TC04325

Appeal number: LON/2008/00827

VALUE ADDED TAX – MTIC – whether connection to fraud established via direct tax loss chains and contra-trading chains – yes – whether the Appellant knew or should have known of the connection – yes – whether alternatively input tax on supplies to the Appellant in relation to which the consideration remained unpaid after 6 months should be disallowed pursuant to s.26A VATA – yes - appeal dismissed

FIRST-TIER TRIBUNAL
TAX CHAMBER

MEGANTIC SERVICES LTD **Appellant**

- and -

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

TRIBUNAL: JUDGE JOHN WALTERS QC
MR MICHAEL SHARP FCA

Sitting in public at: Bedford Square, London on 1-4 October 2013; Field House, London on 14-18 and 23-25 October 2013 and 4-6, 8 and 14-15 November 2013; the Competition Appeal Tribunal, London on 18-22 and 25-27 November 2013 and 2-6, 11, 13, 16 and 17 December 2013; Bedford Square, London on 20, 23, 24, 27, 28, 30 and 31 January 2014 and 3-6, 18-21 and 24-28 February 2014; and 70 Fleet Street, London on 6-9 and 12-15 May 2014

Michael Patchett-Joyce, Counsel, instructed by Litigaid Law, for the Appellant

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

DECISION

1. Megantic Services Limited ("Megantic"), the appellant in this appeal, appeals against the decision of the Respondents ("HMRC") to deny to Megantic the right to deduct input tax (or, as Mr Patchett-Joyce, Counsel for Megantic would have it, the benefit of that right) in the sum of £28,096,892.36. The decision (communicated to Megantic by a letter dated 21 May 2007 sent by Roger Mercott, Higher Officer, National Compliance SCT, Staines, Middlesex) related to £18,037,621.53 claimed as a deduction in Megantic's VAT return for the monthly VAT period 05/06 – i.e. May 2006 – and £10,059,270.83 claimed as a deduction in Megantic's VAT return for the monthly period 06/06 – i.e. June 2006.

2. The input tax with which the appeal is concerned is VAT claimed to be deducted by Megantic in respect of "broker" deals – that is, purchases from UK traders where the goods which were the subject of the purchases (primarily mobile telephones and computer processing units ("CPUs")) had been supplied by Megantic to traders based outside the UK in supplies, which were zero-rated for that reason, and thus, *prima facie* gave rise to the right (or the benefit of the right) of deduction in respect of the VAT included in the price paid by Megantic to its (UK) suppliers. There were 157 of these "broker" deals in the May 2006 period and 97 of them in the June 2006 period – 254 in total.

3. HMRC's primary case is that each of these 254 "broker" deal purchase transactions has been traced back to a loss of VAT which is attributable to fraud and that Megantic (or responsible persons acting on behalf of Megantic) knew or alternatively should have known of this fact when the purchases were transacted. They rely on Joined Cases C-439/04 and C-440/04 *Axel Kittel v Belgium* and *Belgium v Recolta Recycling SPRL* [2008] STC 1537 (collectively referred to herein as "*Kittel*"), in which the Court of Justice of the European Union ("CJEU") laid down the principle that taxable persons who knew or should have known that the purchases, in relation to which their input tax arose, were connected with fraudulent evasion of VAT, may be deprived of a deduction (or the benefit of a deduction) of the input tax in question ("the *Kittel* principle"). HMRC advance an alternative argument in relation to purchases in respect of which Megantic had not paid its supplier, submitting that the input tax referable to such purchases is not creditable because section 26A Value Added Tax Act 1994 ("VATA") applies to that effect.

4. Of the 254 "broker" deal purchase transactions referred to, HMRC claim to have traced 246 transactions back to a loss of VAT which is attributable to fraud through a connection involving two or more chains of supply ("contra-trading connections") which they allege were, or were part of, an orchestrated contra-trading scheme, the sole purpose of which was to cheat the revenue. They say that the scheme was a combination of fraudulent evasions of VAT, fraudulent offsettings of input tax claims against output tax liabilities by contra-traders, and claims for repayment of VAT by "brokers" (Megantic in the context of this appeal). They submit that it is at the point of claim for repayment of VAT that the tax loss "crystallises" (*cf R (on the*

application of Just Fabulous (UK) Ltd and Others v Revenue and Customs Commissioners and related claims [2008] STC 2123 per Burton J at [7]).

5. The remaining 8 "broker" deal purchase transactions (all of which involved CPUs and 6 of which occurred in May 2006 and 2 of which occurred in June 2006) can, on HMRC's case, be traced back directly (i.e. in the same chain of supply) to one of 8 fraudulently defaulting traders (being entities known as Bullfinch, Data Solutions, 'a trader purporting to be Okeda', Resolutions UK, World of Power, 3D Animations, Searchline and Focus Racing, in relation to which we received evidence from Officers Fyffe, Marescaux, Needs, Simmons, Cordwell, Johnson, Lee and Sharrock respectively).

6. Mr Kinnear QC, for HMRC, made clear to us that HMRC had not attempted to allocate specific tax loss deals (that is purchases of goods in a chain of purchases and sales (supplies) leading back to a fraudulent defaulter) carried out by a contra-trader, who appeared in a chain of supply in relation to which Megantic was the broker ("a first-line contra-trader"), to any specific deal carried out by Megantic, still less had they attempted to allocate specific tax loss deals carried out by a contra-trader, who appeared in a chain of supply in relation to which a first-line contra-trader was the broker ("a second-line contra-trader"), to any specific deal carried out by Megantic.

7. What he said was that HMRC's case is that first-line contra-traders effectively built up a pool of tax loss in two ways: first by dealing in chains which trace directly back to a fraudulent evasion of VAT by another trader, and secondly by dealing in chains which trace back to another contra-trader (a second-line contra trader) which itself had dealt in chains which trace back directly to a fraudulent evasion of VAT by another trader. The pool of tax loss attributed by HMRC to a first-line contra-trader is the tax loss attributable to the chains tracing back directly from the first-line contra-trader to the fraudulent evasion of VAT by another trader, and also the tax loss attributable to the pool of tax loss accumulated (in the same way) by the second-line contra-trader which features in a chain traced back to it from the first-line contra-trader.

8. HMRC say that where they identify that Megantic has been a broker in a chain which traces back directly to such a first-line contra-trader, then Megantic's purchase in that chain can be said to be connected, for the purposes of the *Kittel* principle, to the tax loss so attributed by HMRC to that first-line contra-trader.

9. The 246 transactions which HMRC claim to have traced back to loss of VAT attributable to fraud through contra-trading connections break down to (a) 151 deals in May 2006, all involving mobile phones, and each of which they say traces back to one of 6 contra traders (David Jacobs UK Limited ("David Jacobs") – 40 deals; Digital Satellite Limited trading as Powerstrip ("Powerstrip") – 30 deals; Svenson Commodities Limited, sometimes using the trading name Svenson UK (Svenson Commodities") – 42 deals; Selectwelcome Limited ("Selectwelcome") – 21 deals; Svenson Worldwide Limited ("Svenson Worldwide") – 12 deals; or TC Catering Supplies Limited ("TCCS") – 6 deals); and (b) 95 deals in June 2006, all involving mobile phones, and each of which they say traces back to one of 5 contra traders

(David Jacobs – 15 deals; Powerstrip – 18 deals; Svenson Commodities – 12 deals; Selectwelcome – 18 deals; or TCCS – 32 deals).

10. We received evidence relating to David Jacobs, Powerstrip, Svenson Commodities, Selectwelcome, Svenson Worldwide and TCCS from Officers Davies, Ruler, Williams, Gingell, Rowlands, Lane and Conroy respectively (Officers Lane and Conroy gave evidence relating to TCCS). On HMRC's case, these entities in the context of this appeal are first-line contra-traders.

11. It is HMRC's case that of the first-line contra-traders, 3 of them, David Jacobs, Powerstrip and Svenson Commodities, acquired goods in deals which were traced back to one of 6 second-line contra-traders, being entities called 385 North, Blackstar, Digikom, Export Tech, Pan Euro and Rioni. Those alleged second-line contra-traders had themselves acquired goods in deals which were traced back, on HMRC's case, to fraudulently defaulting traders.

12. We received evidence relating to the alleged second-line contra-traders 385 North, Blackstar, Digikom, Export Tech, Pan Euro Ventures and Rioni from Officers Jenner, Sadler, Downer, Berry, Outram and Lewis respectively (Officers Sadler and Downer both gave evidence in respect of both Blackstar and Digikom).

13. HMRC also sought to deny to Megantic, by a letter dated 9 March 2007, sent to Megantic by Officer Mercott, the right to deduct input tax in respect of "broker" deals transacted in its monthly VAT period 04/06 – i.e. April 2006. The input tax concerned amounted to £9,460,431.75 and related to 99 deals transacted in that month. Megantic appealed this decision also, and their appeal was allowed, by way of directions dated 23 June 2008, following HMRC's failure to serve evidence as directed.

14. Notwithstanding the fact that Megantic's appeal related to its VAT period 04/06 has been allowed, HMRC continue to rely for the purposes of the appeal before us on evidence relating to the deals carried out in Megantic's VAT period 04/06 which, they submit, is relevant to showing Megantic's pattern of trade and shows that all of Megantic's deals over the 3-month period of trading (April to June 2006 inclusive) can be traced back to fraudulent evasion of VAT. This, they say, is compelling evidence of Megantic's state of knowledge during its VAT periods in issue in this appeal. The 99 deals carried out in April 2006 break down (according to HMRC) into 1 deal tracing back directly to the fraudulent defaulting trader 'purporting to be KEP 2004' and 98 deals tracing back to loss of VAT attributable to fraud through one of 3 alleged contra traders, David Jacobs, Powerstrip or Svenson Commodities.

15. Mr Patchett-Joyce, for Megantic, objects to this approach, as being fundamentally wrong in principle, and erroneous in point of law. He submits that as VAT is levied on an individual transaction-by-transaction basis, what happened in VAT periods other than those in issue in the appeal is quite beside the point.

16. It is common ground that the right to deduct input tax arises at the time the deductible tax becomes chargeable, and input tax is deductible insofar as the goods or

services to which it relates are used for the purposes of the taxable person's taxable transactions (article 17 of the 6th Council Directive ("the 6th Directive") and articles 167 and 168 of Council Directive 2006/112/EC ("the Principal VAT Directive")). This is the basis on which Megantic is *prima facie* entitled to the deduction of the input tax in issue in the appeal. It is also common ground that it has been laid down (the *Kittel* principle) that taxable persons who knew or should have known that the purchases, in relation to which their input tax arose, were connected with fraudulent evasion of VAT, may be deprived of a deduction (or the benefit of a deduction) of the input tax in question.

17. It is also common ground that the burden of proof, both as to knowledge and means of knowledge and as to the relevant connection between Megantic's purchase transactions and fraudulent evasion of VAT lies on HMRC. The standard of proof is the civil standard – that is, the balance of probabilities.

18. The interpretation and implementation of the *Kittel* principle in England was the subject of the Court of Appeal's judgment in *Mobilx Ltd., Blue Sphere Global Ltd. and Calltell Telecom Ltd. v HMRC* [2010] EWCA Civ 517; [2010] STC 1436 ("*Mobilx*"). Mr Kinnear and Mr Chapman, for HMRC, submit that this Tribunal is bound by the Court of Appeal's decision in *Mobilx* and accordingly that we should approach this appeal by considering, in accordance with the guidance in *Mobilx*, and answering, the familiar following 4 questions, namely:

(a) Was there a tax loss?

(b) If so, did this loss result from a fraudulent evasion?

(c) If so, were the transactions which are the subject of this appeal connected with that evasion?

(d) If so, did Megantic know, or should it have known, that its transactions in issue were connected with that evasion?

19. Mr Patchett-Joyce objects to this approach. He submits that in certain respects (in particular, the observation that transactions connected with fraudulent evasion of VAT are 'outwith', rather than within, the common system of VAT) the guidance in *Mobilx* is (or is arguably) erroneous in point of EU law, as, he says, has been demonstrated by judgments of the CJEU subsequent to *Kittel*, in particular, the Joined Cases *Mahagében kft v Nemzeti Adó- és Vámhivatal Dél-dunántúli Regionális Adó Főigazgatósága* (C-80/11) and *Péter Dávid v Nemzeti Adó- és Vámhivatal Észak-alföldi Regionális Adó Főigazgatósága* (C-142/11) (collectively referred to herein as *Mahagében*) . He submits that there are 2 questions for the Tribunal to consider and answer, namely:

(a) Have the substantive and formal conditions provided under the VAT Directive for the creation and exercise of the right of deduction been fulfilled?

(b) If so, can the benefit of the right of deduction be refused?

20. He submits, on this basis, that the benefit of the right of deduction can only be refused on the basis of 'objective factors', relating strictly to each of the purchase transactions in question, and moreover can only be refused if such refusal respects other fundamental principles of EU law, which are, he says, of a constitutional status – in particular, the principles of proportionality, equal treatment/non-discrimination, legal certainly, fiscal neutrality and effectiveness.

21. As the parties both accept, their cases are advanced on different lines. They are like trains passing on parallel tracks. They do not engage in the same set of legal tests, and the Tribunal must decide which is the correct set of legal tests for the resolution of the issues raised by the appeal.

22. As to that, Mr Kinnear submitted at the hearing that the Tribunal was bound (in HMRC's favour) by the recent decisions of the Upper Tribunal in *Fonecomp Ltd v HMRC* [2013] UKUT 599 (TCC), released on 5 December 2013, *Edgeskill Ltd v HMRC* [2014] UKUT 38 (TCC), released on 27 January 2014 and *Lifeline Europe Ltd v HMRC* FTC/33/2013, released on 24 March 2014.

23. We were informed by Litigaid Law, Megantic's advisers, after the hearing of the appeal, that the Court of Appeal (Richards and Vos LJJ) had given permission to appeal in *Fonecomp Ltd.*, on the basis, chiefly, that Fonecomp's argument, that the *Kittel* principle does not apply where the connection with fraudulent VAT loss is through a contra-trader's activities, requires to be fully argued at that level. That appeal was heard by the Court of Appeal (Arden, McFarlane and Burnett LJJ) on 22 and 23 October 2014 and judgment was handed down on 3 February 2015. That judgment was in HMRC's favour, confirming and giving further authority to Mr Kinnear's submission that the *Kittel* principle is not limited to cases where the default occurs in the same chain of supply (*ibid.* [33] and [34]). We mention that we have been advised by Litigaid Law that permission to appeal against the Court of Appeal's judgment is being sought from the Supreme Court.

24. Mr Patchett-Joyce's response to Mr Kinnear's submissions was that the cases he (Mr Kinnear) relied on are domestic cases and this appeal needs to be determined by reference to principles of EU law, correctly interpreted, which is superior to the domestic law of any Member State. The principles of EU law are formulated by the CJEU which is, as he says, the *fons et origo* of VAT case law. He did not accept HMRC's contention that we are bound by the Court of Appeal's decision in *Mobilx*. He prayed in aid certain Written Observations of the European Commission in the CJEU cases on which he placed reliance, submitting that the European Commission's view of the developing *Kittel* principle was in line with his submissions and at variance with HMRC's case and the decision of the Court of Appeal in *Mobilx*. He submitted that, for this reason, there is a pressing need for a reference to be made in this appeal to the CJEU under article 267 TFEU.

25. The question of a reference was addressed by the Upper Tribunal (Warren J and Judge Sadler) in *Lifeline Europe Ltd.* The Upper Tribunal said (*ibid.* at [14]) as follows:

> 'As a matter of domestic law, we are bound by *Mobilx* and, quite apart from that, we should follow *Fonecomp* and *Edgeskill* unless we are firmly of the view that they were wrongly decided (which we are not: quite the reverse, we think they were correctly decided). And as to EU law, we would not make a reference since, like others, we would regard the matter as *acte clair*.'

26. While expressing the view that we consider that Mr Patchett-Joyce's case on the relevant legal principles was cogently argued, we also consider that it suffers from the defect that its consequences tend to absurdity. In particular, it seems to us, that if he is correct in his submissions as to the limited scope of the *Kittel* principle – that it is restricted to an examination of the objective factors associated with the particular transaction giving rise to the input tax for which a deduction is claimed – then it would follow that a trader in the position of Megantic, in relation to which it was proved, or accepted, that it had full actual knowledge of a convoluted connection to a fraudulent evasion of VAT, either through a single chain, or, more likely, one or more orchestrated contra-trading chains, but that the particular purchase transaction – looked at individually – was entirely regular, would escape the application of the *Kittel* principle. This would be very surprising, not least because the *Kittel* principle was formulated in the light of the wider principles that 'Community law cannot be relied on for abusive or fraudulent ends' and that the prevention of tax evasion, avoidance and abuse is an objective recognised and encouraged by the 6th Directive (*Kittel*, Judgment [54]). This point was also made by Arden LJ giving the leading judgment in *Fonecomp Ltd* (*ibid.* [29]). It is also pertinent to note that we were told that the CJEU had not yet considered a case involving contra-trading and so has not decided that the *Kittel* principle does not apply in such a context.

27. Our conclusion, reinforced by the Court of Appeal's decision in *Fonecomp Ltd*, is that we must follow the domestic authorities to which we were referred – in particular *Mobilx* – and ought not ourselves to make a reference to the CJEU under article 267 TFEU. If this appeal goes further, it will be for a Tribunal or Court higher up in the appellate hierarchy to reconsider the decision we have made on this point and the appropriateness or necessity of making a reference. The Court of Appeal, in the *Fonecomp Ltd* appeal, considered the appropriateness or necessity of making a reference on a similar or the same basis as that urged on us by Mr Patchett-Joyce and declined to do so (*ibid.* [55]). It would, in our view, be inappropriate for us to make a reference when the Court of Appeal has decided not to do so in similar circumstances.

28. Mr Patchett-Joyce submitted that this Tribunal must grapple with the legal issues he advanced as to why we should not follow *Mobilx*. While intending no disrespect to his arguments, we consider for the reasons given above that it is unnecessary for us to do so, and that this Tribunal should concentrate on the essential factual issues raised by this appeal, principally whether there was a sufficient connection between the fraudulent tax losses identified and Megantic's transactions, and, if so, whether Megantic knew or should have known of such connection.

29. We will consider the four questions identified above, taking the first three first and then considering the fourth question.

The first three questions:

(a) Was there a tax loss?

(b) If so, did this loss result from a fraudulent evasion?

(c) If so, were the transactions which are the subject of this appeal connected with that evasion?

The transactions - tracing

30. We note that in addition to the 254 purchase transactions entered into by Megantic in May and June 2006 which were the subject of "broker" deals (noted above), and the 99 such transactions entered into in April 2006, which were also "broker deals" (also as noted above), there were 135 additional purchase transactions entered into in the three months April to June 2006 inclusive (making 488 transactions in total). These 135 additional purchase transactions were the subject of onward supplies by Megantic to traders within the UK (and so, called "buffer" deals), and they are not the subject of the appeals before us, because HMRC have not sought to deny Megantic the right to deduct input tax (or the benefit of that right) where the goods purchased were not the subject of supplies by Megantic to traders outside the UK and for that reason the input tax was not claimed by Megantic to be wholly reclaimable as cash, as being attributable to zero-rated output supplies.

31. Each of the purchase transactions mentioned has been given an individual deal number ("IDN") for the purposes of the appeal. The IDNs run from number 1 to number 486, there having been inserted IDN 363A and IDN 426A.

32. An IDN has also been given to each of the deals carried out by entities said by HMRC to be contra-traders featuring in the case. These IDNs run from IDN 487 to IDN 1758.

33. Following a hearing on 16 February 2011, on 23 February 2011 the Tribunal (Judge Berner) directed that evidence of the connectivity of the deal chains might be given by way of sampling. The sampling method directed was that, first, HMRC should select sample deal chains representative of all the deal chains in issue, that secondly Megantic would be able to comment on HMRC's selection proposing additional or alternative samples, that thirdly HMRC should reconsider their sample deal chains in the light of Megantic's comments, and that fourthly the Tribunal would select 12 further deal chains not already specified as samples to add to the selected samples. The Tribunal directed that it would require underlying evidence to be given at the substantive hearing to prove all the sample deal chains. The Tribunal explained in a Decision accompanying its Directions released on 23 February 2011 that the process of proving the deal chains would involve 'a degree of iteration', that is, that if some only of the samples were proved and others were not, the reason for that outcome would be given and further deal chains sharing the same characteristics as the non-proven transactions, and to which the same reasoning could be applied, would be capable of being identified and treated as a separate category for further proof.

34. In consequence of the sampling approach so directed, there were 125[1] sample deal chains before us, 58 of them being representative of Megantic's deals in April, May and June 2006[2], being either "broker" or "buffer" deals[3]. Within the "broker" deal chains referred to, were all of the 8[4] purchase transactions of Megantic which, on HMRC's case, could be traced back in the same chain of supply to a fraudulently defaulting trader (i.e. "direct" tax loss chains, as opposed to "contra-trade" chains involving Megantic as "broker", in which there was no tax loss).

35. In the course of the hearing Mr Kinnear conceded that one sample, Sample 6 – IDN 132, which had been presented as a Megantic "broker" deal chain, was not reliable because an alternative tracing subsequently appeared to be more likely. The deal chain IDN 132 (which was presented to us as being in a chain of supply leading back directly to a fraudulently defaulting trader – the trader purporting to be KEP 2004) was transacted on 28 April 2006, outside the periods which are the subject of the appeal.

36. The remaining 67 Sample deal chains were chains where one of the identified alleged contra-traders was a broker, or chains where one of the identified alleged contra-traders was an acquirer of goods. HMRC's case was that the input tax *prima facie* deductible by a contra-trader was set off by it in its VAT return against the output tax due on an acquisition of (other) goods from a trader established in a Member State other than the UK, and those (other) goods were sold down a chain from the contra-trader to Megantic – or, in the case of a second-line contra-trader, from that contra-trader to a first-line contra-trader, which would engage in the same offsetting process in relation to acquisitions of (yet other) goods, which would be sold down a chain to Megantic.

37. These 67 Sample deal chains were made up of 59 deal chains in which one or other of the alleged contra-traders was the "broker"[5] and 8 deal chains in which one or

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[1] They were presented as 127 Sample deal chains, numbered from 1 to 126, including an extra sample (9A), but within that numbering each of two deals had double Sample numbers (15-16 and 26-27) – see: the next footnote – so there were in fact 125 Sample deals before us.

[2] The 58 were numbered as follows: Samples 1 to 47 inclusive (but these included two deals each with double Sample numbers (15-16 and 26-27), so Samples 1 to 47 accounted for 45 deal chains; and Samples 9A, 59, 68, 69, 75, 86, 115 to 119 inclusive, 121 and 125 (13 deal chains).

[3] The Samples within the 58 which were Megantic "broker" deals were Samples 1 to 9 inclusive, Sample 9A, Samples 12 to 18 inclusive (including Samples 15 and 16 which related to one deal), Samples 21 to 37 inclusive (including Samples 26 and 27 which related to one deal), Samples 39 to 47 inclusive, Sample 115, Sample 118 and Sample 125. (A total of 44 deal chains)

The Samples within the 58 which were Megantic "buffer" deals were Samples 10, 11, 19, 20, 38, 59, 68, 69, 75, 86, 116, 117, 119 and 121. (A total of 14 deal chains)

[4] In May 2006: IDNs 149, 150, 176, 192, 270 and 288 (respectively Samples 9, 9A, 18, 22, 30 and 32). In June 2006: IDNs 346 and 364 (respectively Samples 36 and 37).

[5] These 59 deal chains where an alleged contra-trader was the "broker" and which did not (apart from Sample 50) feature Megantic were composed of: 11 deal chains where David Jacobs was the "broker" (Samples 48 to 57 inclusive and 120); 9 deal chains where Svenson Commodities was the "Broker" (Samples 58, 60 to 65 inclusive, 113 and 126); 10 deal chains where Powerstrip was the

other of the alleged contra-traders was the acquirer of goods into the UK[6]. Megantic did not (as far as we can see) feature in these deal chains – except in one, Sample 50 (IDN 531 and 532), presented as an example of a deal chain where David Jacobs, a contra-trader, was the "broker".

38. In that deal chain, Megantic is shown as the "buffer" trader who bought the goods (3,000 Nokia 7380 phones) from Tracker Trading UK Limited and sold them to David Jacobs. That deal chain traced back to the defaulter Stock Mart Limited. David Jacobs's customer was Adobcom LDA. The transactions in the deal chain were carried out on 11 May 2006.

39. There was however a very significant amount of duplication in the characters of the Sample deal chains.

40. For example, Samples 68, 69, 75 and 117, presented as samples of Megantic deals, were also deal chains showing that Powerstrip was the "broker" – in each case Megantic was the "buffer" which sold the goods to Powerstrip. Other Sample deals presented as samples of Megantic deals were also deal chains showing another alleged contra-trader as broker – Sample 59 showed Svenson Commodities trading as Svenson UK as the "broker" and Megantic as the "buffer" who sold the goods to Svenson Commodities; Sample 86 showed TCCS as the "broker" and Megantic as the "buffer" who sold the goods to TCCS; and Sample 121 showed Svenson Worldwide as the "broker" and Megantic as the "buffer who sold the goods to Svenson Worldwide.

41. Similarly, Sample 125, presented as an example of Megantic's deals in May 2006 and included in the 58 Sample deal chains referred to above (at paragraph 34), also showed an acquisition of goods from an entity established outside the UK by an alleged contra-trader (Powerstrip). Powerstrip purchased the goods (6,000 N70 phones) from Adobcom LDA. The chain also shows Megantic as the "broker" (it sold to Intangible Media and Ascomp Trading).

