and JY2 transactions were connected with the fraudulent evasion of VAT. If we are wrong in that conclusion then it seems to us to be clear that Mr Titheridge should have known that those transactions were part of an arrangement to evade VAT fraudulently because that was the only reasonable explanation for the uncommercial features of the transactions.

98. Mr Titheridge did not dispute that he was aware that there was widespread fraud in the mobile phone trading sector in 2005 and 2006. As stated above, HMRC sent DTL a 'Redhill' awareness letter on 4 April 2005, not long after DTL had submitted its first VAT return. The letter stated that MTIC VAT fraud was a serious problem for the UK and throughout the EU. The letter specifically referred to mobile phones as among the goods used to perpetrate MTIC fraud. The letter also set out procedures for checking the VAT status of potential suppliers and customers. On 8 April 2005, Mr Titheridge attended the Portsmouth VAT office and was interviewed by HMRC officer Peter Stubbs who issued him with Public Notice 726 on Joint and Several Liability.

99. Just over one year later, on 25 April 2006, Mr Stubbs set DTL a letter stating that six deals that DTL had entered into in June, August, September, October and December 2005 all traced back to defaulting traders, resulting in a tax loss exceeding £330,000. The letter made clear that DTL could be jointly and severally liable for any unpaid VAT unless it took demonstrable steps to check the integrity of its supply chain. Mr Titheridge said that he had been horrified when he received the letter dated 25 April 2006 from HMRC which stated that six of DTL's deals had been traced to defaulting traders. He said that he spoke to Mr Tuppen who assured him that it was a mistake and that "nothing untoward was going on with his suppliers". Although he was aware that fraud was widespread in the sector and that six of DTL's previous deals (including five deals with KTS), Mr Titheridge continued to trade with KTS as before.

100. In fact, HMRC established that 16 of the 21 transactions involving mobile phones carried out by DTL between June 2005 and July 2006 had a connection with fraud. The evidence showed that 15 of the transactions traced back to a defaulting trader who failed to account for VAT. The other transaction traced to Highbeam which the evidence of Mr Smith showed to be a buffer to defaulting traders in other transactions including the disputed June transactions with DTL (in respect of which the connection with fraud was admitted). It seems to us to be highly unlikely that someone with no knowledge of the fraud would find themselves caught up in fraudulent transactions on so many occasions.

101. Mr Titheridge, however, says that he was an innocent party who trusted Mr Tuppen. Mr Titheridge's evidence was that he did not know and had no reason to suspect at the time that Mr Tuppen was not being honest with him. Mr Titheridge subsequently accepted that he had been manipulated by Mr Tuppen into becoming involved in transactions connected with fraud. We do not believe Mr Titheridge's evidence on this point and, for the reasons set out below, we conclude that it is more likely than not that Mr Tuppen told Mr Titheridge about the true nature of the business ie that the transactions were connected with the fraudulent evasion of VAT. We reach this conclusion because of the close personal and working relationship between Mr Tuppen and Mr Titheridge and also because of the important position occupied by DTL as the broker in the fraudulent scheme.

102. Mr Tuppen and Mr Titheridge were long standing friends. They resumed contact when Mr Titheridge came out of the Royal Navy. Mr Tuppen provided help to Mr Titheridge when his marriage began to fail. Mr Tuppen suggested that Mr Titheridge could make some money by making a loan to Katian in May 2004. In June 2005, Mr Tuppen gave Mr Titheridge a job as his assistant/driver at KTS. Mr Titheridge worked for KTS for seven months, earning some £23,000 in that time. From the beginning of and throughout the period of Mr Titheridge's employment at KTS, DTL was allowed to use the offices of KTS to carry on a trade in mobile phones. In the course of that trading, DTL bought the phones from KTS and sold them onto its customers in other EU countries. We heard no evidence that any rent was paid for the use of the KTS offices. That arrangement continued after Mr Titheridge stopped working for KTS in January 2006. In 2006, Mr Tuppen lent Mr Titheridge £30,000 to help Mr Titheridge buy a house. That loan was still outstanding at the time of the hearing. In the light of that relationship, we consider that it is highly unlikely that Mr Tuppen would not have told his friend, Mr Titheridge, what he was becoming involved in.

