[2019] UKFTT 176 (TC)

TC07026

Appeal number: TC/2013/03349

VAT – Value Added Tax – Invalid invoices – Regulations 14 and 29 of VAT Regulations 1995 – conformity with EU law – Principal VAT Directive - discretion to accept alternative evidence – reasonableness of discretion – the decision maker whose discretion is subject to scrutiny – denial of input tax for periods 06/09 & 09/09 – carbon credit trading – missing trader intra community fraud - Kittel – knowledge or means of knowledge of connection to fraudulent evasion of VAT – assessments for periods 06/09 & 09/09 under section 73 Value Added Tax Act 1994 ("VATA") – whether an assessment was made for period 06/09 as a matter of law – Aria Technology Ltd – whether assessments were made within time pursuant to section 73(6)(b) VATA – appeal allowed in part

FIRST-TIER TRIBUNAL
TAX CHAMBER

TOWER BRIDGE GP LIMITED **Appellant**

- and -

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

TRIBUNAL: JUDGE RUPERT JONES

Sitting in public at the Rolls Building, London on 6, 7, 8, 9, 12, 16, 19, 20, 21, 22 & 23 March 2018

Nicola Shaw QC and Michael Jones of Counsel, instructed by Pinsent Masons solicitors, for the Appellant

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Supplementary written submissions on behalf of the Appellant & HMRC made on 29 March, 9 July, 31 August, 21 November & 19 December 2018

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DECISION

Introduction

1. The Tribunal begins by thanking counsel and the representatives for both parties for their assistance before, throughout and after the hearing. It would not have been possible to decide an appeal such as this without their cooperation and professionalism. The Tribunal apologises for the length of time it has taken to release this decision, a draft of which was circulated for corrections on 11 February 2019.

The decisions under appeal

2. The Appellant, Tower Bridge GP Limited ("Tower Bridge"), appeals against the following decisions of Her Majesty's Revenue and Customs ("HMRC").

Denial of Input Tax

3. The first set of decisions under appeal are those of HMRC to deny the Appellant input tax in respect of VAT periods 06/09 and 09/09 in a decision dated 6 December 2012 ('the Decision') as varied by HMRC's review in a decision dated 12 April 2013 ('the Review Decision') and by an amendment to the Review Decision on 25 June 2013.

4. The Decision of 6 December 2012 was to refuse to grant the Appellant the right to deduct input VAT incurred on purchases of carbon credits in VAT periods 03/09, 06/09 and 09/09. HMRC denied the Appellant input tax totalling £36,330,792.25 (this included denials of £690,294.29 in respect of 03/09, £34,317,697.80 in respect of 06/09 and £1,322,800.16 in respect of 09/09).

5. The purchases of carbon credits were made by two members of the VAT group of which Tower Bridge is the representative, Cantor CO2e Limited ("CO2e") which arranged and undertook the relevant transactions, and Cantor Fitzgerald Europe Ltd ("CFE") which executed the relevant transactions and received and issued the relevant invoices.

6. CFE and CO2e will be referred to collectively as "CFE" unless the distinction between the two is of relevance. CFE may also be referred to as "the Appellant" unless the distinction becomes meaningful.

7. The first effect of the Review Decision was to uphold part of the Decision denying input tax on the basis that invoices to CFE from Stratex Alliance Ltd ("Stratex") were invalid. The second effect was to withdraw that part of the Decision which decided that input tax should be denied on invoices from other suppliers to CFE on the basis they were invalid VAT invoices.

8. The third effect of the Review Decision was to change the date at which HMRC contended that CFE first knew or should have known that the transactions upon which input tax was claimed were connected with the fraudulent evasion of VAT. The effective date for CFE's knowledge / means of knowledge was moved from 18 May 2009 to the later date of 8 June 2009 (with the exception of the decision in relation to Stratex invoices where it remained 18 May 2009).

9. The result of the Review Decision was no longer to deny input tax in respect of period 03/09 and reduce the amount of input tax disallowed from £36,330,792.25 to £7,126,810.14 (£5,804,009.98 in respect of 06/09 and £1,322,800.16 in respect of 09/09).

10. The transactions now subject to dispute took place between 8 June 2009 and 29 July 2009. Thus, the appeal against the denial of input tax only concerns the periods 06/09 and 09/09.

11. The Review Decision was amended in a further correction letter dated 25 June 2013 ('correction' or 'supplementary assessment') from HMRC notifying the Appellant of a correction increasing the total input tax disallowed to be £7,730,812.34 (£6,408,012.18 in respect of 06/09 and £1,322,800.16 in respect of 09/09). The letter also raised a consequential supplementary assessment for 06/09 of £604,002.20.

12. Therefore, the input tax said to have been incurred by CFE but denied by HMRC and remaining in dispute after the Review Decision and correction / supplementary assessment is £7,730,812.34. This figure is the sum now subject to appeal.

13. It comprises three elements:

i. £5,605,119.74 claimed on 17 invoices from Stratex in VAT period 06/09 but denied on the bases that (i) the invoices were invalid for VAT purposes and HMRC refused to exercise their discretion in CFE's favour to accept alternative evidence, and (ii) CFE knew, or should have known, that the transactions were connected with the fraudulent evasion of VAT;

ii. £798,892.24 claimed on invoices from GW Deals Ltd ("GWD") (1 invoice), AH Marketing and Distribution Ltd ("AHMD") (7 invoices), and Ayres t/a Mettec Ltd ("Ayres" or "Mettec") (1 invoice) in VAT period 06/09 but denied on the basis that CFE knew, or should have known, that the transactions were connected with the fraudulent evasion of VAT; and

iii. £1,322,800.16 claimed on 4 invoices from the supplier Westis Ltd ("Westis") in VAT period 09/09 but denied on the basis that CFE knew, or should have known, that the transactions were connected with the fraudulent evasion of VAT.

14. The total sum of input tax denied, £7,730,812.34, can be broken down by way of relevant dates and amounts in the following way:

(1) The Stratex transactions - A total of 17 transactions which took place between 18 May and 3 June 2009 between CO2e and Stratex Alliance Ltd producing input tax of £5,605,119.74.

(2) The AH Marketing and Distribution transactions - A total of 7 transactions which took place between 8 and 18 June 2009 between CO2e and AH Marketing and Distribution Ltd producing input tax of £675,488.54.

(3) The G W Deals Limited transactions - One transaction which took place on 8 June 2009 between CO2e and G W Deals Ltd producing input tax of £42,477.62.

(4) The Ayres Limited t/a Mettec transactions - One transaction which took place on 10 June 2009 between CO2e and Ayres Ltd (trading as Mettec) producing input tax of £84,926.28.

(5) The Westis transactions - A total of 4 transactions which took place on 28 and 29 July 2009 between CO2e and Westis Ltd producing input tax of £1,322,800.16.

VAT Recovery Assessments

15. The second set of decisions under appeal are HMRC's assessments against the Appellant to pay tax in respect of periods 06/09 and 09/09 in consequence of the denial of input tax in the Decision, the Review Decision and amendment to the Review Decision.

16. On 18 January 2013 HMRC notified the Appellant of a VAT recovery assessment in the sum of £2,013,094.00 plus interest in respect of the net VAT owing to HMRC for VAT periods 03/09 and 09/09 after the adjustment of the Appellant's VAT returns for those periods. This assessment was consequent upon the earlier decision of HMRC on 6 December 2012.

17. By the Review Decision on 12 April 2013, the denial of input tax for the period 03/09 was withdrawn because the Review Officer of HMRC decided that the Appellant had provided satisfactory alternative evidence to support deduction for that part of the input tax denial based on the fact the invoices were invalid. Thus, the assessment for £690,294.29 fell away.

18. The Review Decision upheld the denial of input tax for the period 09/09 of £1,322,800.16 on the basis of means of knowledge such that, of the assessment of £2,013,094 made on 18 January 2013, the assessment of £1,322,800.16 in respect of 09/09 remained in effect.

19. In respect of VAT period 06/09, it is in issue between the parties whether as a matter of fact and law HMRC have made any valid assessment and if so, whether it was made within the statutory time limits. This topic is dealt with below.

20. If HMRC have made an assessment for period 06/09, this was initially notified to the Appellant by way of a letter dated 3 January 2013. HMRC notified the Appellant that as a result of their decision of 6 December 2012 denying input tax of £34,317,697.80 for the period 06/09, the Appellant's VAT return for VAT period 06/09 was adjusted from a repayment claim of £4,742,232.30 to a payment due to HMRC of net tax of £29,575,465.50.

21. In HMRC's review letter of 12 April 2013, the total input tax denied for 06/09 was reduced to £5,804,009.98.

22. By a letter dated 25 June 2013 the total input tax disallowed for 06/09 was amended and increased to £6,408,012.18. In this letter HMRC notified the Appellant of a supplementary VAT recovery assessment in the sum of £604,002.20 which corrected two figures in the Review Decision ("the Supplementary Assessment").

23. By letter dated 29 July 2013 HMRC notified the Appellant in relation to period 06/09 that the letter dated 3 January 2013 was adjusted so that the Appellant's VAT return should be further amended so that the net tax due from the Appellant for the period should be reduced to £1,665,779.88.

24. The net result of this, if there is a valid assessment for 06/09, is that HMRC have made assessments for the recovery of VAT from the Appellant in the sums of £1,665,779.88 for 06/09 (of which £604,002.20 was issued explicitly as a supplementary assessment) and £1,322,800.16 for 09/09.

The issues in the appeal

25. The following issues were raised for determination by the Tribunal, not all of which appeared in the grounds of appeal. The Tribunal decides them in the following order.

26. The first issue ("First Issue") is whether HMRC was entitled to deny the Appellant the input VAT claimed on the Stratex invoices on the basis they were not valid VAT invoices in accordance with domestic law. HMRC decided the Stratex invoices were invalid, principally because they did not contain a VAT registration number ("VRN") as required by Regulation 14 of the VAT Regulations 1995 ("VATR"). The question is whether that decision is in conformity with EU law under the Principle VAT Directive (the EU law question).

27. The second issue ("Second Issue") is whether HMRC's decision to refuse to exercise their discretion in favour of the Appellant to allow the input VAT claimed on the Stratex invoices on the basis they were not valid VAT invoices was unreasonable. HMRC Officers, Mr Ball and Mr Birchfield, declined to exercise the discretion allowed to HMRC by regulation 29(2) of the VATR to accept alternative evidence of the VAT charge[1], consequently HMRC decided the Appellant was not entitled to recover the input tax. The question is the reasonableness of HMRC's exercise of its discretion to refuse to accept alternative evidence (the reasonableness challenge).

28. There is also a sub issue - the reasonableness of which decision is to be reviewed. Is it that of the original decision of Officer Ball or the review decision of Officer Birchfield?

29. The third issue ("Third Issue") is whether CFE knew, or in the alternative should have known, that its transactions in 06/09 and 09/09 in respect of which input tax has been denied were connected with the fraudulent evasion of VAT. It is not in dispute that the transactions were connected with the fraudulent evasion of VAT. The issue in dispute is whether the Appellant knew or should have known of this (knowledge or means of knowledge).

30. The fourth issue ("Fourth Issue") in the appeal is whether as a matter of law HMRC have made an assessment under section 73 of the Value Added Tax Act 1994 ("VATA") against the Appellant in respect of the period 06/09 (the validity of HMRC's assessment). HMRC submit that the assessment for this period was made as a consequence of the Decision of 6 December 2012 to deny input tax for the period and was calculated and notified in the VAT return adjustment letter of 3 January 2013.

31. The fifth issue ("Fifth Issue"), if there is a valid assessment as a matter of law, is whether each of HMRC's assessments for 06/09 and 09/09 were made in time or were time barred by virtue of sections 73(6)(b) of the VATA (the time bar issue). This involves determining whether each assessment was made within one year of HMRC Officer Ball being of the opinion that evidence of facts sufficient to raise the assessment had come to his knowledge.

The Evidence

32. The Tribunal received 52 lever arch files of evidence including witness statements and exhibits.

33. Witness statements were received from the following witnesses on behalf of the Appellant:

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[1] Officer Ball also denied the Appellant input tax in respect of invoices from Adduco Consulting Ltd, ADE International Ltd, Carbondesk Ltd, Northumberland Consultants Ltd and SVS Securities Ltd on the basis that they were invalid because they stated the VAT amount in Euros instead of sterling. This decision was reversed following the Review, as indicated above.

Witness	Date of statement(s)	Position (at the relevant time unless otherwise stated)
Laurence Rose	24/2/15	Chairman of CO2e
Mark Cooper	24/2/15, 19/5/17	General Counsel for Europe and BGC Group (including CFE and CO2e)
Wayne Buchan	23/2/15	Chief Risk Officer at the Cantor Fitzgerald Group ("CFG")
Tracey Ann Mills	24/2/15, 28/4/17	Head of Compliance at Cantor Fitzgerald (since 2011 only)
Martin Sharratt	24/2/15	Partner and Head of VAT at Smith & Williamson LLP, tax advisers and accountants
Steven Adcock	24/2/15	Operations Manager at CFG
Robert Snelling	28/4/17	Director of Legal (Europe and Asia) at Cantor Fitzgerald and BGC Partners

34. All of the witnesses gave oral evidence and were cross examined during the hearing other than Martin Sharratt and Steven Adcock whose statements were read as agreed.

35. Witness statements on behalf of HMRC were received from the following witnesses (all being employees or Officers of HMRC):

David Ball	22/12/14 (x3), 24/03/17,20/02/18	Original decision maker
Peter Birchfield	17/12/14	Review decision maker
Duncan Smith	26/11/14	
Gavin Stock	18/12/14 (x2)	
John Lyon	19/12/14	
Stewart McCaskell	19/12/14	
David McMaster	22/12/14	
Jasvinder Bhabra	23/12/14	
Steven Kenrick	23/12/14	
Roderick Stone	23/12/14	

36. The Tribunal only heard oral evidence from HMRC witnesses Officers David Ball and Peter Birchfield who were cross examined during the hearing. The statements of all other HMRC witnesses were read as agreed.

37. The Tribunal has considered all the evidence as lodged and served even when it has not been referred to within the body of this decision. Given the volume of evidence it is impossible to refer to it all, even in a lengthy decision such as this. That does not mean that the Tribunal has not given it due consideration.

38. The Tribunal heard oral evidence beginning on the second day of the hearing, on 7 March 2018, concluding on the tenth day, 21 March 2018.

39. Where the Tribunal has made no comment upon their evidence, it has found the witnesses' evidence to be reliable and credible and accepted it on the balance of probabilities.

Where it has found a witness's evidence to be unreliable or unreasonable the Tribunal makes findings that it rejects that evidence together with reasons in support.

40. The Tribunal has found all facts on the balance of probabilities, in particular indicating its reasons where there is a conflict in the evidence or where it finds a witness's evidence to be inconsistent, unbelievable or otherwise unsatisfactory.

The First Issue

41. The First Issue is whether HMRC's decision to deny CFE the input VAT claimed on the Stratex invoices on the basis they were not valid VAT invoices conformed with EU law. The Appellant submits that it has a directly effective right to deduct input tax because the Stratex invoices met the substantive conditions for the right to deduct under article 168 of the Principle VAT Directive even if they did not meet the formal conditions under article 226.

The Facts on the First Issue

42. For the purposes of deciding this issue it suffices to record that the 17 invoices provided by Stratex Alliance Ltd ("Stratex") for its supplies to CFE between 18 May 2009 and 3 June 2009 did not contain any VAT Registration Number (VRN), nor was Stratex registered for VAT. It is not in dispute that these transactions were connected with the fraudulent evasion of VAT.

43. The following was also not in dispute:

(a) CFE was at all material times a taxable person;

(b) the carbon credits were supplied to CFE and used for the purposes of its taxable business. The carbon credits supplied to CFE were to be used by CFE for the purposes of its own onward (taxable) transactions in carbon credits;

(c) The carbon credits in question were supplied to CFE by Stratex, which was also, given the volume and nature of its trades, a "taxable person" for the purposes of the Directive. Stratex was a taxable person (by virtue of the size of the transaction in issue); and

(d) VAT was due in respect of the supply by Stratex to CFE.

44. For further relevant factual findings bearing on the issue of whether the Stratex invoices were invalid as a matter of domestic or EU law please see paras 223-234 considered as part of the Second Issue below.

The Law on the First Issue

EU Law

45. The relevant European law is set out in the Principal VAT Directive, Directive 2006/112/EC, ("PVD").

46. Article 2 of the PVD provides, so far as material:

The following transactions shall be subject to VAT:
(a) the supply of goods for consideration within the territory of a Member State by a taxable person acting as such…

47. Article 14(1) of the PVD provides:

‘Supply of goods’ shall mean the transfer of the right to dispose of tangible property as owner.”

48. Article 167 of the PVD provides that:

A right of deduction shall arise at the time the deductible tax becomes chargeable.

49. Article 168(a) in so far as relevant provides:

In so far as the goods and services are used for the purposes of the taxed transactions of a taxable person, the taxable person shall be entitled, in the Member State in which he carries out these transactions, to deduct the following from the VAT which he is liable to pay:

(a) the VAT due or paid in that Member State in respect of supplies to him of goods or services, carried out or to be carried out by another taxable person;
…

50. Art.178(a) in so far as relevant provides:

In order to exercise the right of deduction, a taxable person must meet the following conditions:

(a) for the purposes of deductions pursuant to Article 168(a), in respect of the supply of goods or services, he must hold an invoice drawn up in accordance with Articles 220 to 236 and Articles 238, 239 and 240;
…

51. Article 179 of the PVD provides, in as far as is relevant:

The taxable person shall make the deduction by subtracting from the total amount of VAT due for a given tax period the total amount of VAT in respect of which, during the same period, the right of deduction has arisen and is exercised in accordance with Article 178.

52. Article 180 of the PVD provides, in as far as is relevant:

Member States may authorise a taxable person to make a deduction which he has not made in accordance with Articles 178 and 179.

53. Article 182 of the PVD provides:

Member States shall determine the conditions and detailed rules for applying Articles 180 and 181.

54. Article 226 of the PVD provides, in as far as is relevant:

Without prejudice to the particular provisions laid down in this Directive, only the following details are required for VAT purposes on invoices issued pursuant to Articles 220 and 221:
…
(3) the VAT identification number referred to in Article 214 under which the taxable person supplied the goods or services;
…
(5) the full name and address of the taxable person and of the customer;
(6) the quantity and nature of the goods supplied or the extent and nature of the services rendered;

(7) the date on which the supply of goods or services was made or completed or the date on which the payment on account referred to in points (4) and (5) of Article 220 was made, in so far as that date can be determined and differs from the date of issue of the invoice;
…
(9) the VAT rate applied;
(10) the VAT amount payable, except where a special arrangement is applied under which, in accordance with this Directive, such a detail is excluded;

55. Article 228 of the PVD provides, in as far as is relevant:

Member States in whose territory goods or services are supplied may allow some of the compulsory details to be omitted from documents or messages treated as invoices pursuant to Article 219.

UK Domestic Law

56. The relevant domestic law is set out in the Value Added Tax Act 1994 ("VATA") and the VAT Regulations 1995 ("VATR").

57. Section 4 VATA provides as follows:

(1) VAT shall be charged on any supply of goods or services made in the United Kingdom, where it is a taxable supply made by a taxable person in the course or furtherance of any business carried on by him.

(2) A taxable supply is a supply of goods or services made in the United Kingdom other than an exempt supply.

58. Section 24(1)(a) VATA, so far as is relevant, defines "input tax" in relation to a taxable person as:

VAT on the supply to him of any goods or services ...being (in each case) goods or services used or to be used for the purpose of any business carried on or to be carried on by him.

59. Section 24(6)(a) VATA provides that regulations may provide for VAT to be treated as input tax:

...only if and to the extent that the charge to VAT is evidenced and quantified by reference to such documents [or other information] as may be specified in the regulations or the Commissioners may direct either generally or in particular cases or classes of cases;

60. Section 25(2) VATA provides that a taxable person shall be:

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

61. Section 26 VATA, so far as is relevant, provides for input tax allowable under Section 25:

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

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

(a) taxable supplies;...

62. Regulation 29 of the VATR provides:

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

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

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

provided that where the Commissioners so direct, either generally or in relation to particular cases or classes of cases, a claimant shall hold, instead of the document or invoice (as the case may require) specified in sub-paragraph (a)…above, such other documentary evidence of the charge to VAT as the Commissioners may direct.

63. Regulation 13(2) of the VATR provides that the particulars of the VAT chargeable on a supply of goods shall be provided on a document containing the particulars prescribed in Regulation 14(1).

64. Regulation 14(1) of the VATR states, in as far as is relevant:

(1) Subject to paragraph (2) below and regulation 16 save as the Commissioners may otherwise allow, a registered person providing a VAT invoice in accordance with regulation 13 shall state thereon the following particulars—

…

(d) the name, address and registration number of the supplier,
(e) the name and address of the person to whom the goods or services are supplied,
[...]
(g) a description sufficient to identify the goods or services supplied,
(h) for each description, the quantity of the goods or the extent of the services, and the rate of VAT and the amount payable, excluding VAT, expressed in [any currency]
…
(l) the total amount of VAT chargeable, expressed in sterling,

…

65. In summary, the provisions of the PVD set out above are implemented into UK law by sections 24, 25 and 26 of VATA and regulations 14 and 29 of the VATR. More particularly:

(1) Section 24 VATA defines "input tax" in relation to a taxable person as, *inter alia*, VAT of the supply to him of any goods or services used or to be used for the purpose of any business carried on or to be carried on by him.

(2) Section 25 VATA sets out a taxable person's obligation to account for output tax and provides a right to deduct input tax.

(3) Section 26 VATA sets out the input tax allowable under s.25.

(4) Regulation 14 VATR details the particulars that a VAT invoice is to contain.

(5) Regulation 29 VATR governs claims for input tax. It implements the requirement that the taxable person making the claim hold a VAT invoice. It also provides (in reg.29(2)) that, in the event that the taxable person does not hold a VAT invoice, HMRC have a discretion to accept alternative evidence of the VAT charge.

66. HMRC's "Statement of Practice – VAT Strategy: Input Tax deduction without a valid VAT manual" (March 2007 edition) sets out HMRC's policy at the time of the Decision in relation to invalid VAT invoices.

The relevant case law

67. As regards HMRC's discretion under reg.29(2) of VATR, a taxpayer can appeal against a refusal by HMRC to accept alternative evidence but the scope of the appeal is limited to the question of whether the discretion had been properly exercised, for example by examining whether HMRC took into account some irrelevant matter or had disregarded something to which they should have given weight: see *CEC v Peachtree Enterprises Ltd* [1994] STC 747, at 751b-f; *Kohanzad v CEC* [1994] STC 967, at 969d-g). The burden is on the taxpayer to show that HMRC's decision was unreasonable in that sense (*Kohanzad*, at 969g).

68. The right to deduct input tax is an integral part of the VAT scheme and in principle may not be limited: see *Kittel v Belgium* (Joined cases C-439/04 and C-440/04) [2008] STC 1537, at [47]. The right itself has direct effect: see *BP Supergas Anonimos Etairia Geniki Emporiki-Viomichaniki kai Antiprossopeion v Greece* (Case C-62/93) [1995] STC 805, at [35]-[36].

Substantive and formal conditions

69. Further, as regards the requirements of the provisions of the PVD, the Directive governing input tax deduction, the CJEU has drawn a twofold distinction between (1) the *"substantive conditions"* which must be met in order for the right to arise, and (2) the *"formal conditions"* for the right of deduction to be exercised: see *Senatex GmbH v Finanzamt Hannover-Nord* (Case C-518/14) [2017] STC 205 ("*Senatex*").

70. The judgment of the CJEU in *Senatex* can be summarised as follows (see in particular [28] and [29]):

(1) The substantive conditions are those found in Art.168 of the Directive, and require that the person seeking deduction be a "taxable person"[2] within the meaning of the Directive and, secondly, that the goods or services relied on to give entitlement to the right of deduction have been supplied to that taxable person by another taxable person to be used by the first for the purposes of his own taxed output transactions: see ibid, at [28].

(2) The formal conditions, on the other hand, include those found in Art.178(a) of the Directive, namely the requirement to hold an invoice drawn up in accordance with Art.226 of the Directive: see ibid, at [29].

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[2] I.e. "any person who, independently, carries out in any place any economic activity, whatever the purpose or results of that activity": Art.9(1) of the Directive. Art.9(1) goes on to provide that: "Any activity of producers, traders or persons supplying services, including mining and agricultural activities and activities of the professions, shall be regarded as 'economic activity'. The exploitation of tangible or intangible property for the purposes of obtaining income therefrom on a continuing basis shall in particular be regarded as an economic activity".

(3) The fundamental principle of the neutrality of VAT requires deduction of input VAT to be allowed if the substantive requirements are satisfied, even if the taxable persons have failed to comply with some formal conditions: see ibid, at [38].

71. In its judgment the CJEU in *Senatex* concluded at [43]:

> Having regard to the above considerations, the answer to Questions 1 and 2 is that Article 167, Article 178(a), Article 179 and Article 226(3) of Directive 2006/112 must be interpreted as precluding national legislation, such as that at issue in the main proceedings, under which the correction of an invoice in relation to a detail which must be mentioned, namely the VAT identification number, does not have retroactive effect, so that the right to deduct VAT exercised on the basis of the corrected invoice relates not to the year in which the invoice was originally drawn up but to the year in which it was corrected.

72. At [34] of its judgment in *Senatex* the CJEU distinguished its earlier decision in *Petroma Transport SA v Belgium* (Case C-271/12) [2013] STC 1466. In *Petroma* the CJEU drew the distinction between the existence of the right to deduct which arises when the substantive requirements have been met and the need for the taxpayer to comply with the formal requirements before exercising that right. At [33] & [36] of that judgment the Court had stated:

> [33] The appellants in the main proceedings argue that the fact that the invoices do not contain certain particulars required by national legislation is not such as to call into question the exercise of the right to deduct VAT when the occurrence, nature and amount of the transactions have been subsequently demonstrated to the tax authority.
>
> …….
>
> [36] Consequently, the answer to the first question is that the provisions of the Sixth Directive must be interpreted as not precluding national legislation, such as that at issue in the main proceedings, under which the right to deduct VAT may be refused to taxable persons who are recipients of services and are in possession of invoices which are incomplete, even if those invoices are supplemented by the provision of information seeking to prove the occurrence, nature and amount of the transactions invoiced after such a refusal decision was adopted.

