TC04075

Appeal number: LON/2008/01942

FIRST-TIER TRIBUNAL
TAX CHAMBER

VAT –denial of input tax deductions- transactions connected with fraudulent transactions – whether Appellant knew or should have known that the deals were so connected– Kittel and Mobilx applied – director of Appellant sophisticated and knowledgeable – no commercial explanation for how deals arranged– large number of similar deals – mobile phone handsets not new to market - box ticking due diligence- should have known that first deal connected to fraud - knew remaining 15 deals connected to fraud -appeal dismissed.

PRIZEFLEX LTD **Appellant**

- and -

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

TRIBUNAL: JUDGE RACHEL SHORT
MR RICHARD THOMAS

Sitting in public at the Competition Commission, Victoria House, Bloomsbury Place, London WC1A 2EB on 28 July – 1 August and 5 August 2014.

Simon Farrell QC and Robert Morris instructed by Jeffery Green Russell Solicitors representing the Appellant

Jonathan Kinnear QC and Howard Watkinson, instructed by the General Counsel and Solicitor to HM Revenue and Customs for the Respondents

DECISION

1. This is an appeal against a decision by HMRC of 5 August 2007 that £1,326,470.87 of input tax deductions claimed by Prizeflex Ltd ("Prizeflex") for the VAT periods 05/06 and 06/06 should not be allowed. HMRC denied Prizeflex the right to deduct the input tax because the transactions on which it was incurred were connected with the fraudulent evasion of VAT and Prizeflex knew or should have known of that. Prizeflex appealed against HMRC's decision on 3 September 2008.

Agreed Facts.

2. The input tax in dispute relates to 16 deals, the details of each of which are set out below.

Deal	Invoice number	Invoice Date	Net sale (£)	Units	Goods	Released to market
1	2685	09-May-06	394,500.00	3,000	Nokia 7610	May 2004
2a	2686	15-May-06	315,000.00	1,000	Nokia 9300i	Jan 2006
2b	2686	15-May-06	357,000.00	1,000	Nokia N91	April 2006
3	2688	15-May-06	263,000.00	2,000	Nokia 7610	May 2004
4	2690	17-May-06	624,000.00	3,000	Nokia N70	Sept 2005
5a	2691	18-May-06	187,873.50	499	Nokia N80	April 2006
5b	2691	18-May-06	160,339.50	999	Samsung D600	Sept 2005
6	2692	18-May-06	317,000.00	1,000	Nokia 9300i	Jan 2006
7	2693	23-May-06	437,000.00	2,000	Sony Ericsson W810i	March 2006
8a	2696	26-May-06	99,300.00	600	Nokia 6270	Sept 2005
8b	2696	26-May-06	216,750.00	750	Nokia	June 2005

		N90	
9a 2698	26-May-06 514,800.00 1,300	Nokia N80	April 2006
9b 2698	26-May-06 580,500.00 1,500	Nokia 8800	Oct 2005
10 2701	30-May-06 376,500.00 1,000	Nokia N80	April 2006
11 2705	13-Jun-06 736,000.00 2,000	Nokia 8800	Oct 2005
12a 2707	15-Jun-06 432,600.00 1,400	Nokia N80	April 2006
12b 2707	15-Jun-06 362,000.00 1,000	Nokia 8800	Oct 2005
13a 2708	19-Jun-06 165,000.00 500	Nokia 8800	Oct 2005
13b 2708	19-Jun-06 96,500.00 500	Sony Ericsson W810i	March 2006
14 2709	23-Jun-06 327,500.00 1,000	Nokia N91	April 2006
15 2710	27-Jun-06 700,000.00 2,000	Nokia 8800	Oct 2005
16 2800	03-Jul-06 310,000.00 1,000	Nokia N91	April 2006

Total value of all sales £7,973,163.00

3. There is no dispute that each of the 16 deals in which Prizeflex was involved for these periods and for which it claims input tax have been traced to a fraudulent trader, the fraud in question being missing trader intra-community fraud ("MTIC") or that the onus is on HMRC to demonstrate that Prizeflex knew or should have known at the time that its deals were connected to fraudulent transactions.

Preliminary Matters – Evidence.

4. Mr Farrell raised a number of points relating to the evidence provided by HMRC which the Tribunal considered as preliminary matters. Mr Farrell said that there were a number of issues that had not been particularised in HMRC's statement of case and should be excluded from the arguments before the Tribunal. In particular Mr. Farrell took issue with;

(1) Mr Fletcher's status as an expert witness and the potentially biased nature of his evidence.

In previous directions of 20 October 2011 Judge Berner considered whether Mr Fletcher's evidence could be allowed as expert evidence in this case and confirmed that it could be. The Tribunal therefore refused Mr Farrell's request to exclude this evidence but took notice of his comments concerning the weight which should be given to it.

(2) The late inclusion of allegations concerning an alleged loan of £150,000 made on 1 June 2006 to Prizeflex by Mr Mohammed Shabir Patel, a director of First Solutions (England) Ltd and Mobile Solutions, supplier to one of Prizeflex's suppliers. The lateness was exacerbated by the fact that the main witness for Prizeflex involved in the making of this loan, Mr Sumati Surana, was now dead.

The Tribunal agreed with Mr Farrell that HMRC's references to the significance of the alleged loan from Mr Patel in their statement of case had not been clearly set out, but nevertheless did not consider that there was sufficient prejudice to Prizeflex in having to deal with this issue to persuade the Tribunal to exclude the evidence.

(3) A lack of detailed pleadings of fraud, which had to be specifically pleaded. Mr Farrell referred to a number of allegations of fraud which he said had not been specifically pleaded by HMRC including the allegation that Prizeflex had dealt with fraudulent traders in Germany in 2009.

The Tribunal accepted the principle that allegations of fraud had to be specifically pleaded but considered that since it had been accepted by the parties that the deals in dispute had been traced to fraudulent transactions, HMRC's case was based on Prizeflex's knowledge of the fraud of others, rather than its own fraudulent dealings, therefore Mr Farrell's point of principle was not strictly relevant.

The Issue in Dispute

5. The issue in dispute between the parties is whether the deduction for input tax claimed by Prizeflex can be denied by HMRC because it relates to transactions which Prizeflex knew or should have know were connected with fraud.

Background Facts

6. Prizeflex was incorporated in 1987 and was registered for VAT in February 1988, the VAT1 describing its business as "*importer/exporter/wholesale of jute goods and clothes*". Mr Sumati Surana was a director of Prizeflex from 1987 until his death in 2009. Nishel Surana ("Mr Surana") was the son of Sumati Surana. He had worked in the business on a part time basis from 2003 after leaving university and working for O2. Mr Surana started working full time for the business and was made a director in April 2006 and had sole responsibility for Prizeflex's mobile phone business. In July 2004 "*telecommunication*" was added to Prizeflex's VAT trade classification. On 26 May 2005 Prizeflex applied to make VAT returns monthly.

7. HMRC wrote to Prizeflex on 26 July 2004 setting out the scale of MTIC fraud and asking them to carry out Redhill verification on their counterparties. HMRC visited Prizeflex's offices on 24 August 2004 and explained "joint and several liability" and Redhill verification to Prizeflex and visited again on 24 June 2005 and

issued Prizeflex with Notice 726. HMRC wrote to Prizeflex on 1 December 2005 requesting the company's business records for its exports. On 12 September 2006 HMRC Officers Quinn and Ebechidi carried out a further visit to Prizeflex and obtained detailed information about Prizeflex's mobile phone business. Prizeflex notified HMRC by a letter of 24 September 2006 of the details of the due diligence which they undertook on their suppliers and customers.