42. Indeed very many of the Sample deal chains showed activities of more than one trader which were relevant on HMRC's case to the issue of the connection of Megantic's deals with fraudulent evasion of tax.

"broker" (Samples 66, 67, 70 to 74 inclusive, 76, 112 and 114); 5 deal chains where Selectwelcome was the "broker" (Samples 77 to 81 inclusive); 2 deal chains where Svenson Worldwide was the "broker" (Samples 82 and 83); 8 deal chains where TCCS was the "broker" (Samples 84 to 90 inclusive and 122 and 123); 2 deal chains where Blackstar was the "broker" (Samples 91 and 92); 8 deal chains where Digikom was the "broker" (samples 93 to 100 inclusive); 1 deal chain where Pan Euro was the "broker" (Sample 101); 1 deal chain where Export Tech was the "broker" (Sample 102); 1 deal chain where 385 North was the "broker" (Sample 103); and 1 deal chain where Rioni was the "broker" (Sample 104).

[6] These 8 Samples showing that an alleged contra-trader acquired goods from an entity established outside the UK were: Samples 105 to 107 inclusive and 124 (acquisitions by David Jacobs); Samples 108 and 109 (acquisitions by Svenson Commodities); Sample 110 (an acquisition by Powerstrip); and Sample 111 (an acquisition by Selectwelcome).

43. For example, Sample 10 was presented to us as a Megantic "buffer" deal chain, IDN 151. It showed 3,100 Nokia 8810 phones passing from Starlet BV to Powerstrip as acquirer of the goods in the UK (on 5 May 2006), and from Powerstrip to Megantic, from Megantic to Base Interactive (another UK entity, which acted as "broker") (on 8 May 2006). It also showed Base Interactive selling 1,600 Nokia 8810 phones on 8 May 2006 to Cayenne Trading SA (an entity established outside the UK).

44. IDN 1453, presented to us as a Powerstrip acquisition deal, was in fact the same deal chain as IDN 151, with the additional information that Base Interactive as well as supplying (as a "broker") 1,600 Nokia 8810 phones to Cayenne Trading SA also supplied 1,500 of these phones (the balance of the supply to it from Megantic) to another entity established outside the UK (so, also as "broker") namely Globalfone.

45. Mr Kinnear took us through these Sample deal chains to show, by reference mainly to documentation produced to HMRC by the traders involved, the supply chain followed in each deal (IDN).

Megantic's purchases in direct tax loss chains

46. Where that supply chain was a direct tax loss chain showing Megantic as the "broker" – that is, a supply chain leading from a defaulter or a hijacked VAT registration (in either case an entity that had fraudulently defaulted on its liability to account to HMRC for output VAT) to Megantic, who supplied the goods concerned onwards to an entity established outside the UK – HMRC's case was that the supply chain itself connected the fraudulent default to Megantic's purchase.

47. This was the position, as stated above, with 8 of Megantic's purchase transactions. They were as follows: Samples 9, 9A, 18, 22, 30, 32, 36 and 37, respectively IDNs 149, 150, 176, 192, 270, 288, 346 and 364 (see: footnote 4 above). The defaulters or hijacked VAT registrations in these supply chains were (on HMRC's case): in Sample 9 (IDN 149), Resolutions UK; in Samples 9A and 18 (IDNs 150 and 176), Bullfinch; in Sample 22 (IDN 192) Data Solutions; in Sample 30 (IDN 270), a trader purporting to be Okeda; in Sample 32 (IDN 288) World of Power; in Sample 36 (IDN 346), 3D Animations; and in Sample 37 (IDN 364), Focus Racing and Searchline. As stated above, we received evidence in relation to these defaulters from Officers Simmons (Resolutions UK), Fyffe (Bullfinch), Marescaux (Data Solutions), Simmons (Okeda), Cordwell (World of Power), Johnson (3D Animations), Sharrock (Focus Racing) and Lee (Searchline).

48. The tracing exercise for Samples 9, 18, 22, 30, 32 and 36 showed the deal chain from the respective defaulters to Megantic by reference to invoices. There was not a full invoice trail in the tracing for Samples 9A and 37 and HMRC relied on other evidence (purchase orders) for the tracing in these Samples.

49. In tracing Sample 9A, the link between the alleged defaulter, Bullfinch, and its customer, the first "buffer" Data Solutions (also a missing trader), was not proved by an invoice, because HMRC did not have one, but instead by a purchase order.

50. In tracing Sample 37, in which there were two relevant defaulters, Focus Racing and Searchline, the chain of supply connecting Focus Racing and Megantic passed through the "buffer" trader, Fern. HMRC were not able to produce an invoice showing the supply from Fern to its customer, the "buffer" Stardex, but they did adduce a purchase order in respect of that supply.

Chains showing tax losses but which did not feature Megantic's 'broker' transactions, and chains showing no tax loss, connecting alleged contra-traders to each other or to Megantic's 'broker' transactions, or showing acquisitions of goods into the UK by alleged contra-traders

51. Where the supply chain followed in a Sample deal chain was not a direct tax loss chain showing Megantic as the "broker" (which was the case with all the Sample deal chains except those just referred to), it was (at least) one of the following: (*a*) a supply chain leading from a defaulter or hijacked VAT registration to an alleged contra-trader, or (*b*) a supply chain leading from an alleged second-line contra-trader to an alleged first-line contra-trader, or (*c*) a supply chain leading from an alleged first-line contra trader to Megantic in the position of 'broker', or (*d*) a supply chain showing an acquisition of goods into the UK by an alleged contra-trader (first-line or second-line), or (*e*) (in 5 cases) none of the above. As stated above, there was a very significant amount of duplication so that a particular Sample deal chain often came under more than one of these categories (*a*) to (*d*).

(a) Sample supply chains leading from a defaulter or a hijacked VAT registration to an alleged contra-trader

52. Samples 20, 49 to 54 (inclusive), 59, 66 to 71 (inclusive), 77 to 104 (inclusive), 117 and 121 to 123 (inclusive) fall into this category.

53. The alleged contra-traders concerned were David Jacobs (Samples 20, and 49 to 54 inclusive), Svenson Commodities (Sample 59), Powerstrip (Samples 66 to 71 inclusive and 117), Selectwelcome (Samples 77 to 81 inclusive), Svenson Worldwide (Samples 82, 83 and 121), TCCS (Samples 84 to 90 (inclusive) and 122 and 123), Blackstar (Samples 91 and 92), Digikom (Samples 93 to 100 inclusive), Pan Euro (Sample 101), Export Tech (Sample 102), 385 North (Sample 103), and Rioni (Sample 104).

54. The defaulters or hijacked VAT registrations were: Midwest (Samples 49, 66 and 67), Stock Mart (Samples 20, 50, 59, 68, 117 and 121), XS Enterprises (Samples 51, 69, 70 and 71), Prompt Info (Sample 52), West One (Samples 53, 86 and 87), Tracker Trading (Samples 54 and 81), Birdwood (Samples 77 and 78), Mopani (also in Sample 78 and in Samples 79, 83 and 122), RS Sales Agency (Samples 80 and 89), Hillgrove (Sample 82), 3D Animations (Samples 84 and 85), DTM Provisions (Samples 88 and 123), Advertising South (Sample 90), Fastec (Sample 91), Bright Time (also in Sample 91 and in Samples 92 and 104), Home Sales and Lettings (also in Sample 104 and in Sample 102), Pentagon UK (Samples 93 to 100 inclusive), UR Traders (Sample 101) and Premier Insurance (Sample 103).

55. We received evidence in relation to these defaulters or hijacked VAT registrations from HMRC Officers as follows: Bycroft (Midwest), Williams (Stock Mart), Monk

(XS Enterprises and Mopani), Kumar (Prompt Info), Lam (West One), Appleby (Tracker Trading), Davis (Birdwood), Parsons (RS Sales Agency), Ruler (Hillgrove), Johnson (3D Animations – also a defaulter in a direct tax loss chain leading to Megantic), McBrine (DTM Provisions), Outram (Fastec), Stock (Bright Time), Ball (Home Sales and Lettings), Austin (Pentagon UK), and Matthews (UR Traders).

56. We had also Witness Statements in relation to Advertising South and Premier Insurance from Officers Richards and O'Neill respectively. These officers were not available to give oral evidence, and replacement statements had been prepared by Officers Riley and Lyon respectively. However neither Officer Riley nor Officer Lyon gave oral evidence. Officer Outram gave oral evidence in relation to Premier Insurance.

(b) Sample supply chains leading from an alleged second-line contra-trader to an alleged first-line contra-trader

57. Samples 55 to 57 inclusive, 60 to 65 inclusive, 73 and 114 fall into this category.

58. Sample 55 shows a chain leading from Pan Euro (as acquirer from Cherry Tree (a Cyprus entity)) to David Jacobs as 'broker'. Sample 64 shows a chain leading from Pan Euro (as acquirer from Cherry Tree) to Svenson Commodities as 'broker'.

59. Sample 56 shows a chain leading from 385 North (as acquirer from Powertec (a Portuguese entity)) to David Jacobs as 'broker'. Sample 65 shows a chain leading from 385 North (as acquirer from Powertec) to Svenson Commodities as 'broker'.

60. Sample 57 shows a chain leading from Digikom (as acquirer from Prabud (a Hungarian entity)) to David Jacobs as 'broker'. Sample 61 shows a chain leading from Digikom (as acquirer from Prabud) to Svenson Commodities as 'broker'. Sample 73 shows a chain leading from Digikom (as acquirer from Prabud) to Powerstrip as 'broker'.

61. Sample 60 shows a chain leading from Blackstar (as acquirer from Avoset (an Estonian entity)) to Svenson Commodities as 'broker'.

62. Sample 62 shows a chain leading from Export Tech (as acquirer from Xbox Red (a Spanish entity)) to Svenson Commodities as 'broker'. Sample 114 shows a chain leading from Export Tech (as acquirer from Xbox Red) to Powerstrip as 'broker'.

63. Sample 63 shows a chain leading from Rioni (as acquirer from Powertec) to Svenson Commodities as 'broker'.

(c) Sample supply chains leading from an alleged first-line contra trader to Megantic in the position of 'broker'

64. Samples 1 to 5 inclusive, 7 and 8, 12 to 17 inclusive, 21, 23 to 29 inclusive, 31, 33 to 35 inclusive, 39 to 47 inclusive, 115, 118 and 125 fall into this category. They are examples of supply chains leading to Megantic as 'broker' from each of the 6 alleged first-line contra-traders.

65. Samples 1, 4, 5, 13, 17, 21, 31, 41, 44 and 115 showed chains leading from David Jacobs to Megantic as ‘broker’.

66. Samples 2, 8, 14, 15, 34, 39 and 125 showed chains leading from Powerstrip to Megantic as ‘broker’.

67. Samples 3, 7, 12, 16, 23, 35, 40, 42, and 118 showed chains leading from Svenson Commodities to Megantic as ‘broker’.

68. Samples 24, 26, 27, 28 and 46 showed chains leading from Selectwelcome to Megantic as ‘broker’.

69. Samples 25 and 29 showed chains leading from Svenson Worldwide to Megantic as ‘broker’.

70. Samples 33, 43, 45 and 47 showed chains leading from TCCS to Megantic as ‘broker’.

(d) Samples showing supply chains which show an acquisition of goods into the UK by an alleged contra-trader (first-line or second-line)

71. Samples 10, 11, 25, 29, 33, 43, 45, 47, 48, 54 to 58 inclusive, 60 to 65 inclusive, 73 to 76 inclusive, 105 to 115 inclusive, 118, 119, and 124 to 126 inclusive fall into this category. There may be other Samples which also fall into this category. All 12 alleged contra-traders feature in the Samples below.

72. Samples 10, 11, 48, 58, 110 and 125 show acquisitions by Powerstrip.

73. Samples 33, 43, 45, 47, 54, 74, 75, 112 and 119 show acquisitions by TCCS.

74. Samples 105, 106, 107, 115 and 124 show acquisitions by David Jacobs.

75. Samples 108, 109 and 118 show acquisitions by Svenson Commodities.

76. Samples 76 and 111 show acquisitions by Selectwelcome.

77. Samples 25 and 29 show acquisitions by Svenson Worldwide.

78. Samples 55 and 64 show acquisitions by Pan Euro.

79. Samples 56 and 65 show acquisitions by 385 North.

80. Samples 62 and 114 show acquisitions by Export Tech.

81. Samples 60 and 113 show acquisitions by Blackstar.

82. Samples 57, 58, 61 and 73 show acquisitions by Digikom.

83. Samples 63 and 126 show acquisitions by Rioni.

(e) Samples showing supply chains not falling into any of the above categories

84. Samples 19, 38, 72, 116, and 120 do not fall into any of the above categories.

85. Sample 19 shows a supply chain featuring Megantic as a 'buffer', and although it features one of the hijacked VAT registrations (Okeda) it does not feature any of the alleged contra-traders.

86. Sample 38 also shows a supply chain featuring Megantic as a 'buffer', and although it also features Okeda (and Resolutions UK, another known defaulter in relation to which Officer Simmons gave evidence), it does not feature any of the alleged contra-traders.

87. Sample 72 shows a supply chain in which Powerstrip acts as 'broker' selling to Neo Abaco (a Swiss entity). Powerstrip purchased from Nobel Wireless (an entity with a UK VAT registration) which, according to Officer Ruler's evidence (in relation to Powerstrip), was an entity which submitted its VAT return but did not submit to HMRC any information about its own supplier. Nobel Wireless is regarded by HMRC as a 'blocker', being an entity which effectively 'blocked' HMRC from establishing the full deal chain and determining whether or not there was a tax loss in it. Officer Ruler's evidence was that there were 7 deal chains of this type.

88. Sample 116 also shows a supply chain featuring Megantic as a 'buffer', and although it also features Tracker Trading (another known defaulter in relation to which Officer Appleby gave evidence), it does not feature any of the alleged contra-traders.

89. Sample 120 also shows a supply chain featuring Megantic as a 'buffer', and although it also features David Jacobs as a 'buffer', the entity acting as 'broker' – that is, selling to an entity established outside the UK, in this case Adobcom – was Iventures UK Ltd, not an alleged contra-trader. In this Sample also, the supply chain did not show a defaulter or hi-jacked VAT registration. It had been traced back to an entity called I Conekt (formerly MM Connexions) which was regarded as a 'blocker' in this instance, although we received evidence from Officer Payne that it was a defaulter in (presumably another) Megantic 'buffer' deal chain and in TCCS 'broker' deal chains.

Proof of the tracing of tax loss chains which did not feature Megantic's "broker" transactions and chains showing no tax loss, connecting alleged contra-traders to each other or to Megantic's "broker" transactions, or showing acquisitions of goods into the UK by alleged contra-traders – see: (a) to (e) above

90. Most of these Sample chains were proved by Mr Kinnear taking us through the VAT invoices at each stage connecting defaulters or hijacked VAT registrations to alleged contra-traders, and, where alleged second-line contra-traders featured, from those contra-traders to alleged first-line contra-traders, and from alleged first-line contra-traders to Megantic and its non-UK customers. With regard to the supply chains showing an acquisition of goods into the UK by an alleged contra-trader (first-line or second-line) – category (*d*) above – Mr Kinnear proved the acquisitions by reference to VAT invoices.

91. In a few instances an invoice could not be shown and such cases were among those chosen deliberately by HMRC to be Samples. In such cases often we were shown a "pro forma" invoice indicative of a proposed sale, which would prove the transaction in the chain for which a VAT invoice was not shown. Some transactions were sought to be proved by way of deal logs compiled by individual traders and supplied by them to HMRC, or by HMRC themselves, having viewed the records. An example of HMRC's reliance on their deal sheet is in relation to Sample 73, where they rely on the deal sheet to prove the acquisition by Digikom from Prabud and Digikom's supply to Greystone. Greystone's invoice to Powerstrip was produced to prove that link in the supply chain.

92. In some cases the deal logs relied on had been compiled by overseas authorities. An example of this was in relation to Sample 74 where HMRC proved the acquisition by TCCS from Adobcom by reference to a deal sheet for Adobcom compiled by the Spanish revenue authorities. Another example was Sample 81, where HMRC proved an onward supply to an entity called Hilton Moore by the German entity BRD, which had purchased from Selectwelcome (acting as 'broker'), by reference to a deal sheet for BRD compiled by the German revenue authorities.

93. In some cases where no invoice could be produced, HMRC relied on documents showing goods at freight forwarders (for example, shipping instructions or release notes). In the case of Sample 79 a handwritten note on the headed paper of the freight forwarder MSG Freight Limited indicating a release of 3,500 Nokia N91 phones from Mopani to Adworks was relied on to prove that link in the chain leading from the defaulter (Mopani) to Selectwelcome (a first-line contra-trader). Another example of this relates to Sample 82, where the link between the Swiss entity Integral, as supplier, and its customer, the defaulter Hillgrove, was proved by reference to a visit report compiled by HMRC officers from information found on the files of the freight forwarder, ASR Logistics, on a visit made on 16 May 2006.

94. Where a valid VAT invoice could not be shown, Mr Kinnear invited the Tribunal to infer from the surrounding documentation that such a VAT invoice existed and that the chain of transactions concerned, linking Megantic (or an alleged contra-trader) to either an (or another) alleged contra-trader or to a defaulting trader or hijacked VAT registration, had been proved. He explained that in some of the Sample deal chains there is a missing trader (and sometimes more than one) at the beginning of the chain, which acquired goods from outside the UK or was a "blocker" trader, and in such cases there was very often (and for obvious reasons) a void in the paperwork at the start of the chain.

95. Mr Patchett-Joyce did not put forward a general positive contrary case or challenge in relation to the tracing exercise. He did, however, submit that the tracing exercise was (or might be) unreliable because there could be more than one trace – that is, a chain of transactions might exist which was more likely to be accurate than the one presented by HMRC. He cited HMRC's concession that Sample 6 could not be relied on to support this submission.

96. He also pointed out that there were some gaps in HMRC's tracing exercise and that HMRC had relied on documents outside the material derived by them from the various traders' deal packs.

Proof of connection

97. Our task on this aspect of the case is to decide whether on the balance of probabilities HMRC has proved its case in relation to connection as follows. First: has HMRC shown that there were tax losses at the points in the chains where defaulters or hijacked VAT registrations feature? Second: has HMRC shown that such tax losses resulted from fraudulent evasion? Third: has HMRC shown (by reference to the tracing exercise) a connection between such tax losses and (a) Megantic directly (where applicable), or (b) the alleged contra-traders (where applicable)? Fourth: in the cases involving contra-traders, has HMRC shown a connection between Megantic and the tax losses shown to be connected to the alleged contra-traders?

98. We will take these four points in turn.

Tax losses, fraudulent evasion and connection thereof to Megantic and the alleged contra-traders in the direct tax loss chains – findings of fact

99. We were satisfied from the evidence of the Officers referred to in paragraphs 47, 55 and 56 above that there were tax losses at the points in the Sample chains where defaulters or hijacked VAT registrations feature. The Officers' evidence on this point was not challenged by Mr Patchett-Joyce.

100. We were also satisfied from those Officers' evidence that such tax losses resulted from fraudulent evasion of VAT. Again, this was not challenged by Mr Patchett-Joyce.

101. We were also satisfied that HMRC had shown (by reference to the tracing exercise) a connection between the tax losses in the chains leading to Megantic directly and Megantic itself (Samples 9, 9A, 18, 22, 30, 32, 36 and 37).

102. Similarly we were satisfied that HMRC had shown (by reference to the tracing exercise) a connection between the tax losses in the chains leading to alleged contra-traders and those alleged contra-traders (Samples 20, 49 to 54 (inclusive), 59, 66 to 71 (inclusive), 77 to 104 (inclusive), 117 and 121 to 123 (inclusive)).

Connection to fraudulent tax losses of Megantic's purchase transactions via alleged contra-traders

103. HMRC sought to prove the connection between Megantic's purchase transactions in issue and the tax losses shown to be connected to the alleged contra-traders' transactions by showing that each of the deal chains was contrived as part of an orchestrated scheme to defraud the revenue.

104. HMRC submitted that the following factual circumstances showed the contrivance which they alleged.

105. First, HMRC's submission was that the profile of the alleged contra-traders' VAT returns indicated that they were indeed engaged in contra-trading activity.

David Jacobs

106. Thus, Officer Davies's evidence was that the VAT return submitted by David Jacobs for the VAT accounting period 06/06 (covering April to June 2006 inclusive) showed net sales of £392.90 million and net purchases of £380.70 million, giving rise to an output VAT liability of £40.01 million before offset of a claimed input tax credit of £43.97 million, giving rise to a claim for repayment of £3.96 million. The returned sales showed an increase from £225.12 million returned for the previous VAT accounting period (03/06), which in turn showed an increase from £42.72 million returned for the next previous VAT accounting period (12/05).

Powerstrip

107. Officer Ruler's evidence in relation to Powerstrip's VAT return for the VAT accounting period 06/06 (covering April to June 2006 inclusive) was that it showed total net sales of over £367 million, total net purchases of just under £354 million, net EU supplies ("broker" deals) of £166.8 million and net EU purchases (acquisitions) of £138.5 million, giving rise to a total output tax liability of £59.28 million (including acquisitions tax of £24.25 million), a total input tax claim of £61.93 million and a net repayment claim of £2.65 million. The returned sales showed an increase from £182.12 million returned for the previous VAT accounting period (03/06), which in turn showed an increase from £44.64 million return for the next previous VAT accounting period (12/05).

Selectwelcome

108. Officer Gingell's evidence in relation to Selectwelcome's VAT return for the same VAT accounting period (06/06) was that it showed total net sales of £224.02 million, total net purchases of £224.00 million, giving rise to an output tax liability of £24.51 million before offset of a claimed input tax credit of £24.58 million, giving rise to a claim for repayment of £70,921.62. The returned sales showed an increase from £8.16 million in the previous VAT accounting period (03/06), which in turn showed an increase from £461,448 in the next previous VAT accounting period (12/05).

Svenson Commodities

109. Officer Williams's evidence in relation to Svenson Commodities' VAT return for the same VAT accounting period (06/06) was that it showed total net sales of £404.53 million, total net purchases of £393.24 million, dispatches to other EC member states of £165.09 million, acquisitions from other EC member states of £102.23 million, an output tax liability of £42.01 million, a claimed input tax credit of £50.74 million and a net claim for repayment of £8.73 million. The returned sales showed an increase (from £215.61 million) in the previous VAT accounting period (03/06), which in turn showed an increase (from £81.68 million) in the next previous VAT accounting period (12/05).

Svenson Worldwide

110. Officer Rowlands's evidence in relation to Svenson Worldwide's VAT return for its first same VAT accounting period (06/06) (23 November 2005 to 30 June 2006) was that it showed total net sales of £34.83 million, total net purchases of £32.70 million, giving rise to an output tax liability of £2.86 million before offset of a claimed input tax credit of £2.88 million, giving rise to a claim for repayment of £18,700.11. EU supplies returned were £17.72 million and EU acquisitions returned were £16.26 million.

TCCS

111. Officer Lee's evidence in relation to TCCS's VAT return for the 06/06 VAT accounting period (covering April to June 2006 inclusive) was that it showed total net sales of £258.42 million, total net purchases of £256.86 million, giving rise to an output tax liability of £27.33 million before offset of a claimed input tax credit of £27.32 million, giving rise to a net claim for repayment of £9,767.42. EC dispatches returned were £104.31 million and EC acquisitions returned were £102.68 million. The returned sales showed an increase of 22,014.44% in value over the net sales (£665,239) for the previous VAT accounting period (03/06).

385 North

112. Officer Jenner's evidence in relation to 385 North's VAT accounting period ending 30 June 2006 was that its output tax liability on its UK sales was £9.17 million, its claim for input tax credit was £9.92 million, giving rise to a repayment claim was £745,097.80.

Blackstar

113. Officer Sadler's evidence in relation to Blackstar was that in its VAT accounting period covering April to May 2006 (when it went into liquidation) it made UK sales of goods acquired from EU VAT registered traders for which the net purchase cost had been £141.10 million. Blackstar had also made UK purchases in the period to a total cost of £163.56 million, apparently giving rise to an input tax credit of £28.62 million.

Digikom

114. Officer Sadler's evidence in relation to Digikom was that in its VAT accounting period covering April to June 2006 (06/06), it made UK sales of goods acquired from EU VAT registered traders for which the net purchase cost had been £161.48 million, and UK purchases to a total cost of £212.05 million, apparently giving rise to an input tax credit of £37.11 million.

Export Tech

115. Officer Berry's evidence in relation to Export Tech was that in its VAT accounting period covering April to June 2006 (06/06), it made UK sales of goods acquired from EU VAT registered traders for which the net purchase cost had been £98.50 million, giving rise to an acquisition tax liability of £17.24 million. These goods had been supplied to UK customers for £98.64 million, giving rise to an output tax liability of £17.26 million. In the same period Export Tech had made UK purchases to a total cost of £104.32 million, apparently giving rise to an input tax

credit of £17.45 million. The apparent claim for repayment of VAT was therefore about £190,000 (£17.45 million less £17.26 million).