73. The Upper Tribunal in *Scandico v HMRC* [2018] STC 153 held that *Senatex*, and the other line of CJEU decisions relied on by the taxpayer, had no application to the situation that arose in that case, being where the national tax authority does not have sufficient information before it to decide whether the substantive requirements are satisfied (see *Scandico*, at [52]).

74. In *Scandico* the nature of the goods in issue (mobile phones) were such that the taxpayer could have obtained them from persons who were not "taxable persons" and who would not be "taxable persons" by virtue of supplying them; and, whilst the taxpayer had till receipts for the phones from the Apple store, those till receipts did not indicate that they had been sold by Apple to the taxpayer. Accordingly, HMRC did not consider that the substantive requirements had been met.

Zipvit in the Court of Appeal

75. In *Zipvit Ltd v HMRC* [2018] EWCA Civ 1515, handed down on 29 June 2018, the Court of Appeal considered the law in relation to invalid VAT invoices.

76. In *Zipvit* the appellant taxpayer made supplies of vitamins and minerals by mail order. Zipvit used the services of Royal Mail to despatch its mail orders and to distribute advertisements including one branded as Mailmedia. At the time when Royal Mail made the

relevant Mailmedia supplies to Zipvit they were considered to be exempt from VAT by Royal Mail, Zipvit and HMRC. The CJEU later confirmed that the supplies were standard rated for VAT and Zipvit made a claim for the input tax that it claimed to have incurred.

77. The second issue before the Court of Appeal in *Zipvit* was whether the absence of a valid VAT invoice showing that VAT was charged to Zipvit by Royal Mail, and giving details of the rate of tax and the amount charged, was fatal to Zipvit's claim to recover input tax. The Royal Mail invoices on which Zipvit sought to deduct the input tax did not comply with Article 226(9) and (10) of the PVD and their domestic equivalents.

78. At [48] of Henderson LJ's. leading judgment (with which Asplin, LJ. and Dame Gloster DBE agreed) the Judge recorded the principle deriving from *Bonik EOOD* that the right to deduct does not depend on showing that the input tax in question has been paid for or accounted for by the supplier as output tax to the revenue authorities. However, at [49] Henderson, LJ said:

"49. Nevertheless, this principle cannot be applied in isolation, and in particular does not in my judgment override the requirement for a person exercising the right of deduction to produce a VAT invoice evidencing payment of the relevant VAT by the supplier. I will return to this point in my consideration of the second main issue on the appeal."

79. Henderson, LJ. returned to the invalid invoice issue at [91], noting as he set out the relevant legislation that the language of Article 178(a) of the PVD was mandatory in that the taxable person must hold an invoice drawn up in accordance with the specified Articles in order to exercise the right to deduct.

80. Zipvit accepted that the Royal Mail invoices were defective because they did not show the details of the charge to VAT but submitted that these defects were later remedied when the necessary further information was later provided to HMRC [100]-[101]. Henderson, LJ. then considered the relevant EU case law on VAT invoices.

81. Having cited *Petroma* his Lordship dealt with Zipvit's reliance on Case C-516/14, *Barlis 06 – Investimentos Imobiliários e Turísticos SA v Autoridade Tributária e Aduaneira*, EU:C:2016:690 ("Barlis") in which the Portuguese authorities had refused the right to deduct on invoices that only stated the dates between which various legal services had been provided to and did not condescend to the details of those services. The CJEU held that the tax authorities could not refuse the right to deduct on the sole ground that an invoice did not satisfy the conditions in Article 226(6) and (7) of the PVD if they had available all the information to ascertain whether the substantive conditions for that right were satisfied.

82. Henderson, LJ. distinguished *Barlis* at [108] saying:

"108. At first sight, the decision in Barlis may appear to provide some support for Zipvit's case. But the facts could hardly have been more different. The only defects in the relevant invoices were that they did not provide a proper description of the legal services which had been supplied, and thus did not comply with Article 226(6) and (7) which required details of "the extent and nature of the services rendered" and the date on which the supply had been made or completed. There was no reason to doubt that the corresponding output tax had been paid by the lawyers, nor was there any doubt about its chargeable rate and amount. In the present case, by contrast, the original invoices issued by Royal Mail to Zipvit described the supplies as exempt, and Zipvit has been wholly unable to provide any evidence that tax on the supplies was paid or accounted for by Royal Mail when it became clear that the supplies were in fact standard rated. Zipvit is therefore claiming to be entitled to exercise its right to deduct

without being able to produce either a compliant VAT invoice, or supplementary information which shows that the conditions of Article 226(9) and (10) are satisfied, that is to say details of "the VAT rate applied" and "the VAT amount payable", coupled with evidence of payment of that amount by Royal Mail."

83. Henderson, LJ. then cited various parts of Advocate General Kokott's opinion in *Barlis*, as endorsed by the CJEU, before concluding at [112-119]:

'112. I have referred to these parts of the Advocate General's opinion because they were expressly endorsed by the Court in paragraph 27 of its judgment. I have already quoted that paragraph, but will repeat the critical sentence:

"As the Advocate General observes in points 30, 32 and 46 of her Opinion, the objective of the details which must be shown in an invoice is to allow the tax authorities to monitor payment of the tax due and, if appropriate, the existence of the right to deduct VAT."

Properly understood, therefore, the decision of the Court in Barlis appears to me to expose a fatal flaw in Zipvit's case. One of the main purposes of the mandatory requirement for a VAT invoice is to enable the taxing authorities to monitor payment by the supplier of the tax for which a deduction is sought, or as the Advocate General put it "to enable a check on whether the person issuing the invoice has paid the tax." Zipvit remains wholly unable to satisfy this condition, because the only invoices which it can supply show the complete opposite, namely that no tax was paid because the supplies were considered to be exempt. Nor can it be said that the position was remedied by the exiguous further information supplied with the letter of claim in September 2009. All this did was to show the VAT component of the original purchase prices, on the assumption that the supplies were taxable. It provided no evidence that a penny of that tax had been paid by Royal Mail to HMRC, and still less did it do so in the form of an invoice issued by Royal Mail.'

113. Mr Thomas argues that none of this matters, because Zipvit was entitled to exercise its right to deduct input tax referable to the supplies which it made to its own customers, on which it accounted for output tax in the usual way. To deny a deduction on the sole basis that Royal Mail cannot be shown to have paid tax on the relevant supplies which it made to Ziptvit is, he submits, to rely on a wholly irrelevant consideration, because it would offend the well-established principle that the right of deduction is unaffected by the question whether VAT due at an earlier stage in the chain of supply has been paid to the public purse. In my view, however, this objection misses the point. Exercise of the right to deduct is subject to a mandatory requirement to produce a VAT invoice, which must contain the specified particulars. Zipvit is unable to produce invoices which satisfy the requirements of Article 226(9) and (10), and it is also unable to produce any supplementary evidence showing payment of the relevant tax by Royal Mail. A necessary precondition for exercise of the right to deduct therefore remains unsatisfied.

114. I also fail to see how Zipvit could hope to circumvent this fundamental difficulty by arguing that the requirement for a compliant VAT invoice is one of form rather than substance, and by invoking the discretion which HMRC have to accept alternative evidence under regulation 29(2) of the 1995 Regulations. It is true that Barlis (at paragraphs 40 and 41), and a number of other cases which we were shown, consistently draw a distinction between the substantive conditions which must be met in order for the right to deduct VAT to arise, and the formal conditions for the exercise of that right. <u>But to describe a requirement as "formal" does not necessarily imply that compliance with it is optional, or that a failure to satisfy it is always capable of being excused. Cases like Barlis show that some of the requirements relating to invoices in Article 226 must be dispensed with, if the tax authorities are supplied with the information necessary to establish that the substantive requirements of the right to deduct are satisfied. But the Court was careful in Barlis to confine its discussion to the requirements in Article 226(6) and (7), and I do not think its reasoning can be extended to cover a failure to comply with the fundamental requirements relating to payment of the relevant tax in Article 226(9) and (10). Provision of an invoice which complies with those requirements is essential to the proper performance</u>

by HMRC of their monitoring functions in relation to VAT, and is needed as evidence that the supplier has duly paid or accounted for the tax to HMRC.

115. It needs to be remembered in this context that the amounts for which Zipvit is claiming a deduction have not been paid by Zipvit in response to a request by Royal Mail for payment once the taxable status of the supplies had been established. In that situation, Royal Mail would have rendered an invoice showing the VAT due, and would then have been liable to account for it to HMRC as output tax in the usual way. In those circumstances, there would have been no difficulty about Zipvit deducting the amount shown on the new invoice as input tax. All that has actually happened, however, is that Zipvit now wishes to treat the payments which it originally made to Royal Mail, on the common understanding that the supplies were exempt, as comprising an element of VAT, and to obtain a deduction for that element on the strength of nothing more than the original payment.

116. Even if it is open to Zipvit to recharacterise the original payment in this way (which at this stage of the argument must be assumed in Zipvit's favour), there would be an obvious detriment to HMRC and the public purse if Zipvit were able to obtain such a deduction without first showing that the tax in question had been paid by Royal Mail. The normal way of fulfilling that obligation is by production of a fully compliant VAT invoice. Since Zipvit is unable to produce such an invoice, I am unable to see any grounds upon which HMRC could properly conclude that Zipvit should nevertheless be allowed the deductions claimed, to the detriment of the general body of taxpayers. In effect, a retrospective recharacterisation of sums originally paid on the footing that the supplies in question were exempt would now yield an uncovenanted bonus to Zipvit, generated by nothing more than Zipvit's unilateral decision to treat the amounts originally paid as VAT-inclusive. It would, I think, be offensive to most people's sense of fiscal justice if a mechanical accounting exercise of this nature were permitted to generate a very substantial input tax credit, in circumstances where (for whatever reason) none of the tax in question has been paid by the supplier.

117. Whether the situation is described as one in which HMRC have no discretion, because the requirements of Article 226(9) and (10) cannot be dispensed with, or as one where there is in law a discretion but on the facts of the present case it can only be exercised in one way, does not seem to me to matter. The important point is that the inability of Zipvit to produce a compliant VAT invoice in support of its claim to deduct input tax is in my judgment fatal. This was rightly recognised by the two Tribunals below, although I would (with respect) not adopt their analysis of the position in terms of the absence of an "economic burden" on Zipvit. That way of looking at the matter seems to me misconceived, because Zipvit did bear the economic burden of paying the original purchase price for the supplies. The real issue, as I see it, is whether Zipvit can claim a deduction for VAT by treating the original price as VAT-inclusive, without producing evidence that the tax in question has been duly paid by the supplier.

118. My conclusion also makes it unnecessary to resolve the question, as a matter of EU law, whether the requirements of Article 226(9) and (10) should be treated as both formal and substantive, in the sense that compliance with them is essential to a valid exercise of the right to deduct input tax. There are passages in the interesting discussion by Advocate General Kokott in Biosafe which would lend support to such a conclusion, and it seems to me that the law may well develop in that direction. As Mr Thomas rightly points out, however, this reasoning was not adopted by the CJEU in its judgment, which was able to decide the case on grounds which did not require a re-examination of the existing law on the right to deduct. The same is true of the Court's decision in Volkswagen, which repeats the now familiar jurisprudence of the Court on the principles which govern the right to deduct: see the judgment at paragraphs 36 to 42. Put negatively, I am satisfied that no support can be found in either case for the proposition that a right to deduct may be recognised and given effect without production of a VAT invoice showing that the tax in question has been paid by the supplier.

119. Finally, I should make it clear that the need for a VAT invoice which complies with Article 226(9) and (10) is in my judgment fatal to Zipvit's claims, whether or not the new contractual material is admitted, and whether or not the original purchase price was agreed to be inclusive of VAT. It also

follows that it is unnecessary to make a reference to the CJEU on the first main issue, because all the claims must anyway fail on the second issue.'

[Emphasis Added]

Appellant's submissions on the First Issue

84. The Appellant's submission in relation to the First Issue is that its invoices met the substantive conditions contained in Art.168(a) of the Directive, and therefore it has a directly effective right to deduct the VAT on the supply to it by Stratex of the credits, notwithstanding the formal requirements of regulation 29(2) of the VAT Regulations 1995.

85. More particularly Ms Shaw QC submits:

(1) As regards the substantive requirements:

(a) The Appellant was at all material times a "taxable person" within the meaning of Art.9 of the Directive;

(b) The carbon credits in question were supplied to the Appellant by Stratex, which was also, given the volume and nature of its trades, a "taxable person" for the purposes of the Directive; and

(c) The carbon credits supplied to the Appellant were to be used by the Appellant for the purposes of its own onward (taxable) transactions in carbon credits.

(2) Accordingly, the substantive requirements of Art.168(a) were met. Indeed, this is, or should be, common ground;[3] it is no part of HMRC's case that those substantive requirements have not been met.

(3) Rather, HMRC's objection in respect of this issue is that the invoices held by the Appellant relating to Stratex did not contain a VRN and therefore did not comply with Art.226 of the Directive (reg.14 of the VAT Regulations 1995).

(4) But that requirement is part of the formal conditions for the exercise of the right to deduct; indeed, it was expressly identified as such by the CJEU in *Senatex* (at [29]). It, therefore, cannot lawfully be used to deny the Appellant's directly effective right.

86. Ms Shaw QC, on behalf of the Appellant, submitted that where it is shown that the substantive conditions of Art.168 of the PVD are met, the taxable person has a directly effective right to deduct the input tax in question, notwithstanding that he has not met the formal conditions found in Art. 178 and 226 of the Directive. Therefore, the absence of VRN on the Stratex invoices to CFE did not entitle HMRC to deny it its input tax. CFE was entitled to deduct.

87. She submitted that if there is a right to deduct engaged then it must be given effect in domestic law; and insofar as UK domestic law is inconsistent with it, the domestic law must be made to conform with the EU law position. If possible, this should be done by giving the legislation a conforming construction; but such a construction must not *"go against the grain"* of the legislation: see *Vodafone 2 v HMRC* (No. 2) [2010] Ch 77, at [37]-[38]. If it is not

[3] In paras 410 to 411 and 414 of his first witness statement, Officer Ball describes the purchases made by CFE from Stratex and also describes the onward sales made by CFE of the credits acquired from Stratex. Officer Birchfield in his letter of 12 April 2013 also appears to accept, having been given an explanation and sample evidence of how the settlement process worked, that the Appellant/CO2e paid for all the supplies made to it: see exhibits PB4 and PB5.

possible to give the legislation a conforming construction then the offending provision must be disapplied: ibid, at [26].

88. Ms Shaw QC submitted that regulation 29(2) of the UK's VAT Regulations 1995 is inconsistent with that right insofar as it requires the person claiming deduction of input tax to hold a VAT invoice containing the particulars listed in reg.14 in circumstances where it can be demonstrated that the substantive conditions for the deduction of input tax are met; and although, as already noted, regulation 29(2) does give HMRC a discretion to adopt an alternative course, it is submitted that a directly effective right, if it is to be effective, must be available as of right and not as a matter of administrative discretion: see the principle stated in *Fleming (trading as Bodycraft) v HMRC* [2008] 1 WLR 195, at [61]. Accordingly, the requirement in reg.29(2) simply falls to be disapplied.

89. She submitted that the Appellant has demonstrated that the substantive conditions for the deduction of tax - that is to say, the requirements of Article 168 of the Directive - are met in respect of the Stratex transactions because it is not in dispute that:

(1) the Appellant was at all material times a taxable person;

(2) the carbon credits were supplied to the Appellant and used for the purposes of its taxable business;

(3) Stratex was a taxable person (by virtue of the size of the transaction in issue); and

(4) VAT was due in respect of the supply by Stratex to the Appellant.

90. Moreover, HMRC not only had the means of establishing that the substantive conditions for input tax deduction had been met in respect of the Stratex transactions but had in fact concluded that to be the case in advance of Officer Ball's decision letter being issued on 6 December 2012.

91. She therefore submitted that the Appellant had a directly effective right to deduct the input tax payable on the Stratex transactions notwithstanding the fact that it did not have a valid invoice by virtue of the fact that the invoices did not contain a VRN.

92. The position of the Appellant was therefore said to be materially indistinguishable from the position of the taxpayer in *Senatex*. As the CJEU explained, the fundamental principle of the neutrality of VAT requires deduction of input VAT to be allowed if the substantive requirements are satisfied, even if the taxable person has failed to comply with some formal conditions.

93. Ms Shaw QC submitted, and as the CJEU has explicitly held, holding an invoice showing the supplier's VRN is a formal condition, Per art.226(3) of the Directive, not a substantive condition, of the right to deduct VAT: see *Senatex*, at [38]. It follows that a taxpayer in the position of Senatex has a (directly effective) right to deduction notwithstanding the absence of a VRN from the VAT invoice.

94. Moreover, she submitted that it was clear from the Court's judgment that the fact that the supplier subsequently issued a valid VAT invoice to *Senatex* was not material to the Court's reasoning.

95. As regards the principles of EU law relied on by the Appellant, and in particular the distinction drawn by the CJEU between (1) the *"substantive conditions"* which must be met in order for the right to deduct input tax to arise, and (2) the *"formal conditions"* for the right of deduction to be exercised, she submitted that HMRC had misapplied the law. More particularly Ms Shaw QC submitted:

96. HMRC relied on the decision of the Upper Tribunal in *Scandico v HMRC* [2018] STC 153 to rebut the Appellant's case on that issue, but that reliance was misplaced.

97. First, the UT in *Scandico* did not, and could not, suggest that the distinction and principles laid down by the CJEU in *Senatex* were wrong; rather it held that *Senatex*, and the other line of CJEU decisions relied on by the taxpayer, had no application to the situation that arose in that case, being where the national tax authority does not have sufficient information before it to decide whether the substantive requirements are satisfied (see *Scandico*, at [52]).

98. In *Scandico* the nature of the goods in issue (mobile phones) were such that the taxpayer could have obtained them from persons who were not "taxable persons" and who would not be "taxable persons" by virtue of supplying them; and, whilst the taxpayer had till receipts for the phones from the Apple store, those till receipts did not indicate that they had been sold by Apple to the taxpayer. Accordingly, HMRC did not consider that the substantive requirements had been met.

99. In the present appeal, by contrast, those requirements were clearly met for the invoices. Moreover, HMRC had sufficient information to decide that they were met, and indeed they do not dispute that they were.

100. Further, Ms Shaw QC submitted, that *Scandico* did not hold anything even approximating a VAT invoice, whereas in *Senatex*, and in this case, the taxpayer obtained an invoice which was lacking one formality, namely a VRN. The CJEU in *Senatex* was clear that such a formality could not be used to deny the right to deduct where the substantive conditions are met.

101. Indeed, Ms Shaw QC submitted that the distinction drawn and the principles set out by the CJEU in *Senatex* could not be clearer. They can safely be taken to mean what they say and represent the latest word on the point.

102. Moreover, it is important to be precise about the EU law regarding a tax authority's discretion.

103. The relevance of a VAT invoice is that it essentially creates a rebuttable presumption that the taxpayer has satisfied all the substantive requirements for deduction.

104. She submitted that Article 180 of the Directive is then permissive: it allows member states to authorise a taxable person to make a deduction otherwise than in accordance with the formal requirements, including where the taxpayer does not hold a valid invoice.

105. What Article 180 does not do, as HMRC seem to suggest, is give tax authorities a discretion as to the taxpayer's right to deduct, regardless of whether he has satisfied the substantive requirements.

106. In other words, Ms Shaw QC submitted, Article 180 permits member states to allow deduction notwithstanding a lack of compliance with the formal requirements; it does not give

them a discretion to deny deduction where the substantive conditions are met. Cases such as *Senatex* make this clear.

Appellant's reply to HMRC's post hearing submissions

107. HMRC filed post-hearing submissions on 9 July 2018 relying upon the subsequent judgment of the Court of Appeal in *Zipvit Ltd v HMRC* as set out above. The Tribunal gave permission for these to be considered with the Appellant having an opportunity to file submissions in response.

108. The Appellant filed post hearing submissions on 31 August 2018 in which it observed that HMRC had now argued that there was a further invalidity in that the Stratex invoices failed to name CFE as a customer.

109. Ms Shaw QC submitted that this point is not one that was taken by HMRC in (1) their original decision (dated 6 December 2012), (2) their statutory review (dated 12 April 2013), (3) their Statement of Case (dated 18 December 2013) or (4) their "Opening Submissions" (dated 19 February 2018); indeed, in closing, HMRC's counsel accepted in an exchange with the Tribunal that an absence of CFE's name on the Stratex's invoices was a matter neither *"pleaded* [nor] *relied upon"* by HMRC. It was therefore surprising that HMRC were seeking to run this argument after the trial has finished and without seeking the permission of the Tribunal.

110. Ms Shaw QC submitted that it was far too late for HMRC to introduce another ground of challenge. Not only had the trial concluded in March 2018, HMRC having had ample time to decide on the challenges they wished to mount, but HMRC expressly disavowed reliance on the point they now seek to raise, as shown by the exchange highlighted in the previous paragraph. Should HMRC seek permission, it was respectfully submitted that it should be refused.

111. Further, she submitted that HMRC's point was not a good one, perhaps explaining why it formed no part of HMRC's decisions, their Statement of Case or their case at trial. Whilst the term "Cantor Fitzgerald Europe" does not appear on the Stratex invoices, the entity is identified on the invoice as *"CANT"* under the heading *"Client ID"*. It is therefore identified as the customer, albeit in abbreviated form.

112. Furthermore, the requirement in question is a formal requirement. As had already been submitted, the body of CJEU cases of which *Senatex* forms part shows that deduction of input VAT must be allowed if the substantive requirements for deduction are satisfied, even if the taxable person has failed to comply with some formal conditions. Accordingly, even if HMRC were permitted now to raise the argument, and if it is found that the argument has merit in principle, it was submitted that EU law precludes their challenge for the reasons outlined above.

Appellant's submissions on the application of Zipvit

113. Ms Shaw QC made submissions on the application of the judgment of the Court of Appeal in *Zipvit.* She submitted that the Court of Appeal had acknowledged, as it had to, the line of CJEU authority in which *Senatex* sits and the consistent distinction drawn in those cases between the substantive and formal conditions to the right to deduct: see [114] of CA judgment.

114. She submitted that the Court of Appeal did not examine that line of authority, however. Rather it focussed in particular on the CJEU's decision in *Barlis 06-Investimentos Imobiliários e Turísticos SA v Autoridade Tributária e Aduaneira* (Case C-516/14) EU:C:2016:690 ("*Barlis*"), on which the appellant in *Zipvit* placed considerable reliance.

115. The Court of Appeal recorded the material parts of the CJEU's judgment in *Barlis*, including (at [106] of its decision) the following paragraphs:

42. The Court has held that the fundamental principle of the neutrality of VAT requires deduction of input VAT to be allowed if the substantive requirements are satisfied, even if the taxable persons have failed to comply with some formal conditions. Consequently, where the tax authorities have the information necessary to establish that the substantive requirements have been satisfied, they cannot, in relation to the right of the taxable person to deduct that tax, impose additional conditions which may have the effect of rendering that right ineffective for practical purposes …

43. It follows that the tax authorities cannot refuse the right to deduct VAT on the sole ground that an invoice does not satisfy the conditions required by Article 226(6) and (7) of [the Directive] if they have available all the information to ascertain whether the substantive conditions for that right are satisfied.

44. In this respect, the authorities cannot restrict themselves to examining the invoice itself. They must also take account of the additional information provided by the taxable person. That conclusion is confirmed by Article 219 of [the Directive], which treats as an invoice any document or message that amends and refers specifically and unambiguously to the initial invoice.

116. She submitted that the Court of Appeal did not question what was said by the CJEU in that passage, the contents of which support the submissions already made by the Appellant on this issue. It instead distinguished *Barlis* from the facts of Zipvit's case.

117. More particularly Ms Shaw QC submitted as follows.

118. The circumstances in *Zipvit* were highly unusual. The taxpayer had received supplies of "individually negotiated" postal services from Royal Mail. Those services had, pursuant to the relevant provision of the VATA extant at the time of the supplies, been treated by Royal Mail as VAT exempt, and invoiced to Zipvit as such.

119. After the supplies had been made the CJEU decided in another case that the UK's exemption for postal services was unlawful to the extent that it exempted supplies of "individually negotiated" postal services. As a result, the supplies of postal services by Royal Mail to Zipvit should properly have been treated as standard rated. However, Royal Mail did not recover any additional amount from Zipvit in respect of VAT on those supplies.

120. Zipvit thereafter sought to deduct input tax in respect of the supplies that had been made by Royal Mail. Given the circumstances described above, the invoices that had been issued by Royal Mail did not show either (a) the VAT rate applied (*per* art.226(9)) or (b) the VAT amount payable (*per* art.226(10)), for the simple reason that, at the time of issue, the supply had been treated by everyone as VAT exempt.

121. The Court of Appeal considered that there was a material difference between an invoice which failed to show the particulars required by art.226(9) and (10) and one which failed to show those required by art.226(6) and (7), those being the elements lacking on the facts of *Barlis*. Art.226(6) requires "the quantity and nature of the goods supplied or the extent and

nature of the services rendered"; and art.226(7) "the date on which the supply of goods or services was made or completed".

122. In this regard the Court of Appeal stated (at [114] of its judgment):

'Cases like Barlis show that some of the requirements relating to invoices in art 226 must be dispensed with, if the tax authorities are supplied with the information necessary to establish that the substantive requirements of the right to deduct are satisfied. But the Court was careful in Barlis to confine its discussion to the requirements in art 6 226(6) and (7), and I do not think its reasoning can be extended to cover a failure to comply with the fundamental requirements relating to payment of the relevant tax in art 226(9) and (10). Provision of an invoice which complies with those requirements is essential to the proper performance by HMRC of their monitoring functions in relation to VAT, and is needed as evidence that the supplier has duly paid or accounted for the tax to HMRC.'

123. The Court of Appeal thus distinguished Zipvit's case from *"cases like* Barlis*"*, where the CJEU had expressly held that the particular requirement that was lacking from the invoice in question could be dispensed with, and held, in the absence of any CJEU authority to the contrary, that the requirements in art.226(9) and (10) could not be treated in the same way.

124. In so holding, as the extract set out above shows, Ms Shaw QC submitted that the Court of Appeal in *Zipvit* expressly endorsed the proposition embodied in the line of CJEU authority relied on by the Appellant in the instant case, namely that "*some of the requirements relating to invoices in art 226 must be dispensed with, if the tax authorities are supplied with the information necessary to establish that the substantive requirements of the right to deduct are satisfied*".