The Law

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

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

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

10. The UK's own courts have commented on the application of the *Kittel* decision in *Mobilx Limited (in liquidation) v HMRC [2010] EWCA Civ 517 ("Mobilx")* a decision of the Court of Appeal:

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

Even if a trader has asked appropriate questions, he is not entitled to ignore the circumstances in which his transactions take place if the only reasonable explanation for them is that his transactions have been or will be connected with fraud".

11. There are also a number of recent decisions from this tribunal which consider the same test, including *Else Refining and Recycling Limited v HMRC* ([2012] UKFTT 407(TC)) and notably *JDI Trading Limited v HMRC (*LON/2008/1179) which concluded, in a decision in favour of the taxpayer, that in order to prove that a taxpayer should have known of a connection with fraud, it is not sufficient for HMRC to establish that "*the taxpayer should have realised it was more likely than not that the transactions were connected to fraud*" in order to deny the right to deduct. HMRC must demonstrate that the only reasonable explanation for the circumstances in which the transactions took place is a connection with fraud. Equally in *Davis and Dan Ltd and another v HMRC* ([2013] UKUT 0374) it was accepted that the "should have known test" is a high hurdle; "*HMRC had accepted that it was not enough for them to show that the Appellants were aware of the risk of VAT fraud but that they should have known that their transactions* were *connected to VAT fraud"*

12. Our conclusion on the basis of these authorities is that HMRC need to produce clear and compelling evidence to demonstrate actual knowledge of fraud, given that the hurdle for constructive knowledge is itself a high one.

The Evidence

13. The Tribunal was provided with oral evidence from Mr Fletcher, Mr Reardon and Mr Quinn on behalf of HMRC and Mr Surana and Mr Raithatha on behalf of Prizeflex, all of whom were cross examined. The Tribunal also saw the written witness statements of each of those witnesses which were taken as read.

14. The Tribunal was provided with the contractual documents for each of the 16 deals and the due diligence documents provided by Prizeflex for its suppliers and customers. The Tribunal saw the insurance document entered into by Prizeflex dated 7 November 2006 with Willis Limited and was given a detailed schedule setting out the chains of each of the 16 deals with the prices paid, margins made and other parties involved. The Tribunal requested and was provided by the Appellant with a schedule setting out the first release dates of all of the mobile phones which were transferred in each of the 16 deals.

Mr Fletcher's evidence: The grey market in mobile phones.

15. Mr John Fletcher, principal advisor in KPMG LLP with 15 years experience of the telecoms industry appeared as an expert witness for HMRC. Mr Fletcher provided two witness statements and gave oral evidence before the Tribunal.

16. The Tribunal was provided with a detailed explanation of how the grey market in mobile phones operated in 2006, who the likely participants were and how the grey market operated for Nokia phones in particular. Mr Fletcher stressed that unlike other phone providers, Nokia had a global pricing policy which meant that cross-border price arbitrage, which might otherwise drive the grey market was much less prevalent for Nokia handsets. Their wholesale pricing policy "severely limited" the opportunities for arbitrage with their handsets.

17. Mr Fletcher explained how he understood "dumping" to occur in the mobile phone market. If a new handset was known to be coming to market, older models would be sold quickly and usually in a distant geographical market. He also referred to currency arbitrage opportunities where phones which were priced in Euros could be advantageously traded in other currencies if exchange rates moved significantly.

18. Mr Fletcher explained that the grey market operated to provide liquidity and match supply and demand. Based on his own research and common sense, distributors did not need to deal in extensive chains of suppliers in order to access the grey market. Websites such as IPT.cc provided market information which precluded the need for long chains of suppliers.

19. Mr Fletcher said that grey market trading relied on detailed information and requirements for very specific types of handset, and dealers in the market would not have used some of the rather general terms which were used in Prizeflex's documentation referring for example to "Euro specification" phones (as in their invoice of 15 May 2006 for deal 3)

20. Mr Fletcher also mentioned the UK Plugs and Sockets Regulations 1994 which for the purposes of UK consumer law made it illegal to sell mobile phones with EU specification two pin plugs to retail customers in the UK.

The circularity of the funding and the FCIB accounts – Mr Reardon's evidence.

21. Mr Timothy Reardon Higher Officer of HMRC and a member of HMRC's MTIC fraud team appeared on behalf of the Respondents. Mr Reardon provided three witness statements and gave oral evidence before the Tribunal particularly concerning payments made relating to the 16 deals through the First Curacao International Bank NV ("FCIB") accounts.

22. The Tribunal was provided with detailed evidence from Mr Reardon tracing the payments made by Prizeflex in each of the 16 deals through FCIB accounts and to defaulting traders. This evidence did not demonstrate that all of the deals in which Prizeflex was involved were circular (either as to invoices or cash). Mr Reardon had established circularity of cash for deals 2, 4,7,11,12,14,15 and 16. He accepted that although Prizeflex was involved in these transactions, the cash circularity did not always involve them.

Mr Quinn's evidence

23. Mr Matthew Quinn an Officer of HMRC since 2004 appeared on behalf of the Respondents. Mr Quinn provided five witness statements and gave oral evidence to the Tribunal. He explained that he was the HMRC officer who had investigated Prizeflex's deals. He had worked for HMRC's MTIC team from April 2006 and had been employed by HMRC since leaving university in 2004. He had been involved with Prizeflex since 2006, having visited them first on 12 September 2006.

24. Mr Quinn stated that in his view the 16 deals entered into by Prizeflex were contrived, produced rigid margins and demonstrated inconsistencies in relation to release dates and mis- timed payments for the phones. There were serious shortfalls in the due diligence carried out by Prizeflex on its suppliers and customers and Prizeflex was often paid by its customers before it paid its suppliers. Prizeflex's entry into the mobile phone business was sudden and was not the gradual growth described by Mr

Surana. In fact it coincided with Mr Surana commencing his full time role at Prizeflex; Prizeflex's turn-over increased by 440% in 2006.

25. Prizeflex's EU deals differed significantly from their dealing patterns when selling or buying in the UK. Mr Quinn referred to UK deals carried out by Prizeflex during the 05/06 and 06/06 VAT periods and pointed out that: (i) losses were made on some of these deals; (ii) the same types of phone were sold as in the EU deals but for different, lower prices (the deal 6 Nokia 9300i phones were bought for £242 in the UK but for £354.85 from an EU supplier in deal 6); (iii) Some of the UK deals involved partially filled or split orders; (iv) the UK trades were not done on a back to back basis but with a significant time delay between buys and sells of up to 29 days; (vi) the phones sold were UK specification; (vii) authorised distributors were used in the UK who gave price discounts to Prizeflex; (viii) IMEI numbers were recorded for phones sold in the UK in the 09/06 period for example. This led Mr Quinn to conclude that "*all of the features of Prizeflex's broker deals which alerted suspicion, are almost reversed when Prizeflex undertake smaller buffer deals"*.

26. Mr Quinn referred to some internet research which he had done which suggested that it was known in the market that Prizeflex and Mr Surana were fraudulent traders. He accepted, when Mr Farrell pointed this out, that the VAT number referred to in those searches was not Prizeflex's. Mr Quinn said that nevertheless this material demonstrated the level of scepticism in this market which Prizeflex did not seem to share.