Pan Euro

116. Officer Outram's evidence in relation to Pan Euro was that in its three monthly VAT accounting periods (04/06, 05/06 and 06/06) covering the period April to June 2006 inclusive, its VAT returns showed total net sales of £257.06 million, total net purchases of £254.88 million, giving rise to an output tax liability of £21.49 million before offset of a claimed input tax credit of £23.16 million, giving rise to total net claims for repayment of £1,662,031.57 (£973,561.98 in 04/06, £471,558.37 in 05/06 and £216,911.22 in 06/06). EC dispatches returned were £134.21 million and EC acquisitions returned were £125.31 million.

Rioni

117. Officer Lewis's evidence in relation to Rioni was that in its relevant VAT accounting period (07/06, covering May to July 2006 inclusive), its VAT return showed total net sales of £34.16 million, total net purchases of £33.71 million, giving rise to an output tax liability of £4.43 million (including acquisition VAT of £2.21 million), before offset of a claimed input tax credit of £5.90 million, giving rise to a net claim for repayment of £1.47 million. EC dispatches returned were £21.51 million and EC acquisitions returned were £12.64 million.

118. Secondly, HMRC submitted that there was a very distinct pattern in Megantic's "broker" trades. Of the 353 "broker" deals carried out by Megantic in April to June 2006 (see: paragraphs 3 and 14 above), 344 had been traced back to one of the 6 alleged first-line contra-traders (David Jacobs, Svenson Commodities, Powerstrip, Svenson Worldwide, Selectwelcome and TCCS). The remaining 9 "broker" trades comprise the 8 deals tracing back directly to a tax loss in May and June 2006 (see: paragraph 46 above) and the 1 deal in April 2006 which HMRC originally thought led directly back to a tax loss (IDN 859, Sample 6).

119. HMRC pointed out that Megantic bought directly from the alleged first-line contra-traders and also indirectly in deal chains which involved one or more 'buffer' traders between Megantic and the alleged contra-traders and submitted that that made no commercial sense.

120. HMRC also pointed out that the 6 alleged first-line contra-traders themselves had purchased the mobile phones sold in the deal chains leading to Megantic from only 7 EU-based suppliers, entities known as Mighty Mobile (established in Spain), Adobcom (also established in Spain), Ascomp (established in Denmark), Pol Comm (established in Poland), Forex Handels (established in Germany), BRD (also established in Germany) and Starlet (established in the Netherlands).

121. HMRC submitted that the deal sheet evidence showed that Megantic itself sold to 6 of the 7 EU-based traders who had been suppliers to the alleged first-line contra-traders (Megantic sold to all of them except Starlet). From the schedules provided by HMRC it can be seen that, in the period April to June 2006, out of the 353 "broker"

deals transacted by Megantic, 89 were sales to one of these 6 EU-based traders[7]. Mr Kinnear submitted that this was evidence of goods travelling in a circular fashion (i.e. in a carousel).

122. Mr Kinnear told us that a sample of 59 of Megantic's "broker" deals had been selected at random and the payments for these deals had been traced through the deal chains and beyond, using the banking records of First Curacao International Bank ("FCIB"), with whom virtually all the companies in the various chains (including Megantic) held an account. He said that this exercise had established circularity of funds – money started in one FCIB bank account and was then paid through a series of others, in amounts matching the invoices, before returning to the FCIB account out of which the original payment had been made. He said such circularity of funds had been found in Megantic's deals chains tracing back to defaulting traders and in Megantic's deal chains tracing back to contra-traders and submitted that this cannot have happened by accident or coincidence and was explicable only as the result of careful planning and orchestration.

123. HMRC submitted that the evidence of circularity of funds and of circularity of goods showed in particular that the chains (of goods and of funds) started and finished with two entities, Parasail (based in Spain) and Comica (based in the Netherlands). The evidence was that a certain Adil Kamran was a director of both these companies and that both had bank accounts at FCIB using the same password. Officer Broers produced at the hearing evidence from the Netherlands tax authorities that Adil Kamran was prosecuted in the Netherlands for an offence concerning carousel fraud (deliberately sending in false VAT returns for periods between April 2005 and July 2006) and on 10 May 2007 was sentenced to 30 months imprisonment. The Netherlands Court of Appeal had stated that there was no doubt that Adil Kamran and Comica had been involved in carousel fraud in the period concerned. The evidence was that Adil Kamran had given notice of appeal to the Supreme Court but not as to the result of that. Mr Kinnear said that, as with the circularity of payments, so also the circularity of goods cannot have happened by accident or coincidence, but instead required all parties to the transactions to sell particular goods to particular persons at a particular time and at a particular price. He submitted that without organisation, this exceptionally complex scheme would have broken down immediately. It required control over both the goods and the funds, so that the fraudsters (whoever they were) could be assured that the fraud would work as planned.

Deal chains in which Megantic (as a "buffer") and alleged contra-traders featured

124. HMRC also prayed in aid the "buffer" deals carried out by Megantic in the 3 months April to June 2006, as showing a connection between Megantic and the tax losses shown to be connected to the alleged contra-traders. HMRC's case was that the nature of these "buffer" deal chains further illustrated trading which was contrived as an orchestrated scheme.

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[7] 3 were to Mighty Mobile (all in April 2006); 27 were to BRD (7 in April 2006 and 20 in May-June 2006); 4 were to Adobcom (3 in April 2006 and 1 in May 2006); 19 were to Ascomp (5 in April 2006 and 14 in May-June 2006); 18 were to Pol Comm (7 in April 2006 and 11 in May-June 2006); and 18 to Forex Handels (4 in April 2006 and 14 in May-June 2006).

125. In April 2006, Megantic carried out 53 "buffer" deals according to the schedules presented to us by HMRC. Of these deals, 9[8], according to our examination of the schedules, were in deal chains that featured one of two of the alleged contra-traders. 5 of these chains featured Powerstrip – in 4 of them[9] as a contra-trader, and in 1 of them (IDN 97) as the supplier to Megantic. The other 4 chains featured David Jacobs – in 3 of them[10] as a contra-trader and in the remaining chain (IDN 85) as the supplier to Megantic. (None of these deals had been selected as a Sample deal.)

126. In May 2006, the position was different. Of the 49 "buffer" deals carried out by Megantic in that month (according to HMRC's schedules), 40[11] featured one or more of the alleged contra-traders.

127. 17 of these 40 chains featured Powerstrip – in 7 of them[12] as a contra-trader, and in 10 of them[13] as Megantic's customer (and "broker" in the respective chains).

128. 14 of these 40 chains featured David Jacobs (5 of them[14] also featuring one or two of the other alleged contra-traders). In 2 of them[15] David Jacobs featured as a contra-trader, in 2 of them[16] as Megantic's supplier, in 8[17] of them as Megantic's customer (and "broker" in the respective chains), and in 2 of them[18] as a "buffer" one place removed from Megantic in the respective chains.

129. 8 of these 40 chains featured Svenson Commodities (4 of them[19] also featuring other alleged contra-traders). In 3 of them[20], Svenson Commodities featured as

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[8] IDNs 24, 24A, 27, 85, 97, 101, 101A, 117 and 140

[9] IDNs 24, 24A, 101 and 101A

[10] IDNs 27, 117 and 140

[11] IDNs 151, 151A, 152, 179, 180, 180A, 181, 182, 182A, 183, 204, 204A, 213, 218, 219, 220, 221, 222, 224, 226, 227, 228, 229, 230, 231, 232, 233, 234, 262, 262A, 271, 272, 273, 295, 295A, 295B, 312, 313, 314, and 315.

[12] IDNs 151, 151A, 152 (which were Sample deals 10 and 11) 153, 295, 295A and 295B

[13] IDNs 181 (Sample 68), 218 (Sample117), 221, 228 (Sample 69), 229, 230, 232, 234, 271, and 272

[14] IDN 220, also featuring Selectwelcome (as David Jacobs's supplier) and Svenson Worldwide (as Megantic's customer and "broker" in the chain); IDN 226, also featuring Selectwelcome (as David Jacobs's customer and "broker" in the chain); IDN 233, also featuring Svenson Commodities (as Megantic's supplier); IDN 312, also featuring Svenson Commodities (as David Jacobs's supplier) and TCCS (as Svenson Commodities' supplier); IDN 314, also featuring TCCS (as David Jacobs's customer and Megantic's supplier); and IDN 315, also featuring Selectwelcome (as David Jacobs's supplier).

[15] IDNs 204 and 204A

[16] IDNs 220 and 312

[17] IDNs 180 and 180A (Samples 20 and 50), 222, 226, 227, 231, 233, and 273

[18] IDNs 314 and 315

[19] IDN 222, also featuring David Jacobs (as Megantic's customer and "broker" in the chain); IDN 233, also featuring David Jacobs (as Megantic's customer and "broker" in the chain; IDN 234, also featuring Powerstrip (as Megantic's customer and "broker" in the chain); IDN 312 also featuring

Megantic's customer and "broker" in the respective chains, in 4[21] of them, Svenson Commodities featured as Megantic's supplier, and in 1 of them[22], Svenson Commodities featured as a "buffer" one place removed from Megantic in the chain (behind David Jacobs).

130. 2 of these 40 chains featured Svenson Worldwide (one of them[23] also featuring David Jacobs (as Megantic's supplier) and Selectwelcome (as David Jacobs's supplier)). In both of these chains[24], Svenson Worldwide featured as Megantic's customer and "broker" in the chain.

131. 6 of these 40 chains featured Selectwelcome (3 of them[25] also featuring other alleged contra-traders). In 2 of them[26], Selectwelcome acted as contra-trader. In 2 of them[27], Selectwelcome acted as "broker" in the respective chains at two places removed from Megantic. In the other 2 of them, Selectwelcome acted as "buffer" in the chain, in one case (IDN 220) two places removed from Megantic (behind David Jacobs) and in the other case (IDN 315) 3 places removed from Megantic (behind an entity called Evenmore, and David Jacobs, acting as second and third "buffers" to Megantic's first "buffer" – Selectwelcome acting as fourth "buffer").

132. Finally, 2 of these 40 chains featured TCCS, both of them featuring other alleged contra-traders[28]. In both chains[29] TCCS featured as a "buffer" trader, in one case (IDN 314) as Megantic's supplier, and in the other case (IDN 312) as a "buffer" trader, two places removed from Megantic (behind David Jacobs and Svenson Commodities).

TCCS (as Svenson Commodities' supplier) and David Jacobs (as Svenson Commodities' customer, and Megantic's supplier);

[20] IDNs 182 and 182A (Sample 59), and 183.

[21] IDNs 222, 233, 234 and 313.

[22] IDN 312.

[23] IDN 220 (Sample 121)

[24] IDNs 219 and 220

[25] IDNs 220 (also featuring David Jacobs (as Selectwelcome's customer) and Svenson Worldwide (as Megantic's customer); 226 (also featuring David Jacobs as Selectwelcome's supplier, and Megantic's customer); and 315 (also featuring David Jacobs as Selectwelcome's customer).

[26] IDNs 262 and 262A

[27] IDNs 224 and 226

[28] IDN 312 also featured Svenson Commodities (TCCS's customer) and David Jacobs (Svenson Commodities' customer) as "buffer" traders, and IDN 314 also featured David Jacobs (TCCS's supplier) as a "buffer" trader.

[29] IDNs 312 and 314

133. In June 2006, of the 57 "buffer" deals carried out by Megantic in that month (according to HMRC's schedules), 34[30] were in chains featuring one or more of the alleged contra-traders.

134. 11 of these 34 chains[31] featured David Jacobs (9 of them[32] also featuring other alleged contra-traders). 7 of these 11 chains[33] featured David Jacobs as the customer of Megantic and the "broker" in the chain. 4 of these 11 chains[34] featured David Jacobs as Megantic's supplier.

135. 7 of these 34 chains featured Selectwelcome (all of them[35] also featuring other alleged contra-traders). In 5 of these 7 chains[36] Selectwelcome featured as contra-trader in the chain. In the remaining 2 of these 7 chains[37], Selectwelcome featured as a "buffer" two places removed from Megantic.

136. TCCS featured in 18 of these 34 chains[38] (2 of them[39] also featuring Powerstrip, another of the alleged contra-traders). 14 of these 18 chains[40] featured TCCS as a contra-trader in the chain. 4 of these 18 chains[41] featured TCCS as Megantic's customer and "broker" in the respective chains.

137. Svenson Commodities featured in 3 of these 34 chains[42] (2 of them[43] also featuring another alleged contra-trader (David Jacobs)). In one of these 3 chains[44],

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[30] IDNs 366, 367, 370, 372, 414, 428, 429, 430, 431, 433, 467, 469, 469A, 470, 470A, 471, 471A, 472, 474, 474A, 476, 476A, 477, 477A, 479, 479A, 480, 481, 481A, 481B, 482, 483, 483A, and 486.

[31] IDNs 366, 367, 370, 429, 433, 480, 481, 481A, 481B, 483 and 483A

[32] IDNs 366, 367, 483 and 483A (also featuring Selectwelcome as a "buffer" trader 2 places removed from Megantic); IDNs 370 and 433 (also featuring Svenson Commodities as the supplier to Megantic); and IDNs 481, 481A and 481B (also featuring Selectwelcome as supplier to David Jacobs).

[33] IDNs 366, 367, 370, 429,433, 483 and 483A

[34] IDNs 480, 481, 481A and 481B

[35] IDNs 366, 367, 483 and 483A (also featuring David Jacobs as the "broker" in the chain); and IDNs 481, 481A and 481B (also featuring David Jacobs as Selectwelcome's customer and Megantic's supplier).

[36] IDNs 481, 481A, 481B, 483 and 483A

[37] IDNs 366 and 367

[38] IDNs 428, 467, 469, 469A (Sample 75), 470, 470A, 471, 471A, 472, 474, 474A, 476, 476A, 477, 477A, 479, 479A, and 486

[39] IDNs 469 and 469A (Sample 75) featured Powerstrip as the "broker" in the respective chains.

[40] IDNs 469 and 469A (Sample 75), 470, 470A, 471, 471A, 474, 474A, 476, 476A, 477, 477A, 479 and 479A

[41] IDNs 478 (Sample 86), 467, 472 and 486

[42] IDNs 370, 414 and 433

[43] IDNs 370 and 433 (also featuring David Jacobs as Megantic's customer and "broker" in the respective chains).

Svenson Commodities featured as the contra-trader. In 2 of these 3 chains[45], Svenson Commodities featured as Megantic's supplier.

138. Powerstrip featured in 6 of these 34 chains[46] (3 of them[47] also featuring TCCS, another of the alleged contra-traders). In 5 of these 6 chains[48] Powerstrip featured as Megantic's customer, and the "broker" of the respective chains. In the remaining chain[49] Powerstrip featured as Megantic's supplier.

139. In summary, HMRC's analysis of the deal chains in which Megantic was a "buffer" trader in the months of April, May and June 2006 showed that all of the 6 alleged first-line contra-traders featured in some of those chains, all, except Svenson Worldwide, as a contra-trader, all, except Svenson Worldwide and Selectwelcome, as Megantic's supplier, and all, except Selectwelcome, as Megantic's customer. Powerstrip, David Jacobs, and Svenson Commodities appeared in some chains as Megantic's supplier and in others as Megantic's customer. Frequently 2 or more of the alleged first-line contra-traders appeared in the same chain together with Megantic. Frequently an alleged contra-trader would be Megantic's supplier in some chains but one stage removed from Megantic, behind another "buffer" trader in others.

140. Mr Kinnear showed us that all the deal chains in which Megantic acted as "buffer" trader in April 2006, but which did not trace back to either Powerstrip or David Jacobs as alleged contra-traders, traced back to defaulting or hijacked traders, viz: KEP 2004, C&B Trading Limited, Computec Solutions Limited, Midwest Communications Limited, Flooring Centre (UK) Limited, Oracle (UK) Limited and Samson Trading. We had received evidence from Officers Armstrong, Taylor, Reardon, Bycroft and Edmead in relation to the first four of these named defaulting entities respectively, and from Officer Johnson in relation to Samson (Officer Johnson's witness statement replaced that originally made by Officer Lamb). There were witness statements made by Officer Stevens (adopted by Officer Edmead, who gave evidence) relating to Flooring Centre to the effect that this entity also fraudulently defaulted on its VAT obligations to HMRC. There had originally been a witness statement filed by Officer Cameron-Watson in relation to Oracle, but this statement was not adopted by any of the Officers giving evidence.

141. Mr Kinnear showed us that all the deal chains in which Megantic acted as a "buffer" trader in May 2006, but which did not trace back to David Jacobs, Powerstrip or Selectwelcome as an alleged contra-trader, traced back to defaulting or hijacked traders, viz: 3D Animations, KEP 2004, Okeda, UK Communications Limited,

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[44] IDN 414

[45] IDNs 370 and 433

[46] IDNs 372, 430, 431, 469, 469A (Sample 75), and 482

[47] IDNs 372, 469 and 469A (also featuring TCCS as a "buffer" trader 1 place removed from Megantic)

[48] IDNs 372, 430, 431, 469, and 469A

[49] IDN 482

Prompt Info Limited, Stockmart, World of Power and XS Enterprise Systems. We had received evidence from Officers Johnson, Armstrong, Needs, Medcroft (adopting statements made by Officer Cameron-Watson), Kumar, Williams, Cordwell and Monk in relation to these named defaulting entities respectively.

142. Mr Kinnear showed us that all the deals in which Megantic acted as a "buffer" trader in June 2006, but which did not trace back to Svenson Commodities, TCCS or Selectwelcome as alleged contra-traders, traced back to defaulting or hijacked traders, viz: Okeda, UK Communications, Advertising South, Birdwood, I Conekt, Many Services Limited, DTM Provisions, Restar UK Limited, Rukford Limited and West One. We had received evidence from Officers Needs in relation to Okeda, and Medcroft (adopting Officer Cameron-Watson's statements) in relation to UK Communications, Davis in relation to Birdwood, Payne in relation to I-Conekt, Monk in relation to Many Services, McBrine in relation to DTM Provisions, Speight in relation to Restar, Dean in relation to Rukford, and Lam in relation to West One to the effect that these named entities fraudulently defaulted on their obligations to HMRC. A witness statement in relation to Advertising South had originally been made by Officer Riley but it was not presented to us or adopted by another Officer.

143. Mr Kinnear showed us by taking us to HMRC's schedules, that during the months April to June 2006 inclusive, Megantic sold goods to 24 EU/overseas customers in respect of "broker" deals and 32 UK-based customers in respect of "buffer" deals.

144. As noted above (see: paragraph 30 above), in the months of May and June 2006, Megantic entered into 389 deals in total – 254 "broker" deals and 135 "buffer" deals. Mr Kinnear told us that almost all of these deals had been traced by HMRC and had been shown to commence with an EU supplier and end with an EU, or sometimes an overseas, customer. He submitted that there was an overwhelming inference that the remaining few deals had this characteristic also.

Evidence of the transaction chains featuring alleged contra-traders

145. Officer Humphries gave evidence that he had reviewed the deal sheets detailing the transaction chains of what he termed as 'the contra traders supplying Megantic' in April to June 2006 inclusive. He made the point that the deals sheets were prepared by HMRC officers from information supplied by traders. He had examined the various chains of transactions from the EU suppliers, through the UK to the EU/overseas customers. He noted that the six alleged first-line contra traders had common EU suppliers, using only 8 suppliers between them and that these EU suppliers also appeared as EU customers of the "brokers" in the chains of transactions involving the alleged first-line contra-traders.

146. His analysis was that the acquisition chains which had involved the alleged first-line contra-traders featured one of the 8 EU suppliers identified (Adobcom, Ascomp, BRD, Forex, Mountainrix, Mighty Mobile, Pol Comm or Starlet) and that those suppliers had in each case themselves been supplied by either Comica or Parasail. The chains had featured a number of UK "buffers", between the alleged first-line contra-traders and the UK "brokers" (one of which was Megantic). Those

"buffers" included David Jacobs, Svenson Commodities and TCCS acting in the capacity of "buffer". 30 such "buffers" were identified.

147. Officer Humphries's analysis showed that the immediate EU customers of the "brokers" in the chains (one of which was Megantic) were confined to 21 entities, including all of the 8 EU suppliers to the alleged first-line contra-traders. These EU customers then supplied the goods to Comica or Parasail. Megantic sold goods to 19 EU customers, including 7 of the 8 EU suppliers – Adobcom, Ascomp, BRD, Forex Handels, Mighty Mobile, Mountainrix and Pol Comm.

148. Mr Kinnear told us that the FCIB evidence demonstrated that Comica and Parasail were both controlled by one individual, Adil Kamran, and that deals chains starting with Comica regularly ended with Parasail and *vice versa*.

149. Officer Humphries also gave evidence as to the activities of the alleged second-line contra-traders, 385 North, Blackstar, Digikom, Export Tech, Pan Euro and Rioni. He had analysed their deals in May and June 2006 and produced charts illustrating the chains in which they featured.

150. These charts show 385 North acquiring goods from Powertec and selling them to David Jacobs, Powerstrip or Svenson Commodities (all alleged first-line contra-traders) which despatched them to one of a number of EU-based customers.

151. Likewise the charts show goods acquired by Export Tech from X Box Red, passing *via* a UK-based entity Greystone UK, to David Jacobs (an alleged first-line contra-trader), which despatched them to one of a number of EU-based customers. Similarly goods acquired by Export Tech from X Box Red passed *via* Greystone UK or Nobel Technologies to Svenson Commodities (another alleged first-line contra-trader), which despatched them to one of a number of EU-based customers. Again, goods acquired by Export Tech from X Box Red passed *via* Nobel Technologies or Greystone UK to Powerstrip, which despatched them to one of a number of EU-based customers.

152. The charts also show goods acquired by Digikom from Prabud, passing *via* Greystone UK to David Jacobs, Powerstrip or Svenson Commodities, which despatched them to one of a number of EU-based customers.

153. The charts also show goods acquired by Pan Euro from Cherry Tree passing to David Jacobs or Powerstrip, which despatched them to one of a number of EU-based customers. They also showed goods acquired by Pan Euro from Cherry Tree passing either directly or *via* an entity called Trade 24/7 to Svenson Commodities, which despatched them to one of a number of EU-based customers.

154. The charts also showed goods acquired by Blackstar from Avoset passing directly to Svenson Commodities, which despatched them to one of a number of EU-based customers.

155. Similarly in relation to Rioni, the charts showed goods acquired by Rioni from Powertec passing *via* Nobel Technologies or Trade 24/7 to Svenson Commodities, which despatched them to one of a number of EU-based customers.

156. It should be noted that the EU-based customers to whom goods were despatched by David Jacobs, Powerstrip or Svenson Commodities in these deals were in every case one of 16 entities – Globalphone, Ascomp, FAF, Cayenne, IMD Trade, Freitex, BRD, Planetmania, Intangible Media, Senbetel, Forex, Olympic Europe, Eurotronics, Elandour, New Abaco or Nano Infinity.

FCIB evidence

157. Officer Letherby gave evidence on how the forensic evidence recovered from FCIB was interrogated, investigated and analysed, so as to make it available for use in civil and criminal cases. He spent 2½ years (from March 2008 to mid-2010) on this task.

158. Officer Downer gave evidence about his analysis of the FCIB records, including the electronic bank ledgers and statements and the account application forms, including the material that was provided to FCIB to support these applications. He was later assisted by 3 HMRC analysts, Officers Mercer, Loftus and Young, who provided witness statements – Officers Mercer and Young gave oral evidence. These analysts checked Officer Downer's work and provided additional detail (which became available at a later stage) in relation to the timing of payments, the IP addresses from which they were made, and the passwords used to access the accounts. They presented the results of their analysis in a series of charts and diagrams. Although Mr Patchett-Joyce established that the original material from which the charts were derived was not before the Tribunal, we accepted the Officers' evidence that the charts were accurate, having no reason to suppose that they were not.

159. The IDNs selected for review by the Officers covered the different types of deals conducted by Megantic – that is, "broker" deals tracing to an alleged contra-trader (50 IDNs), all the "broker" deals tracing to a defaulting or hijacked trader, and 4 IDNs which were "buffer" deals. The deals analysed were not confined to the periods in relation to which the decisions appealed were made. They were, however, all included in the Samples directed for the tracing exercise.

160. The Officers found that 43 (some 85%) of the "broker" deals examined, which led to alleged contra-traders, demonstrably involved the circular movement of funds. The other "broker" deals leading to alleged contra-traders could not be traced because Megantic had not been paid and/or had not made payment or involved the same accounts where circularity had been found. Of the "broker" deals leading to a defaulting or hijacked trader, 7 (over 70%) demonstrably involved the circular movement of funds. Of the 4 "buffer" deals analysed, 3 demonstrably involved the circular movement of funds and the remaining deal could not be traced due to the use of a non-FCIB account.

161. The analysis revealed that four entities in particular – SM Systems International ("SMS"), Amira, Comica and Parasail (which also adopted the name Negresco for

FCIB banking purposes) – were instrumental in the circular movement of funds. Documentation from the FCIB established close connection between these entities. The signatory on SMS's account with FCIB was one Imran Memon of an address in Dubai and the password "bushra" was used on that account. The same password was used by Mr Memon on the account of Amira. For Comica, the FCIB documentation showed that the account was operated by Adil Kamran, with the password "naeema", who also operated the Negresco (Parasail) account with the same password.

162. The information analysed also included details of the IP addresses of computers operated to effect transactions in the FCIB accounts and, in particular, of the times when those computers were online for those purposes.