103. Mr Titheridge said that he went to work for Mr Tuppen at KTS in June 2005 in order to learn something from Mr Tuppen about the trading business, because he had no prior experience. Despite that being the intention, Mr Titheridge said that he worked as a driver and general assistant for Mr Tuppen, taking him to meetings. Mr Titheridge was unable to describe in any detail what Mr Tuppen did. Mr Titheridge said that Mr Tuppen "was a very private man. He didn't really give me any detail about exactly what he was doing." We find it highly suspicious that Mr Titheridge was not able to describe what Mr Tuppen did by way of trading despite the fact that DTL traded with KTS in 20 of its 21 deals. We consider Mr Titheridge's evidence on this point to be unsatisfactory. It either leads us to conclude that Mr Titheridge did not learn the detailed mechanics of trading in mobile phones from Mr Tuppen while he was employed by KTS or that Mr Titheridge is not being truthful when he says that Mr Tuppen did not explain exactly what he was doing in any detail. Our view is that Mr Tuppen probably did explain exactly what he was doing to his friend, Mr Titheridge.

104. The lack of a detailed explanation by Mr Tuppen seems especially implausible when the time between starting work at KTS (3 June 2005) and DTL's first deal (13 June 2005) is taken into account. During that period of just over one week, Mr

Titheridge, who was carrying out his duties as a driver and general assistant for Mr Tuppen, must have received instruction in how to carry out a trade in mobile phones and applied it in making his first deal. In that period, he must have been taught how to find a customer who wanted to buy mobile phones and a supplier who could provide those phones, negotiate prices for the purchase and sale of the phones that would generate a return while remaining competitive, arrange the transport and associated checking of the goods and insurance. Having gained that knowledge, Mr Titheridge completed his first deal on 13 June. We cannot conceive how Mr Titheridge, with no relevant previous experience, would have been able to carry out that first deal unless Mr Tuppen had explained in detail what had to be done and how to do it.

105. The only possible alternative explanation for Mr Titheridge's inability to describe in any detail what Mr Tuppen did is that Mr Titheridge did not carry out DTL's first trade himself but was simply doing what he was told to do by Mr Tuppen. That was not suggested by either party. Our assessment of Mr Titheridge is that, while he was somewhat in awe of Mr Tuppen, he would not simply allow someone else to tell him what to do. We consider that it is very unlikely that Mr Tuppen would simply have been able to manipulate Mr Titheridge and DTL into entering into the transactions. We conclude that Mr Tuppen told Mr Titheridge what was happening and why.

106. We are also supported in our conclusion that Mr Tuppen told Mr Titheridge about the true nature and purpose of the transactions by the fact that DTL, as the broker, occupied an important position in the fraudulent scheme. It seems to us to be highly unlikely that the organiser of the fraud (whether that was Mr Tuppen or someone else) would risk having an innocent dupe in that position. Involving a person who was unaware of the true purpose of the transactions in the chain carried the risk that the fraud would be frustrated and/or found out. The fraud depends on the goods being supplied through the chain of transactions as intended by the organiser of the fraud. An innocent party might buy goods from a genuine supplier outside the fraudulent chain or sell the goods to a different customer from the one intended and, in either case, the chain would be broken and the fraud would not achieve its purpose. There was also the risk that an innocent person might become suspicious that the transactions were connected with fraud and alert HMRC. The chances of this happening would be particularly high given the general awareness of MTIC fraud in the sector and the potential for joint and several liability.

107. In our view, the circumstances in which DTL carried out its trades show that the transactions between KTS and DTL were not genuine commercial transactions but were part of a contrived arrangement and Mr Titheridge must have known that to be the case.

108. Between June 2005 and January 2006, when Mr Titheridge was working for KTS, DTL appears to have conducted nine broker deals. In eight of these deals, DTL was supplied by KTS. We find it incredible that KTS would allow its employee, with no experience of trading, to make significant profits on trades thereby reducing KTS's own profits. Mr Titheridge could not give any convincing reason why KTS would

allow DTL to siphon off its potential profits. Taken together, the lack of training and experience in trading and the inherent improbability of KTS allowing DTL to simply siphon off its potential profits, leads us to conclude that the relationship between KTS and DTL was something other than simply commercial.