27. On questioning from Mr Farrell, Mr Quinn said that in his view Notice 726 meant that a trader was obliged to do more than check the status of their immediate suppliers; they needed to be confident of the integrity of the whole supply chain in which they participated. He accepted that the Notice 726 test referring to deals being done at substantially below market prices was not relevant to these deals.

28. Mr Quinn said that he had studied the margins made by Prizeflex for each of these 16 deals and concluded that while those margins did fluctuate, there was a pattern depending on which entity was supplying Prizeflex. He accepted that back to back trading was not unusual, but said that what made these deals unusual was the length of the supply chains. Mr Quinn also suggested that the deals were "bunched" in concentrated periods of time, suggesting that the deals were contrived and that there were some days on which Prizeflex did not trade at all.

29. Under questioning from Mr. Farrell Mr Quinn accepted that he had failed to notice an inspection report for deals 9A and 9B and that he had not mentioned the letter which explained the documentation discrepancies for deals 13A and 13B. Nevertheless Mr Quinn pointed to a number of aspects of Prizeflex's documents which seemed odd:

(1) The casual reference in the comments box of the inspection report for deals 9A and 9B that "*everything was alright*".

(2) The reference to the "*colour; country variant*" for Nokia N91s in deal 2A and 2B, which were in fact always stainless steel.

(3) The reference in deals 8A and 8B to "*HMRC stamps cut out*" as part of the inspection carried out at the freight forwarder Hawk's warehouse, which Mr Quinn suggested indicated circularity of goods.

Due Diligence.

30. Mr Quinn accepted that Prizeflex had not received any "joint and several liability" letters or "veto" letters from HMRC for any of the parties they had dealt directly with. Mr Quinn pointed out that many of the credit checks for which Prizeflex had provided evidence had been done after the deals had been carried out and that a significant number of these checks had been confirmed verbally to Mr Surana and no written evidence existed of them. In Mr Quinn's view a "Redhill" check should have been carried out prior to every deal which was entered into rather than 6 months before the deal. (A Redhill check is a means of obtaining confirmation from HMRC that a particular trader remains validly registered for VAT). Mr Quinn had no evidence of the online Europa checks which Mr Surana referred to as a quicker alternative to the Redhill checks or any evidence of payment having been made for credit checks. Mr Quinn had seen no evidence of Prizeflex researching their suppliers' history.

31. Mr Quinn acknowledged that it was not a legal requirement for companies to keep IMEI numbers before October 2006 and it was accepted that Prizeflex's insurance did not require the keeping of IMEI numbers.

32. Overall Mr Quinn concluded that the due diligence done by Prizeflex did not amount to the actions of a business entering into commercial deals in a new and risky type of trade, but were the actions of a business entering into contrived deals with no commercial risk.

Mr Surana's evidence

33. Mr Surana is a Director of Prizeflex and appeared as a witness for the Appellant. Mr Surana provided three witness statements and gave oral evidence to the Tribunal.

34. Mr Surana struck us as an intelligent man whose evidence was cogent and clear in most respects.

Market Knowledge

35. Mr Surana's witness evidence confirmed that he was experienced in the mobile phone industry having been working in that industry since he was at college in 2003 and full time with his father's firm since 2006. Prizeflex had seven employees in 2006, including his father, sister and mother. Mr Raithatha was the general manager of the business. Mr Surana's father dealt with all financial matters and ran the jute side of the business. Mr Surana was in sole charge of the mobile phone part of the business.

36. Mr Surana had worked at the O2 store on Oxford Street after he left college and, at the same time, sold phones to small independent retail shops, trading with a turn-over of about £50 – £60,000 in 2004-5. He had contacts with large UK phone suppliers such as AirCall, 20/20, (an authorised Nokia dealer), and Elite Mobile. He had visited Elite's premises and knew their sales manager. Mr Surana said he had no doubts about the honesty of his suppliers.

37. Mr Surana had good contacts in the mobile phone industry and had attended CeBIT fairs in Germany and CTIA fairs in Las Vegas and used the IPT.cc exchange website as a means of identifying customers. He understood the grey market in mobile phones but disputed that this would always involve an "authorised distributor". He did

not accept that the only commercial route to market was from an authorised distributor or a "multiple" or that acquiring from an authorised distributor would always be cheaper.

38. Under questioning from Mr Kinnear, Mr Surana was able to explain the purpose of the documents used in these deals including the "ship on hold" conditions in Prizeflex's Release Documents and the details contained in the various invoices as well as the details of the insurance provided by Willis Limited to Prizeflex. He described "ship on hold" as "*an agreement for us to be able to ship the goods in the control of the freight forwarder. So, we would not be able to get release of the goods and it would not give us full credit of the goods or title of the goods, but it would allow us to ship it to the customer*"

Knowledge of fraud risk.

39. Mr Surana said that he had seen and read Notice 726 and that he had attended meetings with HMRC (including with Mr Quinn) and/or had details of these meetings reported back to him from his father. He had seen HMRC's letter of 26 July 2004 setting out the risks of MTIC fraud and their letter of 1 December 2005 setting out their requirements for the documents which should be retained by traders. In his view Prizeflex had always worked with HMRC and there was nothing in HMRC's dealings with Prizeflex which had put him on notice that they could be involved in fraudulent trading. He had provided company details including name, VAT number, contact details and directors' names as part of the Redhill checking process for his clients and this information had always been stamped and verified by HMRC. He had provided all required documentation to HMRC as part of these Redhill checks and for previous VAT reclaims and HMRC had never suggested that any of the documentation was inadequate or flawed.

40. Mr Surana stressed that his understanding of the fraud risk was "defaulting trader risk", where a trader in the chain fails to account for VAT. He consistently said that he did not understand "carousel fraud" and was not aware of that term in 2006.

Due Diligence

41. Mr Surana was aware of the need to carry out due diligence on his suppliers including the Redhill checks and credit checks. Mr Surana said that Prizeflex often relied on "Europa" rather than Redhill since the response time from HMRC for Redhill checks could be very slow. He did not consider that it was necessary to do more than one Redhill check per supplier or to do a check immediately prior to dealing.

42. He carried out credit checks on his suppliers but this was often done online and no records of these checks were printed out. He obtained references for his suppliers from the trading platforms and the market. For example for deal 9A and 9B with new customer World Communications, Mr Surana said that he relied on confirmation that their VAT number was valid, the company's registration documents, a copy of the company's letterhead and IPT.cc member references. Relying on Notice 726 he had considered that it was more important to check his suppliers than his customers.

43. When goods were held at a freight forwarder either Prizeflex would inspect the goods themselves or they would hire an inspection company to do it. Mr Surana would usually obtain a document confirming that the goods had been inspected but often this was confirmed by phone. He could not provide notes of those phone confirmations.

44. Mr Surana accepted that all of the phones which he had traded in these deals had two pin European plugs but did not accept that this meant they could not be used in the UK because it was easy to acquire a charger adapter. When asked why his deal documentation (such as in the sale to Sunico A/S for deal 3) a requirement was stated that there were "no customs stamps", he replied that this was because customers did not want stamped goods. He did not accept that this indicated either that the goods had been carouselled or that he was aware that the goods had been carouselled.