163. Thus, in the case of IDNs 119 and 120 (Sample 5), it was possible to trace a circularity of money movements starting on 9 May 2006 at 11:24 a.m. (the IP address was online between 11:20 and 11:29 a.m.) when David Jacobs (the alleged contra-trader in the deal chain) sent £1,007,422.50 in respect of 4,650 Nokia N70 mobile phones to Mighty Mobile (the EU-based supplier). At 12:03 p.m. that day, payment of £1,005,562.50 (in two tranches) in respect of 4,650 Nokia N70 mobile phones, was made by Mighty Mobile to Comica, who paid £1,004,400 to SMS for 4,650 Nokia N70 mobile phones at 12:33 p.m. that day. The next day (10 May 2006), SMS is recorded as paying in aggregate over £5m to Amira (both SMS and Amira being entities whose accounts were operated by or under the direction of Imran Memon). Moments later, £4.8m is shown as being paid by way of "Investment Loan" by Amira to Parasail, and Parasail is seen to fund the purchase of 4,650 Nokia N70 mobile phones in two consignments, one from Forex (£604,597.50 was paid at 16:09 on 10 May 2006) and the other from BRD (£454,300 was paid at 16:12 on that day). Forex paid £603,935 to Sigma (Sixty) BV for its consignment (of 2,650 Nokia N70 mobile phones) at 16:18 on 10 May 2006. Sigma (Sixty) BV then paid Megantic £601,285 at 16:36 on that day. At 16:18 on that day, BRD had paid Megantic £453,800 for its consignment (of 2,000 Nokia N70 mobile phones) – the 2 consignments adding up to the 4,650 phones which had been acquired by Megantic from Regent (invoice date: 26 April 2006) and by Regent from David Jacobs (invoice date: 26 April 2006). The payment trail shows Megantic paying Regent £1,191,917.06 on 13 June 2006 at 16:39, and Regent paying David Jacobs £1,189,185.19 at 16:51 that same day. Thus the chart demonstrated that funds had gone round in a circle starting and finishing with David Jacobs over the course of 5 weeks or so. The evidence also showed that the payments by Megantic to Regent, and by Regent to David Jacobs were made from the same IP address.

164. This chart was an example of the extensive evidence on circular payments produced by HMRC from the FCIB records. In particular detailed evidence was given of circularity of payments in deals involving 5 of the 6 alleged first-line contra-traders (IDNs 137 and 154 (Svenson Commodities); IDN 168 (Powerstrip); IDN 267 (Svenson Worldwide); IDN 462 (TCCS); and IDNs 187 and 188 (David Jacobs)).

165. In relation to Selectwelcome, there were a number of charts produced. For example, Officer Mercer produced a chart in which the payments moving in IDN 259 (one in which Selectwelcome was the alleged contra-trader) were traced. These

payments were not circular, but Officer Mercer had traced payments moving in a chain from Desert Wing Trading (a Dubai entity controlled by Imran Memon) through Amira (also controlled by Imran Memon), Comica (controlled by Adil Kamran), Intangible, Megantic, TM Global, Selectwelcome, Pol Comm, Parasail (controlled by Adil Kamran) and SM Systems (controlled by Imran Memon). A chart produced by Officer Downer in relation to IDNs 260 and 261, which followed paths very similar to IDN 259, did suggest circularity, in that SM Systems made payments to Amira against invoices to complete a circle that had started by Amira making "investments loans" to Comica.

166. Officer Humphries's evidence in relation to the deals carried out by the alleged second-line contra-traders (385 North, Blackstar, Digikom, Export Tech, Pan Euro and Rioni) in May and June 2006 is recorded at paragraphs 149 to 156 above. We accept that these entities regularly took part in deal chains whereby goods acquired by them from EU-based entities (X Box Red, Prabud, Cherry Tree, Avoset and Powertec) were passed either directly, or *via* a single UK-based "buffer" entity (either Greystone UK, Nobel Technology or Trade 24/7) to one of the alleged first-line contra-traders identified.

167. Officer Downer's evidence of his analysis of the FCIB records did not include an analysis of any of these deal chains (which did not involve Megantic).

168. We did, however, receive evidence from Officer Humphries that he had examined work done on the FCIB records by another officer, Officer Birchfield, who did not give evidence, showing money flows. This evidence was primarily intended to give further information on the involvement of Comica and Parasail, as mentioned above, but it also gave some information on money flows in deals conducted in late May 2006 by Svenson Commodities, which involved 4 of the 6 alleged second-line contra-traders (*viz:* Export Tech, Blackstar, Digikom and Rioni) in the position of "contra-trader" in the deal chains concerned.

169. This information suggested that at least some of these deal chains involved circular money chains starting and finishing with an entity called Bigisel Ticaret (although the name of Bigisel Ticaret was printed against a magenta background which indicated "possible duplicate") or Retro Group (a non-EU overseas entity). The chains of money flowing from Bigisel Ticaret went *via* a non-UK entity to an EU-based customer of Svenson Commodities (Neo Abaco, Nano Infinity, Eurotronics, FAF, Elandour or Olympic – all customers noted at paragraph 156 above) – thence to Svenson Commodities and thence either directly, or *via* Nobel Technology, Greystone or Trade 24/7, to one of the 4 alleged second-line contra-traders. The money flows were traced from the 4 alleged second-line contra-traders to their suppliers (X Box Red, Avoset, Powertec, or Prabud) back to Bigisel Ticaret. Most of these deal chains were marked "Paris agreed" on Officer Humphries's chart, which we assume is a reference to the FCIB Paris server. The chains of money flowing from Retro Group went *via* a non-UK entity to Olympic, thence to Svenson Commodities, thence to Blackstar, thence to Avoset and thence back to Retro Group

170. There were also two deal chains on this chart which similarly indicated circularity of funds from and to Bigisel Ticaret *via* Svenson Commodities, which included Pan Euro, another of the 6 alleged second-line contra-traders. However Pan Euro is shown as fulfilling the role of UK "Buffer", rather than contra-trader in the chart.

Evidence on alleged second-line contra-traders

171. We go on to refer to the evidence given by the several Officers who were allocated by HMRC to deal with the affairs of these alleged second-line contra-traders.

385 North

172. Officer Jenner gave evidence in relation to 385 North. He identified 30 deals out of the 40 carried out in the VAT period ending 30 June 2006 where 385 North had bought from Powertec and sold on to David Jacobs (6 deals), Powerstrip (17 deals) and Svenson Commodities (7 deals). The VAT involved in these deals amounted to over £9 million, which was claimed to be reduced by – set off against – the input tax claimed in that period by 385 North, which amounted to £9,917,950 and had all been identified as input tax on purchases in deal chains tracing back to defaulting or missing suppliers, predominantly Premier Insurance Services (a defaulting trader in relation to which Officer Outram gave evidence). Officer Jenner's evidence was that there was 'a raft of indicators' that 385 North was involved in MTIC activity. It traded as a "broker" (9 of the other 10 deals carried out in the period) selling to a customer, Valdemara of Latvia, in chains traced back to UR Traders, known to be a defaulting or hijacked entity on the evidence in this appeal. 385 North is also suspected by HMRC of trading in non-existent goods. The other deal carried out in the period was a sale to The Accessory People Global Limited, identified as a "buffer" trader. 385 North has disappeared owing over £40 million in VAT to HMRC.

Blackstar

173. Officer Sadler and Officer Downer gave evidence in relation to Blackstar. Officer Sadler's evidence was that Blackstar also conducted two types of trades in April and May 2006: 26 deals where Blackstar purchased from one UK VAT registered entity (Red WM Ltd) and despatched to one EU-based customer, Vista Assistance (established in Slovakia), giving rise to an input tax deduction claim of over £28 million; and 87 deals where goods were acquired from one of two EU-based entities (Avoset and Prabud) and supplied to one of 10 UK VAT registered traders. Sample 60 (IDN 646 and IDN 1632) showed a chain carried out on 19 May 2006 and leading from Avoset to Blackstar to Svenson Commodities to Olympic Europe. Svenson Commodities' invoice number 2426 links this deal to the evidence of money flows derived from the FCIB records given by Officer Humphries, where there is a circular money flow starting and finishing with Retro Group (see paragraph 169 above). Blackstar's UK purchases were traced back through the relevant deal chains to the defaulting or hijacked traders Bright Time and Fastec (in relation to which we received evidence from Officers Stock and Outram respectively).

174. Officer Downer's evidence in relation to Blackstar was of the discovery of two compact discs by West Midlands Police in 2006. The CDs contained documents and

transaction chains involving the wholesale trade of electronic goods covering a time period from approximately April 2005 to January 2006 (therefore not in the VAT periods with which this appeal is directly concerned). The transaction chains included chains featuring Blackstar and further work by Officer Downer had established that at least some of these deals had actually taken place. His conclusion from the analysis he carried out was that the buying and selling of the companies featured on the CDs, including Blackstar, was all pre-arranged and the CDs themselves were evidence of this.

Digikom

175. Officer Sadler and Officer Downer also gave evidence in relation to Digikom. Officer Sadler's evidence was that Digikom also conducted two types of trade in its VAT period from 1 April to 30 June 2006. There were 118 deals entered into, being purchases from UK VAT registered traders where the goods were despatched to one of 3 EU customers, Phista Trading of Cyprus, Scorpion Electronics of Portugal or Estomcom Distribution of Estonia. These deals gave rise to an input tax claim of over £37 million. There were also 109 deals, being acquisitions of goods from 4 EU VAT registered traders (Dunas & Pinheiros, Powertec, Prabud and Georitual Unipessoal, all of Portugal) which were supplied to one of 6 UK VAT registered traders. Samples 57, 61 and 73 show acquisitions by Digikom from Prabud and supplies by Digikom to Greystone, and by Greystone to David Jacobs ((Sample 57) who despatched them to Eurotronics)) or by Greystone to Svenson Commodities ((Sample 61) who despatched them to Nano Infinity)) or by Greystone to Powerstrip ((Sample 73) who despatched them to Neo Abaco)). Eurotronics, Nano Infinity and Neo Abaco all feature in the list of EU-based customers listed at paragraph 156 above.

176. The deal chain in Sample 61 (IDN 662) features Svenson Commodities' invoice number 24565 and this links this deal to the evidence of money flows derived from the FCIB records given by Officer Humphries, where there is arguably a circular money flow starting and finishing with Bigisel Ticaret (see paragraph 169 above).

177. The purchases by Digikom from UK VAT registered traders have been traced by HMRC to the defaulting traders Pentagon (UK) Limited (a hijacked VAT registration) and Premier Insurance Services. As stated above, Officer Outram gave evidence that Premier Insurance Services was a defaulting trader. Similar evidence in relation to Pentagon (UK) Limited was received from Officer Austin.

178. Officer Downer's evidence in relation to Digikom also related to the discovery of the two compact discs by West Midlands Police in 2006, already referred to. The transaction chains detailed on the CDs included chains featuring Digikom and further work by Officer Downer had established that at least 6 of these deals (sales from Reliance Limited to Digikom) in August 2005 had actually taken place. His conclusion from the analysis he carried out was that the buying and selling carried out by the companies featured on the CDs, including Digikom, was all pre-arranged and the CDs themselves contained documentation and information relating to chains of transactions which were contrived for the purpose of perpetrating MTIC fraud.

Export Tech

179. Officer Berry gave evidence in relation to Export Tech. He said that in the 03/06 VAT period Export Tech 'began to bear the hall marks of a Contra trader', with 39 EU acquisition deals where the goods were sold to UK companies and 11 "broker" deals, where the goods were sold to EU-based customers.

180. In the 06/06 VAT period, Export Tech conducted 83 deals of which 65 were EU acquisitions sold to UK companies with a liability to output VAT of £17,261,921.61, and 18 were "broker" deals giving rise to a claim for deductible input tax of £17,451,476.88 (a difference of £189,555.27) but the total input tax credit claimed in the period was £18,258,389.92.

181. The 65 EU acquisitions were all from Xbox Red (a Spanish entity). The goods so acquired were supplied to one of 3 customers, Greystone UK, Nobel Technologies or Trade 24/7. Greystone UK and Nobel Technologies (but not Trade 14/7) made onward supplies to Svenson Commodities and Powerstrip (who acted as "brokers"). Greystone UK also made onward supplies to David Jacobs (who acted as a "broker").

182. The 18 "broker" deals carried out in the 06/06 VAT period by Export Tech have been traced back by HMRC to 2 hijacked VAT registrations (East Midlands Engineering Services Limited, and Home Sales and Lettings) in relation to which evidence was given by Officers Mee and Ball respectively. The hijacks have given rise to substantial (over £39 million) of output VAT fraudulently not accounted for. Export Tech's customers in these "broker" deals were Estocom Distribution OU (17 deals) and High Level Trading (1 deal).

183. Mr Patchett-Joyce in his cross-examination of Officer Berry did not suggest that Export Tech had not fraudulently offset the input tax on the purchases giving rise to 18 "broker" deals against the output tax due on the supplies of goods acquired from Xbox Red.

Pan Euro

184. Officer Outram gave evidence in relation to Pan Euro. In the relevant VAT period (06/06), Pan Euro carried out 18 transactions where stock was acquired from EU-based suppliers and sold within the UK, and 7 transactions where stock was acquired from one UK-based supplier, First Associates, and, in "broker" transactions, sold to one EU-based customer, Valdemara, based in Latvia (which was also 385 North's customer – see: paragraph 172 above).

185. The 18 acquisition transactions were carried out on one day, 30 June 2006. The 7 "broker" transactions were carried out on 27 June (3 deals), 29 June (2 deals) and 30 June 2006 (2 deals).

186. The 18 acquisition transactions were purchases from one supplier, Cherry Tree, of Cyprus. The stock so acquired was sold to one of 3 customers, being Svenson Commodities, Powerstrip or David Jacobs. These companies sold to EU-based customers in "broker" deals.

187. Officer Outram told us that information from the Latvian authorities had shown that Valdemara had failed to account in Latvia for VAT on the acquisitions of stock from Pan Euro.

188. Pan Euro's 7 "broker" transactions had been traced back through First Associates to Premier Insurance Services, which, as noted above, was, on Officer Outram's evidence, a defaulting trader, and, behind Premier, to the hijacked VAT registration of UR Traders, as to which Officer Matthews had given evidence.

189. Mr Patchett-Joyce in his cross-examination of Officer Outram did not suggest that Pan Euro had not fraudulently offset the input tax on the purchases giving rise to 7 "broker" deals against the output tax due on the supplies of goods acquired from Cherry Tree.

Rioni

190. Officer Lewis gave evidence in relation to Rioni. In the relevant VAT period (07/06), Rioni carried out 5 "broker" deals – all purchases from Crestmount Solutions Ltd., which have been traced back to the hijacked VAT registration of Home Sales and Lettings, as to which we had heard evidence of its fraudulent default from Officer Ball. In the same period, Rioni made 10 acquisitions, all from Powertec (of Portugal). 7 of these acquisition deals were of goods supplied by Rioni to Nobel Technologies and 3 of them were of goods supplied by Rioni to Trade 24/7. 4 of the purchases by Nobel Technologies were supplied onwards by it to Svenson Commodities (the remaining 3 were supplied onwards to Just Fabulous UK Limited) and all 3 of the purchases by Trade 24/7 were supplied onwards by it to Svenson Commodities.

191. The 3 supplies by Rioni to Trade 24/7 and 2 of the 4 supplies by Rioni to Nobel Technologies featured on Officer Humphries's chart containing the evidence referred to at paragraphs 169 and 170 above – they can be identified by Svenson Commodities' invoice numbers 2475, 2474, 2492, 2515 and 2523 – as parts of circular chains of money flows arguably beginning and ending with Bigisel Ticaret.

192. Mr Patchett-Joyce in his cross-examination of Officer Lewis invited the Officer's confirmation that he considered that Rioni was 'a fraudster' and did not suggest that Rioni had not fraudulently offset the input tax on the purchases giving rise to the 5 "broker" deals against the output tax due on the supplies of goods acquired from Powertec.

Allocation to Megantic of identified tax losses

193. The question of allocation to Megantic of identified tax losses in chains leading to alleged contra-traders arose in the course of argument. This was dealt with by a statement on the subject agreed as to its factual correctness by Mr Patchett-Joyce, which Mr Kinnear read into the transcript of the hearing. The statement was as follows:

194. "HMRC originally proceeded with the extended verification exercise on a basis designed to prevent potential problems in relation to multiple recovery. As a result, the contra officers allocated the identified tax losses in the tax loss chains between the

ultimate brokers, so as to avoid any possibility of multiple recovery. During September 2009, HMRC revised its policy concerning multiple recovery after concluding that the right to deduct and the recovery of VAT are entirely divorced from each other in terms of the *Kittel* principle. As a result, the practice of allocating tax losses was discontinued."

195. Mr Kinnear contended before us that it was not necessary to HMRC's case on the denial of input tax recovery by a "broker" – here, Megantic – that HMRC should show tax losses of an amount equal to or greater than the amount of the input tax sought to be recovered. All that was necessary was for HMRC to show a tax loss and the connection of the transaction giving rise to the input tax sought to be recovered with the tax loss shown. However, he contended that in this case that point was academic because the tax losses shown in chains leading to the alleged contra-traders are equal to or greater than the input tax sought to be recovered by Megantic.

"Pools" of tax loss attributed by HMRC to the alleged contra-traders

196. Mr Kinnear put in evidence schedules prepared by HMRC showing the "pools" of tax loss attributed by HMRC to each of the entities alleged by them to be contra-traders for the purposes of this appeal. According to these schedules, just short of £26 million of tax loss is attributed to David Jacobs, just over £26 million of tax loss is attributed to Svenson Commodities, some £24.5 million of tax loss is attributed to Powerstrip, just short of £14.5 million of tax loss is attributed to Selectwelcome, just short of £3.5 million of tax loss is attributed to Svenson Worldwide, just over £18 million of tax loss is attributed to TCCS, just over £27 million of tax loss is attributed to Blackstar, just over £23 million of tax loss is attributed to Digikom, just over £7 million of tax loss is attributed to Pan Euro, just over £18 million of tax loss is attributed to Export Tech, just over £17.5 million of tax loss is attributed to 385 North and just over £4.5 million of tax loss is attributed to Rioni.

197. The attributed tax losses are analysed over the chains starting with a defaulting trader or hijacked VAT registration and leading to the alleged contra-trader in question. In addition, all of the alleged contra-traders, except Svenson Worldwide feature in the analyses of tax losses attributed to the alleged contra-traders – so that, for example, the tax losses attributed to David Jacobs (£26 million) are made up as to £11.3 million by tax losses in chains leading to Svenson Commodities, Powerstrip, Selectwelcome, TCCS, Pan Euro, 385 North, Export Tech and Digikom.

198. There are in total 7 different defaulting traders or hijacked VAT registrations in chains leading to the alleged second-line contra-traders (Fastec, Bright Time, Pentagon, UR Traders, EMES, Home Sales and Lettings, and Premier Insurance) in relation to all of which we have received and accepted evidence that they had fraudulently defaulted on their VAT obligations (from Officers Outram, Stock, Austin, Matthews, Mee, Ball and Outram respectively – Officer Outram gave evidence in relation to both Fastec and Premier Insurance).

199. There are in total 23 different defaulting traders or hijacked VAT registrations in chains leading to the alleged first-line contra-traders but most of them feature in chains leading up to two or more of them. The 23 defaulting traders or hijacked

registrations are: Bullfinch, Midwest, Stockmart, XS Enterprises, Prompt Info, Birdwood, Restar, Muhammed Ali, West 1, C and B, Mopani, Many Services, I Conekt, RS Sales, Heathrow Business, Advertising South, Direct Accessories, PM Wholesale, Hillgrove, 3D Animations, DTM Provisions, Tracker Trading, and Urban Spice. We received and accepted evidence that each of these entities (except Advertising South and Urban Spice) had fraudulently defaulted on its VAT obligations (from Officers Fyffe, Bycroft, Williams, Monk, Kumar, Davis, Speight, Foster, Lam, Taylor, Monk, Monk, Payne, Parsons, Lewis, Allen, Foy, Ruler, Johnson, McBrine, and Appleby respectively – Officer Monk gave evidence in relation to XS Enterprises, Mopani and Many Services). As noted above, we had a Witness Statement in relation to Advertising South from Officer Richards, who was not available to give oral evidence. A replacement statement had been prepared by Officer Riley who did not, however, give oral evidence. We had no evidence in relation to Urban Spice. The tax losses attributed to Advertising South were £488,536 in 3 chains leading to Selectwelcome and £2,407,720 in 10 chains leading to TCCS. The tax losses attributed to Urban Spice were £218,728 in 1 chain leading to TCCS. In context, we do not regard these instances of lack of evidence to be significant.

200. While we saw (and would have expected to see) the schedules of "pools" of tax loss to show losses in chains leading to alleged second-line contra-traders featuring in the losses attributed to alleged first-line contra-traders, we noted also that all the alleged first-line contra-traders (except Svenson Worldwide and TCCS) featured as what Mr Kinnear described as 'quasi second-line contra-traders' in the attributions of tax loss to David Jacobs, Svenson Commodities and Powerstrip. Tax losses attributed to alleged first-line contra-traders, as 'quasi second-line contra-traders' accounted for £2.8 million of the £25.9 million total attributed to David Jacobs, to £1.59 million of the £26.4 million total attributed to Svenson Commodities and £2.7 million of the £24.5 million total attributed to Powerstrip.

201. We noted, and regard as significant, that the attributions of tax loss to the alleged first-line contra-traders came from many more defaulting traders and hijacked VAT registrations than the attributions to alleged second-line contra-traders, and we also noted the repeated appearances of so many defaulting traders and hijacked VAT registrations in the attributions to the different alleged first-line contra-traders (which was a much less striking feature of the attributions to the different second-line contra-traders). The significance of this was that we discern that those behind the orchestrated scheme did not consider it necessary to overcomplicate the chains connecting tax losses to second-line contra-traders, but that this was considered necessary in relation to the chains connecting tax losses to first-line contra-traders. It was in a general sense evidence of orchestration.

202. Whereas 14 of the 23 different defaulting traders or hijacked VAT registrations noted in paragraph 199 above[50] feature in the chains leading to 2 or more alleged first-line contra-traders, only Home Sales, out of the 7 different defaulting traders or

[50] The 9 exceptions are: Muhammed Ali, C and B, Direct Accessories, PM Wholesale, Hillgrove, 3D Animations, DTM Provisions, Tracker Trading and Urban Spice.

hijacked VAT registrations, features in the chains leading to 2 of the alleged second-line contra-traders (Rioni and Export Tech).

203. Furthermore, whereas there were relatively many chains leading from the 23 different defaulting traders or hijacked VAT registrations to the alleged first-line contra-traders, and the tax losses in each chain were relatively modest, generally it can be said that the chains leading from the 7 different defaulting traders or hijacked VAT registrations to the alleged second-line contra traders were fewer in number and the tax losses in each chain were relatively large. Also, we observed that the tax losses in the chains leading from 'quasi second-line contra-traders' to the alleged first-line contra-traders were generally much greater than the tax losses in the chains leading from the defaulting traders or hijacked VAT registrations to those alleged first-line contra-traders.

204. Thus, the largest tax loss in an individual deal chain leading from defaulting traders or hijacked VAT registrations to David Jacobs was £337,645 (in a deal chain starting with Birdwood) whereas a tax loss of £633,857 featured in a deal chain leading from 385 North to David Jacobs. Similarly, the largest tax losses in individual chains leading from defaulting traders or hijacked VAT registrations to Svenson Commodities, Selectwelcome, Svenson Worldwide and TCCS were £267,576 (in a deal chain starting with Stockmart), £418,210 (in a dealing chain starting with Many Services), £332,206 (in a deal chain starting with Stockmart), and £405,300 (in a deal chain starting with Mopani, respectively), whereas a tax loss of £798,000 featured in an individual deal chain connecting Blackstar with Svenson Commodities. The position with the deal chains leading to Powerstrip did not conform exactly to this pattern. There was a tax loss of £932,262 in a chain leading from Midwest to Powerstrip, but that was by far the largest tax loss in a single chain connecting Powerstrip to a defaulting trader or hijacked VAT registration. The next highest such tax loss was £356,370 (in a chain connecting Birdwood to Powerstrip). Generally, higher tax losses featured in individual deal chains connecting alleged second-line contra-traders to Powerstrip - £445,016 in a chain connecting Export Tech to Powerstrip and £417,375 in a chain connecting 385 North to Powerstrip – but in the case of Powerstrip the difference was not as pronounced as that observed in other cases.

205. Our final observation in this area is that the Sample deal chains connecting alleged second-line contra-traders to alleged first-line contra-traders are noticeably much shorter than the deal chains connecting defaulting traders or hijacked VAT registrations to "brokers", whether they are alleged contra-traders or not (Megantic is, of course a "broker" which is not an alleged contra-trader). The Sample deal chains connecting alleged second-line contra-traders to alleged first-line contra-traders[51] have, at most, one "buffer" trader between the alleged second-line contra-trader and the alleged first-line contra-trader. In the relevant Sample deal chains, which sometimes include no "buffers", there is, of course, no tax loss and the goods concerned are acquired from an EU-based trader by the alleged second-line contra-trader, supplied either directly or via one "buffer" to the alleged first-line contra-

[51] Samples 55 to 57 inclusive, 60 to 65 inclusive, 73 and 114

trader and dispatched by the alleged first-line contra-trader to another EU-based trader. In stark contrast, the chains leading to Megantic (being a "broker" making a claim for repayment of input tax) and the chains leading to alleged contra-traders from defaulting traders or hijacked VAT registrations, in all of which there is a tax loss, contain multiple "buffer" stages.