125. Furthermore, she submitted that, had the invoices held by Zipvit been lacking the particulars required by art.226(6) and (7), the Court of Appeal would have simply applied the principle in *Barlis*. The difficulty facing Zipvit was that it could not point to any authority to support the contention that the requirements in art.226(9) and (10) could be treated in the same way.

126. Ms Shaw QC submitted that the position in the instant case is different. *Senatex* was specifically concerned with the requirement in art.226(3) for an invoice to show the supplier's VRN. It is clear authority that that requirement, like those in art.226(6) and (7), must be dispensed with if the tax authorities are supplied with the information necessary to establish that the substantive requirements of the right to deduct are satisfied. Likewise, as regards the requirement to identify the customer (art.226(5)), the CJEU has confirmed that this requirement is of a similar nature: see *Kopalnia Odkrywkowa Polski Trawertyn P Granatowicz, M Wąsiewicz, spółka jawna v Dyrektor Izby Skarbowej w Poznaniu* (Case C-280/10) [2012] STC 1085 ("*Kopalnia*"), at [40]-[43].

127. Put shortly, therefore, *Zipvit* was concerned with whether the particulars required by art.226(9) and (10) are of the dispensable type. Save to confirm and endorse the core proposition advanced by the Appellant (as submitted above), it had no relevant application in the present case because it is common ground that the Stratex invoices contained those particulars.

Appellant's reply to HMRC's post hearing submissions

128. The following further points were made on behalf of the Appellant in reply to the post-hearing submissions advanced by HMRC in relation to *Zipvit*.

129. First, HMRC contend, in their application, that *Zipvit* is authority for the proposition that:

"[w]hether a taxable person in possession of an invalid VAT invoice can provide any evidence that the supplier of that invoice has paid any of the VAT on that invoice to HMRC is relevant to the question of whether the conditions for the right to deduct to arise are met"

130. Ms Shaw QC submitted on behalf of the Appellant that HMRC's submissions were based on a misreading of the decision. More particularly:

131. She submitted that paragraphs [112] and [113] of the judgment in *Zipvit*, to which HMRC refer in support of their contention, were aimed specifically at the particular circumstances of Zipvit's case, namely that it held invoices which did not show either (a) the VAT rate applied or (b) the VAT amount payable. The question of whether Zipvit could provide any evidence that Royal Mail had paid VAT in respect of its supplies to the former was relevant to the question of whether Zipvit had a right to deduct notwithstanding that it did not hold invoices which contained those particulars.

132. Importantly, and contrary to the suggestion implicit in HMRC's contention, the Court of Appeal did not conclude that a taxpayer must demonstrate that its supplier has paid the VAT in question to the authorities before it can deduct it. In fact, the Court of Appeal did not question the principle that the right of deduction is unaffected by the question of whether VAT due at an earlier stage in the chain of supply has been paid to the public purse, describing it as *"well-established"*: see [113]. The point being made by the Court was instead that that principle did not, in its view, render the requirements in art.226(9) and (10) dispensable on the facts of Zipvit's case.

133. Similarly, the observations of the Court of Appeal about the obvious detriment to the public purse if deduction were allowed without first showing that the tax in question has been paid by the supplier were comments aimed, in terms, specifically at Zipvit and the circumstances of its case: see [116]. It was not, and not intended to be, a general statement of the law.

134. Ms Shaw QC submitted that the same is true of the Court's comment in [116] about Zipvit's claim offending *"most people's sense of fiscal justice"*. This was clearly also aimed specifically at Zipvit and the particular exercise it was attempting, hence the reference in the passage in question to *"a mechanical accounting exercise of* ***this*** *nature"* (emphasis added). The exercise in question being the retrospective re-characterisation by Zipvit of sums originally paid on the footing that the relevant supplies were exempt, with that re-characterisation being based on nothing more than Zipvit's unilateral decision to treat the amounts originally paid as VAT-inclusive.

135. In this connection it was material to note the observation of the Court of Appeal at [115] that:

'It needs to be remembered in this context that the amounts for which Zipvit is claiming a deduction have not been paid by Zipvit in response to a request by Royal Mail for payment once the taxable status of the supplies had been established. In that situation, Royal Mail would have rendered an invoice showing the VAT due, and would then have been liable to account for it to HMRC as output tax in the usual way. In those circumstances, there would have been no difficulty about Zipvit deducting the amount shown on the new invoice as input tax. All that has actually happened, however, is that Zipvit now wishes to treat the payments which it originally made to Royal Mail, on the common understanding

that the supplies were exempt, as comprising an element of VAT, and to obtain a deduction for that element on the strength of nothing more than the original payment.'

136. Ms Shaw QC submitted that it was clear from this that the Court did not consider that there is any separate requirement for the taxpayer to show that its supplier has in fact handed the relevant VAT over to HMRC. The sentence beginning *"In that situation…"* shows that the Court of Appeal considered it sufficient that the invoice from the supplier shows that VAT is due, with the result that the supplier is liable to pay the same to HMRC (by dint of para.5, Schedule 11, VATA). Paragraph 5 of Schedule 11 of VATA provides that where an invoice shows a supply as taking place with VAT chargeable on it, there shall be recoverable from the person who issued the invoice an amount equal to that which is shown on the invoice as VAT, regardless of whether: (a) the supply shown on the invoice actually took place, (b) the amount shown as VAT was chargeable on the supply, or (c) the person issuing the invoice is a taxable person.

137. Secondly, HMRC contended that a given particular of a VAT invoice is *"fundamental"*, and thus indispensable, if it is *"necessary for the taxing authority to monitor payment by the supplier of the tax in question"*. They then seek to build on that proposition and argue that if that "fundamental" element is missing then a taxpayer can only obtain a deduction of the VAT in question if it can show that the supplier has in fact paid the VAT due on the invoice.

138. Ms Shaw QC submitted that both parts of HMRC's submission were incorrect.

139. The flaw in the second part has already been addressed in her submissions above.

140. As to the first part, she submitted that HMRC offered no authority to support their submission, and indeed there is none. In fact, it is contradicted by the jurisprudence of the CJEU.

141. Ms Shaw QC submitted that as the CJEU observed in *Barlis* (at [27]), the objective of the details which, under Article 226 of the Directive, must be shown in an invoice is to allow the tax authorities to monitor payment of the tax due and, if appropriate, the existence of the right to deduct VAT. Nevertheless, it is also clear from cases like *Barlis* that a right to deduct will arise notwithstanding that the taxpayer holds an invoice which lacks some of those details.

142. She submitted that the case law of the CJEU therefore shows that a requirement of a VAT invoice may be indispensable notwithstanding that the particular is necessary to enable the tax authority to monitor payment by the supplier.

143. She therefore submitted that the foundation of HMRC's submission was unsound.

144. Thirdly, so far as concerns HMRC's discretion under regulation 29(2) VATR, the existence of a directly effective right to deduct means that the issue of that discretion does not arise.

145. Where the issue does arise, the position is not as stated by HMRC where they submitted:

'In terms of the exercise of HMRC's discretion to allow an input tax deduction in the absence of a valid VAT invoice and where there is no evidence that the supplier has paid the output VAT charged, it is now tolerably clear from *Zipvit* at [116] that there will no grounds upon which HMRC could properly conclude that the such deduction could be permitted.'

146. Ms Shaw QC, for the Appellant, submitted this was unsupportable. She maintained all the submissions made on this issue which will be considered as the Second Issue about the nature and scope of HMRC's discretion. As will be addressed, HMRC's discretion is to accept alternative evidence that the substantive requirements, or at least that part related to the input VAT charge, are met.

147. She submitted that nothing in *Zipvit* calls those submissions into question. The "*real issue"* as regards discretion in that case, according to the Court of Appeal (at [117]), was that Zipvit was seeking to obtain an *"uncovenanted bonus"* by unilaterally treating the original price it paid to Royal Mail as VAT-inclusive in circumstances where (a) this was done by Zipvit years after the supplies had been made; (b) everyone, including Zipvit, had originally considered the supplies to be VAT exempt at the time they were made and invoiced, and (c) there was no evidence that Royal Mail had also sought to treat the supplies as taxable or that it was accountable to HMRC for the VAT in question.

148. She submitted that what Zipvit was seeking to deduct was an entirely notional amount of VAT that would never be due or paid because the supplies in question had been treated as exempt and there was no intention or possibility that that treatment would be reversed. This is emphasised by the Court of Appeal in [115] and [116], where the Court refers to the *"obvious detriment"* to HMRC of a mismatch in the treatment of the supplies for the purposes of input tax and output tax.

149. It was in those circumstances that the Court of Appeal considered that there were no grounds upon which HMRC could properly conclude that Zipvit should be allowed the deductions claimed. But those circumstances were highly unusual, if not unique. They have no parallel in the present case.

150. Moreover, Ms Shaw QC submitted that as regards HMRC's argument that a taxpayer must "*evidence that the supplier has paid the output VAT charged*", it is important to pay close attention to what the Court of Appeal actually said about that. Specifically, at [115], the Court said:

> 'Even if it is open to Zipvit to recharacterise the original payment in this way (which at this stage of the argument must be assumed in Zipvit's favour), there would be an obvious detriment to HMRC and the public purse if Zipvit were able to obtain such a deduction without first showing that the tax in question had been paid by Royal Mail. The normal way of fulfilling that obligation is by production of a fully compliant VAT invoice. Since Zipvit is unable to produce such an invoice, I am unable to see any grounds upon which HMRC could properly conclude that Zipvit should nevertheless be allowed the deductions claimed, to the detriment of the general body of taxpayers.'

151. She submitted that this extract demonstrated that the *"obligation"* to show that the tax in question has been paid by the supplier does not have the literal meaning for which HMRC contend. That obligation can be fulfilled by production of a VAT invoice, and yet neither the production of such an invoice, nor the fact that VAT is shown as having been charged at a given rate and in a given sum on it evidences, in any way, that the supplier has actually paid the VAT over to HMRC.

152. Ms Shaw QC submitted that it is clear, therefore, that the *"obligation"* referred to by the Court of Appeal does not extend to proving that the tax has in fact been paid. Rather, it will suffice to show that the supplier was at least liable to account for the VAT to HMRC by virtue of having shown VAT as due on an invoice (see para.5, Schedule 11, VATA, referred to above).

153. Whilst Zipvit could not show that, because the invoices from the Royal Mail did not show any VAT chargeable, the Appellant indisputably can. Stratex rendered invoices showing the VAT due, and was then liable to account for it to HMRC as output tax in the usual way.

154. Ms Shaw QC submitted that the question of whether it can be shown that the supplier has paid the VAT in question is an irrelevant factor given that the discretion given to HMRC is expressly confined to considering the adequacy of alternative documentary evidence of the charge to VAT in respect of which deduction is claimed. But if and insofar as the Appellant needs to *"evidence that the supplier has paid the output VAT charged"*, it has done so according to *Zipvit*.

Conclusion

155. For all those reasons, she submitted on behalf of the Appellant in summary that:

156. *Zipvit* contains an endorsement of the principles already advanced by the Appellant as having been established at CJEU level.

157. *Zipvit* also shows that where the CJEU has specifically held that a given invoice requirement must be dispensed with if the substantive conditions have been shown to have been met then that guidance is to be respected and applied. *Senatex* is one such case, as is *Kopalnia*.

158. Contrary to HMRC's latest contentions (many of which are without foundation), *Zipvit*, therefore, provides further support to the Appellant's case, rather than HMRC's.

159. Besides that, the *Zipvit* decision does not take the issues in the present appeal much further. That is because the ratio of the case is actually a fairly narrow one, namely that the requirements in art.226(9) and (10) are not dispensable. That is nothing to the point in the present appeal, however, since it is common ground that the Stratex invoices met those requirements.

HMRC's submissions on the First Issue

160. Mr Puzey of counsel, on behalf of HMRC, submitted that HMRC could, as a matter of law, deny the Appellant its right to deduct input tax when it has met the substantive conditions to exercise that right but not all of the formal conditions. He originally relied heavily upon the Upper Tribunal's decision in *Scandico*.

161. He submitted that the taxpayer in *Scandico* sought to persuade the Upper Tribunal of the same argument at [45]. The Upper Tribunal concluded that:

i. In EU and domestic law where a taxpayer cannot produce a VAT invoice to support its claim to deduct input tax, the tax authority has a discretion whether to accept alternative evidence as satisfying it that a taxable supply has taken place entitling the taxpayer to the credit [52];

ii. That discretion is clearly contemplated by the PVD and Invoicing Directive [53];

iii. The case of *Petroma Transport SA and others v Belgium* (C-271/12) confirms the distinction that the CJEU has always drawn between the existence of the right to deduct which arises when the substantive requirements have been met and the need for the taxpayer to comply with the formal requirements before exercising that right; and

iv. The case of *Senatex*, was not relevant to the issue.

162. Mr Puzey submitted on behalf of HMRC that Article 180 of the PVD affords Member States a discretion as to authorising a taxable person to make a deduction when he does not hold a valid VAT invoice.

163. Mr Puzey submitted that it should be recalled that the Stratex invoices did not even name CFE as the customer, did not bear any VRN and that Stratex was unregistered for VAT and only entered into the transactions for the purposes of fraud.

164. He submitted that the effect of the Appellant's arguments is that HMRC's Statement of Practice on the deduction of input tax without a valid VAT invoice is completely wrong; that even absent a valid VAT invoice, where the invoice did not name the customer, where the supplier has never been registered for VAT, where the invoice charged VAT nonetheless and did not bear a VRN and the supply has been made for the purposes of fraud, HMRC has no discretion to refuse the Appellant the right to deduct input VAT.

165. Mr Puzey submitted that there is no such principle. The CJEU case law does not provide such a principle. The closest one gets is to a case not put forward by the Appellant: *Mahageben v Nemzeti* (Taxation) [2012] EUECJ C-80/11 ("*Mahageben*"). In *Mahageben*, the CJEU dealt with two similar cases: *Mahageben* and *David*.

166. In *Mahageben's* case the company was in receipt of sixteen invoices from a supplier, none of which contained any defect that would render them invalid. The tax authority concluded that the supplier did not have the capacity to supply the acacia logs said to have been supplied on the invoices.

167. In *David's* case, the taxpayer was in receipt of invoices from a supplier, again, none of which contained any defect that would render them invalid. The tax authority concluded that the sub-contractor who had invoiced *David* did not take place.

168. The CJEU set out at [36], that the essential question referred to it was:

"…whether Articles 167, 168(a), 178(a), 220(1) and 226 of Directive 2006/112 must be interpreted as precluding a national practice whereby the tax authority refuses a taxable person the right to deduct from the VAT which he is liable to pay the VAT due or paid in respect of services supplied to him on the ground that the issuer of the invoice relating to those services, or one of his suppliers, acted improperly, without that authority establishing that the taxable person concerned was aware of that improper conduct or colluded in that conduct himself."

169. At [44] the CJEU specifically set out that the invoicing requirements had been complied with:

"44 Moreover, it is apparent from the order for reference that the questions referred are based on the premises, first, that the transaction relied on as a basis for the right to deduct was carried out, as is to be inferred from the corresponding invoice, and, second, that that invoice includes all the information required by Directive 2006/112, with the result that the substantive and formal conditions provided for by that directive for the creation and exercise of the right to deduct are fulfilled. It is necessary to point out, in particular, that the order for reference does not indicate that the applicant in the main proceedings himself acted unlawfully by, for instance, filing false returns or issuing improper invoices."

170. The CJEU then said of such circumstances:

"45. In those circumstances, a taxable person can be refused the benefit of the right to deduct only on the basis of the case-law resulting from paragraphs 56 to 61 of Kittel and Recolta Recycling, according to which it must be established, on the basis of objective factors, that the taxable person to whom were supplied the goods or services which served as the basis on which to substantiate the right to deduct, knew, or ought to have known, that that transaction was connected with fraud previously committed by the supplier or another trader at an earlier stage in the transaction."

171. Mr Puzey submitted that what the CJEU was astute not to rule out, was a circumstance where the supplier was not registered for VAT, charged VAT on an invoice without a VRN and did so as part of a fraud. That, he submitted, is the position as regards the Stratex invoices.

172. The CJEU picked up the distinction at [51-52], again, saying at [52]:

"52 In that regard, it is apparent from the order for reference and, in particular, the first question, that the questions referred in Case C-80/11 are, like those referred in Case C-142/11, based on the premise that the substantive and formal conditions provided for by Directive 2006/112 for the exercise of the right to deduct are fulfilled, in particular the condition which requires the taxable person to be in possession of an invoice which confirms that the goods were actually supplied and which complies with the requirements of that directive. Accordingly, in the light of the response given in paragraph 50 of the present judgment, which also applies in the case of the supply of goods, the right to deduct can be refused only where it is established, on the basis of objective evidence, that the taxable person concerned knew, or ought to have known, that the transaction relied on as a basis for the right to deduct was connected with fraud committed by the issuer of the invoice or by another trader acting earlier in the chain of supply."

173. At [60-61] the CJEU said:

"60. It is true that, when there are indications pointing to an infringement or fraud, a reasonable trader could, depending on the circumstances of the case, be obliged to make enquiries about another trader from whom he intends to purchase goods or services in order to ascertain the latter's trustworthiness.

61. However, the tax authority cannot, as a general rule, require the taxable person wishing to exercise the right to deduct VAT, first, to ensure that the issuer of the invoice relating to the goods and services in respect of which the exercise of that right to deduct is sought has the capacity of a taxable person, that he was in possession of the goods at issue and was in a position to supply them and that he has satisfied his obligations as regards declaration and payment of VAT, in order to be satisfied that there are no irregularities or fraud at the level of the traders operating at an earlier stage of the transaction or, second, to be in possession of documents in that regard."

174. Again, the CJEU did not rule out a national taxing authority having a discretion to refuse the right to deduct in the circumstances of this case. Indeed, [60-61] show that the discretion is preserved.

175. At [66] the CJEU said:

"66. In the light of the foregoing considerations, the answer to the questions referred in Case C-80/11 is that Articles 167, 168(a), 178(a) and 273 of Directive 2006/112 must be interpreted as precluding a national practice whereby the tax authority refuses the right to deduct on the ground that the taxable person did not satisfy himself that the issuer of the invoice relating to the goods in respect of which the exercise of the right to deduct is sought had the status of a taxable person, that he was in possession of the goods in question and was in a position to supply them, and that he had satisfied his obligations as regards declaration and payment of VAT, or on the ground that, in addition to that invoice, that taxable

person is not in possession of other documents capable of demonstrating that those conditions were fulfilled, although the substantive and formal conditions laid down by Directive 2006/112 for exercising the right to deduct were fulfilled and the taxable person is not in possession of any material justifying the suspicion that irregularities or fraud have been committed within that invoice issuer's sphere of activity."

176. Mr Puzey submitted that, again, the discretion is preserved here, since what the CJEU was dealing with were valid VAT invoices, meaning that both the substantive and formal conditions to exercise the right to deduct were satisfied.

177. He submitted that *Senatex* does not assist the Appellant in the circumstances of this case. In *Senatex* the VRN on the supplier's invoices was missing, but Senatex later provided it. The issue before the CJEU was whether the right to deduct exercised on the corrected invoices related to the year in which the invoice was originally drawn up, or the year of correction. The CJEU did not consider the discretion afforded to Member States by the PVD in the absence of valid VAT invoices, where there were no corrected VAT invoices, where the invoices did not name the customer, where the supplier was not registered for VAT and where the purpose of the transaction from the supplier's point of view, was VAT fraud.

178. Mr Puzey relied upon the decision in *The Commissioners for Her Majesty's Revenue & Customs v Boyce* [2017] UKUT 177 (TCC) where Mr Justice Arnold in the Upper Tribunal, accepted that a real and obvious risk of fraud was a relevant factor when HMRC exercises its discretion in the absence of a valid VAT invoice (at [17] and [23]), and that (at [22-23]):

"..(i) the rule, as a matter of both EU and UK VAT law, is that without a valid VAT invoice there can be no input tax deduction; (ii) the use of the discretion in regulation 29(2) involves creating an exception to that rule; and (iii) it is therefore entirely reasonable for the Commissioners to insist on strict adherence to that rule unless and until the taxpayer can demonstrate that why an exception to it should be made."

179. Accordingly, Mr Puzey submitted that the Appellant's submissions that fraud is irrelevant to the exercise of HMRCs' discretion are, on binding authority, wrong. Accordingly, HMRC invited the Tribunal to dismiss the Appellant's appeal on the invalid invoice ground.

180. Following the conclusion of the hearing HMRC were granted permission by the Tribunal to rely upon written submissions as to the consequence of the Court of Appeal's decision in *Zipvit Ltd v HMRC* handed down on 26 June 2018. The Tribunal considers these submissions below.

Discussion and Decision on the First Issue

181. Deciding the First Issue may not be straightforward, as the length of the competing arguments suggests.

182. None of the authorities to which the Tribunal was referred consider similar, let alone identical, facts. All of the authorities are distinguishable.

183. It is common ground between the parties that the invoices from Stratex upon which the Appellant claims input tax are not valid VAT invoices.

184. The Stratex invoices neither named CFE as the customer[4], nor, more importantly, did they bear any VRN. They did not comply with all the formal conditions or requirements of Article 226 of the PVD and Regulation 14 of the VATR.

185. The invalid Stratex invoices have never been corrected.

186. It is also common ground that Stratex was unregistered for VAT and fraudulently defaulted on its obligations to account for and pay over the sums charged as VAT on the invalid invoices.

187. Therefore, the absence of VRN on the Stratex invoices was not simply the absence of a technical formality on a document but evidence of a lack of VAT registration on the part of Stratex. There was a tax loss occasioned by these invoices and it was fraudulently occasioned when Stratex failed to account for and pay over the sums charged as VAT on the invalid invoices.

188. For the purposes of this issue it is unnecessary and not relevant for the Tribunal to take account its finding, made for the reasons set out in the Second and Third Issues, that CFE failed to take reasonable care and check that Stratex were VAT registered before making payments to them.

189. Article 226 PVD sets out the requirements for VAT invoices, in as far as is relevant, as follows:

"Without prejudice to the particular provisions laid down in this Directive, only the following details are required for VAT purposes on invoices issued pursuant to Articles 220 and 221:

… (3) the VAT identification number referred to in Article 214 under which the taxable person supplied the goods or services; …

(5) the full name and address of the taxable person and of the customer; …"

190. The Stratex invoices therefore failed to comply with Article 226(3) and (5) PVD.

191. Domestically, Regulation 14(1) of the Value Added Tax Regulations 1995 sets out the contents of VAT invoices, in as far as is relevant, as follows:

"(1) Subject to paragraph (2) below and regulation 16 and save as the Commissioners may otherwise allow, a registered person providing a VAT invoice in accordance with regulation 13 shall state thereon the following particulars –

… (d) the name, address and registration number of the supplier,

(e) the name and address of the person to whom the goods or services are supplied, …."

192. The Stratex invoices therefore also failed to comply with Regulation 14(1)(d) and (e) of VATR.

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[4] Despite the Appellant's objection, the Tribunal takes this into account to a limited extent. The absence of the customer name is apparent from the face of the invoices and was referred to in the original submissions of HMRC. While the absence of the customer name on its own may not have been determinative, the absence of VRN on the Stratex invoices is determinative for the reasons given.

193. The Appellant's position is that once the "substantive" conditions are met for the right to deduct to arise, then it has a directly effective right to deduct regardless of whether the "formal" conditions governing the exercise of that right have been complied with. The Appellant asserts that the presence of the supplier's VRN on a VAT invoice is only a "formal" requirement by reference to the CJEU case of *Senatex* [49].

194. In *Senatex* the VRN on the supplier's invoices was missing, but Senatex later provided it. The issue before the CJEU was whether the right to deduct exercised on the corrected invoices related to the year in which the invoice was originally drawn up, or the year of correction. The CJEU did not consider the discretion afforded to Member States by the PVD in the absence of valid VAT invoices, where there were no corrected VAT invoices, where the invoices did not name the customer, where the supplier was not registered for VAT, where the purpose of the transaction from the supplier's point of view, was VAT fraud and where the VAT charged on the invoice was never paid by the supplier.

195. The Tribunal accepts HMRC's submission that *Senatex* does not assist the Appellant in the circumstances of this appeal. What is more, the CJEU explicitly avoided stating that the particular requirement for a supplier's VRN to appear on a VAT invoice was merely a "formal" condition.

196. On that basis alone, the Tribunal would be satisfied that HMRC was entitled to apply the domestic law under Reg 14 VATR, as it implements Art 226 of the PVD, and to deny input tax on the Stratex invoices.

197. The absence of information meeting some of the formal conditions on the invoices betrayed a much greater deficiency with the invoices as is set out above ie. that they were connected to a fraudulent loss of VAT. For example, it is not that the absence of VRN was oversight – there was no VRN to record on the invoices because Stratex was not registered for VAT. There was no payment by Stratex (the supplier) of the tax for which a deduction is sought by the Appellant.

198. There is no binding authority that HMRC, or the Tribunal, must disapply the domestic law under Reg 14 VATR, as it implements Art 226 of PVD, and give direct effect only to the substantive requirements of Art 168 in the circumstances of a case such as this. HMRC were lawfully entitled to deny input tax upon the Stratex invoices in conformity with EU law.

199. To the extent further required, the Tribunal adopts the arguments relied upon by HMRC derived from the judgment of the Court of Appeal in *Zipvit Ltd v HMRC* [2018]. The following principles emerge from *Zipvit*.

200. One of the main purposes of the mandatory requirement for a VAT invoice is to enable the taxing authorities to monitor payment by the supplier of the tax for which a deduction is sought - [112] of *Zipvit*.

201. Whether a taxable person in possession of an invalid VAT invoice can provide any evidence that the supplier of that invoice has paid any of the VAT on that invoice to HMRC is relevant to the question of whether the conditions for the right to deduct to arise are met - [112-113] of *Zipvit*.

202. The exercise of the right to deduct is subject to a mandatory requirement to produce a VAT invoice which must contain the specified particulars. Where a person seeking deduction

cannot produce invoices that satisfy the requirements of Article 226 (9) and (10) of the PVD and is also unable to produce any supplementary evidence showing payment by its supplier of the relevant VAT, a necessary precondition for the exercise of the right to deduct remains unsatisfied - [113] of *Zipvit*.