45. Mr Surana said that while Prizeflex originally kept a record of IMEI numbers, they stopped doing this because they did not know what to do with the information and it was a costly process to scan and keep the information. Prizeflex had told HMRC that they were not keeping IMEI numbers. They did record serial numbers for the phones. Mr Surana said that Notice 726 did not require the keeping of IMEI numbers. He knew that he dealt with reputable companies and this was his real protection from being involved in fraud.

46. Mr Surana had enlisted the help of advisers CTM to draft his "Suppliers' Declaration" document which was intended as an additional protection for Prizeflex. CTM had suggested the information which should be included in this declaration.

Terms of Deals and Negotiation

47. Mr Surana explained that to match buyers and sellers he had a whiteboard in his office where he recorded details of buyers' requests and sellers' offers. He spent his time co-ordinating between buyers and sellers by phone and had a target of a 4 – 8% profit margin for exports. Most of his dealing was done by telephone and email. He could not explain why EU based buyers and sellers would have wanted to purchase from him or why they did not buy directly from each other other than to say that people preferred to deal with people who they knew. He could not explain why he could always match his buy and sell orders with no failed trades and no partially filled orders. When asked how he found his suppliers and customers, for those that he could remember, he said that he had contacted most of the suppliers either from his trade fair contacts or IPT.cc and on some occasions through referrals from freight forwarders Hawk. He had first got in touch with Elite Mobile at CeBIT in March 2006. All of his buyers had contacted him through IPT.cc. He could not readily explain why these buyers and sellers needed to use him as a middleman. Nor could he explain how it was that each of his eleven suppliers and customers had manipulated him into being involved in deals connected with fraud.

48. Mr Surana accepted that EU suppliers would have provided a cheaper source of phones for these deals and said that he did attempt to deal with EU suppliers, but it was harder to get to know EU suppliers and much easier for him to buy from UK suppliers who he knew. He said that he did deal with UK authorised distributors but had not done so for any of these deals. When buying from UK authorised distributors he would sell to UK buyers, but in other deals he had bought from UK authorised distributors and exported to the EU. When asked to explain why goods were being sold from the EU between UK suppliers and then back to the EU, he said that this reflected arbitrage opportunities and was balancing supply and demand.

49. Mr Surana explained that it was common to receive an order from a customer and then ask Prizeflex's supplier to ship the goods on hold, so the goods could be sent to the buyer without Prizeflex having paid to obtain title to the goods. Prizeflex's supplier would be paid only when they were paid by the buyer. A release of the goods was confirmed only once payment had been received from the buyer. Freight

forwarders understood this process and so there was no risk of Prizeflex being exposed for loss of the goods, which were also insured.

Deal Documentation

50. Mr Surana was taken through several deals and their related documents by Mr Kinnear. Mr Surana accepted that in some cases the Suppliers' Declaration documents were not signed until after the deals had been done. He also accepted that some Redhill checks were not carried out until after the deals had been done, but did point out that this was in part as a result of the length of time taken by HMRC to process the checks. In respect of goods being transported on ship on hold terms (such as in deal 1 to Sunico A/S) Mr Surana said that he was happy to take this risk in order to obtain a significant new client like Sunico and accepted that title to the goods remained with the supplier (in that case London Mobile Communications Limited) until Sunico paid Prizeflex and Prizeflex paid London Mobile.

51. Mr Kinnear referred to the shipping documents in deal 8A and 8B when Prizeflex's supplier, Santok Enterprises Ltd, appeared to have requested that the goods be sent to Denmark prior to them being transferred to Prizeflex, suggesting that Santok knew that Prizeflex's customer was Sunico A/S in Denmark. Mr Surana could not provide an explanation for this.

52. Mr Surana was also asked about deal 9, a sale to World Communications and the fact that Prizeflex did not receive payment for this deal (according to their bank statements) until a week after the goods had been released on 29 May 2006. Mr Surana accepted that in this case payment had been made late but could not explain why, particularly since World Communications were a new customer and insisted that it was not his usual practice to release goods before receiving payment and that the freight forwarder would not release goods if they knew the seller did not have title.

53. Mr Surana was asked to explain why World Communications were willing to honour the terms of deal 9 despite the fact that the value of the phones had gone down by the time payment was made (as was clear from the pricing of the same phones in deal 10). Mr Surana could only reiterate that this was because World Communications were effectively committed to buy the phones in deal 9.

Mr Raithatha's evidence.

54. Mr Pradip L Raithatha appeared as a witness for the Appellant and provided a witness statement dated 9 January 2014 and oral evidence to the Tribunal. Mr Raithatha confirmed that his witness statement was incorrectly dated and had actually been signed on 9 July 2014. Mr Raithatha is the general manager for Prizeflex, a position he has held since 1987. As a witness Mr Raithatha appeared somewhat easily confused

55. Mr Raithatha was a long standing employee of Prizeflex who knew both Mr Surana and his father well. He testified that Mr Surana was an honest businessman.

56. Mr Raithatha described the Prizeflex office as busy, with phones constantly ringing and Mr Surana being in attendance every day. He explained that part of his own role was to prepare the release notes for the mobile phones which were then faxed to the clearing agent. He said that these were prepared on an existing template and were usually prepared with some urgency and sent in a rush. When questioned about the release note for deal 9A dated 29 May he said that this would have been

sent on the same day. This aspect of his evidence differed from Mr Surana's suggestion that release notes could be dated but then not sent for several days.

Taxpayer's Arguments.

57. Mr Farrell representing the Appellant started by explaining that during the periods in question the EU mobile phone industry experienced explosive growth with large demand for phones: in 2006 there was more than one hand set per person in the EU. In 2005-6 30 new Nokia hand sets were introduced into the EU market. He also stressed that in 2006 relatively little was known of carousel type VAT fraud, the most common type of fraud which was discussed in the mobile phone market in 2006 was "missing trader fraud".

58. Mr Farrell spent some time referring to Mr Surana's background and demonstrating that he was an honest businessman who had no history of involvement in any kind of criminal activity and this was supported by Mr Raithatha's evidence. Mr Farrell suggested that Mr Surana could not be described as the kind of cunning fraudster who would be involved in transactions which he knew were fraudulent.

Hallmarks of Innocence

Grey Market Trading

59. There was nothing in Prizeflex's trading model which was inconsistent with grey market trading in which Prizeflex's role was to add liquidity to the market and add value by organising the movement of phones between two geographical markets. The level of margin made by Prizeflex reflected the costs and capital required for these cross border transactions compared with UK to UK deals. Even if Mr Fletcher's evidence could be accepted, despite Nokia's pricing policy there was still a grey market for Nokia phones in the EU, where prices could be undercut by for example, not spending on advertising for popular phone models.

Knowledge of fraud.

60. Mr Farrell pointed out that there were innocent traders in the mobile phone market at this time who were being used by fraudsters. Not all of those who were brokers in this market were involved in VAT fraud. Mr Farrell also took pains to point out that only 8 of the 16 deals in dispute were actually circular (based on the tracing exercise carried out by Mr Reardon) being deals 2A, 4, 7, 11, 12A, 14, 15 and 16 and only deals 8A and B were circular by reference to the invoices issued and the cash paid. Any other "circularity" was based on Mr Reardon's tracing exercise which was dealing with fungible streams of cash. While Mr Farrell accepted Mr Reardon's evidence that all of the 16 deals were linked to fraudulent defaulting traders, there was no evidence that the parties with whom Prizeflex dealt directly were defaulting traders and in fact many were substantial companies (such as Elite Mobile PLC, London Mobile Communications and Santok Enterprises Ltd) which continued in business today.