206. Mr Kinnear makes no allegation that Megantic acted fraudulently in relation to the transactions in issue (or any transactions) but he does submit that we should find as a fact, on the basis of the evidence of the factual circumstances as they have been presented to us of the way that the alleged contra-traders traded, that the alleged contra-traders acted fraudulently in the transactions in which (as HMRC have sought to demonstrate) claims for repayment of input tax derived from chains featuring tax losses caused by defaulting traders or hijacked VAT registrations ('dirty' chains) have been diverted into chains not featuring tax losses so caused ('clean' chains) by the offset of such input tax against output tax due on acquisitions of goods from EU-based traders which were then supplied to UK traders.

207. While accepting that the evidence outlined above does make out a *prima facie* case that the alleged contra-traders have acted fraudulently as alleged, we are reluctant to find as a fact that they have done so, particularly where no such allegation is made against Megantic which, being a party to the appeal, would have been in a position to answer any such allegation. As Mr Patchett-Joyce observed in his written 'Outline closing submissions in reply to HMRC's closing submissions' the alleged contra-traders have not been before the Tribunal to hear and respond to the allegations, and we consider that there is force in his submission that Megantic has been denied the benefit of the procedural safeguard of the requirement that fraud must be specifically pleaded and the possibility of claiming indemnity in contribution proceedings against traders found to have been fraudulent contra-traders. We therefore decline to find as a fact that any of the alleged contra-traders have acted fraudulently in relation to the alleged contra-trading transactions. We also decline to find that they were innocent of any knowing involvement in VAT fraud.

208. We reiterate, however, that we do find that the tax losses caused by the failure of the defaulting traders and hijacked VAT registrations identified by HMRC to account to HMRC for their respective VAT liabilities were occasioned by fraud carried out by the traders involved respectively.

Authority in relation to connection with tax loss via contra-traders

209. In reaching our conclusion on the question of whether there was any connection (and, if so, what it was) between Megantic's purchase transactions in issue and the tax losses shown to be connected to the alleged contra-traders' transactions, we have considered *dicta* in the decided cases which appeared to be relevant to this point.

210. One of these cases which was not cited to us was *Megantic Services Limited v HM Revenue and Customs* [2006] EWHC 3232 (Admin), a judgment of Charles J on an application by Megantic for permission to bring judicial review proceedings in relation to the failure (at that point) of HMRC to make a decision triggering proceedings before this Tribunal (actually its predecessor, the VAT and Duties

Tribunal) and HMRC's refusal to make an interim payment on a claim for repayment of input tax. (The application was successful and permission was granted although Charles J refused to order an interim payment.)

211. In his judgment (at [39]) Charles J recorded that in the course of argument he had raised a point with Counsel to the effect that HMRC's case on connection concerning contra-trading might not satisfy the *Kittel* test. Charles J went on to say that he had concluded that the point raised was a bad one and that the contra-trading 'construct' (to use Mr Patchett-Joyce's term) would establish a relevant connection. He said:

> 'It has the relevant connection. Indeed such trading [contra-trading] is put in place for the express purpose of providing a diversion or a smoke screen.'

212. Charles J's conclusion was referred to by Burton J in *Just Fabulous ibid.* at [52] where he said:

> '… my concluded view is the same as was the untutored response of Charles J in *Megantic* and the same as the provisional view of Mr Bishopp in *Calltel* (see (2007) VAT Decision 20266, para 18) that:
>
> "… if the Respondents can show that the transactions were what they claim them to be … they have at least an arguable case that a trader who, knowingly or with means of knowledge, engages in conduct designed to conceal, or avoid the consequences of discovery of, a fraud should be in no better position than the perpetrator of the fraud."'

213. *Calltel* was one of the appeals heard by the Court of Appeal with those of Blue Sphere Global Ltd and Mobilx Ltd – see the judgment in *Mobilx*. *Calltel* was a case where the Tribunal had found that Calltel had actual knowledge that it was engaged in transactions whose purpose was the commission of a fraud on HMRC and decided that Calltel had 'forfeited' its right to deduct input tax 'even if he has no privity of contract with the perpetrator of the fraud' (Tribunal's Decision [46] cited in *Calltel Telecom Ltd and another v Revenue and Customs Commissioners (No 2)* [2009] STC 2164 (Floyd J) at [78]).

214. Floyd J accepted that the *Kittel* principle can apply to the connection between a trader's purchase transaction and a fraudulent tax loss traced through a contra-trading transaction. In this he followed Burton J in *Just Fabulous* and Lewison J in *Revenue and Customs Commissioners v Livewire Telecom Ltd and Others* [[2009] STC 643 on the basis that the CJEU in *Kittel* had not qualified the principle by requiring that the taxable person concerned must be a member of a defaulter chain or dealing with the same goods as had been the subject of a defaulter chain – see: *Calltel ibid.* at [80].

215. Lewison J observed that in the case of contra-trading, the fraudulent conduct extends to conduct "designed" to conceal or avoid the discovery of a fraud:

> 'In other words, the cover up is part of an overarching scheme, and is part of an overall fraud' *Livewire* [101].

216. He said that it was for the Tribunal to decide whether there was such an overarching scheme (*ibid.* [101]).

217. He also said that in a case of alleged contra-trading, where the taxable person claiming repayment of input tax is not himself a dishonest co-conspirator, there were two potential frauds: (i) the dishonest failure to account for VAT by the defaulter or missing trader in the 'dirty' chain; and (ii) the dishonest cover-up of that fraud by the contra-trader (*ibid.* [102]) HMRC must establish that the taxable person knew or should have known of a connection between his own transaction and at least one of those frauds (*ibid.* [103]).

218. However, Lewison J also considered the case where, on the facts, it was found that the contra-trader was not himself dishonest. In such a case, he said:

> 'there will only have been one fraud, namely the dishonest failure to account for VAT by the defaulter in the dirty chain. In that situation, the taxable person will not, in my judgment, be deprived of his right to reclaim input tax unless he knew or should have known of that fraud.' (*ibid.* [106])

219. Lewison J acknowledged that there was an evidential or factual difficulty in proving a connection with fraud in a case of contra-trading, where the contra-trading is not part of an overall scheme to defraud the revenue (*ibid.* [107]) and went on to say that he thought that the whole concept of contra-trading (which was HMRC's own coinage) necessarily assumes that the 'dirty' chain and the 'clean' chain were part of an overall scheme to defraud the revenue (*ibid.* [109]).

220. In *Blue Sphere Global Ltd. v Revenue and Customs Commissioners* [2009] STC 2239, the Chancellor, Sir Andrew Morritt, referred to Lewison J's judgment in *Livewire*. He noted that the Tribunal in *Blue Sphere Global* had considered that the evidence was insufficient to enable them to find that Infinity (the alleged contra-trader in that case) was itself fraudulent (*ibid.* [33]), but that they had found a connection between Blue Sphere Global's transactions (in the 'clean 'chains) and the fraudulent tax loss (in the 'dirty' chains) because:

> '[Blue Sphere Global's] transactions were used as a basis for offsetting the input tax claims which Infinity would otherwise have had to make at the end of its 06/06 VAT return period in respect of the "despatch" deals [in the 'dirty' chains] for which one or other of [the fraudulent defaulters] was the supplier at the head of the relevant chain.' (*ibid.* [35])

221. The Tribunal concluded (at [228] of its Decision) that that Blue Sphere Global ought to have known of that connection (*ibid.* [38]).

222. The Chancellor upheld the Tribunal's conclusion that there was a connection between Blue Sphere Global's transactions and the fraudulent tax loss. He said:

> 'The nature of any particular necessary connection depends on its context, for example electrical, familial, physical or logical. The relevant context in this case is the scheme for charging and recovering VAT in the member states of the EU. The process of off-setting inputs against outputs in a particular period and accounting for the difference to the relevant revenue authority can connect two or more transactions or chains of transaction in which there is one common party, whether or not the commodity sold is the same. If there is a connection in that sense it matters not which transaction or chain came first.' (*ibid.* [44])

and

> ‘Given that the clean and dirty chains can be regarded as connected with one another, by the same token the clean chain is connected with any fraudulent evasion of VAT in the dirty chain because, in a case of contra-trading, the right to reclaim enjoyed by [the contra-trader] in the dirty chain, which is the counterpart of the obligation of [the defaulter] to account for input tax paid by [the defaulter’s ‘buffer’ customer] is transferred to [the ‘broker’] (BSG) in the clean chain.’ (*ibid.* [45])

223. The Chancellor went on to make the important observation that not all persons involved in either chain, although connected, should be liable for any tax loss. He said that the ‘control mechanism’ lies in the need for either direct participation in the fraud or sufficient knowledge of it. (*ibid.* [46])

224. He concluded, allowing the appeal, that the Tribunal had been wrong to hold that Blue Sphere Global ought to have known of the connection between its transactions in the clean chains and the fraudulent evasion of tax in the dirty chains. (*ibid.* [56]). His reasoning was that, absent a finding of conspiracy involving the contra-trader and the defaulter, it was not enough to show that the ‘broker’ in the clean chain ought to have known of the fraudulent evasion of VAT in a *subsequent* dirty chain (*ibid.* [55]). If the ‘broker’ could not actually have known of the fraudulent evasion, the Chancellor asked rhetorically, how could there be circumstances from which it could properly be concluded that the ‘broker’ ought to have known? (*ibid.* [54])

225. The appeal from the Chancellor’s decision in *Blue Sphere Global* was heard by the Court of Appeal together with the appeals in *Calltel Telecom* and *Mobilx*.

226. The Court of Appeal in *Mobilx* upheld Floyd J’s dismissal of the appeal in *Calltel*. There could be no question of a second challenge to the Tribunal’s finding that Calltel had actual knowledge that it was engaged in transactions whose purpose was the commission of a fraud on HMRC.

227. The Court of Appeal also upheld the Chancellor’s decision in *Blue Sphere Global*. (*ibid.* [74] and [76]) However, this was on the limited ground that the Tribunal, in determining that Blue Sphere Global ought to have known that, by its purchases, it was participating in transactions connected with fraudulent evasion of VAT, had focussed on what the director of Blue Sphere Global might have discovered had he made further investigations – when, as the Chancellor had pointed out, no amount of enquiry would have revealed knowledge of the fraud with which the contra-trader’s transactions were connected in the dirty, but not the clean chain, of which Blue Sphere Global’s transactions formed part. *ibid.* [70])

228. The findings of the Tribunal did not (quite) justify the Court of Appeal in reaching the conclusion that that Blue Sphere Global ‘should have concluded that the only reasonable explanation for the circumstances in which it entered into the impugned transactions was that those transactions were connected with fraud’. (*ibid.* [74])

229. However, *Mobilx* makes it clear that the “should have known” limb of the *Kittel* principle includes those who should have known from the circumstances which

surround their transactions that they were connected to fraudulent evasion (*ibid.* [59]) The Court of Appeal held that 'it cannot matter a jot that [the fraudulent] evasion precedes or follows [the trader's] purchase'. (*ibid.* [62])

230. Thus the Chancellor's rationale in *Blue Sphere Global* has effectively been overruled and it is not the law that absent a finding of conspiracy involving the contra-trader and the defaulter, it is not enough to show that the 'broker' in the clean chain ought to have known of the fraudulent evasion of VAT in a *subsequent* dirty chain. The approach to the "should have known" limb of the *Kittel* principle, as laid down by the Court of Appeal in *Mobilx*, is that the Tribunal must decide whether or not the trader in question (here, Megantic) should have known that the only reasonable explanation for a transaction in which it 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 it should have known of that fact. (*ibid.* [59])

231. We are now in a position to state our conclusion on the question of the connection of Megantic's purchase transactions to fraudulent tax losses *via* the alleged contra-traders. The ambit of any connection will be important in our consideration of the fourth question, particularly the 'actual knowledge' limb – did Megantic know that its transactions were connected with fraudulent evasion of VAT? As Lewison J said in *Livewire* (*ibid.* [90]), it is necessary, in applying the *Kittel* principle, to identify what it is that the taxable person knew or should have known.

232. Like Charles J in *Megantic*, Burton J in *Just Fabulous*, Floyd J in *Calltel*, and the Chancellor in *Blue Sphere Global* on the facts of their respective appeals, we conclude on the facts proved in this case that HMRC has established that Megantic's purchases in chains leading to the alleged first-line contra-traders were connected to the fraudulent tax losses in the chains leading to purchases by both the alleged second-line contra-traders and the alleged first-line contra-traders.

233. The connection at its simplest is the connection as explained by the Chancellor in *Blue Sphere Global* – see paragraph 222 above – that the scheme for charging and recovering VAT involving the process of off-setting inputs against outputs can connect two or more chains of transactions where there is one common party, whether or not the commodity sold is the same. Clearly if a chain to which an alleged second-line contra-trader is a party (which includes a fraudulent defaulter) is connected to a chain linking that alleged second-line contra-trader with an alleged first-line contra-trader, and the last-mentioned chain is connected to a chain linking the alleged first-line contra-trader with Megantic, then the original 'dirty' chain which includes both the fraudulent defaulter and the alleged second-line contra-trader, is connected to the 'clean' chain linking the alleged first-line contra-trader with Megantic.

234. But our conclusion on the evidence as a whole, as we have rehearsed it in this Decision up to this point, and which we accept, is that the characteristic of the connection was that all the transactions in the relevant chains were part of an overarching, orchestrated and contrived scheme of transactions, the sole purpose of which was to defraud the revenue. That scheme involved the alleged second-line

contra-traders and the alleged first-line contra-traders and Megantic (and doubtless other 'brokers').

235. We consider, on the basis of that evidence, that it is entirely safe to conclude that each of the alleged first-line contra-traders, David Jacobs, Svenson Commodities, Svenson Worldwide, Powerstrip, Selectwelcome and TCCS was indeed a contra-trader, in that all of them had arranged their trading so as to transfer *prima facie* entitlement to input tax credit from purchases in 'dirty' chains where there had been fraudulent loss of tax by defaulting traders or hijacked VAT registrations failing to account to HMRC for their output tax obligations, to other chains where goods acquired from EU-based entities were passed on by them to UK-based traders and eventually to Megantic, which made a claim for repayment of input tax.

236. We also consider, on the basis of that evidence, that each of the alleged second-line contra-traders, 385 North, Blackstar, Digikom, Export Tech, Pan Euro and Rioni was indeed a contra-trader, in that all of them had arranged their trading so as to transfer *prima facie* entitlement to input tax credit from purchases in such 'dirty' chains to other chains, where goods acquired from EU-based entities were supplied by them either directly or *via*, at most, one "buffer" to one of the identified first-line contra-traders, enabling them to transfer *prima facie* entitlement to input tax credit to other chains where goods acquired from EU-based entities were passed on by them to UK-based traders and eventually to Megantic, which made a claim for repayment of input tax.

237. Our conclusion on the third question posed at paragraph 18 above is that Megantic's transactions which are the subject of this appeal were connected with the tax losses arising from fraudulent evasion by the defaulters or hijacked VAT registrations in the direct tax loss chains leading to Megantic (see: paragraph 101 above) and in the 'dirty' chains leading to the second-line and first-line contra-traders identified. The latter connection is not only the 'accounting' connection inherent in the VAT system as a whole, but is inherent in the fact that, as we have found, the transactions giving rise to the tax losses caused by fraudulent evasion by the defaulters or hijacked VAT registrations in the 'dirty' chains leading to the second-line and first-line contra-traders were part of an overarching, orchestrated and contrived scheme of transactions, the sole purpose of which was to defraud the revenue, linking them, for the purposes of the application of the *Kittel* principle, to Megantic's purchase transactions in issue in this appeal. We have to decide whether Megantic knew or should have known of these connections.

The fourth question:

> **(d) We having found that there were tax losses resulting from fraudulent evasion with which the transactions which are the subject of this appeal are connected, did Megantic know, or should it have known, that its transactions in issue were connected with that evasion?**

238. Besides the evidence of HMRC's witnesses, principally Officer Broers, the evidence relevant to this question was given by Megantic's witnesses, Philip Howard Nicholson, referred to as Howard Nicholson ("HN"), David Waddington ("DW") and Stephen Joseph Brookfield ("SB"), who each gave oral evidence and had provided Witness Statements. Evidence relevant to this question was also, of course, contained in the vastly extensive documentary evidence before us.

239. Before setting out a chronology of the events which are relevant to this question (see paragraphs 292 and following, below), we list the natural and legal persons which feature most prominently in the evidence, with a brief description of each of them and their relevance.

Description of the natural and legal persons who feature most prominently in the evidence

240. ***Howard Nicholson (HN)***. HN gave relevant evidence on the trading of Megantic and on the due diligence carried out by Megantic. He was, we find, central to the story of how Megantic built up its trade in mobile phones and CPUs to the extent that in the months in issue in this appeal its turnover was £143.46 million (in May 2006) and £89.29 million (in June 2006).

241. HN studied accounting and finance at Liverpool Polytechnic and qualified as a Chartered Accountant in 1989. He initially worked for Coopers & Lybrand and in the late 1990s he went to work for a client, The Phone People Plc, as their finance director. The Phone People Plc was a retailer of mobile phones with a turnover peaking at about £50 million and with about 500 employees. His role with The Phone People Plc developed to one akin to managing director and CEO. The Phone People Plc went into administration in or around 2002. HN put a deal together with some funders to buy The Phone People Plc. out of administration, but the venture did not survive for more than about a year.

242. Relatively soon thereafter HN became a consultant to a company called Phonebitz 2000 Export. This was a company trading as a wholesaler in phones (it also had a retail shop) whose directors were two individuals, Karl Cavanagh and Michael McKenna. There is a record of a visit by HM Customs & Excise to Phonebitz 2000 Export in January 2003 which was attended by HN with Messrs Cavanagh and McKenna. Fairfax Gerrard Holdings Limited ("Fairfax Gerard") (see: below paragraph 253) made a secured loan to Phonebitz 2000 Export on 15 March 2003.

243. Phonebitz 2000 Export had, as HN was aware, signed up to the Memorandum of Understanding between HM Customs & Excise and companies in the mobile phone industry which was designed to establish a Code of Conduct for those companies to prevent MTIC fraud.

244. HN was also a consultant to a company called Phonebitz 2003 Limited, a subsidiary of Fairfax Gerrard, trading as a wholesaler in mobile phones. His role was to find customers and suppliers for Phonebitz 2003 Limited.

245. On 23 September 2003 HN and Duncan Howarth ("DH") (see: below paragraph 248) were appointed directors of Caledonian Consulting Limited ("Caledonian") (see below: paragraph 247), a company that had been incorporated on 8 July 2003. HN and DH resigned these directorships on 1 February 2004, when HN's brother, Adam Nicholson ("AN") (see below: paragraph 247), was appointed in their place.

246. On 28 June 2004, a company was incorporated in Gibraltar under the name of Petrojas Industries Limited. It changed its name to Megantic Services Gibraltar Limited ("MSGL") (see below: paragraph 258) on 18 October 2004 and later, on 26 October 2006, it changed its name again to Asphodel Limited. On incorporation, the shares in the company were held by Redbridge Services Limited on trust for HN, who was around that time resident in Gibraltar.

247. ***Adam Nicholson (AN)*** and ***Caledonian.*** As stated above, AN is HN's brother. He did not give evidence in this appeal. He has no financial qualifications and had worked for The Phone People Plc. He was appointed the director of Caledonian on 1 February 2004. Caledonian entered into a service agreement with MSGL at some time in 2005 (we assume on or around 7 April). This assumption is necessary, because the copy of the service agreement before us is unsigned and undated – it was not suggested by either party that the service agreement had not in fact been entered into. The service agreement provided for Caledonian to supply services in conducting due diligence to MSGL, although not in relation to any trade actually conducted by MSGL but in respect of trading companies nominated by MSGL, to which MSGL had provided working capital finance. The consideration for Caledonian's provision of these services was to be calculated on a costs plus 10 per cent. formula. The relevance of this is that MSGL provided working capital finance to Megantic and Caledonian provided services in conducting due diligence in relation to Megantic's trade.

248. ***Duncan Howarth (DH).*** DH also did not give evidence in this appeal. He was formerly a bank manager for Barclays Bank and, according to HN, was "very good or useful at raising money". He and HN had known each other for a number of years before the events relevant to this appeal. He and HN acted in relation to Megantic as an informal partnership – HN described him in cross-examination as "a partner". DH and HN were also owners and directors of a company called Marldon Corporation Limited ("Marldon") (see: paragraph 262 below). As stated above, DH had been a director of Caledonian, with HN, for about 6 months from July 2003.

249. ***David Waddington ("DW").*** DW was the Company Secretary of Megantic (appointed on 23 January 2006) and gave evidence in the appeal. He was also the Company Secretary of Marldon. He trained as an accountant with HN in Liverpool. He and HN thought that he, DW, had an expertise in tax planning. He advised on the structure of the arrangements between MSGL, Caledonian and Megantic – in particular the "Global Agreement" of 7 April 2005, between MSGL and Megantic, to which we make further reference below – together with KPMG (Chartered Accountants) and Dorsey & Whitney (Solicitors) (although in his witness statement DW referred to DLA Piper). It was not put to DW in cross-examination that he knew of any connection between Megantic's transactions and fraud, nor is it (as we understand it) suggested by HMRC that he should have known of any such

connection. We therefore find that he neither knew nor should have known of the connection which we have found to have existed.

250. ***Stephen Brookfield ("SB").*** SB is the only director of Megantic and was a director of Megantic during the months of May and June 2006, which are directly relevant to this appeal. He gave evidence at the hearing. SB is a Chartered Accountant, and had known HN since their schooldays, and DW since the 1980s – their connections being through sporting activities and the Liverpool accountancy circuit.

251. He had worked at PKF (Chartered Accountants) between 1997 and 2000. Shortly before that, HN had approached him for help with the management buy-out of The Phone People Plc. mentioned above. In or after 2001, SB set up a business called Bridgegate Holdings to carry out corporate salvage work. This became a specialty of SB and by 2005 he had had experience of buying companies. HN and others were involved with SB in his work through Bridgegate Holdings. Indeed there were several companies of which SB and HN had been directors between 2001 and 2003 including Bridgegate Holdings, and companies referred to as TFV Audit and SB&P.

252. In July 2005 he was introduced to Fairfax Gerrard by HN in the context of advising Chris Ash ("CA") on a possible management buy-out. Chris Ash had a difficult relationship with the other director of Fairfax Gerrard, David Ross. In the event there was no such management buy-out and Chris Ash and David Ross remained as directors of Fairfax Gerrard. However, SB's involvement in this work developed into a proposal that he himself might acquire the share capital of Megantic, which had up to this point been held by Fairfax Gerrard. He did acquire the share capital of Megantic from Fairfax Gerrard for a consideration of £2 by an agreement dated 25 January 2006 drafted by himself and Chris Ash. There was no goodwill accounted for in the balance sheet of Megantic as at SB's acquisition of the shares. He explained in cross-examination: "my goodwill in this would have been nil anyway, because would I have had an ability to trade?" The trading of Megantic was entirely dependent on the activities of MSGL (effectively HN and DH), pursuant to the "Global Agreement" which had been concluded on 7 April 2005. SB had had no prior experience of the wholesale trade in mobile phones.

253. ***Chris Ash (CA) and Fairfax Gerrard.*** As stated above, CA was at all material times a director (with David Ross) of Fairfax Gerrard, a trade and transaction financier. CA did not give evidence in the appeal. Fairfax Gerrard was incorporated in about 1993 and developed a specialism in lending VAT bridging finance to companies which were VAT repayment traders and needed to fund the VAT between the point when they paid their suppliers and the point when it was repaid by HMRC (formerly HM Customs & Excise).

254. Fairfax Gerrard's usual business model at the relevant time was to incorporate a subsidiary (special purpose vehicle) of Fairfax Gerrard itself. The subsidiary would be provided with a bank account and a VAT registration number. In this way Megantic was incorporated as a subsidiary of Fairfax Gerrard in 1996 and was registered for VAT from 1 September 1998 (although with a period of deregistration

between 16 May 2003 and 30 November 2003). A subsidiary (special purpose vehicle) would be available to carry on the trade of prospective clients who approached Fairfax Gerrard for financial assistance.

255. In the case of Megantic, Caledonian (the directors of which at the time were HN and DH, or AN) arranged with Fairfax Gerrard that its subsidiary (special purpose vehicle) (Megantic) should be the vehicle through which a wholesale trade in mobile phones would be carried on, all the day-to-day running of the business being performed by Caledonian. This was in late 2003 or early 2004. Megantic's first deal was carried out on 29 March 2004. (As noted above, HN had in March 2003 financed Phonebitz 2000 Export through Fairfax Gerrard.) Fairfax Gerrard took interest (at a high rate) on the funds advanced to Megantic and other charges from Megantic by way of fees or charges billed by Fairfax Gerrard to Megantic. What remained of the profits of Megantic (unless left in Megantic as working capital to finance further trades) were taken by HN and DH through Caledonian, or BHN Services Limited ("BHN") (see: paragraph 263 below), again in the form of fees or charges, so that minimal value remained in Megantic itself.

256. The "Global Agreement" of 7 April 2005 was entered into between MSGL and Megantic, while Megantic was still a subsidiary of Fairfax Gerrard. This agreement envisaged that MSGL would advance to Megantic more of the transactional VAT bridging finance needed by it. HN's evidence was that while Fairfax Gerrard remained involved, he and CA would "sit down and have a conversation" at the end of every month and agree the basis of the charge which MSGL would make to Megantic pursuant to the "Global Agreement".