203. The distinction between a "substantive" and "formal" requirement does not necessarily imply that compliance with it is optional, or that a failure to satisfy it is always capable of being excused and *Barlis* was confined to failure to comply with Articles 226(6) and (7) of the PVD.

204. Some of the requirements in Article 226 of the PVD must be dispensed with if the tax authorities are provided with the information necessary to establish that the substantive conditions of the right to deduct are satisfied, but that cannot extend to a failure to comply with a fundamental requirement relating to the payment of the relevant tax. Provision of an invoice that complies with those fundamental requirements is essential to the proper performance by HMRC of their monitoring functions in relation to VAT, and is needed as evidence that the supplier has duly paid or accounted for the tax to HMRC - [114] of *Zipvit*.

205. There is an obvious detriment to the public purse where the taxpayer can obtain a deduction without first showing that the tax in question has been paid by its supplier; the ordinary way of doing that is by the production of a fully compliant VAT invoice.

206. Where a person seeking a deduction does not have a fully compliant VAT invoice and cannot show that the VAT in question was paid by the supplier there will be no grounds upon which HMRC could properly conclude in the exercise of their discretion that the taxpayer in question should be allowed a deduction to the detriment of the general body of taxpayers. It would be offensive to fiscal justice if a mechanical accounting exercise can generate a very substantial input tax credit where, for whatever reason, none of the tax in question has been paid by the supplier.

207. The principles extracted above are of application to the instant appeal.

208. Firstly, the Appellant's general proposition that once the "substantive" requirements are met the right to deduct can be exercised regardless of failures to comply with the invoicing requirements is inconsistent with Henderson, LJ's judgment in *Zipvit*. The Tribunal does not consider the Appellant's broad proposition to be correct.

209. Secondly, the particular deficiencies in the Stratex invoices are such that the "fundamental" requirements of VAT invoices, *viz.* those necessary for the taxing authority to monitor payment by the supplier of the tax in question, have not been met. Where those requirements have not been met, and the person seeking to reclaim the input tax cannot provide other evidence that the supplier has paid the VAT due on the invoices, it is apparent that a necessary precondition for the right to deduct remains unsatisfied.

210. In this case, Stratex's invoices bore neither the name of its customer, nor, more importantly, its own VRN. These are fundamental requirements, since they are necessary for HMRC to monitor whether the supplier has paid the tax due. Moreover, there is authority that the requirement imposed by Article 226(10) is a fundamental condition of the right to deduct, it makes no sense to speak of a sum of VAT being payable by virtue of an invoice if that invoice fails to identify the person required to pay the sum in question.

211. The VRN identifies the particular taxable person who has made the supply and is due to account for the output tax and the customer name identifies the counterparty with sufficient particularity that the invoice could not, for example, be issued multiple times. These symmetrical requirements cumulatively mirror the operation of the principle of fiscal neutrality. Together, therefore, these requirements amount to a fundamental requirement of a VAT invoice that has not been met by the Appellant.

212. At the second stage of the analysis, the Appellant cannot show that the VAT charged on the Stratex invoices has been paid, since it is common ground that Stratex fraudulently failed to account for it. Therefore, since the invoices relied upon by the Appellant fail to satisfy a fundamental requirement of a VAT invoice, and the Appellant cannot provide any evidence that Stratex paid the VAT charged on the invoices, in the language of *Zipvit* at [113] a necessary precondition for the exercise of the right to deduct therefore remains unsatisfied.

213. Henderson, LJ made plain the importance of establishing the payment of the output tax where an invoice is invalid for VAT purposes by iterating the point that Zipvit could not do so on no less than five occasions at: [112, 113, 115, 116 and 117].

214. What is more, the Judge's analysis of the importance of either the invoice, or alternative evidence where the invoice is invalid, establishing that the tax has been paid by the supplier must have been explicitly intended to go beyond the facts of *Zipvit*, since otherwise the parenthesis in [116] is inexplicable:

"…It would, I think, be offensive to most people's sense of fiscal justice if a mechanical accounting exercise of this nature were permitted to generate a very substantial input tax credit, in circumstances where (for whatever reason) none of the tax in question has been paid by the supplier."

215. In terms of the exercise of HMRC's discretion to allow the Appellant's input tax deduction in the absence of a valid VAT invoice and where there is no evidence that the supplier has paid the output VAT charged, it is now to be inferred from *Zipvit* at [116] that there will no grounds upon which HMRC could properly conclude that such a deduction could be permitted.

216. This also disposes of the Appellant's assertion, which will be considered as part of the Second Issue, that the decision-making officer's reliance in making his decision upon the fact that Stratex had fraudulently failed to account for the output tax was somehow an irrelevant factor. To the contrary, in the light of Henderson, LJ's. analysis in *Zipvit*, the fact of non-payment by the supplier (for whatever reason) is of real importance to a decision not to exercise HMRC's discretion in such circumstances.

Conclusion on the First Issue

217. This ground of appeal is dismissed. The Tribunal is satisfied that HMRC were lawfully entitled to deny the Appellant the right to deduct input tax upon the Stratex invoices in conformity with domestic and EU law. The Stratex invoices were invalid as a matter of domestic and EU law in that they did not meet all of the requirements of Article 226 PVD and Regulation 14 VATR and on the facts of this case, HMRC were entitled to refuse the deduction of input tax.

The Second Issue

218. Seventeen invoices for the supply of carbon credits by Stratex to the Appellant between 18 May 2009 and 3 June 2009 charged £5,605,119.74 in VAT which the Appellant duly paid and claimed as input tax in period 06/09.

219. It is not in dispute that Stratex's invoices were invalid because they did not contain a VAT registration number ("VRN"), indeed Stratex was not VAT registered. HMRC decided the Appellant was not entitled to recover the input tax on these invoices.

220. On 6 December 2012 Officer David Ball declined to exercise the discretion provided to HMRC by regulation 29(2) of the VAT Regulations 1995 ("VATR") to accept alternative evidence of the VAT charge[5] and denied the Appellant input tax claimed on the Stratex invoices. Officer Peter Birchfield upheld this decision on review in a letter dated 12 April 2013.

221. The Second Issue is whether HMRC's decision to refuse to exercise their discretion in favour of CFE in respect of the invalid Stratex invoices and accept alternative evidence to allow the input VAT claimed on the invoices was unreasonable (the reasonableness of the discretion to refuse).

222. There is a sub issue: which is the relevant decision for which the discretion is to be reviewed? Was it the decision of Officer David Ball, the original decision maker, or that of Peter Birchfield who reviewed and upheld Officer Ball's decision?

The Facts on the Second Issue

223. The Tribunal finds the following facts on the balance of probabilities having heard oral evidence from Officers David Ball and Peter Birchfield, each of whom was cross examined.

224. As is set out above, it is not in dispute that seventeen invoices for the supply of carbon credits by Stratex Ltd ("Stratex") to CFE between 18 May 2009 and 3 June 2009 charged over £5 million in VAT which the Appellant duly paid and claimed as input tax in period 06/09.

225. It is not in dispute that Stratex's invoices were invalid because they did not contain a VAT registration number ("VRN"), indeed Stratex was not VAT registered. HMRC decided the Appellant was not entitled to recover the input tax on these invoices.

226. It is not in dispute that input tax upon other invalid invoices from other suppliers to CFE which HMRC initially denied, they later allowed following Officer Birchfield's Review.

227. Neither is it in dispute that CFE had its own internal invoicing, tax, legal and credit departments in house. The Tribunal finds, in the absence of any evidence being put forward for why these invoices were processed and paid out upon without query, that there was no effective checking by CFE of the validity of the invoices nor VRN nor VAT registration of Stratex.

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[5] Officer Ball also denied the Appellant input tax in respect of invoices from Adduco Consulting Ltd, ADE International Ltd, Carbondesk Ltd, Northumberland Consultants Ltd and SVS Securities Ltd on the basis that they were invalid because they stated the VAT amount in Euros instead of sterling. This decision was reversed following the review of Officer Birchfield.

228. In his decision letter dated 6 December 2012 Officer David Ball stated the following:

"3. Regulations 13(1) of the VAT Act 1994 requires taxable persons to have a valid VAT invoice in order to reclaim input tax on taxable supplies. The contents of a VAT Invoice are set out in Regulation 14(1). You do not have a valid VAT invoice for a number of transactions on which you seeking to claim input tax as detailed below.

4……..

As you can see above Regulation 14(1)(d) requires the VAT invoices to have a valid VAT number.

5. On 18th May 2009, CO2e received an invoice for Stratex Ltd. The invoice from Stratex bore no VAT Registration Number, however Stratex Ltd charged CO2e VAT, which CO2e paid to Stratex on or about 19th May 2009. Payment would have been processed by the accounting department and the input tax posted to the VAT account. As Stratex was not registered for VAT none of their invoices could have had a valid VAT registration number.

6. Under regulation 14(1)(d) CO2e did not have a valid VAT Invoice on which to recover VAT and therefore it has no right to claim input tax on these particular transactions.

7.Any recovery of input tax in these circumstances is subject to HMRC's discretion under VAT regulation 29(2). However, given the low level of commercial checks, particularly in light of what FSA, FATF & JMLSG guidelines recommend, undertaken by CO2e in relation to these transactions (see para14(ii) below) I have decided to deny CO2e's claim to input tax. This is on the basis that it does not have a valid VAT invoice, Stratex was not registered for VAT at the time of the transactions, the transactions were connected with VAT fraud and CO2e did not carry out a reasonable level of due diligence and therefore we would decline to apply our discretion to allow the input tax."

229. Officer Ball gave evidence about this in his first witness statement in the following terms:

"416. The copy of Stratex's invoice sent to us by CFE shows that Stratex's banker was Marfin Popolare Bank Cyprus. The invoice does not show a UK VAT number although VAT is included on the invoice.

417. On the basis of the information received CFE has made very few third-party checks such as financial checks from Dunn & Bradstreet or similar organisations.

418. CFE has not provided any: annual accounts, independent references, banking references, checks on Stratex's director and his background and experience.

419. Despite having no financial information about the company between 18th May – 3rd June 2009 CFE did 17 trades totalling €48,882,969. There is no evidence that CFE sought to check with HMRC whether Stratex was registered for VAT.

420. Stratex had only been incorporated on 6th October 2008 and therefore had no or very little track record. CFE state the business was "no risk" as they did not pay Stratex Limited until they had received the EUAs. On this basis Stratex would have received credit facilities from the trader who sold the EUAs to them. In the case of the trades mentioned above on 28th May 2009 Stratex would have needed credit of about €13,139,440.

421. Had CFE applies its KYC checks and risk management systems properly and taken notice of the available information it would have been able to identify the fact that Stratex had no financial or trading history, that the director Avi Alkobi was unknown in the field of environmental trading and that Stratex had no permanent premises in the UK, instead relying upon a third party to provide office services. In addition, Stratex were not registered for VAT in the UK, but were charging VAT. CFE also failed to take into account that Stratex could purchase large volumes of carbon EUAs at a price less than CFE

could purchase and the payments made by CFE, including the amounts due as VAT to HMRC were to an account at Marfin Popular bank in Cyprus.

422.The 17 invoices that CFE provided from Stratex were invalid because they did not show any VAT registration number on them and could not, because Stratex were not registered for VAT and had never been registered for VAT. Despite the fact that the invoices were invalid under Regulation 14 of the Value Added Tax Regulations 1995 for the reason set out above I nonetheless had the discretion to accept other evidence of the charge to VAT as evidence of the supplies in question having been made and to permit an input tax deduction on that basis.

423. The only documentation that CFE provided me with in relation to the Stratex transactions were the invalid invoices themselves and the due diligence documents listed above. No proof of payment to Stratex was provided by CFE. As set out in my letter of 6th December 2012 to CFE I declined to exercise my discretion in favour of allowing the input tax deduction because: CFE's due diligence checks into Stratex were inadequate especially in the light of what the FSA, FATF and JMLSG guidelines recommend. The transactions were also connected with fraud."

230. When cross examined on whether he had exercised his own independent judgment and come to his own decision on exercising the discretion to deny input tax Officer Ball was clear that it was his own decision. For the reasons set out in the Tribunal's decision on the Fifth Issue, it is satisfied that Officer Ball did receive guidance and input from Officer Jarvis but the discretion Officer Ball exercised was his own.

231. In his Review Decision of 12 April 2013, upholding Officer Ball's decision on the denial of input tax on the Stratex invoices, Officer Birchfield stated the following at page 2:

"I have examined a sample of the invoices for all the suppliers in question and (……) the invoices are invalid in that they are deficient in one of the requirements for a Tax Invoice detailed in Regulation 14(1)(d).

…………

Officer Ball was then required to exercise his discretion as to whether to allow deduction of input tax based on alternative evidence. Officer Ball has considered allowing deduction based on alternative evidence and decided to refuse deduction (his reasoning is given in paragraphs 7 and 9 of his letter to Tower Bridge GB Ltd of the 6th December 2012).

The invalid invoices issued by Stratex Alliance Ltd are in a different category to the other invalid invoices for which input tax has been denied in that the trader was not registered for VAT. Officer Ball has decided that in this case discretion does not apply and he therefore has not exercised it. Following Policy advice I agree with this approach (but see under the section on MOK as the fact that the Stratex Invoices are Invalid will form part of the evidence available to determine the appellant's knowledge of the connection to fraud under the section on MOK).

In relation to the remaining invalid invoices I have considered the alternative evidence available to Officer Ball and some additional evidence of payment supplied by Tower Bridge following my meeting with representatives of the company and their legal advisors of the 14th March 2013 and I have concluded that:

…………………

Conclusion

Officer Ball has correctly denied the input tax in relation to the Stratex Alliance invoices and has correctly exercised his discretion to refuse deduction based on alternative evidence. This element of the invalid invoice assessment will be upheld. The input tax denied is:

Period 06/09 £5,605,117.74

Towerbridge has satisfactory alternative evidence to support deduction for that part of the input tax denial based on the fact the invoices are invalid solely on their technical deficiencies (even where they can be shown to be connected to a fraud) and that part of the decision will be withdrawn. The input tax denied solely on invalid invoices was:

……………..”

232. As is set out in the footnote above, Officer Ball had previously denied input tax on invoices from Adduco Consulting Ltd, ADE International Ltd, Carbondesk Ltd, Northumberland Consultants Ltd and SVS Securities on the basis their invoices did not contain the total VAT chargeable in sterling. It is to be noted that Officer Birchfield, in his review, overturned Officer Ball's decision to deny input tax in relation to invalid invoices from other suppliers and exercised his discretion to accept alternative evidence and allowed the deduction of input tax in respect of the other invalid invoices supplied.

233. Officer Birchfield dealt with the invalid Stratex invoices in his witness statement in the following terms:

21. I categorised the transactions into two groups, those where Towerbridge bought from Stratex and then all those dated after the 9th June 2009.

22. In the Stratex deals the supplier was not registered for VAT at the time of the transactions and in fact was never registered for VAT. The invoices issued by Stratex to Towerbridge had no VAT number on the face of the invoices. There were 17 transactions including VAT of £5,605,119.74 million pounds and no VAT Registration number was shown on any of these invoices. A VAT Number is a mandatory entry on a VAT Invoice so these 17 invoices were all invalid.

23.Officer Ball considered allowing the deduction of Input tax on an Invalid invoices using alternative evidence in line with the Statement of Practice on deduction of VAT without a valid invoice and so did I but this was not a business error or administrative oversight by Stratex; it was a deliberate fraud, VAT was charged, collected and not paid by Stratex.

24. With that being the context it was then relevant to note that there was a direct connection to a fraud between Stratex and Towerbridge and Towerbridge knew or should have known of that connection primarily because the most obvious reason a supplier doesn't show a VAT number on their invoices is that they don't have one and can't therefore account for the VAT to HMRC. It is a fundamental requirement of a VAT invoice that it shows a VAT number.

25. Therefore, Towerbridge had no or no sufficient grounds on which to suggest that the discretion to allow alternative evidence of the charge to VAT should be exercised and, moreover the Kittel test outlined above was met.

26. In relation to the remaining transactions denied by Officer Ball I have drawn a distinction between "could have known" and "should have known". There are a number of indicators of fraud in the supply chains prior to the 9th June 2009 (which are identified in the original decision letter by Officer Ball) but prior that date the indicators when viewed in isolation and without a well-publicised context of fraud in

the market against which to judge them, did not convince me that Towerbridge should have known that they were connected to fraud."

234. The Tribunal is satisfied that the evidence of both Officer's witness statements and decision letters and the facts contained with them were accurate and that their oral evidence regarding them was reliable. The Tribunal has made some further factual findings regarding their evidence as to the exercise of their discretion as part of its decision on the Fifth Issue. However, those findings do not impact upon the outcome of this issue. The questions are which decision should be reviewed and whether the relevant decision was reasonable.

The Law on the Second Issue

The proper decision maker whose decision is to be challenged

235. The relevant parts of sections 83, 83C, 83F and 83G Value Added Tax Act 1994 ("VATA") provide as follows:

83 Appeals
(1) Subject to [sections 83G and 84], an appeal shall lie to [the tribunal] with respect to any of the following matters—………………..

(c) the amount of any input tax which may be credited to a person;……………………

(p) an assessment—

(i) under section 73(1) or (2) in respect of a period for which the appellant has made a return under this Act; ………………………

83C Review by HMRC
(1) (1) HMRC must review a decision if—

(a) they have offered a review of the decision under section 83A, and

(b) P notifies HMRC accepting the offer within 30 days from the date of the document containing the notification of the offer.

(2) But P may not notify acceptance of the offer if P has already appealed to the tribunal under section 83G.

(3) HMRC must review a decision if a person other than P notifies them under section 83B.

(4) HMRC shall not review a decision if P, or another person, has appealed to the tribunal under section 83G in respect of the decision.

83F Nature of review etc
(1) This section applies if HMRC are required to undertake a review under section 83C or 83E.

(2) The nature and extent of the review are to be such as appear appropriate to HMRC in the circumstances.

(3) For the purpose of subsection (2), HMRC must, in particular, have regard to steps taken before the beginning of the review—

(a) by HMRC in reaching the decision, and

(b) by any person in seeking to resolve disagreement about the decision.

(4) The review must take account of any representations made by P, or the other person, at a stage which gives HMRC a reasonable opportunity to consider them.

(5) The review may conclude that the decision is to be—

(a) upheld,

(b) varied, or

(c) cancelled.

(6) HMRC must give P, or the other person, notice of the conclusions of the review and their reasoning within—

(a) a period of 45 days beginning with the relevant date, or

(b) such other period as HMRC and P, or the other person, may agree.

(7) In subsection (6) "relevant date" means—

(a) the date HMRC received P's notification accepting the offer of a review (in a case falling within section 83A), or

(b) the date HMRC received notification from another person requiring review (in a case falling within section 83B), or

(c) the date on which HMRC decided to undertake the review (in a case falling within section 83E).

(8) Where HMRC are required to undertake a review but do not give notice of the conclusions within the time period specified in subsection (6), the review is to be treated as having concluded that the decision is upheld.

(9) If subsection (8) applies, HMRC must notify P or the other person of the conclusion which the review is treated as having reached.

83G Bringing of appeals

(1) An appeal under section 83 is to be made to the tribunal before—

(a) the end of the period of 30 days beginning with—

(i) in a case where P is the appellant, the date of the document notifying the decision to which the appeal relates, or

(ii) in a case where a person other than P is the appellant, the date that person becomes aware of the decision, or

(b) if later, the end of the relevant period (within the meaning of section 83D).

(2) But that is subject to subsections (3) to (5).

(3) In a case where HMRC are required to undertake a review under section 83C—

(a) an appeal may not be made until the conclusion date, and

(b) any appeal is to be made within the period of 30 days beginning with the conclusion date.

(4) In a case where HMRC are requested to undertake a review in accordance with section 83E—

(a) an appeal may not be made—

(i) unless HMRC have notified P, or the other person, as to whether or not a review will be undertaken, and

(ii) if HMRC have notified P, or the other person, that a review will be undertaken, until the conclusion date;

(b) any appeal where paragraph (a)(ii) applies is to be made within the period of 30 days beginning with the conclusion date;

(c) if HMRC have notified P, or the other person, that a review will not be undertaken, an appeal may be made only if the tribunal gives permission to do so.]

(5) In a case where section 83F(8) applies, an appeal may be made at any time from the end of the period specified in section 83F(6) to the date 30 days after the conclusion date.

(6) An appeal may be made after the end of the period specified in subsection (1), (3)(b), (4)(b) or (5) if the tribunal gives permission to do so.

(7) In this section "conclusion date" means the date of the document notifying the conclusions of the review.

Invalid invoices and the discretion to allow input tax

236. The domestic law on this issue has already been touched upon as part of the decision on the First Issue.

237. Regulation 13(2) of the VAT Regulations 1995 ("VATR") provides that the particulars of the VAT chargeable on a supply of goods shall be provided on a document containing the particulars prescribed in Regulation 14(1).

238. Regulation 14(1) VATR states, in as far as is relevant:

(1) Subject to paragraph (2) below and regulation 16 save as the Commissioners may otherwise allow, a registered person providing a VAT invoice in accordance with regulation 13 shall state thereon the following particulars— …

(d) the name, address and registration number of the supplier, …

239. Regulation 29 of the VATR, in so far as relevant, provides:

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

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

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

provided that where the Commissioners so direct, either generally or in relation to particular cases or classes of cases, a claimant shall hold, instead of the document or invoice (as the case may require) specified in sub-paragraph (a)…above, such other documentary evidence of the charge to VAT as the Commissioners may direct.

240. HMRC issued a Statement of Practice, effective from 16 April 2003 and dated 10 April 2007, updated in March 2007, setting out their policy as to the circumstances in which input tax recovery will be allowed in the absence of a valid VAT invoice.

241. HMRC's policy is titled "Statement of Practice – VAT Strategy: Input Tax deduction without a valid VAT manual". It sets out HMRC's policy at the time of the decision and the review decision in relation to the invalid VAT invoices.

242. The Statement of Practice contains the following relevant paragraphs:

"VAT Strategy – Input tax deduction without a Valid VAT invoice

1.This statement of Practice explains and clarifies HMRC's policy in respect of claims for input tax supported by invalid VAT invoices. It also explains why amendments were made to ….regulation 29(2) of the Value Added Tax Regulations 1995 to introduce new measures……This guidance does not apply to situations where HMRC may deny recovery of input tax for other reasons such as "abuse" of the right to deduct.

…………………………

How do I know I have an invalid VAT invoice?

12.The first step is to ensure that you hold an invoice that contains all the right information. It is difficult to spot an invalid invoice where a false name, address or VAT number has been used. HMRC have established a team who can confirm that supplied VAT registration details are current, valid and match information held by HMRC…….

Invalid Invoice and HMRC's discretion

13. A proper exercise of HMRC's discretion can only be undertaken when there is sufficient evidence to satisfy the Commissioners that a supply has taken place. Where a supply has taken place, but the invoice to support this is invalid, the Commissioners may exercise their discretion and allow a claim for input tax credit. For supplies/transactions involving goods stated in Appendix 3[6] HMRC will need to be satisfied that:

- The supply as stated on the invoice did take place.

- There is other evidence to show that the supply /transaction occurred.

[6] Appendix 3 lists computers, telephones, alcohol and oils but not EUAs or carbon credits

- The supply made is in furtherance of the trader’s business.

- The trader has undertaken normal commercial checks to establish the bona fides of the supply and supplier.

- Normal commercial arrangements are in place – this can include payment arrangements and how the relationship between the supplier / buyer was established.

What do I do if my checks indicate that a fraud exists?

15. If your checks indicate that there may be a fraud should consider whether you wish to continue with the transaction…….

I have an invalid VAT invoice; Can I still recover input tax?

16. Not automatically. However, HMRC may apply their discretion and still allow recovery.

How will HMRC apply their discretion?

17. For supplies of goods not listed at Appendix 3, claimants will need to be able to answer most of the questions at Appendix 2 satisfactorily. In most cases, this will be little more than providing alternative evidence to show that the supply of goods or services has been made (this has always been HMRC's policy).

18. For supplies of goods listed at Appendix 3, claimants will be expected to be able to answer questions relating to the supply in question including all or nearly all of the questions at Appendix 2. In addition, they are likely to be asked further questions by HMRC in order to test whether they took reasonable care in respect of transactions to ensure that their supplier and the supply were 'bona fide'.

19. As long as the claimant can provide satisfactory answers to the questions at Appendix 2 and to any additional questions that may be asked, input tax deduction will be permitted.”

243. The Appellant’s case does not concern any of the goods listed in Appendix 3, and so paragraph 17 applies. Appendix 2 provides:

“Appendix 2 Questions* to determine whether there is a right to deduct in the absence of a valid VAT invoice

1. Do you have alternative documentary evidence other than an invoice (e.g. supplier statement)?

2. Do you have evidence of receipt of a taxable supply on which VAT has been charged?

3. Do you have evidence of payment?

4. Do you have evidence of how the goods/services have been consumed within your business or their onward supply?

5. How did you know that the supplier existed?

6. How was your relationship with the supplier established? For example:

- How was contact made?

- Do you know where the supplier operates from (have you been there)?
- How do you contact them?
- How do you know they can supply the goods or services?
- If goods, how do you know the goods are not stolen?
- How do you return faulty supplies?

*This list is not exhaustive and additional questions may be asked in individual circumstances”

The relevant case law on invalid invoices

244. The effect of Regulation 29(2) VATR is that HMRC has a discretion to allow a credit for input tax notwithstanding that the taxable person does not have a valid VAT invoice (*Kohanzad v Customs & Excise Commissioners* [1994] STC 967 at 969 *per* Schiemann, J.).

245. The Upper Tribunal has recently confirmed that in invalid invoice cases the Tribunal should focus on the reasonableness of the exercise of that discretion and deprecated the practice that had sprung up of Tribunals firstly determining whether a supply had in fact been made in relation to the invoice (see *Scandico Ltd v The Commissioners for Her Majesty's Revenue & Customs* [2017] UKUT 0467 (TCC) (“*Scandico”*) per Rose, J. and Judge Hellier at [39-43] concluding:

“43. In appeals of this kind, the First-tier tribunal should address only the decision which is before it, namely HMRC's decision that, in the absence of the VAT receipts, they were not prepared to exercise their discretion to accept the alternative evidence provided by the taxpayer as to whether there had been a taxable supply. The test that the First-tier tribunal applies in reviewing that decision is the test set out in Kohanzad.”