61. There was nothing to put Prizeflex on notice that their deals were connected with fraud; they dealt regularly with the same person at HMRC (Mr Yule). Prizeflex had had £2.3 million of VAT re paid between 06/05 and 03/06. Prizeflex were obeying the rules set out by HMRC including in Notice 726: "*We do not expect you to go beyond what is reasonable and you are not necessarily expected to know your suppliers supplier"* and its focus on suppliers rather than customers. Mr Farrell stressed that it was clear from the details of Notice 726 that it was not expected that

Prizeflex should know about their supplier's supplier and on that basis it was hard to see what Prizeflex could have done to establish that their deals were connected with fraud. Even if Prizeflex had conducted further checks, it is unlikely that they would have revealed any further evidence of fraud.

62. Mr Farrell also stressed that, unlike other participants in the chain, Prizeflex did not have an FCIB account, suggesting that while other participants were co-ordinating their activities, this did not include Prizeflex. Similarly the margins made by Prizeflex were not consistent, ranging from 2.9 – 7.9% which suggested that the deals were commercial transactions and not contrived.

Due Diligence

63. Prizeflex had obtained inspection reports for all of the 16 deals and any minor discrepancies could be explained by administrative errors. £46,531.44 had been spent by Prizeflex on insurance suggesting that they were protecting the goods which were being transported. Prizeflex was taking commercial risk in the deals; particularly non payment by the customer. Mr Farrell pointed out that the terms of Prizeflex's insurance contract did not oblige Prizeflex to retain IMEI numbers.

64. Mr Farrell explained why Prizeflex could have been chosen by the fraudsters as an innocent player; because it was easier to persuade an innocent participant to make the input tax reclaim from HMRC. There was no reason why the fraudsters could not have ensured that they were at both ends of Prizeflex's deals without Prizeflex knowing. It was not correct to imply that Prizeflex was obtaining a proportion of the profit of fraudulent transactions; the proceeds of the fraud were the amount equal to the VAT which the missing trader at the top of the chain failed to account for.

65. In his view this fraud had been intentionally hidden from Prizeflex and it was the duty of HMRC, not Prizeflex, to carry out detailed investigations into fraudulent transactions. Prizeflex could not be expected to be a fraud investigator. Mr Farrell referred to the joined CJEU cases *Mahagében kft v Nemzeti Adó- és Vámhivatal Dél-dunántúli Regionális Adó Főigazgatósága* and *Péter Dávid v Nemzeti Adó- és Vámhivatal Észak-alföldi Regionális Adó Főigazgatósága* [C-80/11 and C-142/11] in support of the argument that Prizeflex's obligations to check whether there were fraudulent transactions further up the chain were limited. Prizeflex's due diligence while it might have been better, was not so poor as to suggest that Prizeflex knew that these deals were fraudulent. It was perfectly possible for the fraudsters to offer to sell to and buy from Prizeflex at the same time without Prizeflex knowing that they were being manipulated.

Hallmarks of Fraud

66. On the specific hallmarks of fraud raised by HMRC, Mr Farrell suggested that (i) despite Nokia's pricing policy, there remained an incentive to trade Nokia phones in the grey market cross border (ii) there was nothing inherently suspicious about deals being done on a back to back basis (iii) It was common for invoices not to give specific details about the phones transferred (he gave as an example a Carphone Warehouse invoice which was not very specific), (iv) it was unrealistic to expect that all deals would be perfectly documented, including the timing of release documents (v) there was nothing inherently suspicious about goods being imported and then exported from the UK and there was nothing suspicious about importing two pin plug chargers which could easily be changed; it was in the nature of the grey market that

cheap stock would be sourced (i.e. stock which was not originally intended for that market).

67. Mr Farrell specifically rebutted HMRC's contention for deals 13A and 13B that goods had been removed from the freight forwarder, Hawk's warehouse before they had been released by Prizeflex on the basis of evidence provided by Hawk to HMRC. Mr Farrell suggested that Prizeflex had already made this clear to HMRC in their letters of 23 February 2007 but that had not been reflected in Mr Quinn's evidence. Prizeflex's description of the timing of the movement of these phones was also supported by the CMR documentation for deals 13A and 13B.

68. Prizeflex had entered into each of these deals honestly and on the basis of the information available at the time. Prizeflex did not have the means of knowing that the deals were connected to fraud and had acted reasonably believing that each deal was a legitimate commercial deal.

HMRC's Arguments.

69. For HMRC Mr Kinnear started by accepting that the only issue in dispute now was whether Prizeflex knew or should have known that its transactions were connected to fraudulent deals. He suggested that there was no real dispute between the parties as to the law.

70. Mr Kinnear explained his view that it was not necessary for HMRC to demonstrate that Prizeflex had direct knowledge of the fraud which was being perpetrated, but could rely on inferences from the circumstantial evidence as a whole. In this instance, Prizeflex's transactions took place as part of a highly orchestrated and well oiled fraud which itself indicated that all participants, including the Appellant, knew the transactions were fraudulent. Mr Kinnear referred to the decision in *Edgeskill Ltd v HMRC* ([2014] UKUT 38 (TCC)) where it was suggested that "*the question whether the Appellant participated in an overall scheme intended to defraud informs, but does not answer the question whether the Appellant knew or should have known that it was participating in such a scheme*".

Hallmarks of Innocence

Knowledge of Fraud

71. Mr Kinnear referred to HMRC's letter to Prizeflex of 26 July 2004 and their visits on 24 August 2004 and 24 June 2005 setting out the risks of fraud in the mobile phone market and asking Prizeflex about the due diligence checks it was carrying out. It was not possible to suggest that Prizeflex were unaware of the prevalence of fraud in this market.

72. Mr Kinnear accepted that HMRC could not demonstrate a carousel of goods and money in respect of every one of the 16 transactions under dispute but stressed that contrivance was not longer in dispute between the parties. He also made clear that whether the deals were circular was not crucial to HMRC's arguments but "the icing and candles on the cake". For each of deals 1, 3, 5A & 5B, 6, 8A & 8B, 9A & 9B, 10 and 13A & 13B circularity of goods had been established. He referred to the 8 sales between 9 parties which were made in less than 24 hours on a back to back basis across three different countries in deals 8A and 8B to illustrate this point. The circularity of the transactions could not have been achieved without Prizeflex's knowing participation. He also referred to the evidence of Mr Reardon that several of the transactions in which Prizeflex was involved demonstrated circularity of funds.

73. He set much store by the argument that the deals were so highly orchestrated and contrived that Prizeflex must have known that they were fraudulent because the directing minds of the deals would not have risked an innocent dupe in the circle of deals. An innocent dupe might sell to the wrong person or buy from the wrong person, in which event the funds would leave the control of the fraudsters, or the innocent dupe might report their suspicions to HMRC.

74. Mr Kinnear also referred to the length of the chains in each of the deals in which Prizeflex was involved and the fact that Prizeflex always obtained the highest mark up on its sales compared to others in the chain to suggest that the deals were fixed.