257. As stated above, in 2005, CA consulted SB on the possibility of a management buy-out of Fairfax Gerrard (which did not proceed). Instead SB purchased the shares in Megantic from Fairfax Gerrard on 23 January 2006, but CA remained involved with Megantic after that time as a signatory on Megantic's bank accounts and in other respects, including as a director for a period extending beyond 25 July 2006 (the date of the due diligence meeting with HMRC at the Gerrards Cross offices (see: below, paragraph 339).

258. ***MSGL.*** MSGL was, as noted above, a Gibraltarian registered company beneficially owned by HN. It was incorporated on 18 October 2004. It entered into the "Global Agreement" with Megantic on 7 April 2005 (signed by HN for MSGL and David Ross for Megantic), pursuant to which MSGL provided to Megantic funding and "certain consultancy services to assist it in its trading relations". There was no consideration specified in the "Global Agreement" for the provision of the consultancy services, although interest on the funding was specified to be at a rate of 30 per cent. per annum and the loans were to be repaid within 360 days from the date of drawdown. There was however provision (in clause 7) for MSGL to invoice Megantic for all Services (as defined) provided in any month together with interest due on all loans for that month, for payment within 7 days of the date of the relevant invoice. The Services were defined as:

> '1. Facilitating the provision of finance and dealing with third party lenders.

2. Managing lender relationship.

3. Providing general consultancy services based upon MSGL's industry expertise.

4. Assisting Megantic in ensuring that Customs procedures are adhered to and providing a procedural manual.

5. Assisting Megantic in managing its relationship with HM Customs & Excise.

6. Identifying customers and suppliers to enable Megantic Services Limited to trade.'

259. Of these services, item 6 was probably the most important and significant because it effectively covered the provision of all the expertise necessary for Megantic's trade.

260. MSGL itself was funded by revolving loans of £2.3m in total (in transactions of about £400,000 each) from an entity known as Specialist Financial Solutions ("SFS") which had been registered for VAT under the name Lord Holmes Limited in early 2003 (see: paragraph 272 below). It was also – at any rate later – financed by loans from third party investors. The only agreement for such a loan which the Tribunal saw was one entered into by one Robert Smith with MSGL on 15 March 2007, whereby Mr Smith (a French resident) provided MSGL with a 364 day revolving credit facility of up to £350,000, which attracted interest at the rate of 24 per cent. per annum.

261. The first loan made by SFS to MSGL (of £400,000) was drawn down on 30 June 2005. It was repaid with (apparently) £52,780 of interest (though this seems to have been much more than interest at 30% p.a. on the amount advanced for the period of 50 days before repayment) on 19 August 2005. 4 similar loans were made and repaid subsequently, the last one being made on 9 February 2006 and repaid on 24 April 2006. These were clearly loans to enable MSGL to advance moneys to Megantic to bridge the VAT funding gap.

262. ***Marldon, Haddinghall Limited ("Haddinghall") and Lorimer Holding and Finance Limited ("Lorimer").*** Marldon was a company owned jointly by HN and DH. It was both an investment holding company and a financier. Haddinghall was a subsidiary of Marldon (with HN and DH as directors and DW as Company Secretary) and was mentioned in evidence as the vehicle through which the business of the Vue Bar and Grill in Liverpool was taken over as a going concern from a company called Vue Limited, which was owned by Karl Cavanagh, one of the directors of Phonebitz 2000 Export. Lorimer was a British Virgin Islands Company owned by HN, which was also engaged in a finance business. HN used this vehicle to lend £250,000 to Andrew Belfield ("AB") to fund wholesale mobile phone transactions. The funds were routed from MSGL through Lorimer to Belfield.

263. ***Andrew Belfield (AB), BHN/Regent Commodities Limited ("Regent"), Church Lane Developments Limited ("Church Lane") and La Fayette.*** Although HN initially stated in cross-examination that AB had not worked for Megantic, he accepted that AB had done so, when he was shown documents indicating that AB was the contact person for Megantic on a website (Alibaba) and the salesperson for

Megantic in an export deal entered into on 6 April 2005 in which Megantic sold to Desert Wing Trading, the Dubai company identified in Officer Mercer's evidence referred to above at paragraph 165. That deal was a sale of mobile phones for the sterling equivalent of $716,000, requisitioned by AB and authorised by HN.

264. HN said that AB was a friend of his and this explained the extensive financial assistance given to AB by HN which had the effect of setting AB up in Regent, which was also a wholesaler of mobile phones, effectively in competition with Megantic.

265. There was a considerable history of HN giving financial assistance to AB. Through Marldon, HN had lent La Fayette, a company of which AB was a director, a sum of approximately £1m, most of which had been lost in the insolvency of La Fayette. Despite this, Marldon, AB's company, extended to Regent a facility to borrow up to £500,000. HN said the Regent had drawn down about £200,000 – he was not sure of the exact amount – of this facility. HN lent a further £250,000 to Regent through Lorimer (funds that had come to Lorimer from MSGL).

266. AB had purchased the shares in Regent for £60,000 from AN and DH on 23 November 2005, and had been appointed director of Regent on that date. The arrangement was (according to the report of the Assurance Visit made by HMRC to AB on 12 January 2006) that AB would pay £10,000 per month starting from the date of the agreement (although no money had been paid by the date of the visit). The balance sheet of Regent as at 31 October 2005 showed a deficit on shareholder's funds of £56,000 – Regent had made nil VAT returns from 04/05 to 10/05. AB's explanation at the visit (confirmed by HN in cross-examination) was that he had bought Regent for its VAT number. Regent also had a bank account with FCIB in place. AB intended, as HN knew, to use Regent to trade in commodities including mobile phones.

267. The company that became Regent had undergone a series of name changes. It was incorporated as BHN Services Limited on 7 October 2002. On 2 November 2005 the name had been changed to Megantic Services (UK) Limited, and on 21 November 2005 (2 days before AB had purchased the company) the name had been changed again to Regent.

268. AB acquired (later) another company, Church Lane, from Fairfax Gerrard. HN accepted that AB had been introduced to Fairfax Gerrard through himself. Through Lorimer, HN had lent AB a further £865,000 for Church Lane. Church Lane went on to trade in software.

269. Regent's VAT return for the quarterly period 04/06 was selected for extended verification and its claim for input tax repayment was denied. Regent appealed to this Tribunal against the decision to deny its claim, but that appeal (in which Regent was represented) was dismissed on the basis that Regent, by AB, knew that its relevant transactions were connected to fraudulent evasion of VAT (see: *Regent Commodities Limited v Commissioners for HMRC* TC00380).

270. Church Lane was also an appellant in an appeal against a denial of a claim for repayment of input tax. In that appeal Church Lane was not represented, but this Tribunal found that Church Lane had known of the connection of its relevant transactions to fraudulent evasion of VAT (*Church Lane Developments v Commissioners for HMRC* TC02859).

271. HN accepted that he kept on lending AB money, that AB kept on using it to deal in MTIC products, and that HN kept on thereby losing money – to a total amount which HN guessed in cross-examination was £2m. HN however denied that he knew AB was involved in transactions connected to fraud or that he was (by financing AB's businesses) setting up 'just another limb of the same operation that was going on through Megantic'.

272. ***Specialist Financial Solutions Limited ("SFS"), Claiments (Holdings) Limited ("Claiments"), Amran Munir ("AM") and Abdul Koser ("AK").*** SFS was a company registered for VAT as Lord Holmes Limited. The individual behind SFS was Ian Holmes, the director of SFS, who controlled SFS's bank account and had the final say, but its day-today business was run by Daniel McGowan, the commercial manager, to whom HMRC spoke on an assurance visit on 10 May 2007, and whom HN confirmed that he knew. SFS owned a property in Liverpool, 2 Campbell Square, which was let between 2003 and 2004 to a company, Vue Limited, which operated a bar there called Vue Bar and Grill. A director of Vue Limited was (as stated above) Karl Cavanagh, an individual known to HN as a director of Phonebitz 2000 Export, for which HN acted as consultant. The operation of the bar had been taken over as a going concern by Haddinghall, as stated above.

273. SFS ran a business of making loans described by Mr McGowan at the visit as 'basically VAT facilities on 60 day terms'. HMRC ascertained that the entities to which SFS had lent included Evenmore Limited, Rapid Global Limited, R&D International and Tojen Telecom (which HN accepted were all suppliers to Megantic in the periods under appeal), as well as MSGL.

274. A significant source of funding enabling SFS to carry on this business came from Claiments. Claiments was a company (later called AM Projects UK Limited) which was owned or operated by Amran Munir (AM) – who lived, at least some of the time, in the Manchester area (he also had a presence in Dubai). AM, in turn, as he stated in a letter to HMRC, had received funding in 2005 from his uncle, Abdul Koser (AK), who was a director of Svenson Commodities (one of the first-line contra-traders in this appeal). A statement of the account of Claiments with Barclays Bank showed that £1,250,000 had been paid to Claiments by Svenson. HN agreed in cross-examination that SFS was lending AM's money to exporters, though he was not sure whether that happened in 2005 or 2006.

275. Another company of which AM was a director was Bliss Living Consultancy Limited. An Experian Report on this company, obtained by HMRC, showed that another director was Heather Bennani, who was married to Matisse Bennani, who had also been a director. Matisse Bennani had been a contact of HN at Svenson Commodities.

276. AM, in a letter to HMRC dated 4 December 2007, stated that he, or his company, had received a sum of money from Digital Satellite (Powerstrip, another of the first-line contra-traders in this appeal) in connection with a Mercedes S Class motor car.

277. Also in evidence was a report dated 15 November 2007 "to all known creditors" by Kiran Mistry of Wenham Major, liquidator of David Jacobs, another of the first-line contra-traders in this appeal. It is stated in that report that David Jacobs traded from premises on South Wrexham Industrial Estate leased from AM.

278. HN accepted in cross-examination that AM was very heavily connected with Svenson Commodities, Powerstrip and David Jacobs and that Megantic had either directly purchased from all of them or done so indirectly through other companies.

279. SFS lent MSGL £2.3m in revolved loans between 30 June 2005 and 9 February 2006. Although a statement of SFS's bank account which was in evidence showed payments being made in to SFS by Claiments and out to MSGL by SFS within a few days of each other (at the end of April and the beginning of May 2006), HN denied any knowledge that Claiments was the source of SFS's funds. He thought that was the sale proceeds of 2 Campbell Square – he knew that that property had been sold. HN had no explanation for why he had chosen SFS as a source of funds for MSGL, given that SFS had no long history of lending,

280. Experian Reports in evidence showed that SFS, Svenson Commodities and Regent had the same business address.

281. ***Amira Group International Limited ("Amira"), SM Systems International Limited ("SMS"), Fonecode Solutions Limited ("Fonecode"), Imran Memon ("IM") and Desert Wing Trading LLC ("Desert Wing").*** There was in evidence the application for an account with FCIB made by Amira. The account opening documents in connection with that application were reviewed on 4 May 2005 and the opening of the account approved on 9 May 2005. That application showed that the signatory for Amira, a BVI company with a mailing address in Dubai, was Imran Memon (IM). Amira was stated to be beneficially owned by a Lawrence Kayablian.

282. IM's home address (in a statement signed by him) is shown in the application to be 2802 Zabeel Towers, Sheikh Zayed Road, Dubai, UAE 112464. There is also in the application a tenancy contract in relation to Apartment 2802, Zabeel Towers between AM (as resident of that apartment) and IM whereby AM would sublet the apartment to IM on certain terms. (There is an apparent oddity in the sublease, in that its term is stated to start on '21.05.2004' and to be valid 'till the expiry of master agreement till 19.05.2004'.) That oddity does not, however, affect the significance of the document, which is signed by both AM and IM, which is that it shows a connection between them, as HN acknowledged in cross-examination.

283. There was also in evidence a similar application for an account with FCIB made by SMS (another BVI company). In this application IM is shown to be both the

signatory for SMS, its primary contact, and also a beneficial owner and director of SMS. The same tenancy agreement is enclosed in support of this application.

284. The same Dubai address is given for both Amira and SMS. HN accepted that Amira and SMS appeared to be under common control.

285. Also in evidence was a similar application for an account with FCIB made by Fonecode (also a BVI company). In this application, AM is given as the primary contact and director of Fonecode, and also as the beneficial owner of Fonecode.

286. The Dubai business addresses, telephone and fax numbers given in the three applications are the same for Amira, SMS and Fonecode, and HN accepted that all three companies appeared to be operating from the same address and that the same parties were involved, the common thread being AM.

287. The invoice issued by Powerstrip to Desert Wing dated 15 May 2006 in the chain of transactions leading to IDN 218 (Sample 117), shows the Dubai business address of Desert Wing to be the same as the address given in the FCIB applications made on behalf of Amira, SMS and Fonecode. A due diligence document produced by Megantic in relation to Desert Wing shows the same telephone and fax numbers as those which the other documents established were used by Amira, SMS and Fonecode. HN acknowledged in cross-examination that all four companies were linked.

288. When shown AM's connections with Svenson, Powerstrip and DAVID JACOBS and Amira, SMS, Fonecode and Desert Wing, HN accepted in cross-examination that AM seemed to be in control of all these companies and making sure that the money got to the right place and that it 'would be a conclusion' from the evidence that it was a big fraud run by AM as ringmaster.

289. ***Parasail, Comica and Adil Kamran.*** By reference to the evidence in relation to IDN 21 (Sample 1), HN accepted that nearly all of the money that went through Amira's bank account was paid on to Parasail, and similarly that Amira had been paid by SMS, which had, in turn, been paid by Comica. The FCIB evidence on IDN 259 showed the accounts of Desert Wing, Amira and Comica being operated from the same IP address at times very close to each other (Desert Wing is logged on between 16:40 and 16:45; Amira is logged on between 16:46 and 16:55; and Comica is logged on from 16:49 to 17:30.) HN accepted, when shown this evidence, that it looked as though someone had been sitting at a computer making the transfers for all three companies. That seems to us to be the obvious inference. HN also accepted that the evidence showed that the FCIB accounts of Parasail and Selectwelcome (another of the first-line contra-traders in this appeal) had been operated from the same IP address.

290. As stated above, there was evidence (and we are satisfied) that Adil Kamran was a director of both Parasail and Comica, and that both used the same password ("naeema") in operating their individual bank accounts at FCIB (as also did Forex and BRD, in relation to both of which there was evidence that their FCIB accounts had

been operated from the same IP address as the IP address from which Parasail's FCIB account was operated). We have also referred to the evidence that Adil Kamran was prosecuted in the Netherlands for an offence concerning carousel fraud (deliberately sending in false VAT returns for periods between April 2005 and July 2006) and on 10 May 2007 was sentenced to 30 months imprisonment. HN accepted in cross-examination that Adil Kamran controlled both Parasail and Comica and, in view of Adil Kamran's conviction, that the transactions in which Parasail and Comica were involved, must have been fraudulently set up.

291. In relation to HMRC's evidence as to the FCIB payments made in connection with IDNs 336 and 337, which showed payments flowing from Parasail to Comica in two streams, one *via* Fonecode, and the other *via* Solutions Beyond and Amira, HN accepted that this was not surprising given the connection between these entities. We find, on the basis of the evidence of the money flows between FCIB accounts in these and other deals, that Adil Kamran, AM and IM all, together, with or without other persons' knowing involvement, knowingly orchestrated the contrived scheme of transactions in which Megantic's purchases, in issue in this appeal, featured.

Chronology

292. Having described the natural and legal persons which featured most prominently in the evidence, we turn to a chronology of the events which are relevant to the question of whether Megantic knew or should have known of the connection of its transactions in issue in the appeal with fraudulent evasion of VAT.

293. On 29 March 2004, Megantic conducted its first wholesale deal in mobile phones – a sale of 2,000 Nokia 6600 phones (which had been purchased from Mobile Link UK Limited) to Space Enterprises of Amsterdam.

294. On 28 June 2004, MSGL was incorporated.

295. On 29 November 2004, Officer Mercott of HMRC wrote to Megantic informing Megantic of an amendment to its VAT return for May 2004 to recoup input tax which had been repaid in respect of 2 deals on 27 and 28 May 2004, where the supplier had been Calltel Telecom Limited and the customer Sunico A/S of Denmark. The reason for the amendment was that HMRC had discovered that in both chains of supply there had been a defaulting VAT registration number. (Following the ruling of the Court of Justice on 12 January 2006 in *Optigen Ltd.*, *Fulcrum Electronics Ltd.* and *Bond House Systems Ltd. v HM Customs and Excise* (Joined Cases C-354/03, C-355/03 and C-484/03) – see: below – this amendment was withdrawn on 3 March 2006.)

296. By the end of 2004, Megantic had completed only 49 deals.

297. On 25 January 2005, Dorsey, Solicitors, wrote to HMRC a without prejudice letter on behalf of Phonebitz 2003 Limited, a subsidiary (as noted above) of Fairfax Gerrard, in relation to which HN acted as a consultant. This letter explained that Phonebitz 2003 conducted wholesale trades in mobile phones as principal, although the trades were arranged by Phonebitz 2000, in relation to which HN also acted as a consultant, which was a company independent of Fairfax Gerrard in point of

ownership and was a signatory to the Memorandum of Understanding with HMRC referred to above. (This was a very similar arrangement to that later put in place by Megantic with, first, Fairfax Gerrard, and then MSGL.) It proposed a meeting to try to resolve the dispute which had arisen between Phonebitz 2003 and HMRC over HMRC's refusal to repay some input tax claimed in the October 2003 return and all the input tax claimed in the November 2003 return on the grounds that the sums claimed related to supplies forming a circular transaction and therefore not constituting economic activities.

298. On 23 March 2005, Megantic had contact with Desert Wing, sending them their New Customer/Supplier Verification Check List, which was returned, signed off by IM on 14 March 2006, almost a year later.

299. On 6 April 2005, notwithstanding the fact that the Verification Check List had not, at that point, been returned by Desert Wing, Megantic made a sale to Desert Wing, requisitioned by AB and authorised by HN.

300. On 7 April 2005, Megantic and MSGL entered into the "Global Agreement".

301. On or about 7 April 2005, MSGL and Caledonian entered into a service agreement whereby Caledonian would supply to MSGL the services of conducting due diligence in respect of trading companies to which MSGL had provided working capital finance.

302. HN described the effect of the "Global Agreement" as MSGL providing working capital finance and various services, including finding customers, finding suppliers and providing staff through its (MSGL's) agreement with Caledonian. He said the purpose of the "Global Agreement" and the service agreement was 'really to formalise the trading relationship' between Megantic, MSGL and Caledonian.

303. There was no evidence, from HN or from SB, as to how much precisely Megantic still owed MSGL under the "Global Agreement". When asked in cross-examination whether interest at 30% per annum was still accruing on any outstanding amount, HN said he did not know and would need to take legal advice as to the effect of the agreement. DW was clearer – he said that interest would continue to run until the debt was settled. It appeared to us that this was likely to be the position at law.

304. On 8 April 2005, IM, as managing director of Desert Wing sent to Megantic a certificate that Desert Wing had 'no intentions of sending [identified stock to be exported by Megantic to Desert Wing] back into the UK and [had] no intentions of selling this stock at a cheaper price than [they] paid for it'.

305. On 24 April 2005 Desert Wing paid Megantic the price of that deal ($965,625).

306. At about the beginning of June, 2005 Megantic's bank account with FCIB was opened. CA opened the account, with input from HN. HN claimed in cross-examination that the reason the FCIB account was opened was banking efficiency. It is a fact, however, that all the traders with whom Megantic dealt had accounts with FCIB.

307. CA and others at Fairfax Gerrard had and retained the ability to access and operate Megantic's FCIB account and statements of the account were sent as late as March 2006 (well after SB's acquisition of the share capital in Megantic from Fairfax Gerrard) to Mr Ali, an officer of Fairfax Gerrard based in Gerrards Cross.

308. On 15 June 2005 Megantic made its first sale to Amira in Dubai. This was a 1,000 goods described as 'Imate Jam', for a total price of £297,000. These goods had been bought the same day from Svenson UK (for £279,000 plus VAT). A document entitled "Intention of Trade" had been faxed to HM Customs and Excise with the details of this deal on the same day. A document bearing a date stamp of the same day from the Redhill VAT office of HM Customs & Excise was sent (presumably faxed) to Megantic confirming that the VAT registration of Svenson Commodities was valid 'at this time', but warning that the confirmation was not to be regarded as an authorisation by HM Customs and Excise for Megantic to enter into commercial relations with Svenson and that any input tax claims Megantic make may be subject to subsequent verification. (This was standard wording on 'Redhill confirmation' letters.)

309. With the deal pack for this deal is a note dated 17 June 2005, apparently made out by AN, sent to 'Lawrence' at Amira, whom we conclude was Lawrence Kayablian, the beneficial owner of Amira, covering the shipping details for the Imate phones 'as promised'.

310. On 28 June 2005 MSGL entered into the loan agreement with SFS (Lord Holmes Limited). Clause 1 of agreement gave the terms and conditions on which SFS would make available to MSGL a fixed rate short term loan of £400,000. The purpose of the loan was stated to be to finance VAT payable to HM Customs & Excise in relation to the trading of commodities. Interest was to be paid on each Interest Payment Date (as defined) from the Drawdown Date (as defined) at the Applicable Rate (as defined). Clause 6 of the agreement provided that: 'save as otherwise agreed between [SFS] and [MSGL], the Loan (and any accrued but unpaid interest) shall be repaid in full on the Maturity Date [(as defined)]'.

311. The definition of the Applicable Rate was "50% of the Net Profit (as defined) on each transaction where the Loan is utilised". "Net Profit" was defined as:

> 'the profit after all transactional costs including but not exclusively, all Fairfax Gerrard's costs, all shipping inspection and insurance costs, any transactional exchange rate gain or loss, the cost of the Loan to [SFS] calculated as follows to be advised, the cost of exchange of dollars to sterling and vice versa in relation to the repayment of the Loan amount (a net profit statement will be made available on the date upon which [MSGL] receives payment in respect of the refund by HM Customs & Excise of amounts due in respect of Relevant Value Added Tax)'

312. It is clear that this definition of "Net profit" is entirely inappropriate to the loan transaction between SFS and MSGL because MSGL was not itself going to incur any transactional costs as envisaged and was not going to receive payment in respect of any refund of VAT. It was Megantic (pursuant to the "Global Agreement") which was going to incur transactional costs and receive refunds of VAT. MSGL was going

to use funds loaned by SFS to it to make loans to Megantic to provide working capital finance.

313. The definition of "Maturity Date", in the loan agreement, meaning 'the date upon which [MSGL] receives payment in respect of the refund by HM Customs and Excise of amounts due in respect of Relevant VAT' was similarly inappropriate, and effectively meaningless.

314. HN accepted that these were 'drafting errors'. It was put to him that the reference to Fairfax Gerrard's costs in the definition of "Net Profit" was also a drafting error. He denied this, pointing out that at 28 June 2005 (after the "Global Agreement" had been entered into) Fairfax Gerrard was still incurring administration costs which were invoiced to Megantic. We do not accept this explanation. It seems to us much more probable, and we find, that a pre-existing loan agreement between Fairfax Gerrard and Megantic (when Megantic was still a special purpose vehicle and a subsidiary of Fairfax Gerrard) had been incompetently adapted to serve as a template for the loan agreement between SFS and MSGL. HN accepted that Megantic (himself effectively) had provided SFS with a template for SFS to alter to suit their loans.

315. On 30 June 2005 the first loan (of £400,000) was made by SFS to MSGL.

316. In July 2005 SB was introduced to CA of Fairfax Gerrard by HN. CA was at that time considering a management buy-out of Fairfax Gerrard (effectively buying David Ross out) and it was thought that SB could assist CA in this. No such buy-out actually happened, but instead SB began to think about acquiring Megantic himself. His evidence was that from around mid-2005 until 23 January 2006 the accounts of Fairfax Gerrard and Megantic were inspected and negotiations were continually entered into as part of SB's own due diligence exercises.

317. On 7 September 2005 there was a meeting between Officer Broers and another HMRC officer with CA and HN at Megantic's administration offices, which were then still at Fairfax Gerrard's offices in Gerrards Cross (Fairfax Gerrard at that time still being Megantic's parent company). The aim of that meeting was to review the due diligence practice undertaken by Megantic and Phonebitz 2003. The types of due diligence checks undertaken were confirmed, including the taking of IMEI numbers, undertaking company credit reports and Dun and Bradstreet checks.

318. On 2 November 2005 the name of BHN Services Limited, then owned by AN, was changed to Megantic Services (UK) Limited. According to SB this was done 'as part of the strategy to acquire Megantic'. It was thought that this change of name – threatening that the business hitherto conducted through Megantic could instead be switched to Megantic Services (UK) Limited – would 'put pressure on Fairfax Gerrard to move towards a deal for Megantic'.

319. On 13 November 2005 (11 days later) DH resigned as a director of Megantic Services (UK) Limited and on 18 November 2005 (5 days after that) Megantic Services (UK) Limited was sold to AB, who immediately renamed the company

Regent Commodities Limited (Regent). As stated above, the purchase price was £60,000 and Marldon lent AB this money.

320. On 23 November 2005 AB was appointed director of Regent.

321. On 6 December 2005, DH was in Dubai. There was in evidence a Megantic site visit report form filled out by "Duncan", clearly DH, who visited Amira. The report contained no details of the visit. There is also a similar form, also filled out by DH recording a visit on the same day to Desert Wing, where he visited "Imran" (clearly IM). Again, the report contained no details of the visit. It appears that the visits were part of Megantic's due diligence on its customers. The customer signature given on both forms looks the same and it is reasonable to assume that the contact visited at Amira was also IM. The last deal date for Amira was recorded as 10 November 2005. The last deal date for Desert Wing was recorded as 9 November 2005. HN in cross-examination accepted that it was a long way for DH to go to do two due diligence visits and that DH did not in fact do many due diligence visits, but he maintained that these visits were due diligence visits although no details of either visit had been recorded. HN did accept that Megantic never did another deal after 6 December 2005 with either Amira or Desert Wing.