246. The Tribunal exercises a supervisory jurisdiction when hearing an appeal against the exercise of HMRC’s discretion. Thus, the Tribunal’s jurisdiction is to consider whether HMRC have acted in a way in which no reasonable panel of Commissioners could have acted or whether they have taken into account some irrelevant matter or disregarded something to which they should have given weight. The Tribunal should also consider whether HMRC have erred as a matter of law (see e.g. *Revenue & Customs v GB Housley Ltd* [2014] UKUT 320 (“*GB Housley*”) *per* Warren, J. at [10]).

247. If HMRC have failed to exercise their discretion properly (including by not exercising it at all) the exercise of that discretion must be revisited; the Tribunal cannot exercise the discretion itself. However, there is an exception to this where HMRC are able to show that had the discretion been properly exercised the decision would inevitably have been the same again (see e.g. *GB Housley* at [11]).

248. In *McAndrew Utilities Ltd v Revenue & Customs* [2012] UKFTT 749 (TC) the Tribunal considered the relevance of the fact that the transactions for which there were invalid invoices took place in a market known to be vitiated by fraud. The Tribunal concluded at [120-122]:

“120. The respondents say that the appellant’s failure to carry out any meaningful due diligence or commercial checks in a market affected by fraud is a factor in the exercise of its discretion to accept alternative evidence of the charge to VAT. We accept that submission. In such a market we would expect the appellant to have made considerably more effort than it did to satisfy itself as to the identity and legitimacy of persons it was dealing with. The absence of reliable evidence as to the identity and status of the suppliers arises because of the appellant’s failure to carry out any meaningful checks.

121. We bear in mind that the alternative evidence referred to in regulation 29(2) is of the charge to VAT. The questions in Appendix 2 of the statement of practice must therefore be read in the context that they are seeking to establish that there has been a taxable supply to the appellant by a taxable person for which payment has been made. It is evidence to establish the following matters which will be particularly relevant:

(1) The identity of the supplier,

(2) The nature and extent of the goods and services being supplied,

(3) The use to which the goods and services were put in the appellant's business,

(4) Payment for the goods and services.

122. We also consider that the alternative evidence required is evidence to the same level of detail as that which would be contained in a valid invoice, the absence of which gives rise to the discretion."

249. The Tribunal's jurisdiction is strictly supervisory; not appellate nor "substitutionary." Thus, the Tribunal must focus not on whether it agrees with the decision nor whether it would have come to a different decision; but whether the decision falls within the ambit of one that a reasonable body of Commissioners could have reached.

250. The burden of proof is upon the Appellant, both to establish the facts that it relies upon in challenging the decision, and to show that the decision was unreasonable.

HMRC's submissions on the Second Issue

251. Mr Puzey on behalf of HMRC submits that the Appellant's grounds of appeal did not particularise its complaint in respect of the exercise of the discretion beyond suggesting that it was "wrong" and should have been exercised the other way.

252. Mr Puzey submitted that this was an impermissible attack on the merits of the decision, not its reasonableness, and such a challenge cannot lead to the appeal being allowed. He submitted that the Tribunal can only interfere with HMRC's refusal to exercise its discretion in the Appellant's favour if: it was perverse or irrational, if some relevant factor was not taken into account, if some irrelevant factor was taken into account or if the decision was otherwise vitiated by some error of law. Since the Appellant had made no such allegation in its grounds of appeal, its appeal in respect of the denial input tax based on the invalid invoice aspect of the case should fail.

253. He submitted that the Tribunal may only allow the appeal on this issue if the decision of HMRC was unreasonable and that requires the Tribunal to interfere with a question of substance that has built in latitudes for such matters as judgment, discretion and policy. This is a high hurdle for the Appellant to surmount. As Lord Russell said in *Secretary of State for Education and Science v Tameside Metropolitan Borough Council* [1977] AC 1014, 1074H-1075C:

"….it is quite unacceptable …to proceed from 'wrong' to 'unreasonable'…History is replete with genuine accusations of unreasonableness when all that is involved is disagreement, perhaps passionate, between reasonable people:"; "'unreasonably' is a very strong word indeed, the strength of which may easily fail to be recognized."

254. He relied on *In re W (An Infant)* [1971] AC 682, 700D-3 where Lord Hailsham said:

"Two reasonable [persons] can perfectly reasonably come to opposite conclusions on the same set of facts without forfeiting their title to be regarded as reasonable…Not every reasonable exercise of judgment is right, and not every mistaken exercise of judgment is unreasonable."

255. Mr Puzey also relied on *Huang v Secretary of State for the Home Department* [2005] EWCA Civ 105 at [28] where Laws, LJ. said of the unreasonableness test:

"We are sure we need take little time describing the conventional Wednesbury test of public law error. Very shortly, the court would ask itself whether the decision in question was so unreasonable that no reasonable public decision maker could have arrived at it. As is well known the test was re-stated by Lord Diplock in the GCHQ case [19] as condemning "irrational" decisions. However precisely stated, the test imposed on the decision maker a duty to make his decision in good faith, to have regard to all and only relevant considerations, and to bring a rational mind to bear on whatever was the issue. This approach informed a judicial review jurisdiction which was largely remote from the merits of the decision under review. The judge might violently disagree with the merits decision; but applying the Wednesbury test he could only strike it down if he were satisfied that it failed to meet the test's relatively undemanding standards."

256. He submitted that there can be little doubt, from the authorities, that the Tribunal should not intervene on the general grounds of unreasonableness save in a strong case. Therefore, the Appellant had a high threshold to overcome. The Courts have described unreasonable decisions in the following terms: perverse, outrageous in its defiance of logic or of accepted moral standards, so absurd that the decision maker must have taken leave of his senses, so devoid of any plausible justification that no reasonable body of persons could have reached them, and defying comprehension. "Unreasonableness" is thus a high threshold, but not an unattainable one (see *Judicial Review Handbook, 6th Edn., Fordham* at [57.1.12-57.4.1]).

257. Mr Puzey submitted that even if the Appellant were, at the eleventh hour, to apply to change its grounds of appeal to claim that the decision failed to take into account some particularised relevant factor (which would be resisted), the burden would be on the Appellant to prove not only that there was a failure to take into account a relevant factor, but also that this factor was material to the decision i.e. that had the decision-making officer taken into account that factor it might have caused him to reach a different decision. The test set out in *R v Parliamentary Commissioner for Administration, ex p Balchin* [1998] 1 PLR 1, 25C was "whether a consideration has been omitted which, had account been taken of it, might have caused the decision maker to reach a difference conclusion."

258. He relied upon *R v Chief Registrar of Friendly Societies, Ex parte New Cross Building Society* [1984] QB 227 at 260, where Griffiths, LJ. said:

"The court must not allow the tests proposed in Associated Provincial Picture Houses Ltd. v. Wednesbury Corporation [1948] 1 K.B. 223 to be erected into immutable propositions of law. Take as an example the proposition that the decision must take into account relevant considerations and leave out of account irrelevant considerations. In a decision involving the weighing of many complex factors it will always be possible to point to some factors which should arguably have been taken into account or left out of account; even if they should have been, the court should not intervene unless it is convinced that this would have resulted in the decision going the other way. The same applies to an error of law on the face of the record; if the error is fundamental to the decision the court should intervene: but certiorari is a discretionary remedy and not every error of law will justify quashing the decision."

259. Mr Puzey submitted that the question arises as to in whose judgment a factor is relevant. There are normally held to be two categories of factors:

i. Those which the legislation expressly or impliedly identifies as relevant or which are obviously relevant; and

ii. Those which the decision maker may take into account if they see fit to.

260. He relied on the judgment in *London Borough of Newham v Khatun & Ors* [2004] EWCA Civ 55 where Laws, LJ. said at [35]:

'In my judgment CREEDNZ (via the decision in Findlay) does not only support the proposition that where a statute conferring discretionary power provides no lexicon of the matters to be treated as relevant by the decision-maker, then it is for the decision-maker and not the court to conclude what is relevant subject only to Wednesbury review. By extension it gives authority also for a different but closely related proposition, namely that it is for the decision-maker and not the court, subject again to Wednesbury review, to decide upon the manner and intensity of enquiry to be undertaken into any relevant factor accepted or demonstrated as such. This view is I think supported by the judgment of Schiemann J as he then was in Ex p. Costello, to which Mr Luba referred us. That case concerned the degree of inquiry which an authority was obliged to undertake into issues of priority need and intentional homelessness. At p.309 Schiemann J said:

"In my view the court should establish what material was before the authority and should only strike down a decision by the authority not to make further enquiries if no reasonable council possessed of that material could suppose that the inquiries they had made were sufficient."

This approach is lent authoritative support by the decision of this court in *R v Royal Borough of Kensington and Chelsea ex p. Bayani* [9], which was concerned with the authority's duty of inquiry in a homelessness case. Neill LJ said at 415:

"The court should not intervene merely because it considers that further inquiries would have been sensible or desirable. It should intervene only if no reasonable housing authority could have been satisfied on the basis of the inquiries made."'

261. Mr Puzey relied on the judgment in *Jones & Anor, R (on the application of) v North Warwickshire Borough Council* [2001] EWCA Civ 315, at [20], where Laws, LJ. said:

"The general law as regards the duty of a public decision-maker to take relevant considerations into account is well-known.

(1) If the operative statute provides a lexicon of relevant considerations to which attention is to be paid, then obviously the decision-maker must follow the lexicon.

(2) If however the statute provides no such lexicon, or at least no exhaustive lexicon, then the decision-maker must decide for himself what he will take into account. In doing so he must obviously be guided by the policy and objects of the governing statute, but his decision as to what he will consider and what he will not consider is itself only to be reviewed on the conventional Wednesbury principle…"

262. Mr Puzey submitted that in this case there is no statutory lexicon of matters to be treated as relevant by the decision-making officer. HMRC's officer was at liberty to decide what he was going to take into account as relevant. In doing so he was to be guided by the policy and objects of the governing legislation. The Tribunal can only intervene on this ground if the reviewing officer failed to take into account something of "obvious" relevance.

263. He submitted that the legislative and policy background to the invalid invoice decision is obvious: it is to minimise the risk of VAT fraud and to ensure that those who are properly entitled to VAT credits receive them.

264. Mr Puzey noted that the Appellant accepted that the invoices from Stratex upon which it claims input tax are not valid VAT invoices.

265. The Appellant's ground of appeal in relation to the invalid invoice issue is:

"HMRC were wrong to refuse to allow the input tax in respect of the invoices which were invalid because they did not include a VAT registration number and discretion should have been exercised in accordance with the Statement of Practice so as to allow recovery."

266. Mr Puzey therefore submitted that the Tribunal had no jurisdiction to allow the Appellant's appeal on the invalid invoice ground of appeal as pleaded. There was no claim therein that the decision to refuse to exercise the discretion in the Appellant's favour was unreasonable or vitiated by an error of law. The merits of the decision are irrelevant to the Tribunal's task. HMRC therefore submitted that the Appellant's Ground of Appeal in relation to the invalid invoice issue must be dismissed.

Appellant's submissions on the Second Issue

267. Ms Shaw QC submitted that before deciding whether the decision was unreasonable, the Tribunal had to identify who was the relevant decision maker.

The correct decision maker

268. Ms Shaw QC submitted on behalf of the Appellant that it was the reasonableness of the exercise of the discretion by the review decision maker, Officer Peter Birchfield, that was the subject of the appeal. Therefore, she submitted that the Tribunal should consider the decision of 12 April 2013 rather than Officer Ball's original decision of 6 December 2012.

269. She submitted as follows.

270. The law relating to the review of decisions made on or after 1 April 2009 in respect of which an appeal lies to the tribunal under s.83, VATA 1994 is laid down in sections 83A to 83G of VATA 1994.

271. She submitted that it was clear from those sections, and in particular s.83F(5), that the review entails an assessment of the original decision. On review, the reviewer can conclude (pursuant to s.83F(5)) that the original decision is to be (a) upheld; (b) varied; or (c) cancelled.

272. Section 83F(5) provides that:

(5) The review may conclude that the decision is to be—
(a) upheld,
(b) varied, or
(c) cancelled.

273. She submitted that the power of the reviewing officer to vary the original decision indicates that, in a case involving the exercise by HMRC of their discretion under regulation 29(2) of the VAT Regulations 1995, the reviewer has more than the supervisory role that a Tribunal has on appeal, i.e. the reviewing officer has powers which extend beyond merely deciding whether the original exercise of discretion was unreasonable, irrational etc. The power of the reviewer to vary also suggests that the reviewing officer's decision on discretion supersedes the original exercise of discretion.

274. Ms Shaw QC submitted that in terms of the discretion bestowed upon HMRC by regulation 29(2), it is possible for them to re-exercise their discretion subsequently. As was suggested by Dyson J (as he then was) in *CEC v Peachtree Enterprises Ltd* [1994] STC 747, at 752g-j, such a re-exercise of the discretion can be the subject of a fresh appeal pursuant to ss.83 to 83G, VATA 1994.

275. She submitted that such a course (i.e. a re-exercise of the discretion outside the statutory review process generating a discrete appealable matter) is to be distinguished from a reconsideration of the discretion during a statutory review under ss.83A to 83G, VATA 1994. This is for the following reasons:

(1) First, sections 83A to 83G, VATA 1994 do not provide for a distinct right of appeal against a review conclusion itself; rather, there is one relevant decision, being the original one as either upheld, varied or cancelled on review.

(2) If one were to treat a reviewing officer's decision on discretion as a discrete appealable matter (as opposed to something which supersedes the original exercise of discretion) then, in principle, it would itself be subject to its own statutory review under ss.83A to 83G, VATA 1994. If the officer reviewing *that* decision re-exercised the discretion on review then that would generate yet another appealable matter which itself would be capable of being subjected to a statutory review, and so on *ad infinitum*. That would plainly be an absurd state of affairs.

(3) Further, if one were to adopt HMRC's approach of focussing on the original exercise of discretion rather than the reviewing officer's decision then in a case where, as happened to some extent in the present case, the original officer refuses to accept the alternative evidence but the reviewing officer disagrees and does accept it, the taxpayer nonetheless has to challenge the original decision by way of appeal. Again, that would be a surprising consequence.

276. It follows, she submitted, that (1) the Tribunal's supervisory role in a Reg.29(2) case where an original decision has been through a statutory review process involves considering the re-exercise of the discretion by the review officer in light of the material before him or her at that time and (2) the re-exercise of discretion by the reviewing officer supersedes the original decision.

The reasonableness of HMRC's decision not to accept alternative evidence and deny input tax based upon the invalid invoices

277. Ms Shaw QC, on behalf of the Appellant, submitted that the decision of Officer Birchfield in particular, and HMRC in general, not to accept alternative evidence but to deny input tax upon the invalid Stratex invoices was unreasonable.

278. She submitted as follows.

279. The provisions of the Principal VAT Directive are implemented into UK law by sections 24, 25 and 26 of VATA and regulations 14 and 29 of the VATR. More particularly:

> (1) Section 24 VATA defines "input tax" in relation to a taxable person as, *inter alia*, VAT of the supply to him of any goods or services used or to be used for the purpose of any business carried on or to be carried on by him.

(2) Section 25 VATA sets out a taxable person's obligation to account for output tax and provides a right to deduct input tax.

(3) Section 26 VATA sets out the input tax allowable under section 25.

(4) Regulation 14 of the VATR details the particulars that a VAT invoice is to contain.

(5) Regulation 29 of the VATR governs claims for input tax. It implements the requirement that the taxable person making the claim hold a VAT invoice. It also provides (in reg.29(2)) that, in the event that the taxable person does not hold a VAT invoice, HMRC have a discretion to accept alternative evidence of the VAT charge.

280. As regards HMRC's discretion under regulation 29(2), a taxpayer can appeal against a refusal by HMRC to accept alternative evidence but the scope of the appeal is limited to the question of whether the discretion had been properly exercised, for example by examining whether HMRC took into account some irrelevant matter or had disregarded something to which they should have given weight: see *CEC v Peachtree Enterprises Ltd* [1994] STC 747, at 751b-f; *Kohanzad v CEC* [1994] STC 967, at 969d-g). The burden is on the taxpayer to show that HMRC's decision was unreasonable in that sense (*Kohanzad*, at 969g).

281. Alternatively, the Appellant's secondary submission was that, in exercising their discretion under regulation 29(2) HMRC, and specifically Officer Birchfield, took into account irrelevant matters and/or acted irrationally or otherwise failed properly to exercise their discretion.

282. Further, and more particularly she submitted:

283. The Appellant can, and has, answered all of the questions set out in Appendix 2 to HMRC's Statement of Practice satisfactorily. Accordingly, HMRC should have exercised their discretion to permit the Appellant to claim the input tax relating to the Stratex transactions under regulation 29(2) in line with their stated policy.

284. As a consequence, Ms Shaw QC submitted that HMRC's decision was flawed and should be quashed.

285. As far as HMRC's case on UK domestic law and the discretion contained in regulation 29(2) of the VAT Regulations 1995 was concerned, she submitted there appears to be a broad measure of agreement between the parties as to the nature of the Tribunal's jurisdiction when it comes to challenges to the exercise of the discretion. For the avoidance of doubt, the reference in the Appellant's Grounds of Appeal to HMRC's refusal to allow the input tax in issue being wrong includes a reference to a wrongful exercise of their discretion.

286. That this was, and always has been, clear to HMRC is demonstrated by paragraph 7 of HMRC's skeleton argument for the hearing of the parties' disclosure applications on 18 December 2015, which included the following description of the Appellant's appeal: "Lastly, it is maintained that the Commissioners, in failing to accept alternative evidence of the charge to VAT for the Stratex invoices, exercised their discretion under Regulation 29(2) of the VAT Regulations 1995 unreasonably".

287. However, she submitted that the Appellant does not accept the contention made by HMRC that, because the regulation does not prescribe a *"statutory lexicon of matters to be treated as relevant by the decision-making officer"*, *"the officer was at liberty to decide what*

he was going to take into account as relevant" subject only to being *"guided"* by the policy and objects of the legislation.

288. More particularly Ms Shaw QC submitted:

(a) Regulation 29(2) is actually quite prescriptive as to the nature and extent of the discretion: it is a discretion to accept *"other documentary evidence of the charge to VAT"*.

(b) So whilst it is true that the legislation does not list factors which are to be taken into account, it does specify the matter to which the discretion relates, namely the adequacy of alternative documentary evidence of the charge to VAT in respect of which deduction is claimed.

(c) To be relevant, therefore, a given factor must go to whether the evidence in question is adequate to demonstrate that charge to VAT. Indeed, that is the very premise of HMRC's published Statement of Practice on the exercise of their discretion.

289. Further, and on a related note, the Appellant also takes issue with what is said by HMRC where they submit: "The legislative and policy background to the invalid invoice decision is obvious: it is to minimise the risk of VAT fraud and to ensure that those who are properly entitled to VAT credits receive them".

290. Insofar as HMRC's submission is effectively that the discretion in regulation 29(2) can be used by HMRC as a means of policing or reducing the effect of VAT fraud, she submitted it is wrong.

291. As both sides have identified, the discretion stems from Article 180 of the Directive and, as noted above, Article 180 is a permissive provision. It does not give member states a means of policing the VAT system or put the right of deduction within the gift of HMRC.

292. Rather Ms Shaw QC submitted it is a discretion to accept alternative evidence that the substantive requirements, or at least that part related to the input VAT charge, are met.

293. The risk of fraud might go to the level of evidence required to show that those requirements are met, and could be relevant in that sense, but once the officer is satisfied that they are met, as Officer Birchfield was in this case, there is no further relevant role for that factor to play. As the CJEU has stated, the question whether the VAT payable on prior or subsequent sales of the goods concerned has or has not been paid to the Treasury is irrelevant to the right of the taxable person to deduct input VAT: see *Kittel*, at [49].

294. Finally, Ms Shaw QC submitted that it is irrational for HMRC to use their discretion to deny deduction on the basis of their conclusion on the *Kittel* test. The issue of their discretion to allow the deduction of input tax only arises if the *Kittel* test is not satisfied because if it applies then there is no question of the Appellant recovering the input tax.

Discussion and Decision on the Second Issue

Who is the decision maker whose decision is being appealed?

295. The sub-issue before the Tribunal was the identity of the relevant decision maker whose discretion must be considered in deciding the reasonableness of HMRC's refusal to accept alternative evidence for the invalid Stratex invoices for the purposes of Regulation 29(2) of the VAT Regulations 1995. Was it the discretion exercised by Officer David Ball notified in the

original decision letter of 6 December 2012 or that exercised by Officer Peter Birchfield in his review decision letter of 12 April 2013?

296. The Tribunal is satisfied that Officer David Ball was the relevant decision maker, the reasonableness of whose decision is to be considered in this appeal. It adopts most of HMRC's reasoning in coming to that conclusion.

297. The review undertaken by Officer Peter Birchfield (pursuant to section 83C of VATA), as notified on 12 April 2013, was a review of Officer Ball's decision. So far as the issues before the Tribunal are concerned (namely the disallowance of input tax claimed on the Stratex invoices) Officer Birchfield stated expressly in oral evidence that he agreed with the decision of Officer Ball.

298. Further, in his decision letter of 12 April 2013, Officer Birchfield stated:

"Officer Ball has decided that in this case discretion does not apply and he therefore has not exercised it. Following Policy advice I agree with this approach (but see under the section on MOK as the fact that the Stratex Invoices are Invalid will form part of the evidence available to determine the appellant's knowledge of the connection to fraud under the section on MOK).

…………………

Conclusion

Officer Ball has correctly denied the input tax in relation to the Stratex Alliance invoices and has correctly exercised his discretion to refuse deduction based on alternative evidence."

299. Officer Birchfield did not vary this aspect of Officer Ball's decision or substitute it with another decision or overrule it. There was no new exercise of discretion in relation to the Stratex invoices.

300. Section 83 of the Valued Added Tax Act 1994 ("VATA") gives a right of appeal at s.83(1)(c) to "the amount of VAT which may be credited to a person" and s.83(1)(p) provides for a right of appeal against an assessment under s.73 of VATA.

301. It is important to pay careful attention to the statutory language. Section 83 does not provide for a right of appeal against a review decision. This is notwithstanding the fact that amendments were introduced by the Transfer of Tribunal Functions and Revenue and Customs Appeals Order SI 2009/56 to introduce a statutory right to review under sections 83A-G. No right of appeal against a review decision is provided under sections 83A-G either.

302. In light of the fact that sections 83A to 83G, VATA do not provide for a distinct right of appeal against a review conclusion, even where there has been a review conducted there can only be one relevant decision that can be appealed, namely the original decision as either upheld, varied or cancelled on review.

303. Nonetheless, had the specific facts necessitated it, the Tribunal would have been entitled to have regard to the way in which the review decision was reached, particularly if the reasons relied upon for upholding the decision were substantially different. For the reasons set out above, the Tribunal finds they are not substantially different.

304. Some support for the Tribunal's decision is by analogy to the decision of Judge Jonathan Richards who came to a consistent conclusion in respect of similar provisions within the Finance Act 1994 in *Atom Supplies Ltd (t/a Masters of Malt) v Revenue & Customs (EXCISE WAREHOUSE : Approval*) [2015] UKFTT 388 (TC) at paragraphs 51 to 53:

"51. We have been able to decide this appeal by reference primarily to evidence dealing with the background to Officer Ames's original decision. However, it does seem to us that, by virtue of s16(1A) of FA 1994, the right of appeal is against a relevant decision, not against a particular decision letter. Moreover, the effect of s15F(5) of FA 1994 is that, following a review, there is not a fresh "decision", but rather the original "decision" is upheld, varied or cancelled. Therefore, we consider that in principle, where an HMRC decision is upheld following a review under sections 15A to F of FA 1994, the Tribunal is entitled to have regard to the way in which the review decision is reached as the appellant's appeal is against the "decision" as it stands following completion of the review process.

52. Support for this view can be found in s16(1C) of FA 1994. As we have noted at [43], this provides that where HMRC are required to undertake a review in accordance with s15C of FA 1994, a taxpayer is not able to appeal to the Tribunal until the outcome of that review has been communicated. This can only be because Parliament regards the outcome of the review as being relevant to the Tribunal's assessment of the "reasonableness" of the "relevant decision" as a whole. That, moreover, is consistent with common sense since if, following a review, a decision to refuse approval is varied so as to become a decision to grant approval but subject to conditions, a taxpayer should be entitled to challenge the "reasonableness" of the decision to impose conditions.

53. Of course, common-sense will have to prevail. If it is clear in all the circumstances that the review has simply resulted in the original decision being upheld for precisely the same reasons, it may well be that detailed evidence on the review is not necessary. However, there will be cases in which the process by which the review decision is reached is relevant."

305. The Appellant recognises the narrow wording of the appeal provisions in its submissions on the issue but takes the view that there must somehow be a re-exercise of discretion on review "*outside the statutory review process generating a discrete appealable matter*" despite there being no statutory provision for such a procedure. It is not apparent that if there was a right of appeal against a non-statutory review decision prior to 1 April 2009 that it survived the introduction of the statutory review process.

306. The Appellant relies upon the judgment of Dyson J (as he then was) in *CEC v Peachtree Enterprises Ltd* [1994] STC 747 at 752g-j. However, in that case, His Lordship was addressing a quite different situation where the Commissioners had imposed a security on the basis of certain facts. The taxpayer then supplied new information which resulted in a new decision being made that imposed a security in a different amount. Both decisions were appealed. It was held that the Tribunal should consider both decisions on the basis of the information available at the time of each decision.

307. This authority does not support the Appellant's present argument because there was no new information before Officer Birchfield and he upheld Officer Ball's decision because he agreed with Officer Ball's reasoning. In these circumstances there is only one relevant decision, namely that of Officer Ball. Contrary to the Appellant's submissions Officer Ball's decision has not been superseded.

308. Even were the Appellant correct and there is a non-statutory review process which gives rise to a distinct appealable decision there was no new exercise of discretion in the present case, simply the affirmation of an existing decision. In those circumstances the relevant decision-maker for the purpose of the discretion under Regulation 29(2) is Officer Ball.

The reasonableness of Officer Ball's decision not to accept alternative evidence for the invalid invoices

309. Officer Ball exercised a discretion not to accept the Appellant's alternative evidence of taxable supplies for the purpose of its claim to deduct input tax on the Stratex invoices, which were accepted to be invalid. His reasons for denying input tax on the invalid Stratex invoices were encapsulated at paragraph 7 of his decision letter of 6 December 2012 and his witness statement at paragraph 423 as set out above.