Due Diligence

75. Mr Kinnear cited Prizeflex's use of its "Supplier Declarations", such as the one provided to Prizeflex from London Mobile Communications for deal 1 on 10 May 2006 to suggest that Prizeflex was well aware that it was dealing in fraudulent chains and knew all of the hallmarks of fraud and what HMRC required taxpayers to do to try and identify fraud. This and the other due diligence which had been done by Prizeflex was "window dressing" and was in any event inadequate, often being done after the deals had been entered into.

76. Mr Kinnear accepted that Prizeflex had carried out due diligence checks on its suppliers but these were casual and lax. Prizeflex had not been able to provide documentary evidence to support the due diligence which it said it had carried out on its suppliers, saying that these checks were done online or by telephone or in meetings at trade fairs of which no notes were kept.

77. Mr Kinnear referred to a number of examples of Prizeflex's due diligence which he considered had not been thorough or timely. For example Prizeflex's due diligence on Elite Mobile PLC had been based on a Redhill verification carried out in April 2005, obtaining the company's incorporation details, a copy of its headed notepaper and VAT certificate. Prizeflex also had the company's bank details, its 2004 accounts a Companies House print out and its annual return. It was only after Prizeflex had entered into its transactions with Elite Mobile that a credit check was carried out.

78. Mr Kinnear stressed that the Redhill verifications on which Prizeflex relied were not and should not have been treated by them as verification that the entities checked were not involved in MTIC fraud**.** Prizeflex had consistently shipped high value goods to EU customers on the basis of little or no due diligence and without receiving payment.

Hallmarks of Fraud

79. In Mr Kinnear's view any suggestion that Mr Surana on behalf of Prizeflex was an "innocent dupe" was not credible. In his view it could not possibly have been a coincidence that all of Prizeflex's 16 deals traced back to a fraudulent trader. Mr Kinnear did not consider that Prizeflex not having an FCIB account meant that they were not knowingly involved in these circular transactions and explained how he viewed the input tax as having been split between the participants including Prizeflex.

Grey Market Trading

80. Mr Kinnear argued that Prizeflex's patterns of dealing did not exhibit the characteristics of grey trading by reference to Mr Fletcher's description of that market. In fact, Prizeflex's trading pattern suggested that it was not involved in the grey market; it was not trading UK origin phones; it had no significant workforce or warehouse; it did not hold stock; it used generic product descriptions on its invoices; its trades involved Nokia phones which could not be arbitraged because of Nokia's pricing policy; it did not acquire from authorised distributors or distributors based in Europe.

Lack of Commerciality

81. Mr Kinnear also pointed to the lack of commercial aspects in these deals, including the lack of commercial negotiations, the lack of detailed particulars on invoices, the "credit" which was granted to Prizeflex through allowing goods to be transferred ship on hold and the fact that there were no retailers or manufacturers anywhere in the chains. Mr Kinnear particularly stressed that Prizeflex often seemed to have released goods before title had passed, selling goods which it did not own in a haphazard fashion and in all of the deals in question received payment from its customers before making payment to its suppliers. The most extreme example of this being deal 3 in which Prizeflex was paid for the goods but did not release them for 13 days. Mr Kinnear drew the conclusion that this level of trust between buyers and sellers could only be the result of all parties knowingly participating in fraudulent deals.

82. Mr Kinnear described Prizeflex's invoice descriptions of the goods which were being bought and sold as "paltry" and said that in a commercial market this would have led to chaos. He referred as an example of this to deal 5A, Nokia N80s were requested with a two-pin charger by Sunico A/S, but on inspection in Denmark by Sunico they were described as having a three pin charger, however neither party to the transaction suggested that this was a problem.

83. In Mr Kinnear's view, the level of profit made on these deals; £393,019 in total for 16 deals which amounted to 13 days of actual trading was not commercially justifiable and differed significantly from the profits made on Prizeflex's UK to UK deals, in which smaller profits were made.

84. Mr Kinnear said that Prizeflex had produced no evidence to demonstrate that any of these 16 deals had been commercially negotiated, which led to the conclusion that there had been no need for negotiation because Prizeflex knew that the deals were fraudulent. Mr Surana had not been able to provide any documentation such as email chains or notes of daily prices to suggest that there had been any commercial negotiation.

85. Other aspects of Prizeflex's dealings also suggested knowledge of fraud; in particular the failure to record IMEI numbers for the phones in any of these deals, despite its previous practice of doing so. Prizeflex knew that this was the only way to be sure that these phones were not being re-circulated for fraudulent purposes and that it made sense for commercial reasons to record these numbers. The speed with which the deals were done and the phones transported out of the UK was also suggestive of knowledge of fraud.

86. Overall these were tightly orchestrated schemes in which the risk of introducing an innocent party into the chain was very high. There were numerous features of Prizeflex's dealing which suggested that it was knowingly involved in a chain of fraudulent transactions. If Mr Surana had been an innocent dupe, he had failed to

provide any convincing evidence of how he had been manipulated and how these deals could have been put together in the way that they were without his knowledge of what was going on.

87. Even if Prizeflex did not know that its deals were connected with fraudulent deals, there was no other explanation for these deals in a market which Prizeflex knew was rife with fraud and Prizeflex should have known that these deals were so connected. Mr Kinnear referred to the questions commended by Lord Justice Moses in *Mobilx* in the context of what a trader should have known and concluded that Mr Surana's evidence did not suggest any answers to these questions which gave any credible explanation for these deals other than a connection to fraud.

Findings of Fact

88. On the basis of the evidence provided the Tribunal made the following findings of fact:

89. Nine different types of mobile phone handsets were supplied in each of these deals; of these, only the Nokia N80, Nokia N9300i and the Nokia N91 were new to the market during the second quarter of 2006, the other handsets were old models, in some cases more than two years old.

90. The deals were carried out over a two month period from 9 May until 3 July 2006. Over the period deals giving a profit of £399,019 with a profit margin of between 2.9 and 7.9% and an average profit margin of 5.9% were entered into. By comparison the UK to UK deals entered into by Prizeflex usually gave rise to profits of £1 per phone. The trades involved 11 different suppliers and customers.

91. Mr Surana had seen and understood Notice 726 and was aware of the risk of fraud in this market. He had seen HMRC's letters of 26 July 2004 and 1 December 2004 and was aware of HMRC's statements to Prizeflex in their meetings of 24 June 2005 and 24 August 2004.

92. Mr Surana was the controlling mind of Prizeflex for its mobile phone business and had experience in the market including in UK to UK sales. The pattern of trading for Prizeflex's UK deals was markedly different from that in these EU transactions.

93. The goods were sold by Prizeflex on "ship on hold" terms but the precise date on which the goods were released to their buyer in the EU and how and when title to the goods passed was not completely clear either from the documents or Mr Surana's evidence.

94. Some due diligence was done by Prizeflex for both its buyers and sellers, including Redhill VAT checks and credit checks.

95. Prizeflex paid for insurance of the phones which they were responsible for transporting, whether or not they had title to those phones at the time of shipping.

96. Invoices from other participants in this market including Carphone Warehouse were not always precise as to the details of the phones being purchased.

97. Prizeflex had turnover of £209,309 in VAT period 09/04 rising to £5,279,682 in period 05/06. Its turnover in 2006 was £25m. For the 05/06 period 92% of sales were to the EU, for 06/06 that percentage was 97%.

98. All 16 deals were done on a back to back basis, with no surplus of supply or shortfall in demand, all purchases and sales were perfectly matched.