322. On 12 December 2005, Officer Mercott and another HMRC office visited Megantic's administration offices at Fairfax Gerrard in Gerrards Cross. The meeting was at Megantic's request to discuss its concerns over the length of time HMRC were taking to release VAT repayments to Megantic. The officers met CA, David Ross, HN (from MSGL) and AN (from Caledonian). According to the visit report, a general discussion took place with HN and AN outlining their current procedures and due diligence checks. The officers were aware of Megantic's procedures and nothing new was mentioned. Officer Mercott informed the meeting that it would help in getting repayments out if he received the purchase and sales spreadsheet and the IMEI spreadsheet earlier as there was considerable checking to be carried out. There was no mention made at the meeting of any intention on Megantic's part to cease recording IMEI numbers (although Megantic did stop recording IMEI numbers the next month, in January 2006).

323. On 12 January 2006, the Court of Justice handed down its judgment in the *Optigen*, *Fulcrum Electronics* and *Bond House* joint cases. That judgment declared that the arguments up to that point deployed by HMRC in combatting MTIC fraud – that transactions forming part of circular movements of goods did not constitute economic activity for VAT purposes – was unsound as a matter of Community law.

324. On 23 January 2006, SB entered into an agreement with Fairfax Gerrard to purchase the £2 Ordinary Share capital of Megantic for £2. The agreement referred to audited accounts of Megantic for the year ended 31 December 2004 and management accounts to the date of the agreement (23 January 2006). SB and CA drafted the agreement (although it was signed by David Ross on behalf of Fairfax Gerrard). There was no value for goodwill included in the balance sheet used for the purposes of the acquisition. SB explained that "my goodwill in this would have been nil anyway, because would I have had an ability to trade?" – a question expecting the answer

"No" and recognising that all the trading expertise from which Megantic benefited was in fact provided by MSGL.

325. When HN was asked in cross-examination why he and his brother, AN, did not buy Megantic for £1 (or £2), HN had no real answer – he said: "because we didn't" – besides making a suggestion that such a purchase might have affected the tax structure he had put in place. It appears that Fairfax Gerrard took out of Megantic the amounts owing to it up to 23 January 2006, possibly by way of dividend, but we were – and remain – unclear as to how the impending VAT repayment for the month of January 2006 (which was received in March 2006) was accounted for.

326. On 25 January 2006 occurred the first sale by Megantic into the EU for well over 6 months. It was a sale to Forex Handels GmbH of 5,000 Nokia 9500 for £1,750,000. The goods were acquired by Megantic from Matrix Security Consultants Ltd for £1,615,000 plus VAT by an invoice of the same date. The FCIB evidence on IDNs 106 and 107 shows a connection between Forex Handels and Parasail in that both companies (and BRD, another customer of Megantic) were making payments from the same IP address.

327. In the course of the hearing HMRC produced a schedule illustrating the change in Megantic's trading model which occurred at this time. In the period from 1 July 2005 to 24 January 2006 Megantic had made no sales into the EU. In that period it made just short of £88m of sales outside the EU (exports) and something more than £45m of sales within the UK. In the period from 25 January 2006 to 30 June 2006 Megantic made over £296m of sales into the EU, just over £4m of sales outside the EU (exports) and about £150m of sales within the UK. On any view this was a highly significant change in trading practice.

328. On 20 February 2006, Dorsey & Whitney, Solicitors, apparently wrote a letter to Officer Broers at HMRC in the following terms:

> 'Dear Mr Broers,
>
> **RE: Megantic Services Limited – VAT Registration no: 824 4286 28**
>
> We write in relation to the new measures proposed by the Commissioners as detailed in your press release dated 27th January 2006. We believe your proposal for introducing a reverse-charge procedure for transactions of VAT registered businesses trading in certain goods, has the potential to be far more effective than the previous measures employed. We look forward to the introduction of such measures with the hope that it will specifically tackle VAT fraud whilst promoting our business and the businesses of other innocent traders in our industry.
>
> As you know we are continuously reviewing our practices and procedures and obviously with the proposals mentioned above, a complete overhaul of the system will be due in the future. What we wish to currently achieve is a sensible system producing only necessary information to enable you to verify the returns without the needs [*sic*] for the vast amount of documentation that is currently being produced. The level of documentation requested imposes an enormous strain on the business of our client as a result of the time involved to collate the information, not to mention the difficulties that sometimes arise when sending a team to scan products.

To that end, for example, we have now stopped taking the IMEI numbers as we are aware that in the industry as a whole these are not normally taken and with the level of turnover it is not possible to take them, We trust the above is self explanatory and if you would like to have a meeting to discuss we would be more than happy to do so.

Yours faithfully

DORSEY & WHITNEY'

329. This was an extraordinary letter. In particular, apart from one reference to the level of documentation requested imposing an enormous strain on the business of "our client", the letter appears to have been drafted as if written by Megantic itself. HN was unable to explain this, but he did affirm that the letter was written by Dorsey & Whitney personnel. We find this difficult to accept at face value and cannot be sure that the letter was not written by someone connected with Megantic and simply reproduced on Dorsey & Whitney's notepaper above their signature. Further, it seems clear to us on the evidence that the statement that "in the industry as a whole [IMEI numbers] are not normally taken" was incorrect at the time it was made.

330. On 3 March 2006, Officer Mercott of HMRC responded, writing to Dorsey & Whitney as follows:

'Dear Sir,

RE: MEGANTIC SERVICES LTD VAT REGISTRATION NUMBER 824 4286 28

I acknowledge receipt of your letters dated 20/2/06 to Mr Broers, 23/2/06 and 2/3/06 to Ms Styles, the contents of which have been noted.

Firstly, your letter dated 20/2/06 did not specifically require a response, however I will address your statement in due course.

In your letter dated 23/2/06 you state "- our intention to establish a more practical and beneficial system, producing only relevant documents for your verification process", I would point out that it is for The Commissioners to decide what documents are relevant to the verification process and that all business records are subject to scrutiny by The Commissioners. However Ms Styles is aware of your clients decision not to have the *imei* numbers of mobile phones scanned and will take this into consideration in the verification process of the January 2006 return.

Regarding the inspection and scanning of mobile phones, up until January your client had inspections carried out and provided The Commissioners with this information as part of their due diligence checks. This has enabled your client to have an early indication as to whether or not they have previously traded in the same phones. The Commissioners view this as a prudent commercial check to carry out as part of the due diligence procedure.

You have not alluded to the inspection and scanning of CPU's where currently Box and Lot numbers are supplied as part of the verification process. May we assume that your client will continue to carry out these inspections and supply The Commissioners with the relevant Box and Lot numbers.

It is of course your client's decision as to what commercial checks they carry out. However in the light of joint and several liability issues and other Community law it would seem a perverse decision to reduce the level of due diligence checks.

As you may be aware HM Revenue and Customs are experiencing certain problems with businesses in your trade sector offering commodities regularly involved in Missing Trade Intra Community (MTIC) VAT fraud. MTIC fraud may involve all types of VAT standard rated goods and services including computer equipment, mobile phones and ancillary items. The current estimate of the VAT loss from this type of fraud in the UK alone is between £1.06 and £1.73 billion per annum.

Community law precludes the recovery of input tax where the trader's transactions form part of an overall scheme to defraud the revenue where there are features of the trader's transactions (such as pattern of trading), or conduct on the part of the trader which suggests that the trader deliberately or recklessly ignored factors which indicate or may indicate that the transactions they entered into may have formed part of such an overall scheme.

I would again draw your attention to Notice 726 – Joint and Several Liability in the Supply of specified goods (Further copy enclosed)

Yours faithfully

Roger Mercott

Higher Officer

Cc Megantic Services Ltd'

331. Megantic argued in this appeal that it had drawn comfort from the statement that Ms Styles was aware of the decision not any longer to record IMEI numbers and would take that into consideration in the verification process of the January 2006 VAT return. It was pointed out that the repayment claimed on that return had been made, albeit on a without prejudice basis. Mr Patchett-Joyce argued that Megantic was entitled, in view of this, to assume that HMRC had no continuing objection to its policy of not scanning and recording IMEI numbers.

332. On 9 March 2006, the VAT repayment claimed by Megantic for January 2006 (£3,566,295.74) was credited to Megantic's Co-op bank account.

333. On 11 April 2006, Officer Mercott wrote to Megantic informing them that a discretionary payment of £3,265,117.66 had been authorised on a without prejudice basis in respect of the repayment of that amount claimed by Megantic for the February 2006 period.

334. On 26 April 2006, Officer Mercott wrote to Megnatic informing them that a discretionary payment of £5,926,654.40 had been authorised on a without prejudice basis in respect of the March 2006 period.

335. On 24 May 2006, HMRC (Officer Mrs Hurst) wrote to Megantic informing them that 'a period of time [would] now be required for HM Revenue and Customs to undertake a verification of the transaction [*sic*] to which the claim [for repayment of VAT for the April 2006 period] relates, before a repayment can be authorised'. In other words, this was a letter informing Megantic that its claim for repayment of VAT for the April 2006 period would be subject to extended verification.

336. On 22 June 2006, Officer Mrs Hurst wrote a similar letter to Megantic informing it that its claim for repayment for the May 2006 period would be subject to extended verification.

337. On 7 July 2006, Officer Broers and Officer Mercott commenced a full verification of Megantic's claim for repayment of VAT for the June 2006 period.

338. On 18 July 2006, Officer Broers, Officer Mercott and another HMRC officer (Lelliott) visited Dorsey & Whitney's offices for a meeting to address Megantic's concerns regarding the length of time that the VAT verification for the period 04/06 was taking, and to resolve any outstanding issues. Besides Dorsey & Whitney personnel, SB and CA (from Megantic), HN (from MSGL) and AN (from Caledonian) were present. Officer Broers's evidence was that Megantic were keen to point out at that meeting that its business was close to collapse as a result of HMRC's actions and that Megantic's reputation in the industry had been damaged as a result of HMRC's actions as it was no longer able to pay its creditors due to cash flow problems. Officer Broers noted that in spite of this precarious financial position, Megantic went on to trade 13 days later to the value of £6,661,000 sales, with £7,212, 282 in purchases (including VAT). Officer Broers's notes of that meeting indicate that HN argued that as there was no VAT loss in a chain (presumably a chain involving Megantic) HMRC would have to make repayment. Officer Lelliott stated at the meeting that another meeting to discuss Megantic's due diligence would be needed and one was booked for 25 July 2006 at 10:30 a.m. at the Gerrards Cross offices. Certain files were requested for examination

339. On 25 July 2006, the due diligence meeting between Officer Mercott and Officer Broers from HMRC and CA and SB (from Megantic), HN (from MSGL), AN (from Caledonian) as well as a Mr Kelsey (from Dorsey & Whitney) took place. At this meeting, the way Megantic operated was explained – the fact that Megantic had only two people on the payroll, SB and CA, both directors at that time, and that the day-to-day deals were contracted out to Caledonian. No mention was made of the "Global Agreement" in terms but SB told the meeting that MSGL in fact paid Caledonian, and that the money movements between MSGL and Megantic were in the form of loans and would not show up on VAT returns. SB told the meeting that he wanted to grow the business and diversify into new areas and had taken advice from 'people in the City' that there was a potential for Megantic to float on the stock market. But all this was on hold due to HMRC's action in withholding the VAT repayments for April 2006 and subsequent months. SB told the meeting that no significant trading had occurred in July 2006.

340. There was evidence that Megantic had, before the 25 July 2006 meeting, strengthened the due diligence files that had been requested for examination at the 18 July 2006 meeting. Although HN did not accept that any due diligence had been fabricated in that period, he conceded that the evidence gave rise to the suspicion that this had happened and he gave no alternative explanation of that evidence.

341. Megantic's due diligence procedures were discussed in general terms. SB mentioned that Megantic made due diligence visits to suppliers (customers were not

mentioned) and that such visits were undertaken normally by Dave Evans, and sometimes by AN or SB. (DH, who visited Amira and Desert Wing in Dubai on 6 December 2005, allegedly for due diligence purposes, was not mentioned in this regard.) SB said that Megantic tried to visit each supplier at least 3 times a year. The "batch sales system" was explained as in the following extract from HMRC's visit report:

> '**Deal Matching**
>
> [HN] explained that day-to-day trading is controlled via an on-line bespoke computer system, known as "batch sales system" which [CA] said was written in SQL especially for Megantic. When a telephone call is received from (or made to) a customer requiring stock, the details of the call are taken and entered into the database. The same process is followed when a supplier rings up (or is contacted) and it is established that they can provide stock. The database will automatically pair up like for like stock entries, and if the conditions are favourable, this information is highlighted on screen and the Megantic sales team will then commence the deal. [SB] said that from their database, Megantic are able to see what the going rate or market price is for a particular item is each day [*sic*]. He said that if Megantic had received 5 calls of which 4 offered stock at say £250 per unit and 1 offered it at say £230 per unit, invariably the lower price would be scrutinised and possibly rejected. [AN] said that they are currently in phase 5 of this software, and [HN] added that they are hoping to develop their database and make it more interactive with remote access for their own suppliers/customers, and possible regular text updates of current stock availability. Later during the meeting [SB] and [HN] confirmed that to date Megantic appears to have never made a loss in any deal, but recently had one deal in which they appeared to buy and sell stock at the purchase price thus making no mark [*sic*] at all – [HN] put this down to an error made and added that this was a one of [*sic*] occurrence. [SB] also added that the mark-up/profit margins fluctuate on each deal but generally are aimed between 5 to 10%.'

342. When taken to a deal effected on 15 June 2005 in which Megantic bought from Svenson and sold to Amira (both companies with which HN had accepted that AM was very heavily connected), HN said that 'very probably' this deal had been matched by the "batch sales system". When asked how it was that the "batch sales system" managed in about 400 deals to match up the right supplier with the right customer to allow the goods concerned to travel in a circular fashion, HN replied that that was the way the batch system worked – and this was so, even when deals were split (i.e. goods bought from one supplier were sold to two or more customers).

343. On 31 July 2006, Megantic ceased trading in mobile phones.

344. On 21 November 2006, HN on behalf of Asphodel (MSGL) wrote to SB at Megantic as follows:

> 'Dear Steve,
>
> Further to our telephone conversation, I write to clarify the current position as to the amounts outstanding for Megantic. As you are currently aware, Megantic owes Asphodel Limited £19,449,039.62. This amount currently includes the funds advanced (and interest) together with the consultancy services.
>
> We are of course aware that HMRC are carrying out extended verification into your VAT returns and as of today there has been no decisions [*sic*] made as to when HMRC will be making the due repayment. We are also aware that as a result of these enquiries you have been

unable to trade since July 2006 and therefore you are unable to generate profits to sustain a position where you would be able to repay any of the moneys we have loaned to yourselves. We understand that if we were to insist on immediate repayment the company would be likely to be placed in administration and that is in neither of our interests and Asphodel does not intend to place the company in this position.

However, we are extremely concerned that such an amount remains outstanding to Asphodel Limited and we wish to emphasise that we require you and the company to continue to make every effort to ensure the resolution of this matter. Asphodel Limited are not pressing for immediate repayment as it is not Asphodel's intention to liquidate the company in pursuance of our debt however as this issue remains outstanding we have to regularly review our position. I should also make it clear that in the circumstances we would only be able to consider advancing further funds at a higher rate of interest reflecting the associated commercial risk.

Please ensure that we are kept fully up to date with progress in recovery of the moneys that you are due from HMRC.

Yours sincerely,

Asphodel Limited'

345. SB said in cross-examination that his understanding was that the amounts due from Megantic to MSGL (Asphodel) would be agreed between HN and himself – by way of a 'gentleman's agreement'. There had been no such agreement so far. He said, however, that he was not surprised to receive MSGL's letter of 21 November 2006 (though he thought he had been when HN had mentioned the debt on the telephone). He said he wasn't sure how the figure of £19.449m broke down as between funds advanced, interest, and fees for consultancy services. He said that Megantic had recorded in its books a liability of £7m for interest and charges for consultancy services. As to the balance of £12.5m he said: "to me that is for further consultancy services which will have to be discussed, no doubt, both with Asphodel and the corporation tax people". He said he thought the figure (presumably £19.449m) was completely unfair, though he seemed to accept that Megantic was liable for the costs incurred by MSGL under the service agreement between it (MSGL) and Caledonian. The 'bit' that had never been properly determined was HN's costs. There had been no minuted agreement supporting the figure of £19.449m (or any figure). There was no relevant agreement except the "Global Agreement".

346. HN said in cross-examination that he had no breakdown of the figure of £19.449m. He said that MSGL would have advanced "millions" to Megantic – and when pressed he gave a figure of £5 to £10 million.

347. As recorded at the start of this Decision, on 9 March 2007, HMRC wrote to Megantic seeking to deny its VAT repayment claim for the April 2006 period. On 21 May 2007 a similar letter was written in relation to the VAT repayment claims for May and June 2006, and on 20 August 2009 HMRC wrote to Megantic seeking to deny its VAT repayment claim for the July 2006 period (in the sum of £1.07m).

Attribution of knowledge to Megantic

348. Before we continue to the section of this Decision dealing with our answer to the fourth question posed in paragraph 18 above, we consider at this point the issue of

who were the individuals whose knowledge (if any) of the connection between Megantic's transactions in issue with fraudulent evasion of VAT can be attributed to Megantic for relevant purposes.

349. CA and SB were directors of Megantic in the relevant periods (May and June 2006) and so any knowledge either of them had can clearly be attributed to Megantic.

350. However in the context of the application of a rule of Community law which applies to prevent abuse of the VAT system by the purported exercise of the right to deduct input tax on transactions which are connected to fraudulent evasion of VAT, we consider that the policy discernible in the rule of Community law requires that any individual who, as a matter of fact, exercised authority to commit Megantic to entering into such transactions must be an individual whose knowledge (if any) can be attributed to Megantic for relevant purposes.

351. In the context of domestic (English) law, it has been stated that a person who is a company's 'directing mind and will' for relevant purposes (and whose knowledge, therefore, should be attributed to the company for those purposes) is a person having express or implied authority in law to exercise such powers as commit the company to transactions which are relevant for those purposes (*El Ajou v Dollar Holdings plc* [1994] 2 All ER 685).

352. We consider that there is no relevant divergence between English law and Community law in this respect. HN acknowledged that the sales and purchases teams at Megantic (or Caledonian, working, ultimately, for Megantic) were under the control of himself (HN), DH and AN – HN and DH as directors of MSGL, and AN as director of Caledonian. He added SB to this list a little later in the cross-examination. These individuals told the sales and purchases teams what to do and authorised the transactions entered into by Megantic.

353. It follows that we must attribute to Megantic for the purposes relevant to this appeal any relevant knowledge which we find to have been had at the relevant time(s) by any of the following: SB, CA, HN, DH and AN.

Discussion and Decision

354. There has been a superabundance of evidence adduced in this appeal from which it is clear to us that there are, as a matter of fact, many circumstances which raise serious suspicions of actual knowledge of the connection between Megantic's transactions in issue and fraudulent evasion of VAT on the part of those responsible for Megantic's trading – by which we mean principally CA, HN, DH and AN. However to avoid unnecessarily extending this already long Decision we will deal fully with only 4 topics which appear to us to be the most compelling factual indications of such actual knowledge. They are: (1) the lack of commercial rationale to Megantic's trading, including the uncommercial aspects of it which were established by the evidence; (2) the uncommercial relationship between HN and Megantic on the one hand and AB and Regent on the other; (3) the circumstances leading up to the change in Megantic's trading model with effect from 25 January

2006; and (4) the way Megantic's business (and in particular its bank accounts) were run after SB's acquisition of Megantic on 23 January 2006.

355. We do not intend to deal fully with other circumstances which, as we have said, raise serious suspicions of relevant actual knowledge. In particular, although we take account of them, we do not analyse: (1) the quality (or, as we find, the lack thereof) of Megantic's due diligence in the periods in issue; (2) the instances where goods were delivered to a different location from that of the purchasers; (3) the suspicious circumstances where goods which were the subject of split deals with customers from different countries were nonetheless shipped in the same transport to the same overseas freight forwarder (for example, IDNs 43, 44, 49 and 50); (4) the anomalies and uncommercial aspects of the sale and shipping of goods by Megantic and other parties where apparently no title to those goods was held by the selling party; (5) the suspicious consistencies of mark-ups obtained by Megantic which were established on the evidence, and the wide variation of those mark-ups from the much lower mark-ups obtained by other parties in the various chains; or the fact (6) that payments of the sale price on split deals came in to Megantic some time after the deals had occurred but at the same time from both (or all) apparently unconnected purchasers. We find that HMRC's case on all these points was established by the evidence and that they all go to suggest actual knowledge, on the part of those conducting Megantic's trading activities, of the connection with fraud.

356. As to Megantic's due diligence, we record that HN accepted in cross-examination that:

> 'Megantic wasn't that good at paperwork at all. It tried to be, it tried to do bits and bobs of paper, but it wasn't good at paperwork. There are lots of things which it could have done better, I accept that, i.e. the DD [due diligence] file.'

The lack of commercial rationale to Megantic's trading

357. When HN was asked the first time whether he knew that the vast majority of all the mobile phones that Megantic purchased had originated in the EU, his response was that he did not know that, all he (or "we", presumably meaning anyone else involved) knew was that the phones were bought from UK suppliers and he did not know from where the phones originated. It was then pointed out to HN that virtually every single consignment of mobile phones that Megantic bought had European two-pin plugs. HN agreed and further agreed that the only logical conclusion was that the phones had been imported into the UK from the EU.

358. HN reluctantly admitted ("possibly, yes") that 'subconsciously' he realised that the phones at a minimum had been sold out of the EU to the UK, once within the UK between UK traders and then out of the UK (by Megantic) into the EU. When asked what he thought the purpose of the goods coming into the UK from the EU and out again from the UK into the EU was, he replied: "to sell phones. Simple as that, really. I didn't think there was any other purpose to the phones coming in".

359. HN's evidence was that he did not think that the chains in which Megantic was trading were long – 'we only really thought of our immediate customer and our immediate supplier'. But he accepted that within the minimum chain – EU selling

entity : UK acquiring entity : Megantic : Megantic's EU customer – there were 4 traders none of which was the manufacturer of the phones, none of which was an authorised distributor of the phones, none of which was a retailer of the phones and none of which was a retail customer of the phones.

360. HN said he never made what to us seems the only reasonable deduction, that these facts indicated that Megantic's trades must have been connected with fraud. When this was put to him, he responded that Megantic thought that it was trading in a safe environment because the only indication of the possibility that its trading was connected with fraud at the relevant time had been Officer Mercott's letter of 29 November 2004 (see: paragraph 295 above) which had referred to only 2 deals conducted on 27 and 28 May 2004 – and the input tax denied on that occasion had later been repaid with repayment supplement.

361. We reject Megantic's case that this gave any realistic or reasonable grounds for considering that it was trading in a safe environment. The repayment was made only because of legal issues arising from the decision of the Court of Justice in *Optigen*, *Fulcrum Electronics* and *Bond House Systems.* Moreover HN was well aware of the Code of Conduct established pursuant to the Memorandum of Understanding between HM Customs and Excise and companies in the mobile phone industry to which Phonebitz 2000 had been a party. That Code required a trader to consider before supplying stock to a new customer, for example 'Are the goods to be delivered to the country where the customer is resident, or are they to be delivered to another country?' and 'Will the country of destination of your goods be the same as the country that your customer operates in will payment originate from that country?'. Clearly HN knew that it was not sufficient (in terms of protection from involvement in fraudulent trading) in the circumstances of the wholesale trade in mobile phones at the time to do due diligence on your supplier and your customer and carry out your customer's wishes with regard to the goods, whether or not they raised any of the issues highlighted in the Code of Conduct.

362. When asked why he, or anyone else involved in Megantic's trading never paused for a moment in the first half of 2006 to consider how Megantic was able to achieve the enormous turnover actually achieved and make over £21m in profit from, in essence, moving goods from one place to another, HN's response was that it was a hard task: 'I guess strictly we didn't sit down in a meeting and say, "How did we achieve this?". What we were trying to do was grow the business.'

363. We heard expert evidence from Mr John Fletcher, of KPMG, on the grey market for mobile handsets in 2006 in which he said that there were at that time in that market four types of commercial opportunity: dumping, volume shortage, box breaking and arbitrage. HN agreed with this analysis and, when asked which opportunity Megantic had taken advantage of, he replied that he did not know, but he guessed it was engaged in arbitrage. He then said that he was no expert in arbitrage and that 'the opportunity was simply buying and selling phones'. We confidently conclude from the evidence that Megantic's trade did not come within any of the recognised categories of legitimate trade in the wholesale market in mobile phones at the time and that those responsible for Megantic's trading did not think that it did.

364. Another uncommercial aspect of Megantic's trading was that, as HN acknowledged, it released goods (to which it did not apparently have title, not having itself paid for them) to customers. An example of where this happened was in IDNs 296 and 297, deals conducted on 26 May 2006. These deals were a purchase from an entity known as Ace Telecom Trading and a split sale of the goods to Globalfone and Sigma Sixty. Ace's invoice made clear that the property in the goods remained in Ace until payment was received in full. HN accepted that of the total purchase price of over £2m, only £1.973m had been paid, leaving £97,375 outstanding. Nonetheless Megantic released the goods to its customers.