310. In essence, these were that: a) Stratex was not registered for VAT; b) the transactions were connected to fraud and c) that the Appellant failed to conduct reasonable due diligence in relation to the transactions.

311. The Appellant argues that HMRC took into account irrelevant matters and / or acted irrationally or otherwise failed to properly exercise their discretion because Regulation 29(2) circumscribes their discretion.

312. The Tribunal does not accept that these were irrelevant factors which he should not have taken into account nor that it was unreasonable for HMRC, and Officer Ball in particular, to rely on the matters he did in refusing to exercise his discretion.

313. The Appellant's argument amounts to a submission that Regulation 29(2) of the VAT Regulations 1995 and HMRC's Statement of Practice is a document that wholly fetters HMRC's discretion in relation to the allowance of credit for input tax in the absence of a valid VAT invoice. The Tribunal is not satisfied that this is right.

314. The Appellant is right to submit Regulation 29(2) is actually quite prescriptive as to the nature and extent of HMRC's discretion: it is a discretion to accept *"other documentary evidence of the charge to VAT"*. Nonetheless, the Regulation is not prescriptive as to the factors which must be taken into account in order for the claim to input tax to be accepted or that the documentary evidence supplied must be considered in isolation.

315. Further, HMRC's Statement of Practice is a policy document, not binding law, drafted in 2007 and before MTIC fraud became evident in carbon credit trading as it did in 2009.

316. In Appendix 3 to the Statement of Practice, the trade in goods which then posed a higher risk of VAT fraud is specified (including telephone and computer products). Paragraph 18 mandates that claimants 'are likely to be asked further questions by HMRC in order to test whether they took reasonable care in respect of transactions to ensure that their supplier and the supply were 'bona fide'. It is reasonably apparent therefore that the Statement of Practice directs HMRC to exercise its discretion to accept alternative evidence of the charge to VAT with regard to the risk of fraud in the relevant supplies and the level of due diligence that a claimant has undertaken.

317. An implication of the Appellant's argument is that if a taxpayer trades in a product not yet specified to be one at high risk of fraud in 2007 (those products specified in Appendix 3), the Statement of Practice effectively bars HMRC from taking into account that as a matter of fact (and uncontested fact in this case) the transaction was part of such a fraud. The Tribunal does not accept this argument.

318. Even accepting that carbon credits were not listed in Appendix 3, paragraphs 17 and 19 of the Statement of Practice provide as follows:

"17. For supplies of goods not listed at Appendix 3, claimants will need to be able to answer most of the questions at Appendix 2 satisfactorily. In most cases, this will be little more than providing alternative evidence to show that the supply of goods or services has been made (this has always been HMRC's policy).

……….

19. As long as the claimant can provide satisfactory answers to the questions at Appendix 2 and to any additional questions that may be asked, input tax deduction will be permitted."

319. First, the questions posed at Appendix 2 of the Statement of Practice require a person seeking to deduct input tax without a valid invoice to explain how the relationship with his supplier was established. The extent to which the taxpayer seeking deduction establishes that his supplier was a *bona fide* VAT registered trader is relevant to the exercise of HMRC's discretion.

320. In this case it was evident to the decision-making officer that the Appellant had failed to carry out the most basic of checks on Stratex. The primary facts have been established on the balance of probabilities which Officer Ball relied upon. The conclusion he came to was reasonable. This was therefore a relevant matter for the Officer to take into account because it bears directly on how the tax loss has come about.

321. Second, the questions listed in Appendix 2 are not stated to be exhaustive – "*This list is not exhaustive and additional questions may be asked in individual circumstances"*. If there are relevant questions which flow from the answers to the stipulated questions then these must be relevant. For example, question 6 in Appendix 2 focuses on whether goods have been stolen – it too is directed to the bona fides of the transaction.

322. In *The Commissioners for Her Majesty's Revenue & Customs v Boyce* [2017] UKUT 177 (TCC) Mr Justice Arnold, sitting in the Upper Tribunal, accepted that a real and obvious risk of fraud was a relevant factor when HMRC exercises its discretion in the absence of a valid VAT invoice (see [19], and [22-23]):

"19. Furthermore, counsel submitted….The FTT had failed to take into account the fact that there was a real and obvious risk of fraud in that the VAT invoices made out to the Named Purchasers could be used in order to make duplicate claims for the recovery of the VAT shown on them. That risk distinguished this case from one where no VAT invoice had been issued at all.

………………

22. Finally counsel submitted that, in addition to the real and obvious risk of fraud mentioned above, the FTT had failed to keep in mind when assessing the Commissioners' decision that: (i) the rule, as a matter of both EU and UK VAT law, is that without a valid VAT invoice there can be no input tax deduction; (ii) the use of the discretion in regulation 29(2) involves creating an exception to that rule; and (iii) it is therefore entirely reasonable for the Commissioners to insist on strict adherence to that rule unless and until the taxpayer can demonstrate that why an exception to it should be made……

23. In my judgment the FTT erred in law in reaching its conclusion for all of the reasons given by counsel for HMRC……"

323. There is earlier non-binding support for the authority of *Boyce* in the First-tier decision of *McAndrew Utilities Ltd v Revenue & Customs* [2012] UKFTT 749 (TC). There the Tribunal

considered the relevance of the fact that the transactions for which invalid invoices had been supplied took place in a market known to be vitiated by fraud. The Tribunal concluded at [120]:

"120. The respondents say that the appellant's failure to carry out any meaningful due diligence or commercial checks in a market affected by fraud is a factor in the exercise of its discretion to accept alternative evidence of the charge to VAT. We accept that submission."

324. Accordingly, the Tribunal is satisfied that the Appellant's submissions that fraud is irrelevant to the exercise of HMRC's discretion is not correct. The Tribunal accepts that the application of the *Kittel* test is quite separate and independent of the discretion to accept alternative evidence but Officer Ball only relied on the connection to fraud and the poor commercial checks (due diligence) carried out by CFE. He did not rely on an allegation of knowledge or means of knowledge in the exercise of his discretion, simply the connection to fraud.

325. That the transactions were connected to fraud was a material factor for HMRC to take into account in exercising their discretion for the reasons set out above. This is independent of the separate grounds for denial of input tax on the *Kittel* basis. The connection of these transactions to fraud is undisputed. Denial on the basis of *Kittel* requires HMRC to prove knowledge or means of knowledge of such connection to fraud which is in dispute and considered later on within this decision within the Third Issue.

326. Likewise, Officer Ball properly took into account that Stratex was not VAT registered and that the Appellant failed to perform reasonable commercial checks in exercising his discretion to refuse to accept alternative evidence for the invalid invoices and to deny input tax upon them.

327. The absence of a VRN from the Stratex invoices did not simply render them invalid for the purposes of Regulations 13 and 14 of VATR on a technical deficiency or oversight. This was no simple failure to meet a procedural requirement but was an indicator of a substantive absence – that Stratex was not VAT registered at the time of the supplies. This was a relevant factor for the exercise of HMRC's discretion.

328. The lack of reasonable commercial checks or due diligence carried out by the Appellant on Stratex was also a relevant factor for HMRC to take into account in exercising the discretion. The most obvious failure by the Appellant was to check that Stratex had a valid VAT Registration number at the time of the transactions. This failure to perform reasonable due diligence and commercial checks was an example of a real and substantial failure to take reasonable care. A simple check would have revealed that Stratex was not VAT registered.

329. The context in which this failure occurred is striking. The Appellant was a leading multinational and profitable company. In addition to the traders conducting the transactions it had its own internal credit department and tax departments together with in-house legal advisers. It also had access to external expertise. All of this was in addition to the published HMRC, JMLSG and FATF guidance available to the Appellant.

330. Yet despite all of the above, the Appellant conducted 17 transactions between 18 May and 3 June 2009 to a value totalling around €40 million attracting over £5 million in VAT on which it paid out this very large sum in VAT. These transactions were connected to a fraudulent loss of VAT to the exchequer. The absence of VRN on the part of Stratex was a material indicator of fraud. It must have been reasonable for HMRC to take account of, what

can be considered to be a failure to take reasonable care on the part of the Appellant, in failing to conduct the most basic of checks upon its supplier.

331. To the extent that Officer Ball relied on other failures by the Appellant to conduct further commercial checks, as set out in his witness statement at paragraphs 416 to 421, the Tribunal is satisfied that these failures have been proved as a matter of fact and that it was reasonable to take them into account. The Tribunal considers in greater detail the Appellant's failures to perform reasonable and proportionate due diligence within its findings on the Third Issue (denial of input tax based upon the *Kittel* test).

The reasonableness of HMRC's policy when denying input tax and not accepting alternative evidence for invalid invoices

332. To the extent that it is necessary to look at the reasonableness of the exercise of discretion by Officer Birchfield rather than Officer Ball the Tribunal observes the following.

333. There would be no point in having a formal system of requirements for a VAT invoice if the only question was whether the substantive requirements for the charge of VAT were met. A taxpayer could simply assert that it had received a taxable supply without any invoice at all and providing its evidence met the required standard of proof it would be able to deduct -- it would have an unimpeded right to deduct.

334. However, the reason there are formal requirements is in part to make it harder to commit fraud. It is no answer to say one can leave those requirements out of account because HMRC have the ability to deduct input tax based upon *Kittel*. *Kittel* requires proof of means of knowledge, not simply the connection of the invoice to the fraudulent evasion of VAT. The formal requirements for the validity of invoices are meaningful. They make it easier to carry out oversight of the system on the part of the national authority. They make it harder to undertake a fraud and get away with.

335. The manner in which the EU and UK legislation is drafted is such that the holder of an invalid invoice does not have the right to deduct. They may be permitted that right but the starting point is that they do not. The discretion under regulation 29(2) VATR is not simply a technocratic provision whereby the existence of a taxable supply answers all questions.

336. What regulation 29(2) demands is alternative evidence. Simply asking whether the supply has taken place does not give a complete answer (see the decision in *Scandico* at [43]).

337. So in line with both Officer Ball and Birchfield's evidence, HMRC can look at all objective and relevant factors when considering whether to accept alternative evidence, not simply limited to the Statement of Practice, such as whether the invoice issuer holds a VRN. It might be thought that this is such a basic requirement that it would not need to be included in a list of factors when considering whether to accept alternative evidence for an invalid invoice. It certainly cannnot be dismissed as irrelevant or an erroneous consideration, it is absolutely fundamental.

338. The introduction to HMRC's Statement of Practice in paragraph 1 states it has been revised to provide clearer guidance on the updated legal position. Then it goes on to say: "The guidance does not apply to situations where HMRC may deny recovery of input tax for other reasons such as abuse of the right to deduct." It does not purport to be an exhaustive statement.

The existence of the policy obviously acknowledges the existence of a discretion but the application of the policy will always depend on the individual circumstances.

339. Stratex is accepted to have issued many invoices connected to the fraudulent evasion of VAT. The failure to observe the lack of VRN contained in the invoices, because Stratex did not hold one, was an obvious failure by the Cantor Group. In this situation it is not like CFE have been deceived by there being somebody else's VRN put on an invoice. The invoices simply contained no numbers.

340. Officer Birchfield asked a rhetorical question in evidence. There were 17 invoices, over 5 million pounds' worth of VAT paid out by an investment bank with its own tax department. How could that happen?

341. CFG had a tax department, a legal department, a compliance department and an invoice processing department. No evidence was given to explain the failures which allowed the Stratex invoices to be processed. The Tribunal did not hear from any witness from the invoice department. Mr Adcock said that payments would be made but there was nothing about this subject at all in his witness statement. The Appellant did not purport to explain how the situation came to be. The Tribunal did not hear from Mr Treanor, CFG's indirect tax manager. It is simply unexplained.

342. It was therefore reasonable for HMRC, and Officer Ball in particular, to take into account that Stratex were not VAT registered, that the transactions were connected to fraud and the Appellant had failed to conduct reasonable due diligence on Stratex. He took into account relevant factors and did not take into account irrelevant factors.

343. To the extent it is necessary to examine Officer Birchfield's exercise of discretion, it too was reasonable. In refusing to accept alternative evidence he explicitly agreed with Officer Ball. To the extent he gave any different reasons he relied upon the fact that Stratex were not VAT registered and the fact that the transactions were connected to fraud (within his application of the *Kittel* test). Both of these are relevant factors which he was entitled to rely upon.

Conclusion on the Second Issue

344. HMRC, and Officer Ball in particular, reasonably exercised the discretion to refuse to accept alternative evidence and to deny input tax in period 06/09 of over £5.6 million on the Stratex invoices which were invalid in law. This ground of appeal is dismissed.

The Third Issue

345. The third issue is whether CFE, hence the Appellant, knew or should have known that its transactions in 06/09 and 09/09 in respect of which input tax has been denied were connected with the fraudulent evasion of VAT.

346. Attribution of knowledge or means of knowledge to the Appellant is through its officers, employees or agents and those at its associated companies Cantor Fitzgerald Europe Ltd ("CFE") and Cantor CO2e Ltd ("CO2e"), part of the Cantor Fitzgerald group ("CFG") of which the Appellant is the group VAT representative.

347. It is not in dispute that the transactions were connected with the fraudulent evasion of VAT, the issue is whether CFE knew or should have known of this (had means of knowledge).

HMRC denied input tax claimed by the Appellant on these transactions alleging CFE had knowledge or means of knowledge but the Appellant disputes this. The burden is upon HMRC to prove it.

348. The transactions in which knowledge and means of knowledge are in dispute consist of very large quantities of carbon credits supplied to CFE by five suppliers:

Stratex Alliance Ltd (17 transactions between 18 May – 3 June 2009);

AH Marketing and Distribution Limited (7 transactions between 8 – 18 June 2009);

GW Deals Limited (1 transaction on 8 June 2009);

Mettec trading as Ayres Limited (1 transaction on 10 June 2009); and

Westis Limited (4 transactions between 28-29 July 2009).

349. The amount of VAT denied in respect of the disputed transactions is £7,730,812.34.

350. The transactions with CFE's five suppliers and the amount of VAT denied are set out in the table below:

VAT period, Supplier & Transaction Date	**Subject Matter - EUAs**	**VAT (£)**
06/09		
Stratex		
18 May 2009	66,000 units	120,789.99
18 May 2009	20,000 units	179,723.50
18 May 2009	100,000 units	178,933.51
20 May 2009	103,000 units	198,134.30
22 May 2009	214,000 units	419,828.83
22 May 2009	43,000 units	84,385.13
27 May 2009	220,000 units	427,254.77
28 May 2009	263,000 units	457,084.92
28 May 2009	304,000 units	590,388.41
28 May 2009	238,000 units	456,884.79
2 June 2009	200,000 units	395,807.64
2 June 2009	300,000 units	594,107.80
2 June 2009	100,000 units	196,450.59
3 June 2009	180,000 units	341,245.38
3 June 2009	200,000 units	379,161.53
3 June 2009	210,000 units	396,177.56
3 June 2009	100,000 units	188,788.09
AH Marketing		
8 June 2009	70,000 units	118,487.04
15 June 2009	50,000 units	80,126.23
16 June 2009	80,000 units	133,176.96
16 June 2009	35,000 units	58,185.65

18 June 2009	85,000 units	142,623.55
18 June 2009	50,000 units	82,911.91
18 June 2009	36,000 units	59,977.20

GW Deals

8 June 2009	25,000 units	42,477.62

Mettec

10 June 2009	50,000 units	84,926.28

09/09

Westis

28 July 2009	151,000 units	262,427.27
28 July 2009	65,000 units	112,799.38
29 July 2009	250,000 units	426,182.06
29 July 2009	307,000 units	521,391.45

351. As a result of the review conducted by Officer Peter Birchfield, HMRC decided that CFE knew or should have known that its purchase and supply of carbon credits were connected to the fraudulent evasion of VAT in respect of the Stratex transactions between 18 May 2009 and 3 June 2009 and in respect of all four other suppliers from 8 June 2009 onwards until 29 July 2009.

352. HMRC rely on the specific features of the supplies where Stratex was not registered for VAT and supplied no VRN on its invoices as additional features which should have put CFE on notice at the time of these earlier transactions.

353. As is set out above, it is undisputed that all of the transactions in dispute were connected to a fraudulent VAT tax loss. The issue is knowledge or means of knowledge upon which HMRC is required to prove on the balance of probabilities.

The Facts on the Third Issue

Constitution of the Appellant and related companies

354. Tower Bridge GP Ltd ("the Appellant") is the VAT Group Representative for Cantor Fitzgerald Group ("CFG"). The Appellant's relevant directors at the time of the relevant transactions were: Mr Howard Lutnick, Mr Wayne Buchan and Mr Mark Cooper.

355. The Appellant was incorporated under the laws of England and Wales on 15 December 2006 and provides back office support to entities including CFG.

356. As confirmed on http://www.cantor.com/, CFG serves more than 7,000 institutional clients around the world and is recognised for its strengths in equity and fixed income capital markets, investment banking, prime brokerage, commercial real estate finance and for its global distribution platform. Cantor Fitzgerald is also a leader in new businesses and marketplaces including e-commerce and other ventures. One of the leading middle market investment banks, Cantor Fitzgerald & Co. is one of 22 primary dealers authorised to trade U.S. government securities with The Federal Reserve Bank of New York.

357. Cantor Fitzgerald Europe Ltd ("CFE") is a limited company incorporated under the laws of England and Wales with company number 02505767 and is also a member of the Appellant's VAT group.

358. CFE is part of CFG and owned by Cantor Fitzgerald Inc., an investment bank and brokerage business. CFE is a full service multi-national securities and derivatives broker of whom Messrs. Lutnick and Cooper were also directors at the time of the relevant transactions.

359. CFE's principal business was that of broker in equities, equity derivatives, foreign exchange markets and contracts for differences for Eligible Counterparties and Professional Clients (as those terms were defined in the FSA Handbook during the relevant period). It was authorised and regulated in the UK by the UK Financial Services Authority (the "FSA"). CFE's registered office is at 1 Churchill Place, Canary Wharf, London, E14 5RB.

360. During the Relevant Period, CFE employed about 125 staff including brokers, sales people and administrative support personnel in London and another 50 personnel in the rest of Europe and Israel.

361. CFE executed the relevant transactions under appeal and it received and issued the relevant invoices.

362. Cantor CO2e Limited ("CO2e") arranged and undertook the relevant transactions. CO2e is a company incorporated under the laws of England and Wales with company number 04191186 and is a member of the Appellant's VAT group. It is a UK subsidiary of CantorCO2e LLC. At all material times it was regulated by the Financial Services Authority.

363. The relevant directors of CO2e at the time of the relevant transactions were: Mr Steven Drummond (who was suspended on 8 January 2009 and dismissed on 31 March 2009 according to Laurence Rose), Mr Lutnick, Mr Rose and Mr Cooper. Mr Rose was appointed Chairman of CO2e in 2007.

364. CO2e's principal activities as at the end of 2009 were the provision of brokerage, information and consulting services for products related to environmental markets. CO2e principally operated as a broker of carbon credits on the EU Trading Scheme ("ETS") (through CFE) on both a name give-up basis (connecting buyers and sellers and revealing their identities to one another at the point a transaction is agreed) and matched principal basis (serving as the counterparty to both the buyer and seller).

365. CFE's carbon credit broking service consisted of selling them "Over the Counter" ("OTC"), also known as "spot" trading.

Relationship between CO2e and CFE

366. During the relevant period, both CFE and CO2e were owned and controlled by Cantor Fitzgerald, LP. Cantor Fitzgerald, LP also owned and/or controlled four other FSA regulated entities in the UK at this time. During the relevant period they, and the Appellant, also had several directors in common.

367. CO2e was permitted by CFE to execute transactions in emission reduction credits in CFE's name. It was understood between the entities that such transactions would be carried out on a "matched principal" basis and that CO2e was responsible for any losses incurred by CFE as a result of such trades. This relationship was not formally documented.

368. For simplicity, references in the remainder of this decision to CFE should be read as including references to CO2e, save where the context otherwise requires.

369. CO2e did not have the regulatory permissions to act as a principal to trades or to hold client money. Even if it had these permissions, it was anticipated that CO2e would have required a more substantive balance sheet or be supported by guarantees in order that clients would have been prepared to deal with it. For these reasons it used CFE which had the necessary permissions and a more substantial balance sheet. This arrangement was put in place, even though Over the Counter ("OTC") spot trading in emission reduction credits (European Union Allowances ("EUAs"), Certified Emissions Reductions ("CERs") and Verified Emissions Reductions ("VERs")) was not in itself a regulated activity, provided that delivery was made within seven days or less of the trade date (even if trading was carried out for investment rather than compliance purposes).

370. Trading in carbon credits formed only a small part of the overall business of CFE. The revenue from the trades was allocated to CO2e as a matter of internal bookings.

Relevant officers and employees

371. Mr Mark Cooper was the Director and General Counsel of the Appellant, CFE and CO2e at the time of the relevant transactions. He left CFG in 2016.

372. Mr Laurence Rose was the chairman of CO2e at the relevant times. He left CFG in 2016.

373. Mr Wayne Buchan was a director of the Appellant at the relevant times and is Chief Risk Officer for CFG.

374. These three individuals gave evidence on behalf of the Appellant.

375. Mr Steven Drummond was the CEO of CO2e between January – March 2009.

376. Mr James Emanuel was an employee of CO2e and joined in or about October 2005. Mr Emanuel was the Commercial Director and Head of Operations for CO2e. Mr Emanuel was experienced in the carbon credits market, having been involved in it since 2002, and viewed himself as "*something of an authority*" in the field. Mr Rose was not involved in his recruitment but believes that he was hired by Mr Drummond. According to Mr Rose, Mr Emanuel was very experienced in the carbon market and had a lot of knowledge and information about it.

377. Mr Emanuel was hired with his colleague (Mr Benedikt Von Butler). Mr Rose recalls that this was seen as a significant step for CO2e, as Mr Emanuel had been a successful broker at his previous firms and had long established relationships with counterparties. According to Mr Rose, he was good on the phone and knowledgeable about pricing and trends. He was often sought after by the media (both TV and press).

378. Mr Emanuel reported directly to Mr Drummond prior to Mr Drummond's dismissal in January 2009. From January 2009 onwards, Mr Rose worked more closely with Mr Emanuel. The leadership structure at that point relied on Mr Emanuel running the business in London on a day to day basis and then raising more significant issues with Mr Rose, who was based in Toronto and had other responsibilities with Cantor Fitzgerald.

379. Mr Emanuel left CO2e in October 2010, having been made redundant. Around this time the North American part of the business was sold to BGC Partners and the remaining parts of the international division were unwound. The latter was done because it was felt that Cantor had invested significantly and had not achieved a return. Mr Cooper also remarked that, after the event, the view was formed that Mr Emanuel had not performed well in his role because the net position was that, through Mr Emanuel's clients, the Appellant was exposed to a dispute with HMRC.

380. Mr Emanuel headed up the EU Carbon Desk which comprised Benedikt von Butler, Hugh Lynch, John Bush and Emilio Weldon. The desk traded various types of environmental instruments (not just EUAs). Certain personnel on the EU Carbon Desk also had roles in relation to supporting other CO2e business units (as described above). Mr Emanuel in particular tended to get involved in the work of all the CO2e business units.

381. The main traders under Mr Emanuel were therefore: Mr Hugh Lynch, Mr John Bush, Mr Benedikt Von Butler and Mr Emilio Weldon. Each was said to be experienced in the carbon credits market. They all left CO2e in 2010.

382. Mr Steven Treanor was the indirect tax manager at CFE during the relevant period. He left CFG in 2010. Ms. Susie Luard was Senior Tax Manager during the relevant period. She left CFG in 2013.

383. Mr Kevin Taylor was Head of Compliance for Europe & Asia. He left CFG in 2010. Ms Tracey Ann Mills has been Head of Compliance for Europe & Asia since 2012. Mr Ross Tanton was CFE's compliance manager. He left CFG in 2010.

384. None of Mr Emmanuel, the traders, Mr Treanor, Mr Tanton or Mr Taylor gave evidence on behalf of the Appellant in support of the appeal. The significance of this will be considered below.

Background to CO2e

385. Mr Stephen Drummond founded a business called CarbonWeb (and later CO2e.com) with the assistance of PricewaterhouseCoopers Global ("PwC Global"). PwC Global's interest was sold to Cantor Fitzgerald LP in or about 2000. Cantor Fitzgerald's Environmental Brokerage (an existing North American based business) combined its business with CO2e.com in or about March 2007 to operate as one global group under the brand CantorCO2e.

386. CO2e was a leading global provider of financial services to the world's environmental and energy markets, offering finance, consultancy, advice, technology, and transaction services to clients engaged in using energy and managing emissions across the world. CO2e helped people and corporations across the world to manage the financial aspects of their energy and environmental choices. In North America and Europe, this meant providing brokerage services to the energy and environmental commodity markets. Elsewhere, this meant bringing expertise, finance and technology to projects that reduce emissions.

387. CO2e served the carbon market and helped entities transact via electronic trading screens, recorded telephone lines, auctions and negotiated contracts. As well as carbon credits, CO2e brokered renewable energy, such as ethanol and Biodiesel. CO2e advised equity investment funds on carbon finance, introduced investors to projects, and structured forward sales to enable project developers to fund their investments. CO2e also helped 'clean-tech' technology

developers to manage their intellectual property, to develop their licensing strategies, and to roll out their technologies through its global network.

388. CO2e was headquartered in London and San Francisco and at one point had fourteen offices across five continents.

Leadership within CO2e

389. Mr Rose was appointed Chairman of CO2e in or about 2007. He was primarily responsible for launching the Canadian investment banking business in June 2009 but had responsibilities for a number of other businesses, one of which was CO2e.

390. CO2e had a North American and international division. Each division had a CEO and both CEOs reported to Mr Rose. Mr Steve Drummond was the CEO of the International division and Mr Josh Margolis was the CEO of the North American division. At the relevant times Mr Rose reported to Mr Howard Lutnick, the Chairman and CEO of the Cantor Fitzgerald Group ("CFG").

391. Mr Christopher Craib was (and continues to be) the Chief Financial Officer of Cantor Fitzgerald Canada Corporation. Mr Craib worked closely with Mr Rose, providing accounting, tax and other financial advice in relation to the businesses in respect of which Mr Rose had responsibility. During the time Mr Rose served as Chairman of CO2e Mr Craib became involved on a peripheral level with CO2e and assisted Mr Rose in that capacity, including interacting with the London team of CO2e.