Discussion

99. The onus of proof in this instance is on HMRC to demonstrate that Prizeflex knew or should have known that each of these deals was connected to fraud. There is no dispute between the parties that each of these 16 deals can be traced to a fraudulent trader.

100. On the basis of the evidence the Tribunal's conclusion is that, save in respect of deal 1, Prizeflex knew that each of those deals entered into for the periods in dispute were connected with fraud. For deal 1, the Tribunal has concluded that Prizeflex should have known that this deal was connected with fraud.

101. The Tribunal sets out below the reasons for these conclusions. We have assumed that each of deals 2 to 16 have common features unless otherwise specified. We have provided our reasons in the order reflecting the weight we have given to the evidence and made clear where our conclusions are based on a combination of factors.

Some points on the evidence

102. Much of the evidence of Mr Reardon went to the circularity and contrived nature of these deals. On the basis that this has been conceded by Prizeflex, we have not treated this evidence as critical to our decision.

103. Mr Fletcher's evidence was confined to a general description of how he believed the grey market in mobile phones operated. Mr Farrell posed some questions as to Mr Fletcher's capacity to draw these conclusions. We have not relied to any great extent on Mr Fletcher's evidence about the grey market in mobile phones save to conclude that Nokia had a single pricing policy and that the existence of a grey market depended on arbitrage of price or supply between markets.

104. Much of Mr Quinn's evidence consisted of his opinions as Mr Farrell pointed out. This to some degree is understandable as it was Mr Quinn who had issued the decision letter denying repayment to Prizeflex and that letter was required to indicate what HMRC's reasons were for the decision. Mr Quinn's evidence recapitulated much of the decision letter. He was also at times unwilling to give a direct answer to Mr Farrell's questions, preferring to repeat his opinion of the shortcomings in the Appellant's case. While we did not attach any weight to his opinions we did find that some of the factual evidence he had given, especially about Prizeflex's UK-UK sales was useful and relevant.

105. The Tribunal has considered the authorities in this area, *Mobilx* and *Kittel* and has applied the tests set out in those cases namely: *"a taxable person who knew or should have known that by his purchases he was taking part in a transaction connected with the fraudulent evasion of VAT must ..... be regarded as a participant in that fraud"*.

106. Contrary to the Appellant's contentions, it is not necessary for the Tribunal to conclude that Prizeflex, through its director Mr Surana, is either a fraudulent company itself or involved in a fraudulent conspiracy. The Appellant spent some time

discussing Mr Surana's character, but we do not consider that this is relevant to this appeal.

107. We have accepted that the actions of Mr Surana can be taken as the actions of the Appellant, Prizeflex, on the basis of authorities such as *Greener Solutions Ltd* v *Revenue & Customs Commissioners* ([2012] UKUT 18 (TCC)).

Knowledge of Fraud.

Commerciality of deals.

108. The most compelling evidence which has led us to conclude that deals 2 to 16 were entered into by Prizeflex in the knowledge that they were fraudulent is that an intelligent and sophisticated businessman such as Mr Surana entered into these deals but was unable to provide a convincing commercial explanation, or any written evidence, of why they were entered into, how they were negotiated, how particular buyers were found for particular sellers or vice–versa or why it was that no deals failed, were only partially filled or were filled by more than one supplier.

109. Mr Surana's evidence was generally cogent and clear, but was far from that when asked to explain the commercial negotiations surrounding these deals. We have taken this as evidence that these deals were not commercially negotiated, that Mr Surana was aware of that and that there was no commercial negotiation because Mr Surana knew that these deals were connected with fraud. We accept HMRC's point that it cannot have been merely luck which meant that every one of these 15 deals was so readily matched and settled.

110. We have also relied heavily on the fact that Mr Surana understood the UK mobile phone market, having done a number of deals in the UK market prior to and at the same time as these disputed transactions, but these transactions showed marked differences to those UK deals, both in terms of the profit margin achieved, the commercial terms, the parties and the goods being sold. We have noted in particular that Prizeflex did record IMEI numbers for its UK transactions in September 2006, despite Mr Surana suggesting that in respect of these EU deals a decision had been made that this was too difficult and not worthwhile. It must have been clear to Mr Surana that these deals were being carried out in a very different way from his UK transactions. We have concluded that the only reason why he was prepared to do this number of deals in such a different way without raising any concerns was because he knew these deals were connected with fraud.

Knowledge of risks of fraud.

111. Mr Surana was well aware of the risk of fraud in this market, from HMRC correspondence, from Notice 726, from meetings he attended with HMRC and from feedback from meetings with HMRC which were attended by his father. He was sufficiently well aware of this to instigate a paper trail of checks on his suppliers and customers. In particular we do not think that a person of Mr Surana's business acumen could fail to understand the significance of what he was asking of his suppliers in the "Suppliers' Declarations" which had been prepared for him. We accept that Notice 726 is not as comprehensive as it might have been and did not for example include a requirement to keep IMEI numbers, but it is difficult to understand how an intelligent man such as Mr Surana, who had understood the risk of being involved in fraud sufficiently well to implement the measures which he did, would nevertheless enter into transactions which had the hallmarks of fraudulent deals without raising any concerns. We have concluded that Mr Surana was only willing to

do this because he knew that these deals were fraudulent and was happy to participate in them.

112. We did not find Mr Surana's alternative explanations for why these deals were being done on these terms convincing, particularly the suggestion that the transactions reflected grey market trading at a time of explosive growth in the mobile phone business. The evidence which we were provided with about the serial numbers and release dates of the phones suggests that in the main they were not handsets for which, at the relevant time, there would have been a large demand, certainly not at the margins being made by Prizeflex. If there was such a market, we do not accept that it would have been available so readily for every one of these deals, for a number of different models of phone, over such a short time period. Some of the older types of phone may have been suitable for dumping, but there is no evidence that Prizeflex obtained these phones at prices which would allow for dumping.

113. The deals entered into by Prizeflex were for a number of different types of handset of quite different ages; some being relatively new to the market, some being rather old. That being the case, if there was some sort of grey market trade for all of these handsets, we would have expected the patterns of dealing to be different, but this was not the case. Given his knowledge of the market, Mr Surana must also have been aware of the fact that such consistent patterns of dealing in markedly different underlying types of phone could not be explained by anything other than the transactions being driven by fraud.

Indicators of knowledge of fraud

114. There are also a number of actions which were taken by Prizeflex, which while not necessarily indicative of an intention to knowingly enter into fraudulent deals if viewed in isolation, in combination with the actions set out above, suggest that Mr Surana knew he was entering, or about to enter into fraudulent deals:

(1) The fact that Prizeflex asked to be put on monthly VAT accounting from 9 May 2005;

(2) The fact that Mr Surana stopped recording IMEI numbers before any of these deals were entered into;

(3) The fact that Redhill checks were done on three of Prizeflex's main suppliers for deals 1 – 16 at the same time (Sunico, Compagnie Internationale de Paris and World Communications were all Redhill checked on 25 April 2006).

Profitability of deals.

115. Finally, the fact that Mr Surana accepted the level of profit which he was making on these deals by reference to the amount of work which Prizeflex carried out and the amount of risk taken by Prizeflex is itself suggestive that Mr Surana understood that he was being rewarded for taking part in a fraudulent transaction chain. Mr Surana referred to the fact that he was providing cash flow to his suppliers by being willing to wait for the VAT reclaim from HMRC, which others might not be willing to provide. While this is indeed what Mr Surana was providing, the fact that he recognised this and that there were others who were not able or willing to provide this suggested to the Tribunal the Mr Surana was aware of more participants in these transactions than he otherwise suggested in his evidence.