365. HN also accepted that in a number of deals Megantic released the goods to its customer without being paid. HN explained this as a tactic aimed at trying to achieve payment. But we do not accept that this was rational commercial conduct. By releasing the goods without payment, Megantic was losing the only commercial lever it possessed to secure payment. SB's answer in cross-examination seemed to us to be franker. He said it was a collective decision but that: 'it is hard now, sitting here, this many years later, trying to think what the rationale was for the decision at the time, but at the time it was – it felt like the right decision to make. We thought at the time that would help get paid.' SB may have thought that at the time, but it was a trading decision into which we find he had little input, and we have concluded that he was guided in this, as in all trading matters, by the individuals who were putting through Megantic's trading transactions, particularly HN.

366. There was also evidence that before payment by a customer, Megantic would routinely move the goods out of the UK to a freight-forwarder's warehouse in another Member State on a 'ship on hold' basis, where the goods would be held, sometimes for many weeks, pending payment by the customer. HMRC adduced evidence that at this time the price of models of mobile phone which Megantic was dealing in in this way was falling while payment from Megantic's customer remained outstanding. When HN was asked why the customers paid, in those circumstances, when the value of the phones had gone down pending release to them, his response was: "I didn't think about the commercial rationale as such. We had entered into a deal and they paid us on that deal".

367. There was also evidence that in June 2006 Megantic continued to trade with customers (Senbetel, Sigma Sixty and IMD) who had not paid for deals entered into with Megantic on 26 May 2006 (payment was eventually made on July 2006). HN was asked why Megantic continued to trade with customers who were already behind with payment for earlier deals and his response was 'Because we were continuing to trade in June' and 'Because that is what we did. We always did that.' We find that this is another indication of the lack of commercial rationale for Megantic's trade and HN's complaisant attitude to it.

The uncommercial relationship between HN and Megantic on the one hand and AB and Regent on the other

368. We have recorded above the relevant history of HN's commercial and business relationship with AB (see: paragraphs 263 to 271 above).

369. There is evidence of two deals carried out by Regent on 11 April 2006. One (IDN 15) was a purchase from David Jacobs and a back-to-back sale to Megantic. The other (IDN 27) was a deal in which Megantic purchased from David Jacobs and sold on to Regent (Regent was the 'broker' in that deal and sold to BRD – a company which the FCIB evidence shows was connected with Parasail, Comica and Amira, because payments were made for BRD and these other companies using the same IP address(es)).

370. HN was asked in cross-examination how Regent on one day (only 4 months after AB had acquired it) had managed both to buy from Megantic's pre-existing supplier (David Jacobs) and sell on to Megantic's pre-existing customer (BRD). His response was: "I don't know." "That is what we did." In relation to IDN 15, HN was asked how AB had got himself into a position that he could buy cheaper than Megantic. His response was: "I don't know." "I didn't consider it."

371. The FCIB evidence on IDNs 119 and 120 in which Megantic purchased from Regent on 26 April 2006 and sold in a split deal to Sigma Sixty and BRD showed the sales price being paid by both Sigma Sixty and BRD to Megantic within 18 minutes of each other on 10 May 2006. Megantic paid the purchase price it owed to Regent the same day, minutes later. Twelve minutes after that Regent paid the purchase price it owed (to David Jacobs). Megantic's FCIB account was logged on to make the payment to Regent using CA's details, and Regent's FCIB account was logged on to make the payment to David Jacobs using AN's details. However both payments were made from the same IP address. HN suggested that the reason for this was that AB had logged on to Regent's account using AN's details when he was physically visiting CA, who was at the same time logging on to Megantic's account. We consider it is more likely that, as HMRC suggested, both accounts were being operated by the same person.

372. There was also evidence of DW writing to HMRC as the Company Secretary of Regent – which he never was. Mr Waddington admitted in cross-examination that he never was the Company Secretary of Regent and that he must have made a mistake presenting himself as such.

373. We consider that the totality of the evidence relating to AB and Regent (in particular the evidence of the financial assistance given to AB by HN and his companies) shows that Regent did not operate independently of Megantic and was actually a conduit installed as part of the overall orchestrated and contrived scheme to defraud the revenue.

The circumstances leading up to the change in Megantic's trading model with effect from 25 January 2006

374. HN struggled to explain in cross-examination why Megantic's trading model changed with effect from 25 January 2006 so that non-domestic sales thereafter were overwhelmingly to EU-based customers (to which market for at least the previous 6 months there had been no sales) and the previously very flourishing non-EU export market was virtually ignored. He was asked why Megantic had given up such a lucrative export market and his answer was that trading across time zones had put

undue stress on the business and on the staff. We found this answer unconvincing. A natural business development or evolution would, we consider, have seen sales into the EU gradually introduced and export sales outside the EU retained to cover the transition.

375. However the evidence showed that Megantic's first EU-based customer, Forex Handels (which we have found to have been connected with Parasail and Comica) was introduced to Megantic at 10:37 on 25 January 2006 and on the same day £1.75m worth of goods were sold by Megantic to Forex Handels, which were at Eurotunnel at 17:47 on the same day. This was in spite of HN's evidence that Megantic would not deal with random callers. SB in his evidence put a different slant on it. He did not deny that the staff had become tired but he said that opportunities were starting to open up in Europe and that it seemed a natural progression to trade with EU-based customers. He thought that 'the guys' (Megantic's sales team) knew the EU customers before 25 January 2006. As for running down the business with non-EU customers, SB said – we think truthfully – that 'there was no conscious decision *from me* not to carry on trading with them' (our emphasis).

376. We consider that the following are significant facts: (1) the (at first partial) replacement of Fairfax Gerrard by MSGL (ultimately SFS and others) as financiers of Megantic in mid-2005; followed by (2) HN's setting up AB in Regent as a competitor of (additional conduit to) Megantic in November 2005; together with (3) DH's visit to IM of Amira and Desert Wing (companies also associated with AM, who we find was, with IM, operating in association with Adil Kamran) in Dubai on 6 December 2005; (4) the judgment of the Court of Justice in *Optigen, Fulcrum Electronics* and *Bond House* on 12 January 2006; (5) Megantic's decision (in January 2006) to stop recording the IMEI numbers of the mobile phones which passed through their hands (when HN in particular was well aware of the importance of recording them as a due diligence measure, to identify phones which had been traded previously by Megantic); and (6) SB's recruitment, also in January 2006, as a director and owner of Megantic who had no previous experience in the wholesale mobile phone market. These significant facts in our view show the build-up to the remarkable change in Megantic's trading pattern with effect from 25 January 2006. We find that that these facts represent actions which were all steps leading up to Megantic's recruitment – or self-recruitment – as a participator in the overall contrived scheme to defraud the revenue which was organised principally by AM, IM and Adil Kamran in association with each other.

The way Megantic's business (and in particular its bank accounts) was run after SB's acquisition of Megantic on 23 January 2006

377. Following SB's acquisition of Megantic on 23 January 2006, CA, David Ross, Graham Stokes and Richard McDougall, all of Fairfax Gerrard, continued to be signatories on Megantic's FCIB account. SB accepted in cross-examination that 'it took a while to change' the banking arrangements. He took CA on trust, but he acknowledged that he (and presumably the other Fairfax Gerrard signatories) could have 'cleared out' Megantic's bank account.

378. Likewise Megantic's Co-op bank account continued to be controlled by CA and Fairfax Gerrard, who were making transfers out of it of very substantial sums to a treasury-type deposit account after 23 January 2006. SB could not recall whether he became a signatory on the Co-op bank account – it was closed on 8 May 2006.

379. The agreement by which SB purchased the shares in Megantic from Fairfax Gerrard was, as SB accepted in cross-examination, so short on detail that it is impossible to work out from it what was and what was not included in the sale – for example, as already noted, it is unclear how the impending VAT repayment for January 2006 was accounted for.

380. There was an unusual degree of trust between SB and the Fairfax Gerrard personnel over the basis on which SB's acquisition of the shares in Megantic would be worked out in practice.

381. Our conclusion is that although Fairfax Gerrard disposed of the shares in Megantic to SB they still retained some shadowy interest in its activities. HN described Fairfax Gerrard as having continuing administrative functions, and they certainly continued to operate Megantic's bank accounts. CA remained a director of Megantic. It is unclear to us what the arrangement with Megantic was which enabled this continued activity and interest on Fairfax Gerrard's part or how they were to achieve remuneration for it (payments out of Megantic's Co-op bank account to Fairfax Gerrard on 25 April 2006 of some £66,000 in total were noted but not explained).

382. A connected feature is Fairfax Gerrard's apparent complaisance in their then subsidiary, Megantic, concluding the "Global Agreement" with MSGL. That agreement either achieved or promoted an alternative funding system for Megantic. HN explained that Fairfax Gerrard were happy with this development, because it would lead to more working capital funding for Megantic, thus increasing the amount of business it could do and gaining additional income for Fairfax Gerrard in respect of their fees for "administration". However we are left unsure of the commercial rationale of this development from Fairfax Gerrard's viewpoint because most of their income came in the form of interest (at a high rate) on advances to Megantic and the "Global Agreement" clearly meant that Megantic was moving to other sources of funding which had the potential to, and in fact did, eclipse Fairfax Gerrard's interest. SB's suggestion that Fairfax Gerrard had no great trading knowledge and some financial issues of their own did not seem to us to be a convincing explanation.

Findings of actual and/or constructive knowledge:
Howard Nicholson (HN)

383. We have concluded that HN did have actual knowledge at the relevant time of the connection between Megantic's trading transactions and the fraudulent evasion of VAT which was achieved by means of the overall contrived scheme orchestrated, as we have found, principally by AM, IM and Adil Kamran in association with each other.

384. Our reasons for this conclusion appear throughout what we have written above on the fourth question stated in paragraph 18 above, which we are considering in this part of our Decision.

385. In summary, we regard his relatively long history of connection with the wholesale mobile phone industry, in particular his association with Phonebitz 2000, a signatory to the Memorandum of Association, and his consultancy with Phonebitz 2003, as indicative of the fact that he knew all about MTIC fraud in the industry.

386. He accepted under cross-examination that there had been fraud in the direct tax loss chains in issue in the appeal, but he continued to maintain that HMRC had not shown any connection between Megantic and fraud *via* contra-traders. We consider that this gives an insight into his mind-set at the time, which we find to have been that he thought that schemes involving contra-traders would be impenetrable to HMRC, that they would be unable to prove more complicated connections of this kind, and that such schemes were therefore likely to be immune from attack by HMRC. We note that, at the meeting with HMRC on 18 July 2006, HN argued that as there was no VAT loss in a chain (presumably a 'clean' chain involving Megantic), HMRC would have to make repayment of the VAT claimed by Megantic.

387. We consider that MSGL's connection with SFS rightly raises a suspicion of familiarity, dating back some time, between HN and AM and his uncle, AK. We note that AM lived at least some of the time in the Manchester area and that he and his uncle had business interests there. There would have been plenty of opportunity for HN's path and theirs to cross. We note also that as early as March 2005 Megantic (with whom HN was by then already heavily involved) had commercial contact and would soon deal with Desert Wing (IM's company in Dubai). On 15 June 2005, Megantic made its first sale to Amira in Dubai.

388. The sloppy drafting of the loan agreement between MSGL and SFS and the letter dated 20 February 2006 apparently sent by Dorsey & Whitney – but certainly under the instructions of HN and possibly others – to HMRC also point to a lack of care on HN's part, which we consider is explained by his not really caring very much how he defined his, or MSGL's or Megantic's position in law, because in reality such definition had no consequences, because (as he knew) Megantic's and MSGL's activities were caught up in the larger orchestrated and contrived overall scheme.

389. We mention specifically his knowledge and approval of Megantic's decision to stop recording IMEI numbers as, in our view, being only realistically explicable by his knowledge of the connection between Megantic's trading and fraudulent evasion of VAT.

390. We consider that HN was personally, and with actual knowledge, involved in all the circumstances of the uncommercial relationship between himself and Megantic on the one hand and AB and Regent on the other, and also so involved in all the circumstances leading up to the change in Megantic's trading model with effect from 25 January 2006, as we have described it. We further consider that the only credible explanation for the lack of commercial rationale for Megantic's trading was HN's

actual knowledge of Megantic's participation in the overall scheme which we have described.

391. We therefore conclude and find that HN had actual knowledge of the connection between Megantic's transactions in issue and the fraudulent evasion of VAT, and, indeed, that he knew that the only reasonable explanation for Megantic's transactions in issue was that they were connected to fraud.

392. Because we consider that it is correct to attribute HN's knowledge to Megantic, for the reasons given above, we also conclude and find that Megantic had actual knowledge of the connection between its transactions in issue and the fraudulent evasion of VAT.

Adam Nicholson (AN), Chris Ash (CA) and Duncan Howarth (DH)

393. None of these individuals gave evidence. However, from the evidence we have received and which is rehearsed above, we find, on the balance of probabilities, that all three of AN, CA and DH, being closely involved in the trading activities of Megantic in the relevant period, had actual knowledge of the connection between Megantic's transactions in issue and the fraudulent evasion of VAT and, for the reasons given above, that their knowledge ought to be attributed to Megantic.

Steven Brookfield (SB)

394. We have had more difficulty in reaching our conclusions as to SB's state of knowledge at the relevant times. It seems to us that he was in some ways like the '*reine Tor*' or 'pure fool', the eponymous hero in Richard Wagner's *Parsifal*. However, unlike Wagner's hero, he did not bring redemption to the situation in which he intervened, but instead brought obfuscation to the circumstances in relation to which we must make the crucial decision in this appeal.

395. SB came to his involvement with Megantic without any previous experience of the wholesale mobile phone industry. Once he became a director of Megantic he had no major involvement in its trading activities, indeed we find that any involvement which he did have was effectively under the tutelage of HN and CA. He left them to run the business without any effective interference from himself. He said (and we accept) that he had no contact with Megantic's suppliers and not much contact with its customers. He had no experience in putting deals together and his involvement was limited to 'checking that we were happy with the deals' and, we find, he followed CA's and HN's lead on this. He was not a party to Megantic's decision not to record IMEI numbers and he did not ever review it.

396. We consider that the reality underlying SB's purchase of the shares in Megantic for £2 on 23 January 2006, when the "Global Agreement" was already in place, with its elliptical provisions for Megantic to pay an unspecified consideration to MSGL for the consultancy services to be provided, was that SB was taking on Megantic, not specifically to profit from its trading activities but to endeavour to use it as a platform for diversification into new areas. That would have fitted in with his commercial experience – and, we have to say, he appeared to us to be a vain person to whom such a project, however unrealistic, would appeal. He knew CA, and evidently trusted him

as he was content for him to remain as a director of Megantic and as a signatory to Megantic's bank accounts. And he had known HN for a long time. He clearly trusted HN, indeed at the hearing of the appeal he stated that he did not think he had been used by HN – and this in the light of all the evidence in the appeal. He had seen no need for a minuted agreement between himself and HN with regard to the consideration payable by Megantic for MSGL's consultancy services.

397. We consider that he entered into his involvement with Megantic in the knowledge that those directly responsible for Megantic's trading (which he accepted he was not, and could never be) would be entitled to the lion's share of the trading profits it made – because those profits arose from Megantic's trading. We find that he expected a remuneration appropriate to his administrative functions – the only amount we saw going out of Megantic's bank account to him and his wife was £5,000. We regarded his attitude to MSGL's assertion that Megantic owed it £19.449m as revealing. He thought he had (or would reach) a 'gentleman's agreement' with HN. He accepted that Megantic owed MSGL £7m for interest and charges, but he thought that the balance of £12.5m demanded by MSGL for further consultancy services was completely unfair. Indeed we have concluded that his attitude to his relationship with HN, CA, AN and Fairfax Gerrard, in relation to Megantic and participation in the profits that Megantic made, was grounded upon his understanding of what was fair to all parties.

398. SB denied actual knowledge of any connection between Megantic's transactions and fraudulent evasion of VAT emphatically and, we thought, believably. He said: 'initially this started out with meetings where people were trying to explain contra-trading to me. I didn't actually understand what that meant at the time.'

399. If (as we do) we accept that SB was 'pure' in the sense of not actually knowing of Megantic's involvement in the overarching, orchestrated and contrived series of transactions which we have found to have been brought about, we consider that he was obdurate and blind in failing to inform himself of the true nature of MTIC fraud which he knew HMRC were combatting at the relevant time – in particular that it involved long chains and contra-trading – and that that obduracy continued to the point of his cross-examination, when he refused to accept that HMRC's evidence in relation to the circular flows of goods and money represented what had actually happened.

400. There is no doubt in our minds that SB ought to have known that the only realistic explanation for Megantic's purchases in the months of April, May and June 2006 (to the value of £79m in April, £136m in May and £85m in June), which produced sales turnover of £82m in April, £143m in May and £89m in June, was that they were actually connected with fraud. In this regard, we consider that SB accepted as much in cross-examination, when he frankly admitted that he probably thought at the time, and had done since, that Megantic's turnover of almost £300m achieved between his acquisition of the share capital of Megantic on 23 January 2006 and the end of June 2006 was "incredible". This conclusion is enough, by itself, to cause us to dismiss this appeal.

401. We have of course considered whether HMRC had made out their allegation that the evidence as to SB's state of knowledge at the relevant times pointed to SB's actual knowledge of the connection between Megantic's purchases and fraudulent evasion of VAT. It has been difficult for us to understand how a man of SB's professional and business experience could not have actually known of the connection which we have found to have existed. We would have thought that such a man would have wondered – if only because of the spectacular (incredible) turnover achieved by Megantic in the first half of 2006 – whether Megantic's trade was legitimate and would have reviewed the business model to check whether or not this was so. SB undertook no such checks and this could have caused us to conclude that he was actually aware of the connection with fraud but chose not to disturb it.

402. However, our assessment of SB's conduct under cross-examination, particularly his lack of evasiveness, has persuaded us that he had no such actual awareness at the time. Instead we consider that he was complacent in his reliance on HN, DH, CA and AN (whom he did not suspect of knowledge of any connection to fraud) to carry on the trading function of Megantic without any serious interference from himself. SB was concentrating (as he said) on the profit (rather than the turnover) which Megantic was achieving, the funding arrangements for its ongoing business, and 'discussing various things in the City' for the future development of the business – areas in which he considered (in our view somewhat conceitedly) that he had a special expertise.

Section 26A, VATA

403. The evidence establishes that Megantic paid consideration to its suppliers in respect of supplies made to it in its May and June 2006 VAT periods (05/06 and 06/06) a gross sum of £47,663,526.83 less than the gross invoiced value of those supplies. Megantic has claimed credit for input tax referable to all of that unpaid consideration. The claimed input tax referable to that unpaid consideration is £7,098,823.14. On the basis that, as we have decided, the effect of the *Kittel* principle is that Megantic is not entitled to credit for any amount claimed as repayable input tax in its May and June 2006 VAT periods, the issue of whether section 26A VATA has effect to disallow input tax referable to this unpaid consideration does not strictly fall or decision by us. However, since the parties have made submissions to us on this issue, and in case it becomes relevant later, we will address it shortly.

404. Section 26A, VATA provides as follows:

> '**26A Disallowance of input tax where consideration not paid**
>
> (1) Where –
>
> (a) a person has become entitled to credit for any input tax, and
>
> (b) the consideration for the supply to which that input tax relates, or any part of it, is unpaid at the end of the period of 6 months following the relevant date,

he shall be taken, as from the end of that period, not to have been entitled to credit for input tax in respect of the VAT that is referable to the unpaid consideration or part.

(2) For the purposes of subsection (1) above, "the relevant date", in relation to any sum representing consideration for a supply, is-

(a) the date of the supply, or

(b) if later, the date on which the sum became payable.

(3) Regulations may make supplementary, incidental, consequential or transitional provisions as appear to the Commissioners to be necessary or expedient for the purposes of this section.

(4) Regulations under this section may in particular –

(a) make provision for restoring the whole or any part of an entitlement to credit for input tax where there is a payment after the end of the period mentioned in subsection (1) above;

(b) make rules for ascertaining whether anything paid is to be taken as paid by way of consideration for a particular supply;

(c) make rules dealing with particular cases, such as those involving payment of part of the consideration or mutual debts.

(5) Regulations under this section may make different provision for different circumstances.

(6) Section 6 shall apply for determining the time when a supply is to be treated as taking place for the purposes of construing this section.'

405. The regulations referred to at section 26A (3) to (5) VATA are those at Part XIXB of the VAT Regulations 1995 (as amended) (Regulations 172F to 172J inclusive). They provide machinery for the operation of the section by adjustment of the VAT account in VAT period in which the end of the relevant period falls (reg. 172H(1)).

406. The provision of the Principal VAT Directive which provides the *vires* for the enactment of section 26A by the UK is article 90 which provides as follows:

'1. In the case of cancellation, refusal or total or partial non-payment, or where the price is reduced after the supply takes place, the taxable amount shall be reduced accordingly under conditions which shall be determined by the Member States.

2. In the case or total or partial non-payment, Member States may derogate from paragraph 1.'

407. Mr Kinnear and Mr Chapman asserted in their Opening Submissions that Megantic should be denied the entitlement to credit for input tax on the unpaid consideration as a simple matter of the application of section 26A.

408. They submitted that in the event of partial or total non-payment in respect of a unitary taxable supply, the taxable amount corresponding to the unitary taxable supply is to be reduced to reflect the consideration actually paid. The effect is to cancel or reduce the entitlement to input tax in order to ensure compliance with the principle of

fiscal neutrality. They lay emphasis in this respect on the words 'taken … not to have been entitled to credit for input tax' in section 26A(1). The disallowance, they submitted, refers back to the chargeable event in the earlier accounting period in respect of which there is now (following non-payment of the consideration) taken to have been no (or reduced) entitlement to credit for input tax. They cited decisions of this Tribunal in *Belton Estates plc* [2010] UKFTT 330 (TC) at [17] and the Upper Tribunal's Decision on appeal in *Brayfal* [2011] STC 1338. They submitted that section 73 VATA (power to make assessments, where there has been a failure to make returns, etc.) has no relevance to the application of section 26A. They cite the judgment of Simon J in *Infinity Distribution Limited (in administration)* [2010] STC 2258 at [44] – [45], in particular the Judge's observation that:

> 'Where a net balance of VAT is due from the trader as shown on a return, it is recoverable as a debt due to the Crown. The entitlement to recover the debt does not depend on issuing an assessment …'

409. Mr Patchett-Joyce submitted that the effect of section 26A was to bring into existence a state of affairs (*viz:* non-entitlement to credit for input tax) at the end of a period, and not to back-date that non-entitlement to the point when the original entitlement to credit arose. He emphasised that the taxable person, according to section 26A(1) 'shall be taken, as from the end of that period, not to have been entitled to credit for input tax …'. Thus, his argument was that the purpose and effect of section 26A is to create the circumstances in which an assessment can be raised by HMRC, and in this respect their powers under section 73 VATA were relevant.

410. He also submitted that the general time limit of 4 years referred to in regulation 34 (correction of errors) applied with the effect that any overstatement of deductible input tax by Megantic is now to be disregarded. Alternatively the 4-year time limit for making assessments under section 73 VATA applied and HMRC were out of time to make the necessary assessment to recover overstated input tax. He submitted that there was a proper procedure to be followed to implement any section 26A disallowance – it had not been followed and HMRC were now too late to make the appropriate assessment. He cited the recent Decision of this Tribunal in *Dobney* TC03497, 25 April 2014, as approving his analysis that an adjustment to implement section 26A fell to be made by the raising of an assessment.

411. A fundamental point is whether the effect of section 26A is to cancel the right to credit for input tax *ab initio*, or whether it is to call for an adjustment at the end of the relevant period. On this point we are with Mr Kinnear and Mr Chapman. The statutory words are that the taxable person "shall be taken, as from the end of that period, not to have been entitled to credit for input tax in respect of the VAT that is referable to the unpaid consideration or part". We consider that the formula "not to have been entitled" indicates that as from the end of the relevant period the entitlement to credit for input tax is retrospectively cancelled. Regulation 172H of the VAT Regulations cannot, in our judgment, affect this conclusion. That regulation provides machinery for the implementation of the section – its wording cannot affect the substantive charge.

412. As to the machinery for effecting the necessary adjustment, our view is that if (as the Tribunal decided in *Dobney*) HMRC's power to assess under section 73 VATA is appropriate to implement an adjustment called for by section 26A, that is not inconsistent with HMRC's argument in this appeal. HMRC's entitlement to recover a VAT debt as shown on a return does not depend on issuing an assessment (*Infinity Distribution*).

413. It would be strange if a compliant taxpayer who had recorded in his VAT return a clawback of input tax pursuant to section 26A VATA should be in a worse position than a taxpayer who had failed to do so and was able to claim the benefit of the time limit on the raising of an assessment.

414. In our view so to hold would flout the evident legislative purpose behind section 26A and infringe the fundamental principle of neutrality.

415. We accordingly decide the section 26A point in favour of HMRC.

Disposition of the appeal

416. For the reasons given above we dismiss the appeal, upholding HMRC's decisions to deny Megantic the right to deduct input tax in accordance with the *Kittel* principle.

417. 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)" [52]which accompanies and forms part of this decision notice.

JOHN WALTERS QC
TRIBUNAL JUDGE

RELEASE DATE: 17 March 2015