392. Mr Drummond was suspended on 8 January 2009 and dismissed with effect from 31 March 2009 for allegedly failing to tell the company he was in talks with a competitor (EcoSecurities) about a job. The business subsequently sued Mr Drummond, for the return of $2 million it lent him while he was with CO2e. Mr Drummond countersued, claiming he was wrongfully dismissed in 2009.

393. A Bloomberg article dated 21 July 2010 was issued regarding these proceedings entitled "*Howard Lutnick, chairman of Cantor Fitzgerald LP, said that its U.K. carbon credits brokerage was a money-losing failure, with business projections based on dreams"*. The part of the CO2e business Mr Lutnick was in fact referring to was the Clean Development Mechanism ("CDM") business, namely the project-based carbon credit generation side. Mr Drummond's projection of the pipeline of carbon credits that would be generated from CO2e projects had failed to materialise by the time of Mr Drummond's dismissal.

394. From January 2009, following Mr Drummond's dismissal, Mr James Emanuel ran the International Division.

395. The sale of the generated carbon credits did not prove to be profitable and therefore, (as will be explained more fully below) there was a change in focus away from carbon credit generation from CDM projects in late 2008 and the first part of 2009 with a new concentration on brokerage. This might be described as a move from originating something to assisting in the transaction of something.

The background to carbon credits and their use in VAT and MTIC fraud

396. Carbon credits come in two forms, EU Allowances ("EUAs") and Certified Emission Reduction certificates ("CERs"). These carbon credits are issued by the European Community as part of a cap-and-trade system. Each emitter, e.g. an electricity generator or a factory, is provided with a certain amount of carbon credits each year. Where the emitter produces more greenhouse gases than it has certificates to cover it must purchase more, and where it produces less it may sell the surplus. Trading of carbon credits takes place on the ETS (Emission Trading Scheme).

397. Carbon credits are traded on both future and "spot" markets (OTC – over the counter). Carbon credits have unique numbers and are kept in emissions registries maintained by each state that is a member of the ETS. The European Commission Directorate General of Environment ("DG Environment") maintains a log of carbon credits transactions, parts of which were made available to HMRC at various points during the investigations into VAT fraud in the market. To trade in carbon credits a trader must have a registry account to hold carbon credits. Spot trading in carbon credits is for immediate delivery with settlement taking place up to three days later.

398. Whilst there were exchanges for the trading of carbon credits (e.g. the BlueNext SA exchange in Paris ("BlueNext")) they could also be traded business-to-business. Whilst the majority of financial services products are exempt from VAT, at the material time in March to July 2009 carbon credits traded OTC attracted a standard rate of VAT in the UK.

399. CFE and other members of CFG were, at the material time, regulated by the Financial Services Authority ("FSA") in respect of the Money Laundering Regulations 2007 and the Financial Markets Act 2000. CFE *et al* were also subject to statutory duties under the Proceeds of Crime Act 2002 to report suspicions concerning criminal property, money laundering and terrorist financing. While spot trading in carbon credits itself was not regulated by the FSA, the FSA saw itself as having some responsibility relating to the emissions derivatives market (e.g. the futures market). The FSA published a document entitled "*The emissions trading market: risks and challenges*" in March 2008.

400. Prior to the reverse charge being introduced on 1 June 2007, Missing Trader Intra Community (MTIC) fraud caused very large losses to the UK treasury predominantly involving computer chips and mobile telephones. During 2009 carbon credits became a commodity for perpetrating significant MTIC fraud.

401. There is no need to explain in this decision how MTIC fraud (a variant of which is known as 'carousel fraud' as it relies on the circularity of movement of supplies) operates as it is set out at length elsewhere. Suffice to say that it is a type of VAT fraud that relies upon the fraudulent non-accounting for and non-payment of VAT by defaulting companies who receive output tax on their supplies without thereafter accounting for and paying it to HMRC[7].

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[7] When the VAT system is correctly operated, it is axiomatic that: (i) an amount of VAT charged by one VAT registered trader to another VAT registered trader should be accounted for as output tax; and then (ii) the amount of VAT previously charged as output tax may subsequently be reclaimed by the purchaser as input tax (so as to ensure that the tax is neutral regardless of how many transactions are involved); and (iii) when a business's input tax claim exceeds its output tax it will be entitled to make a claim for a repayment of VAT.

A transaction chain in an MTIC fraud typically involves a "missing" "hijacked" of "fraudulent defaulting" trader who acquires goods from another EU member state; one or more intermediary or

402. The fraudulent default is often achieved by such defaulting companies going missing (hence another name 'missing trader fraud'). Thereafter the VAT loss to the revenue is crystallised when traders further down the transaction chains claim deductions or repayments of input tax from HMRC in respect of their VAT inclusive purchases from defaulting traders coupled with sales to other EC member states where no output tax is charged. The fraud exploits the zero rating of trading between companies in different EC Member states and often involves a conspiracy between many members of supply chain to involve themselves in and profit from contrived transactions.

403. Carbon credits were particularly attractive to MTIC fraudsters, since they could be traded with no physical movement of product, traded quickly and in large volumes and traded between EC Member States without any customs authority having immediate sight of the transactions.

404. The first awareness that there was serious VAT fraud afoot in the carbon credits market came in suspicious transaction reports provided to the French authorities by the Caisse des Depots et Consignations ("CDC"), the French national investment authority, in November 2008 (Cour Des Comptes Annual Public Report 2012 Executive Summaries). The reports concerned activity on the BlueNext exchange in France. BlueNext was a VAT registered exchange that matched orders and cleared trades and was the primary exchange for OTC carbon credit trading between October 2008 and July 2009.

405. CFE was a member of BlueNext from 2 May 2007. BlueNext had experienced unprecedented volumes of spot trading in EUAs in late October 2008 as set out in its press releases.

406. The director of the French anti-monetary laundering unit TRACFIN sent a memo to the Ministers of Finance and the Economy on 16 February 2009 in which he set out that he suspected that fraud was taking place on an extremely large scale.

407. On 31 July 2009 and then in 2010 the UK obtained a derogation from the EU to enable the introduction of the reverse charge on trading in zero-rated carbon credits.

"buffer" traders and a "broker" trader. The missing or fraudulent defaulting trader is a VAT registered entity in a transaction chain who purports to acquire goods zero-rated from another EU member state, sells them in the UK charging VAT at the standard rate, and then either disappears or deliberately fails to account for the VAT due to HMRC.

A "hijacked" trader adopts the identity of a VAT registered trader and takes on the role of the fraudulent defaulting trader and does not complete or submit a VAT return and deliberately does not pay the VAT when it becomes properly due.

Buffer traders are each VAT registered and entitled to claim the VAT charged to them as input tax and in turn charge VAT when they make an onward sale. A buffer trader usually acts as a conduit in holding or transferring title to the consignments concerned which also puts distance between the fraudulent defaulting trader and the broker.

The final entity in the UK transaction chain is the broker which will dispatch goods to another EU member state or export them outside the EU. The broker is entitled to reclaim the VAT from HMRC charged by its supplier and subject to certain conditions may zero-rate the removal of goods from the UK.

408. Europol estimated that at its peak in 2009 VAT carousel fraud had cost EU Member State treasuries around £5 billion and that up to 90% of all carbon trading in some European countries was as result of fraudulent activities. HMRC has estimated UK VAT losses from carbon credit trading as between £250-300 million.

409. BlueNext was assessed for VAT due of €355 million arising from a tax audit for the period between January 2006 and May 2009. This was ultimately settled for $42 million.

410. The World Bank report "State and Trends of the Carbon Market 2010" states at 2.3.1:

"EUA transactions in 2009 reached US$118.5 billion (€88.7 billion), making the EU ETS the largest existing carbon credit market. Over 6.3 billion tons of CO2e changed hands in 2009 through spot, futures and options contracts. A substantial portion of the growth came from the spot market, which totalled 1.4 billion tons, an increase of 450% over 2008. Over 70% of spot transactions occurred during the first half of the year… Spot volumes in the first half of 2009 increased 75-fold over the year-earlier period…"

411. A report by the Danish National Audit Office from March 2012 states:

"72. The European VAT authorities first became aware of the fact that VAT carousel fraud was being committed in relation to CO2 allowances in May 2009. VAT carousel fraud was particularly pronounced in France and the UK during the summer and both countries therefore chose in different ways to abolish VAT on allowance trading without prior approval by the EU.

73. On 30 August 2009 SKAT recommended to the Minister for Taxation that Denmark requested the EU to approve an amendment of the Danish VAT rules to eliminate the risk of VAT carousel fraud in Denmark."

412. The French Court of Audit stated in its 2012 Annual Report:

"4 VAT fraud in carbon trading
Extremely large scale fraud
Between the third quarter of 2008 and June 2009, VAT fraud in the carbon trading market developed in France, undoubtedly involving the highest amounts ever detected by tax authorities. The Cour des Comptes estimates the tax loss to the state from this fraud as €1.6 billion. The scam was halted only after the administration issued a tax instruction on 11 June 2009 exempting carbon quotas from VAT."

Risk and Due Diligence at CO2e - The regulatory and legislative context

413. The regulation of the financial services industry is set out principally in the Financial Services and Markets Act 2000 ("FSMA 2000"). FSMA 2000 provides that a person may only carry out *"regulated activities"* (which are typically activities relating to dealing in financial products) if they are authorised or exempt. A person can become an authorised person either by being given permission by the FSA or by qualifying for authorisation under FSMA 2000.

414. Spot trading of EUAs is not a regulated activity for the purposes of FSMA 2000 and the FSA did not regulate the spot trading of EUAs. The FSA's involvement in the emissions trading market was only in relation to the trading of derivatives in respect of EUAs. Spot trading of EUAs was not a regulated activity.

The Joint Money Laundering Steering Group ("JMLSG") Guidance

415. The legislative framework governing the Anti Money Laundering ("AML") / Counter Terrorist Financing Regime ("CTF") regime is set out in the JMLSG Guidance for the financial sector. The version of the Guidance in force at the time of the relevant transactions is dated December 2007. The JMLSG is comprised of 17 trade associations in the financial services industry. Its aim is to promulgate good practice in countering money laundering and to give practical assistance in interpreting the Money Laundering Regulations. At the relevant time the 2007 version of the Regulations applied. The JMLSG Guidance indicates good industry practice in AML/CTF procedures through a proportionate, risk-based approach: see para.2 of the Guidance.

416. Under the terms of the JMLSG Guidance, firms are required to have implemented systems and procedures which are *"appropriate, and proportionate to the risks identified"*: see para.18 of the Guidance. These systems and controls, and the level of resource, should *"reflect the size, complexity and geographical spread of the firm's customer and product base"*: see para.1.32 of the Guidance.

417. The JMLSG Guidance expressly allows firms discretion as to how they apply the requirements of the AML regime: see para.3 of the Guidance; and accepts that the appropriate approach is ultimately a question of judgement by senior management, in the context of the risks they consider the firm faces: see para.4.5 of the Guidance. The JMLSG Guidance is not a checklist of steps to take and should be applied in a thoughtful and considered way: see para.18 of the Guidance. The JMLSG Guidance states that, *"under a risk-based approach, firms start from the premise that most customers are not money launderers or terrorist financers"*: see para.1.3 of the Guidance.

418. The broad objective of the JMLSG Guidance is that *"the firm should know who their customers are, what they do, and whether or not they are likely to be engaged in criminal activity"*. It accepts that the profile of customers' financial behaviour *"will build up over time, allowing the firm to identify transactions or activity that may be suspicious"*: see para.4.10 of the Guidance.

419. A risk-based approach *"starts with the identification and assessment of the risk which has to be managed"*: see para.4.14 of the Guidance.

Customer Due Diligence

420. Chapter 5 of the JMLSG Guidance sets out the standard Customer Due Diligence ("CDD") measures which financial firms are required to undertake. The CDD measures that must be carried out involve (see para.5.1.5 of the Guidance):

"*(1) identifying the customer and verifying his identity;*
(2) identifying the beneficial owner, where relevant, and verifying his identity; and
(3) obtaining information on the purpose and intended nature of the business relationship. The JMLSG Guidance recognised that in some situations this may be self-evident: see para.5.3.21 of the Guidance."

421. For corporate entities this involves understanding the ownership and control structure of the customer. The standard evidence required for a corporate entity is (para.5.3.127 of the Guidance):

"(1) full name;
(2) registered number;
(3) registered office in country of incorporation; and
(4) business address.
For private or unlisted companies the following additional evidence is required:
(5) names of all directors (and equivalent); and
(6) names of individuals who own or control over 25% of the company's share capital or voting rights."

422. Firms also need to verify the company's existence by reference to either its listing on a regulated market or a search of the relevant company registry or a copy of the company's Certificate of Incorporation: see para.5.3.128 of the Guidance.

423. The JMLSG guidance is clear that *"Once the identity of a customer has been satisfactorily verified, there is no obligation to re-verify identity (unless doubts arise about the veracity or adequacy of the evidence previously obtained for the purposes of customer identification)"*: see para.5.2.23.14 of the Guidance.

424. The Tribunal accepts the evidence on behalf of the Appellant, primarily given by Ms Mills, that at the time of the trading in question, information about the source of funds would only have been obtained in a situation which was considered to be high risk. If the customer was a UK-incorporated company then, absent other indicators, such information would not normally be sought. If a customer was blatantly lying about something then that would be something which would call for further enquiry. Nonetheless, the Tribunal is also satisfied that the JMLSG requires a proportionate and responsive approach to due diligence that must adapt to any ongoing indicators of risk which occur during trading.

425. Checking a VAT registration number ("VRN") was not required by the JMLSG Guidance. The Tribunal accepts Ms Mills' evidence that VAT was not something that CO2e's compliance department got involved with. Any risk assessment would have been undertaken by the credit, tax or the finance department in that respect. Nor is it part of compliance checks to examine VAT risk. However, it was accepted that there were money laundering aspects to be considered in relation to tax fraud.

426. Thus, checking a VAT registration number might be required as part of enhanced due diligence responding to a perceived heightened risk. The Tribunal is satisfied it would be proportionate response to an indicator of potential risk such as the absence of a VRN on a VAT invoice. Likewise, aside from AML requirements, the Tribunal is satisfied that checking VAT numbers might form part of reasonable tax, finance or credit functions of an organisation when paying out large sums upon VAT invoices. As will be set out below, CFE did indeed check the VRNs of a number of its suppliers but the manner and circumstances in which it did so require careful scrutiny.

427. The JMLSG guidance was in force from 2007 and did not highlight the EUAs market as one which should be treated as high risk. The regulator regularly issued advisory notices for businesses or areas that were considered high risk for money laundering and it did not identify any reasons why the regulated community should have considered the carbon trading business to be high risk. Nonetheless the Tribunal places little weight on this because the guidance was bound to follow events and be revised only after risk was apparent across a sector (ie. it would

involve an element of hindsight). The absence of such guidance could not absolve a business of its need to assess its own risks in real time and respond accordingly rather than adopt a tick box approach.

428. Evidence on behalf of the Appellant was given in relation to its due diligence, primarily by Ms Annie Mills in relation to AML and Mr Wayne Buchan in relation to credit. It was said that site visits were generally undertaken by CO2e when the client that they were considering was, say, a manufacturing customer or a customer that had a factory or a customer involved with natural resources, so that they could see that they did in fact possess the necessary facilities.

429. When a company's capital and property was intellectual it was not a normal process for CO2e to undertake a site visit. Such a company could legitimately operate from a serviced office. The Tribunal accepts this evidence but it again would not absolve the Appellant of the need to adapt its due diligence and respond to the risk it encountered in its trading. A site visit might not be appropriate for low risk transactions but might become proportionate in response to moderate or high-risk trading.

Monitoring customer activity

430. The 2007 Money Laundering Regulations required firms to monitor their customers' activities by scrutinising transactions undertaken throughout the course of the relationship (including, where necessary, the source of the funds) to ensure that the transactions are consistent with the firm's knowledge of the customer, its business and risk profile and that the documents, data and information held by the firm are kept up to date. This can either by done in real time or after the transactions/activities have taken place: see paras 5.7.1 and 5.7.4 of the Guidance. In particular, the JMLSG Guidance specifies that monitoring is *"not a mechanical process"* and *"does not necessarily require sophisticated electronic systems"*: see para.5.7.8 of the Guidance.

Cantor's compliance function

431. The Money Laundering Reporting Officer's ("MLRO") Report dated 10 February 2010 in respect of the period 1 January 2009 to 31 December 2009 records that during 2009 CFE took on 451 new clients which represented an increase from 2008 of 56.1%.

432. The Compliance Team had systems and controls in place for client take-on, staff training and monitoring. These are set out in the MLRO's Report.

433. It was the CFG Group's policy that all employees have a responsibility to report anything suspicious and staff were trained to be aware of the risks to the firm of money laundering and understand the procedures to be followed if alerted to suspicious activity: see page 7 of the MLRO report.

434. An earlier Money Laundering Report from 2007 stated that the risk weighting for the matched principal business (discussed further in paragraph 101 below) in the wholesale markets for unregulated clients carried a risk weighting of 3 (where 0 indicated no risk and 5 indicated higher risk). This was a moderate to high risk. It was recommended that enhanced monitoring be undertaken on the business with unregulated clients.

Enhanced due diligence

435. According to para.5.7.12 of the JMLSG guidance, higher risk accounts and customer relationships require enhanced ongoing monitoring.

436. Enhanced monitoring involves including more CDD documentation than was required at the outset of the relationship. This may involve doing a screening of the client, which might reveal anything from the fact that they were subject to UN sanctions through to negative press coverage. It might also involve obtaining information that was independently confirmed by a lawyer of the clients in relation to the source of wealth or origin of funds or might also involve a site visit if it was appropriate in the circumstances. CO2e did obtain additional documents over and above the basic requirement of the JMLSG guidance in respect of some suppliers but that does not answer the question of whether it always acted proportionately and appropriately to the risk it encountered by implementing enhanced due diligence.

437. There are many different types of enhanced monitoring that can be undertaken and the person who is responsible for the business and the risk management at the time has to take a view based on the information that they have as to what is appropriate. It is important to note that the JMLSG Guidance does not set out a complete checklist because there are so many variations; rather it provides the foundation for the information that needs to be obtained.

438. Similarly, it should be noted that "simplified" due diligence is not a defined term in the Guidance in the sense that there are no prescribed steps – it is up to individual firms to decide what their lower level of due diligence is taking a risk-based approach.

439. Ms Mills made clear, and the Tribunal accepts, that views of risk can evolve over time. There is no good reason why a risk view taken at one point in time cannot change. The risk terminology that is used can also vary depending on who has written a report and is voicing an opinion as to risk. It can also vary in terms of the processes that it gives rise to.

440. One example is the draft suspicious event report from Mr Kevin Taylor (Head of Compliance for Europe and Asia) from 12 June 2009 which stated that the business of trading in EUAs was considered as low risk (having been classified as medium-high risk in 2007). Whether such consideration was objectively reasonable as at 12 June 2009 will be considered by the Tribunal below. Indeed, the draft report recommended that enhanced customer due diligence be implemented and the trade was categorised as high risk from 15 June 2009.

441. A sample CDD for AML Form for corporates (other than regulated firms), dated 14 May 2009, concerning Stratex Alliance Ltd ("Stratex") showed that when carrying out a standard CDD check, CO2e's Compliance Team looked to establish:

(1) the name of the company and its registered number;
(2) the registered office and business address;
(3) the names of all directors;
(4) the names of shareholders owning more than 25% of the company; and
(5) whether the company or its directors or shareholders were Politically Exposed Persons ("PEPs") or whether they appeared on any sanctions lists (a World Compliance check). This was carried out using the World Compliance or the Accuity System, which is powered by World Compliance.

442. The Tribunal will examine the due diligence specifically performed on its relevant suppliers below.

Responsive Due Diligence

443. It was accepted that there is a need for responsive due diligence. Ordinarily the desk head of CO2e would review matters at the end of each week and bring any matters to the attention of the compliance function.

444. As stated by Ms Mills in her second witness statement, when the perceived level of risk within a particular market changes, then it is appropriate, under a risk-based approach, to conduct a higher level of due diligence in respect of counterparties within that market. Accordingly, when CO2e's compliance department upgraded the perceived level of risk attached to carbon credit trading, then it was appropriate to implement more thorough due diligence procedures in respect of counterparties within this market.

445. This does not mean that the previous due diligence procedures in respect of this market were necessarily inadequate. Rather, it might indicate that the compliance department was monitoring the level of risk within particular markets and was taking action it believed to be appropriate to deal with these risks. As Mr Rose stated, the changes reflected what CFE learned about the market they were in. However, as set out below, the Tribunal finds that the due diligence procedures operated by CFE from 3 June 2009 were inadequate, they failed to respond proportionately to the objective indicators of the risk of fraud.

Background to CFE's trading in carbon credits

446. Prior to mid-2008 while CO2e's business had brokered by way of the "matched principal" model this was done infrequently as the focus had been on building up a Clean Development Mechanism business line. In addition, the various CO2e business units were underperforming in that each carbon credit generation project was not:

(1) generating credits at all; or
(2) generating as many carbon credits as expected; and/or
(3) generating carbon credits at a sufficiently low cost to be sold at a profit.

447. Mr Emanuel therefore presented a new business plan for the EU Carbon Desk in mid-2008 ("the Business Plan").

448. On 5 June 2008 Mr Emanuel sent Messrs. Rose and Drummond his Business Plan, a working document for the new "Cantor CO2e Platform". The document addressed CFE's project to develop itself, encapsulating the new business model as follows:

"Until now CantorCO2e has operated as an execution only broker. As such it has only been able to match buyers and sellers that have a pre-existing legal relationship with each other. This has limited the scope of CantorCO2e to expand its client base as it has been unable to offer a service to the many infrequent users of the market (non-professional compliance traders). These infrequent users of the market currently have very limited access to the market. Their only route to market presently is either via their bank or their energy provider, and they are being offered very uncompetitive prices but have no choice because of the compliance nature of the market.
Cantor CO2e will seek to capture this untapped potential of the market by evolving its business model from execution only to a matched principal business. The matched principal business will be channelled through Cantor Fitzgerald Europe (primarily because of their FSA status that allows them to hold client money and assets but also because of their superior balance sheet which provides comfort to clients….

By virtue of Cantor Fitzgerald operating as a matched principal in future, the parties to any trade will all be matched with Cantor Fitzgerald rather than with each other. This removes the requirement for the buyer and seller to be contractually related with anyone other than Cantor Fitzgerald. By deploying this methodology CantorCO2e will be opening the doors of the market to all those companies that were unable to access in directly in the past. This ought to provide CantorCO2e with liquidity that is not being seen by any of its competitors."

449. *"Schedule 2 – Financial Targets for the new business"* set out that CFE currently brokered an average of 100,000 – 150,000 carbon credits per day and that the aim was to increase daily volumes to 1 million per day by the end of the first year (December 2009) and 1.5 million per day by the end of the second year.

450. *"Schedule 3 – Tax Issues"* set out that Mr Treanor had identified that exchange traded transactions were zero-rated under the Terminal Markets Order but that OTC deals with VAT paid by CFE with subsequent exchange sales would result in VAT reclaims by CFE and OTC – OTC deals would attract VAT.

451. In summary therefore, Mr Emanuel's Business Plan focussed on growing the business by targeting compliance counterparties who did not have direct access to market and operating a matched principal model (i.e. parties to a trade would be matched to CO2e / CFE rather than each other).

452. Matched principal broking is a process whereby seller and buyer are matched via an intermediary (the matched principal) but never know each other's identity and never deal directly with each other. This allows the seller to sell and the buyer to buy instantly by virtue of their respective relationship with the intermediary without having to enter into a contractual relationship with each other.

453. For each matched pair of transactions, CFE would buy the assets from the seller and simultaneously sell those same assets to the buyer. The proceeds of sale would flow via CFE less transaction costs. As a matched principal broker, CFE had genuine credit and settlement risk. If one counterparty to a transaction were to fail for any reason, CFE was still obliged to fulfil its commitments to the other counterparty to the same transaction.

454. Mr Emanuel stated in the Business Plan that *"This ought to provide CantorCO2e with liquidity that is not being seen by any of its competitors."* The implication was that engaging in "execution only business" (where the buyer and seller are contractually related rather than matched through Cantor) was holding CO2e back.

455. With the new business model Mr Emanuel had suggested that CantorCO2e could target trading 1,000,000 certificates per day by end of 2009 and 1,500,000 certificates per day by end of 2010. The Business Plan refers to shifting focus to trying to secure the trade of *"compliance-driven business"*, i.e. those who actually emit carbon, who had no other viable route to market.

456. Mr Emanuel also sent the Business Plan to Mr Wayne Buchan, Chief Risk Officer at the Cantor Fitzgerald Group and its affiliate BGC Partners, on 21 July 2008 in order to consider the risk issues associated with the plan. It is important to note that Mr Buchan's role focussed on credit risk and market risk. Risk of fraud however was within the remit of the compliance team.

457. According to Mr Buchan, provided that those rules on pre-delivery and pre-payment were adhered to, the creditworthiness of the counterparties was not particularly material. Mr Rose recalled that this was also Mr Emanuel's view**.** Further, the fact that a counterparty might not be particularly creditworthy was not inconsistent with the understanding CO2e claims it had at the time as to who the counterparties were and why they were in the market.

458. According to Mr Buchan, CFE's counterparties were understood to be akin to brokers and aggregators who sold excess allowances which had been provided as payment for consultancy services or on trust (i.e. to the counterparty as agent) by emitters who would not have otherwise been able to access the market directly. The emitters would have got the allowances for free and would allow them to be transferred with a view to monetising them without pre-payment. Most commercial businesses are used to receiving funds after they have delivered a product or service.

459. Therefore, based on this assessment of the counterparties, the nature of the transactions was such that counterparty credit risk was considered to be low.

460. However, the Tribunal finds that Mr Buchan and Mr Rose's knowledge or assessment of the nature of CFE's counterparties (brokers or aggregators) was based upon the word of Mr Emanuel that this was the case.

461. There was no detailed scrutiny of whether Mr Emanuel's word would be unreliable, either because he might be mistaken or otherwise. There was a high level of trust placed on his word without sufficient or adequate documentation to evidence that this was the case. The Tribunal will return to this topic in due course concentrating on the explanation for the trade provided by Mr Emanuel which was that the 'counterparties were largely local consultants who were sourcing EUAs from local emitters' (see para 5.39 of the Pinsent Masons report).