109. During the period of Mr Titheridge's employment, KTS supplied more than £148 million pounds worth of goods to customers in in the EU. Mr Titheridge said in evidence that it never occurred to him to ask Mr Tuppen why KTS was supplying DTL with mobile phones to export to customers in the EU at a profit when KTS could easily have done so itself. We do not find this answer or the arrangement between KTS and DTL believable. A supply chain may contain many links where each link contributes something (the added value) to the thing being supplied. One supplier in the chain may have access to a source of supply not available to others, another may have expertise in logistics enabling the goods to be processed and transported more efficiently than others and yet another may be able to access markets and customers that are not open to those earlier in the chain. DTL had no such advantages and added no value to the supply of the mobile phones which it acquired from KTS. KTS was able to transport the phones to customers outside the UK as easily as DTL. Mr Titheridge said that DTL advertised for customers on phone trading websites such as the IPT website which KTS could have done just as easily.

110. Another circumstance that indicates that the transactions between KTS and DTL were not genuine commercial transactions is the fact that, after the first deal with Katian, Mr Titheridge did not try to find any other supplier than KTS. Mr Titheridge said that Mr Tuppen, or his daughter who Mr Titheridge believed to be an employee of KTS, told him when KTS had stock available. Mr Titheridge said that it was easier to deal with just one company. We consider that the failure of DTL to test the market with other suppliers and its reliance on a single supplier demonstrates that the relationship between KTS and DTL was not truly commercial. Mr Titheridge would have known that his profit depended on being able to buy mobile phones as cheaply as possible as well as selling them for the best price achievable. We do not believe that he would have settled for being a captive customer of KTS if he was engaged in genuine trading.

111. When asked in cross examination why he had not asked Mr Tuppen why KTS did not export the mobile phones itself, Mr Titheridge said "It's not for me to question how he operates, is it?" Later, Mr Titheridge said "who am I to actually tell [Mr Tuppen] what he should be doing? I don't know. It wasn't any of my business". We consider that the answers may have revealed the true nature of the relationship between Mr Titheridge and Mr Tuppen but the fact that Mr Titheridge was in a subservient position does not mean that he did not know what was going on. We conclude that, even if he was not told explicitly, Mr Titheridge probably knew from all the surrounding circumstances that the trading arrangements were not commercial and their real purpose was fraudulent evasion of VAT.

112. It is clear that KTS deliberately chose not to make higher profits on the sales of the phones that it sold to DTL. KTS could easily have achieved a higher price for the phones if it had sold them direct to customers in the EU. In our view, the fact that Mr

Titheridge accepted the arrangement with KTS without question is further evidence that he knew that the purpose of the arrangement and his role in it was to facilitate the fraudulent evasion of VAT. We consider that the only reasonable explanation is that the transactions between KTS and DTL were not genuine commercial transactions but were part of a contrived arrangement. We consider that the fact that each chain contained a trader who failed to account for output VAT (or intended to do so in the case of V2) shows that the motive of the uncommercial arrangements was the fraudulent loss of VAT.

113. Other circumstances also indicate that the transactions were not genuinely commercial. In relation to all four deals subject to appeal, the Appellant's supplier, KTS, released high value goods prior to payment by the Appellant. Moreover, the Appellant was allowed to ship the goods out of the country without having paid for them. The goods were not paid for until 6 - 11 days after the Appellant had shipped them. Mr Titheridge said that he sold the mobile phones "ship on hold" by which he meant that the freight forwarders were instructed not to release the goods to the customer until payment in full had been received by DTL. Mr Titheridge accepted that it was an important term of the contracts that DTL entered into with its customers because it protected DTL.