Contributing factors.

116. There are a number of other pieces of evidence which we have treated as not compelling evidence in themselves of the fact that Prizeflex knew that these deals were fraudulent, but which in combination with the other evidence, do colour Prizeflex's activities:

(1) *The weaknesses in the documentation produced by Prizeflex, especially relating to the passing of title to the goods.*

We understand that there is always some commercial slippage and that documents are often not prepared in perfect detail and on time. The invoice which we were shown from Carphone warehouse supported this fact. Prizeflex did provide an explanation for some of the discrepancies in their documentation highlighted by HMRC (such as the timing of release of the goods in deals 13A and 13B). However, the release notes produced by Prizeflex were very significant documents for goods worth a lot of money in relation to Prizeflex's business and we do not think that someone who had a real commercial stake in these goods would have been as haphazard as Prizeflex was in the preparation of these documents. Mr Surana's attempts to explain the discrepancies in the dates when goods were released were not supported by the evidence of Mr Raithatha or by commercial common sense.

(2) *Mr Surana's attitude to due diligence on his clients.*

While at one level, as Mr Surana tried to suggest, Prizeflex's due diligence was in line with the requirements of Notice 726, nevertheless it appeared to us to be mainly a "box ticking" exercise, with no evidence of any attempt to take a realistic view of the possibility of fraud being present beyond the formalistic requirements of Notice 726. Prizeflex suggested that they relied on HMRC and were lulled into a false sense of security, but we do not think this is an adequate response to a proposed series of dives into "shark infested waters" (to use a phrase of Mr Farrell's). Nor do we think that it detracts from this view that Mr Surana never dealt directly with a fraudulent trader (i.e. the person in the deal that failed to pay the VAT). Mr Surana's actions do not fulfil the requirements articulated in *Kittel* that "*Even if a trader has asked appropriate questions, he is not entitled to ignore the circumstances in which his transactions take place"*.

Minor Factors

117. Finally there are a number of other arguments put to us by HMRC which we have taken account of in our conclusions, without according them very much weight;

(1) Mr Kinnear focussed on the fact that these deals were actually part of a larger orchestrated fraud, with a significant degree of circularity (of either goods or cash). His conclusion was that the very orchestrated nature of the fraud meant that each participant must have known that the deals were connected to fraud. Our view of this argument is that it is not a sufficient answer to the question of what Prizeflex actually knew as a participant in the chain to suggest that at some higher level of abstraction, the chain could only work if everyone understood their place in it.

(2) As a related argument, HMRC suggested that the fraud was too sophisticated to fail and that sophisticated fraudsters would not have risked an "innocent dupe" in the chain who might have given the game away. This is a

slightly more persuasive argument and although it is possible to posit a situation in which everyone but Prizeflex knew what was going on and ensured, without Prizeflex's knowledge that the right seller and buyer always showed up, we accept that this would be difficult to maintain in practice. The better response to this argument we think is that Mr Surana did not appear to us to be someone who would be easily duped in a market which he knew well.

(3) HMRC referred to a loan which appeared to have been made to Prizeflex not by one of its suppliers, but by one of its supplier's suppliers. HMRC argued that this suggested that Prizeflex was involved in the fraudulent chain beyond its immediate customers. Neither Mr Surana nor Mr Raithatha could provide any evidence about the reasons for and background to this loan and the Tribunal has therefore not relied on this as a significant piece of evidence.

(4) Mr Reardon provided detailed evidence tracing the payments made in each of the deals through various FCIB accounts. We know that Prizeflex did not have an FCIB bank account, which the Appellant tried to argue suggested innocence. We would not go that far, but neither do we think that HMRC having established circularity of funds or cash for each of these deals necessarily proves anything about Prizeflex's actual knowledge of these deals being connected to a fraudulent transaction.

Deal 1 – Should have known connected to fraud.

118. Deal 1: It was made clear at the start of the hearing that each of these 16 transactions should, if necessary, be considered separately in deciding whether Prizeflex knew or should have known that it was connected with fraud.

119. The Tribunal has concluded that Prizeflex should have known that deal 1 was connected with fraud. We have considered deal 1 in the context of what Mr Surana knew or should have known at the time when he entered that deal, and therefore ignored the subsequent 15 deals and the consistent patterns which they reveal.

120. Nevertheless, many of the conclusions which we have drawn for deals 2 to 16 apply equally to this initial deal, including the lack of any negotiation, the coincidence of matched buyers and sellers, the lack of recorded IMEI numbers, lack of certainty about when title passed and Prizeflex's level of due diligence.

121. However, we accept that some of our conclusions for the later deals rely on the fact that many of the hallmarks of fraud were consistently repeated in each of these deals and this would not have been apparent to Mr Surana at the time when he entered deal 1. While some aspects of deal 1 might have been unusual, we are willing to accept that on the basis of only one deal the features are not so unusual as to lead to an inevitable conclusion that Mr Surana knew that this deal must have been connected with fraud. Deal 1 was with an existing customer, London Mobile Communications Limited as seller (which had been involved in UK deals and known to Prizeflex since 2005) and a new customer, Sunico AS, as buyer. Sunico was Redhill checked by Mr Surana on 16 May 2006, after the date of this deal.

122. We do think that there were enough of the hallmarks of fraud apparent in deal 1 to have put Mr Surana on notice that the deal was fraudulent; including the importation pattern, the type of phones imported (Nokia 7610s – which were first released in mid 2004, so were actually very old by this date) and the margin which he made; 6.9% and £25,500.00 of profit. Adding those factors to what Mr Surana had

been told by HMRC about the existence of fraud in this market, we have concluded that Mr Surana should have known that the only reasonable explanation for the unusual features of this transaction was that it was connected with fraud. Indeed, had Mr Surana responded as a commercial business man should have done to this first transaction, including considering why the deal was structured in the way in which it was it is unlikely that he would have entered into any of the subsequent deals.

123. This might appear to be drawing an arbitrary line between the first deal and all 15 following deals, and it is impossible to be certain at what stage Mr Surana's state of knowledge changed, but all of deals 2-6 were entered into the week immediately after deal 1 was concluded and we think that this timing in itself suggests that at least by the time deal 2 was entered into Mr Surana was fully apprised of the reality of the situation and was happy to enter into a number of deals on similar terms.

Conclusion

124. For these reasons the Tribunal has concluded that all of the input tax claimed by Prizeflex for the two periods in dispute should be disallowed since Prizeflex knew that all of deals 2 – 16 were connected with fraudulent transactions and should have known that deal 1 was connected with fraud.

This document contains full findings of fact and reasons for the decision. Any party dissatisfied with this decision has a right to apply for permission to appeal against it pursuant to Rule 39 of the Tribunal Procedure (First– tier Tribunal) (Tax Chamber) Rules 2009. The application must be received by this Tribunal not later than 56 days after this decision is sent to that party. The parties are referred to "Guidance to accompany a Decision from the First-tier Tribunal (Tax Chamber)" which accompanies and forms part of this decision notice.

RACHEL SHORT
TRIBUNAL JUDGE

RELEASE DATE: 15 October 2014