114. The first and only dealings that DTL had with Allimpex were the two transactions in July 2006. In relation to Allimpex, Mr Titheridge said that he had all the company details and had run the normal checks on the company's VAT registration through Redhill and also the Europa website. Mr Titheridge said that he had planned to visit Allimpex but he did not do so and he was satisfied from the checks that he had carried out that it was legitimate. The JY1 and JY2 deals with Allimpex did not include any "ship on hold" condition. Mr Titheridge accepted that the omission of the ship on hold term left DTL exposed but said that this was an oversight. We consider that the fact that a contract term which, according to Mr Titheridge, was of such importance could be overlooked in the case of a customer which Mr Titheridge had never dealt with before or even met indicates that DTL did not place any reliance on that contract term.

115. It was put to Mr Titheridge that if something went wrong, eg the customer rejected the phones or did not pay, DTL would be exposed. Initially, Mr Titheridge said that he had insurance but then, when asked, he acknowledged that he was not insured for non-payment. If the goods were shipped out of the UK but then were not paid for, DTL would be responsible for bringing the goods back to the UK. When asked what arrangements he had for bringing goods back to the UK, Mr Titheridge said that he would have had to sort it out but that there had never been a problem as all his deals had concluded successfully and he had never been left holding any excess stock. When asked if he had ever given the possibility of having to bring goods back to the UK a moment's thought, Mr Titheridge said no because he didn't think it was going to be an issue.

116. In our view, the only explanation for Mr Titheridge's casual attitude to the inclusion of the ship on hold term in the contract with Allimpex and to the risks of shipping goods before they were paid is that he knew that the contracts lacked

commercial substance and reality. The lack of substance and reality can, in our view, only be explained if the true purpose of the transaction was not a genuine commercial transaction but the furtherance of the fraudulent scheme. Accordingly, we conclude that Mr Titheridge's relaxed attitude to the contractual terms and risks shows that he knew that the transactions were connected with fraud.

117. For the reasons set out above, we find, on the balance of probabilities, that Mr Titheridge knew that the J1, J2, JY1 and JY2 transactions were connected with the fraudulent evasion of VAT.

118. If we are wrong in our primary conclusion, we are clearly of the view that Mr Titheridge should have known that those transactions were part of an arrangement to evade VAT fraudulently. We have no doubt that Mr Titheridge had ample opportunity to put two and two together while working for KTS and afterwards when trading through DTL from KTS's premises. Mr Titheridge would have seen that KTS was not exporting goods to Europe, as it had done, but was allowing DTL to make profits on sales to customers in the EU. He would have known that DTL made considerable profits (up to £27,000 per deal) seemingly without effort or risk and without adding any value by participating in the transaction chain. Mr Titheridge must also have realised that the mobile phones had travelled from the EU to the UK and were destined to return to the EU. When questioned about whether he thought it was strange that goods of EU specification were in the UK in the first place, Mr Titheridge said, "I didn't really consider it too much". We do not accept that Mr Titheridge was unaware that moving EU phones through the UK would simply add an unnecessary cost to the transaction.

119. In short, it must have been obvious to Mr Titheridge that DTL's mobile phone trading business was too good to be true. Mr Titheridge is not an unintelligent man as his successful career in the Royal Navy and work as a technical author between 2002 and 2005 show. Given the circumstances, he cannot have failed to realise that KTS was giving DTL the opportunity to make a profit that KTS could easily have retained without any advantage accruing to KTS. We conclude that, if he did not know that there was something dishonest about the trading arrangements, Mr Titheridge had the means of knowing that the deals were fraudulent and deliberately closed his eyes to the possibility that the purpose of the arrangement was the dishonest evasion of VAT.

Decision

120. For the reasons given above, we have found that:

(1) V2 did not intend to account for VAT arising from the JY1 and JY2 transactions which are, therefore, transactions connected with fraud; and

(2) Mr Titheridge knew that the J1, J2, JY1 and JY2 transactions were connected with the fraudulent evasion of VAT or, if he did not know, then he should have known that the only reasonable explanation for the transactions was they were so connected.

Our decision is, therefore, that DTL's appeal is dismissed.

Rights of appeal

121. This document contains full findings of fact and reasons for the decision. Any party dissatisfied with the Tribunal's 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.

GREG SINFIELD
TRIBUNAL JUDGE

RELEASE DATE: 3 May 2013