462. Mr Emanuel's business model had CO2e acting as a broker. It was not in the business of "beating" market prices; it was in the business of putting together buyers and sellers. Not all of the sums which would be received by such parties would be remuneration, rather they would be entitled only to a fraction of the sums by way of fee or commission.

463. It was stated in the Business Plan that:

"The primary opportunities that exist in the market centre on the enormous number of companies that do not have direct market access but for whom the trading of emission certificates is an intrinsic part of their business, Cantor CO2e is re-designing its business model in order to specifically target this segment of the market".

464. Based on Mr Emanuel's explanation it was thus anticipated that the emitters would be the source of the credits but not necessarily the direct counterparties. Based upon this understanding, CFE saw no commercial need to undertake checks to verify it because the nature of the business did not require it. Again, the Tribunal will return to whether this was a reasonable approach from 3 June 2009.

Counterparties encountered following initiation of the Business Plan

465. Mr Emanuel gave Mr Rose several reasons for the way in which some of the clients, in particular the newly established ones, were originated and for the increase in business.

466. Mr Emmanuel explained that the counterparties were businesses set up as environmental consultants acting for small and medium-sized emitters in various different European countries. The consultants would give advice to the emitters on matters such as their carbon footprint projections, use of green energy and compliance requirements. The consultants may have been paid by the emitters in EUAs.

467. Mr Emanuel explained the consultants would also provide a liquidity service selling excess allowances on behalf of these small and medium size emitters who would not otherwise have necessarily been able to access the market easily. It is to be noted that CO2e did not implement the web-based platform as envisaged in the Business Plan.

468. Mr Emanuel suggested to Mr Rose that these consultants were coming to CO2e because of the excellent service it provided and this reputation had spread by word of mouth. CO2e was an early entrant into the carbon market and its brand was becoming more and more known. People were searching for brokers (e.g. on Google) and coming to CO2e because of this brand recognition.

469. This was described to Mr Rose by Mr Emanuel on more than one occasion. Mr Rose felt that Mr Emanuel knew the business and knew the market. In effect Mr Rose was relying on Mr Emanuel's word.

470. Mr Rose did not think it unusual or suspicious that many of the new counterparties were operating through a UK entity even though the directors and features of the counterparty may have been linked to other countries. He understood the carbon market to be a global one. In addition, Mr Rose regarded London as the financial centre of Europe and assumed therefore that many businesses linked to a number of European countries might choose to use a UK entity.

471. The Tribunal accepts Mr Rose's evidence. However, it finds he was far too trusting of the explanations given by Mr Emanuel at least from June 2009. Although he might have asked more questions and asked for more evidence before June 2009, Mr Rose's approach might have been understandable at the time of the initiation of trading and up until June 2009. Thereafter however, Mr Rose failed to ask sufficient questions of Mr Emanuel about the nature of the trade and CFE's counterparties from June 2009 once the picture developed and warning signs about the transactions emerged. This is set out in more detail below.

472. Mr Rose cannot recall specifically whether he was aware at the time of the counterparties using foreign bank accounts, but he believed this again would not have been a cause for suspicion as Cantor Fitzgerald dealt with plenty of legitimate businesses who used offshore bank accounts. It would only be a cause for concern if the bank account was in the name of another entity or was based in a jurisdiction which was subject to international sanctions.

473. Mr Rose recalls Mr Emanuel remarking at the time that it was not market practice to ask a seller where they acquired title in the allowances. Mr Rose's understanding was that the seller's EUA position was equivalent to the holder of a bearer bond and held through an official government registry. Further Mr Emanuel's suggestion that there were a huge number of EUAs in the market which the counterparties were aggregating seemed credible to Mr Rose. Mr Rose also took comfort from the fact that the credits were held in a government registry.

474. Again, the Tribunal accepts Mr Rose's explanations as being honest and reasonable when operating in a low risk environment. However, they fail to take account of the warning

indicators before Mr Rose and CFE collectively as of early June 2009 that there was something untoward in their carbon credit trading. The Tribunal will return to this below.

Subsequent appraisal of the business

475. In July 2010 Reuters reported that Mr Lutnick had described CFE's carbon credits brokerage as *"a money-losing failure, with business projections based on dreams*" and that Cantor was suing Mr Drummond for the return of $2 million lent to him whilst running the unit.

476. Mr Lutnick later said in a witness statement in the High Court proceedings between CFE and Mr Drummond, dated 20 May 2010, of Mr Drummond's wish to purchase a property in March 2008:

"7. Mr Drummond had equity in CantorCO2e, LLC and he wanted to use this to raise money to fund the purchase of the house, but there was little value in the equity because the company had sustained significant losses over a number of years and it was envisaged that this would continue over the short to medium term."
"19. ...I did not expect CantorCo2e, LLC to do well in the short term..."
"28. I recall that I did have some high level discussions with Mr Rose about a potential new compensation structure for the CantorCO2e group business. I believe this was in the early part of 2008. The business had been suffering from significant losses and was not covering its costs. Mr Rose came to me to discuss possible options for restructuring compensation in a way that would help motivate the employees to produce revenue...."

477. The 'discussions' included bonuses for spot trading.

478. CO2e's Annual Report and Financial Statements 2009 shows that it made a loss of US$2.4 million in the year ending 31 December 2008.

479. The background to CFE's success in Fiscal Year End (FYE) 2009, when it almost exclusively traded carbon credits on a matched principal basis that were connected with the fraudulent evasion of VAT was, previously one of failure.

480. CFE converted that loss-making failure into a profit of US$0.9 million for FYE 2009. CO2e's turnover more than doubled between the 2008 and 2009 financial years, from £2.7 to £5.8 million. The only factor that drove that success, was, as a matter of indisputable fact, widespread VAT fraud in the carbon credits market.

481. All but two of the Appellant's quarterly VAT returns have been payment returns or comparatively modest repayment returns. From period 03/06 the Appellant's reclaims did not exceed £660,000. In VAT period 06/09 alone, during which the majority of the transactions that are the subject of this appeal took place, the Appellant's reclaim increased to more than £4.7 million.

Performance of the market from July 2008 onwards

482. In terms of trading patterns within the market during the relevant period, Mr Rose's understanding, based on the contemporaneous articles exhibited, was as follows.

483. In October 2008, Point Carbon reported that many industrial players were heavily selling carbon credits during this period due to the economic downturn and lower output predictions.

The World Bank's annual report entitled "*State and trends of the Carbon Market*" noted that industrial companies were being constrained from their usual sources of finance and needed to raise cash quickly through the sale of carbon credits (i.e. by monetising those assets). The same report also noted: *"Spot transactions accounted for only 1% of all transactions in the first half of 2008, rising to 7% in the third quarter and 19% in the fourth quarter (and accounting for 36% of all transactions in December 2008 alone)".*

484. A growing / more active market for 2008/2009 was therefore in line with expectation and market commentary.

485. A Deutsche Bank report dated 12 January 2009 stated "as the impact of the credit crunch and recession really began to bite in the early autumn it became clear the free allocation of EUAs gave cash strapped installations a monitizable asset that could be used to raise much needed liquidity". This strategy might involve emitters selling carbon credits not immediately required to get cash. In the event the carbon credits proved necessary for compliance, the emitter could buy carbon credits at a later date (indeed it is possible that the price could have dropped by this time).

486. The expectation of accelerated growth in the market continued throughout early 2009. On 13 February 2009 BlueNext announced it would be extending its trading hours. This measure also implied that BlueNext expected trading to continue to remain high.

487. At the beginning of April 2009, the European Commission released preliminary estimates for 2008 emissions which suggested an overall decrease in total EU emissions for that year. On 15 May 2009, the European Commission released 2008 emissions data which confirmed that emissions had fallen by 3% from 2007 levels as a consequence of the ongoing economic crisis. This further reinforced the predictions made in various market reports about a surplus of 2008 allowances that would be available in the market. For example Bloomberg noted on 27 May 2009 that the UK recession was creating an oversupply of emissions credits.

488. The Tribunal accepts Mr Rose's explanation that there were therefore rational reasons for believing CFE's rapid growth before June 2009 to be based on legitimate market performance rather than the reality, that it was overdriven by VAT fraud.

489. However, for the reasons set out below that understanding should reasonably have changed by early June 2009. Further, the Tribunal is not simply assessing whether that was Mr Rose's understanding, he was the senior most leader based in Toronto geographically and temporally removed from the day to day transactions carried out by the London team for which he was responsible. The Tribunal must examine whether Mr Emanuel and his traders knew or had means of knowing that there was a legitimate or illegitimate explanation for the growth in CFE's business.

Performance of CO2e's EU Carbon Desk in accordance with the Business Plan

490. CO2e saw an increase in trading in the January 2009 to May 2009 period. Mr Rose states he believes this was in line with this market commentary. For the reasons set out below, the Tribunal accepts Mr Rose believed this but as a matter of fact the growth was massively in excess of market commentary.

491. Throughout the period, Mr Rose was pleased that the EU Carbon Desk was showing signs of growth but he wanted to see if the growth continued in future months. Trading volumes

on an exchange could be very volatile especially in this market where the commodity traded may be issued, as EUAs can be, and therefore may reach the market at different times. Volatility in commodity markets is common, with the gold and oil markets being other examples.

492. Mr Rose monitored CO2e's performance by way of review of the Combined Daily Management Report ("CDMR") received by him on a daily basis. This tracked daily, monthly and yearly revenue for each unit/desk within CO2e. This did not however name specific counterparties. This was because the purpose of the CDMR was to monitor the financial performance of the CO2e business as a whole.

493. The EU desk had made approximately $355,000 in revenue in the month to date by 25 March 2009. According to Mr Rose, that figure would normally have been a significant entire month for the desk and so he considered it had started to turn things around by focussing on using the matched principal model. Mr Rose was also aware that the market as a whole was growing and that commentators within the market were speculating as to reasons for the increase, none of which included fraud at that time.

494. Mr Rose understood that part of the March 2009 revenue was derived from trades with a counterparty called Adduco Consulting Limited ("Adduco"). Mr Rose does not recall being particularly curious about them. At the time he had no reason to be suspicious of them, or any counterparty of the EU Carbon Desk.

495. By April and May Mr Rose was coming to the conclusion that the EU Carbon Desk had found a way of becoming profitable as a result of the change in focus away from project origination towards matched principal trading. He hoped that the business had found a way to survive because if it had continued to make losses then it would have been wound down, as had happened with other units within CO2e.

496. On 22 May 2009, CO2e published a press release entitled *"CantorCO2e claims volume surge in Q1"*. This linked the surge in volumes in the first quarter of 2009 to a refocusing of the business to broking. Mr Rose notes that the business had started from a *"very low base"* and so high percentage increases month over month did not cause him to change his opinion that the company was participating in a growing market. Moreover, other brokers could have seen their business increase by an even greater factor than that experienced by CO2e.

497. Officer Ball in cross examination accepted that there were other, commercial, explanations behind the expansion of the market besides fraud and that surplus credits and liquidity requirements were legitimate explanations. The Tribunal finds that based upon the chronology below, that there were legitimate explanations, albeit that these were mistaken, for the market growth and CFE's business growth the considered at the time to the end of May 2009.

498. However, the reasonableness and credibility for these explanations for the market generally and CFE's business growth rapidly diminished in the first two weeks of June 2009.

Chronology of CFE's trading in the carbon credits market from March to July 2009

March 2009

499. In March 2009 CFE began trading in transactions that were connected to VAT fraud when it began buying very large quantities of carbon credits from Adduco, a UK registered

company. This came about in a way which is not entirely apparent but it is not suggested CFE knew or should have known of the connection to fraud at this time.

500. On 9 March 2009 Mr Agnard of Adduco e-mailed Mr Bush, one of the traders of CFE saying:

"As agreed on the phone we confirm our interest to buy or sell EUA allowances on the spot market so please can you give me the procedure to trade with you and also your delivery your commissions…"

501. The record of the telephone call referred to was not before the Tribunal. Mr Bush has not provided a witness statement.

502. Having completed a test trade on 11 March 2009 with a UK domestic bank, for the next transaction Adduco requested that payment be made to its account at Eurobank EFG Cyprus Ltd. This meant that UK VAT was being paid away outside the jurisdiction. This would make it harder for the UK authorities to trace and recover it from Adduco.

503. On 20 March 2009 Mr Christopher Craib (Chief Financial Officer of Cantor Fitzgerald Canada Corporation), queried the volume of the transactions in an email saying:

"I understand that March ties into some sort of EUA higher volume month. So although this is great it's not necessarily a permanent thing?"

504. On 25 March 2009, Mr Emanuel e-mailed Mr Rose attaching brokerage figures for the day of $105,191 saying:

"Nice, huh?
I have never run a non-profitable desk… Problem for the last 3 years at Cantor, I wasn't really running the desk or allowed to use my initiative.
I hope Howard does the right thing. It's in his interest to keep us motivated
…"

505. By 26 March 2009, Adduco was requesting that payment be made to its account at Marfin bank in Cyprus. It was to become a theme of CFE's trading that its counterparties requested payment to this particular bank in Cyprus, and also accounts in Hong Kong.

506. CFE's sudden success in March 2009 appears to have been achieved with little effort. All that was required was for was Adduco, a company with no prior relationship with CFE and neither experience nor repute in trading carbon credits, telephoning Mr Bush and thereafter offering massive volumes of credits to CFE. CFE traded 525,097 carbon credits in March 2009, of which 479,000 (91%) came from Adduco.

507. It was not in dispute that, Adduco fraudulently failed to account to HMRC for the VAT paid to it by CFE.

CFE's transactions connected to fraudulent evasion of VAT in April 2009

508. In April 2009 CFE began trading with further suppliers that had neither experience nor repute in trading carbon credits, Duntai Ltd ("Duntai") and Business Management Consulting Ltd ("BMC").

509. In April 2009 CFE traded 2,693,000 carbon credits, a 5-fold increase on March 2009, of which 1,253,000 (47%) came from Adduco, 476,000 (18%) came from Duntai and 683,000 came from BMC (25%). It is not in dispute that Duntai and BMC were also defaulting companies who fraudulently failed to account to HMRC for the VAT paid to them by CFE.

510. CFE also purchased 10,000 units from Carbondesk Ltd ("CD"). CD purchased the carbon credits that it sold to CFE from V&A Corporation Ltd ("V&A") who, as is not in dispute, fraudulently failed to account to HMRC for the VAT paid to it.

May 2009

511. In May 2009 CFE traded 12,960,808 carbon credits, another 5-fold increase on the previous month.

512. In May 2009 CFE traded with yet more suppliers that had little if any experience or repute in trading carbon credits, Westis Ltd ("Westis"), Mettec (trading name of Ayres Ltd ("Ayres")), ADE International Ltd ("ADE"), Stratex Alliance Ltd ("Stratex"), GW Deals Ltd ("GWD"), AH Marketing and Distribution Limited ("AHMD") and Northumberland Consultants Ltd ("NCL").

513. Of the 12,960,808 carbon credits traded by CFE in May 2009, 1,146,000 (8%) came from Adduco, 934,000 (7%) from ADE, 315,000 (2%) from AHMD, 5,410,000 (42%) from BMC, 724,000 (6%) from Duntai, 28,000 (0.2%) from, 732,000 (6%) from NCL, 1,624,000 (13%) from Stratex, and 1,232,000 (9.5%) from Westis.

514. It is not in dispute that in addition to Adduco and Duntai, ADE, NCL and Westis all fraudulently failed to account to HMRC for the VAT paid to them by CFE. As is set out above, Stratex was never registered for VAT but charged VAT on its invoices to CFE and fraudulently failed to account to HMRC for the VAT paid to it.

515. Mettec / Ayres purchased the carbon credits that it sold to CFE from Acme Direct Ltd ("Acme") who itself purchased from Japek (UK) Ltd ("Japek") who fraudulently failed to account for the VAT paid to it by Acme.

516. GWD purchased the carbon credits that it sold to CFE from Bilta (UK) Ltd ("Bilta"). It is accepted for the purposes of deciding this appeal that Bilta fraudulently failed to account for the VAT paid to it.

517. AHMD purchased the carbon credits that it sold to CFE from Bilta and Pan 1 Ltd ("Pan 1") who itself purchased from Bilta. Again, it is not in dispute for the purposes of this appeal that Bilta fraudulently failed to account for the VAT paid to it.

518. CFE was aware of the huge spike in its carbon credits trading in May and early June 2009, announcing in a press release on 22 May 2009 that its volumes and revenues were up 500% on the same five-month period a year earlier saying: "*Since we refocused our business on core brokerage, our volumes and liquidity have soared*".

519. Putting its knowledge or means of knowledge to one side, what CFE had in fact done was changed to purchasing carbon credits almost exclusively from recently formed or taken-over companies who had little if any track record in trading carbon credits, little or no financial wherewithal, and who, it is now clear, were engaged in VAT fraud or the facilitation thereof.

520. Mr Rose stated in his witness statement that CFE's increase in trading from January to May 2009 was *"in line with ...market commentary"*. The material relied upon by Mr Rose did not support such a broad statement. Market commentary estimated growth over the previous year at around 75% rather than 500% (see below).

521. Between 27-29 May 2009 there was a trade fair and conference called 'Carbon Expo' held in Barcelona. Named on the delegate list were representatives from *inter alia* CD, KO Brokers Ltd, Citibank (Garth Edward) and Mr Emanuel and Mr Von Butler from CFE.

522. Also in attendance at Carbon Expo were representatives of Innovative Energy Group and Innovative Energy France SAS, whose previous companies participated in transaction chains that were part of MTIC frauds. Innovative Energy Group, through its group company, Jetivia, transferred carbon credits to Bilta (agreed to be a fraudulent defaulting trader in CFE's transaction chains for the purposes of this appeal). Bilta sold on these units but Jetivia, a Swiss company, received the payments due to Bilta, inclusive of UK VAT as a third-party payment.

CFE's transactions with Stratex Alliance Ltd in May 2009

Stratex - No VRN – supplier to CFE, fraudulent defaulter and provider of invalid VAT invoices

523. Between 18 May – 3 June 2009 Stratex made 17 sales of carbon credits to CFE totalling 2,914,000 units with a gross purchase value of €48.9 million. The details of the Stratex transactions are set out in Officer Ball's witness statement. Based on information from the DG Environment, Stratex received the carbon credits that it sold to CFE from the fraudulent defaulters BMC, Duntai and Mostcity Ltd.

524. Stratex was a direct supplier to CFE, a fraudulent defaulter (since it charged VAT but was never registered for VAT and did not account to HMRC for it) and it supplied CFE with invalid VAT invoices which did not show any VRN.

525. Stratex was incorporated on 6 October 2008, it provided an address of Suite 2, 23-24 Great James St., London, WC1N 3ES (an address also used by Aristo, a further fraudulent trader whom CFE traded with), it has never filed accounts with Companies House and was dissolved on 18 May 2010.

526. On 8 May 2009 Mr Avi Kolkobi (resident in Ashdod, Israel) was appointed director and Ms. Nantia Efstathiou (resident in Limassol, Cyprus) company secretary of Stratex. Ms. Efstathiou was also company secretary of Westis and Aristo.

527. On 2 September 2009 CFE first confirmed to HMRC that it had not been provided with Stratex's VRN.

528. HMRC Officers visited Stratex on 9 September 2009, finding that its Companies House registered address was the premises of Apollo International ("Apollo"), a corporate service provider. A representative of Apollo informed the Officers that Apollo was purely an agent for Stratex who had come to Apollo via a representative in Russia called Worldwide Consulting Services Ltd. Despite HMRC's attempts, no contact was made with Stratex.

529. Stratex requested to CFE that payments to it be made to its account at Marfin. None of Stratex's invoices bore a VRN and were therefore invalid VAT invoices. The Tribunal has already dealt with this as part of its decision on the First and Second issues.

530. Importantly, the Tribunal has found CFE failed to act with reasonable care in carrying out these transactions. The Appellant failed to identify and act upon the absence of a VRN on 17 invoices over a period of 15 days in sales worth over £40 million with VAT charged of over £5.6 million.

531. CFE was part of a multinational company with internal legal, compliance, tax, invoicing and credit departments together with the option to pay for external expertise in each. None of the internal knowledge or expertise was brought to bear to ensure that CFE was paying out such large sums on valid VAT invoices.

532. Had the Appellant required a VRN from its customer Stratex, or checked to see if Stratex were VAT registered, it would have discovered that it was not VAT registered. This objective fact was readily and reasonable discoverable. CFE should have discovered it. Once on notice of this fact, it would have put the reasonable party on notice there was something untoward occurring. CFE should have been on notice that this irregularity needed exploring.

533. At that time one reasonable explanation for the absence of a VRN would be that Stratex was not VAT registered and there was VAT fraud occurring. This was indeed the case. The Appellant should have been put on notice that there were at least reasonable grounds to suspect such fraud and conducted further and enhanced due diligence as of 17 May 2009. This is all the more so by 3 June 2009 when the seventeenth invalid invoice was accepted and CFE paid out significant VAT upon it.

Due Diligence

534. CFE performed standard Customer Due Diligence ("CDD") upon Stratex.

535. A sample 'CDD for AML Form for Corporates (other than regulated firms)' dated 14 May 2009 concerning Stratex demonstrates that when carrying out a standard CDD check, CFE's Compliance Team looked to establish:

(1) the name of the company and its registered number;

(2) the registered office and business address;

(3) the names of all directors;

(4) the names of shareholders owning more than 25% of the company; and

(5) whether the company or its directors or shareholders were Politically Exposed Persons ("PEPs") or whether they appeared on any sanctions lists (a World Compliance check). This was carried out using the World Compliance or the Accuity System, which is powered by World Compliance.

536. CFE's due diligence documentation in relation to Stratex was as follows:

> (1) Mr Avi Alkobi of Stratex emailed the Appellant's EU Desk on 13 May 2009 requesting that they commence work with CO2e and attaching Know Your Client ("KYC") information. Stratex was approved as a new client by the Compliance Department on 14 May 2009.

(2) In an email on 1 May 2009 Mr Simon Chatterton, a Central Compliance Analyst, asked John Bush, an Emissions Broker, whether Stratex had a prospectus or website as he could not find a public description of the business activity of the company.

(3) Mr Alkobi stated in an email to John Bush on 14 May 2009 that the company was new and the website was under construction. Mr Bush forwarded this response to Mr Chatterton on 14 May 2009. Mr Chatterton approved Stratex for compliance/AML on 14 May 2009.

537. CFE's Compliance Team acquired the following documents to verify Stratex's identity:

(a) a Certificate of Incorporation dated 6 October 2008;

(b) the Memorandum and Articles of Association;

(c) minutes of first board meeting held on 6 October 2008;

(d) a resolution of the Directors dated 6 October 2008 signed by Alfred Brewster executing the share certificate for 1000 Shares to Rea Ketty Yolande Barreau;

(e) a letter of resignation as a director dated 6 October 2008 signed by Alfred Brewster;

(f) a shareholders' resolution appointing Mr Avi Alkobi as director and terminating the appointment of Ms Rea Ketty Yolande Barreau dated 13 April 2009;

(g) a directors' resolution dated 14 April 2009 in respect of transfer of 1000 shares from Ms Rea Ketty Yolande Barreau to Mr Avi Alkobi along with a stock transfer form;

(h) a share certificate dated 14 April 2009 for 100 shares held by Mr Avi Alkobi;

(i) a letter of resignation dated 14 April 2009 signed by Ms Elisana Marie-Antoinette Labonte for and on behalf of ABS Secretary Services Ltd;

(j) an undated director's resolution signed by Ms Barreau in respect of the appointment of Mr Alkobi as a director; and

(k) a certificate of non-trading dated 6 October 2008 showing that the company had not traded up until that date (the company was only incorporated on that date).

538. CFE's Compliance Team also obtained on 13 May 2009:

(a) a Companies House WebCheck webpage displaying basic company details;

(b) a Companies House Current Appointments Report showing Nantia Efstathiou and Avi Alkobi as company secretary and director of the company respectively and the registered address as Suite 2, 23-24 Great James Street, London, WC1N 3ES**.** According to Ms Mills, the fact that the address was that of a corporate service provider was not necessarily something that would be taken into consideration if other indicators did not show that it needed to be investigated; and

(c) a World Compliance search on 13 May 2009. World Compliance is a provider of customer and vendor screening content used for AML purposes. It hosts a database of PEPs across 240 countries with more than 420,000 profiles. The screening process shows up other adverse news

or information in the public domain about an individual or a company. This would include adverse press coverage, which might show, for example, that a person has been accused of something or has been fined or is under investigation. The World Compliance search of the company name and the names of the two directors returned no results. This went above and beyond the requirements of the JMLSG Guidance.

539. CFE therefore acquired all of the information about Stratex which was required by the JMLSG Guidance for standard CDD and went beyond these requirements based on the assumption that the business was low risk.

540. It also verified this information by reference to Companies House documents and ran a World Compliance search to check whether the directors and beneficial owners of Stratex were PEPs and if the company or its directors were subject to sanctions.

541. CFE's assumption that Stratex was low or medium risk may have been justified as at the time the checks were carried out on 13 and 14 May 2009 but it was not from 18 May 2009 once it started receiving invalid VAT invoices charging VAT without the production of a VRN.

542. While the CDD documents obtained on 13 and 14 May 2009 may not have given rise to any suspicion of fraudulent activity or otherwise given rise to any suggestion that further due diligence was needed, the invoices received from 18 May 2009 should reasonably have changed that assessment. The first and obvious check would have been to ask Stratex to supply its VRN and/or for CFE to independently verify this.

543. If CFE had acted reasonably by requesting a VRN from Stratex before paying out upon the invoices or checking that VRN with HMRC or Europa it would have discovered that Stratex was not VAT registered. This should have started a chain of enquiry and investigation akin to enhanced monitoring / due diligence as the risk profile of Stratex should reasonably have been considered high.

544. Enhanced due diligence would have required significant further enquiries to have been undertaken into Stratex to establish its finances, trading pattern, business model etc.

545. Stratex had neither experience in nor repute for dealing in carbon credits, its ability to sell such volumes of them to CFE was commercially incredible and its lack of financial worth made it a poor candidate to enter into such transactions.

546. The Tribunal is satisfied that had CFE *"applied its KYC checks and risk management systems properly and taken notice of the available information it would have been able to identify"* a number of negative indicators about Stratex.

547. These facts were relevant for AML and VAT purposes and would have put CFE on notice that the transactions might have been connected with VAT fraud.

548. As above, the most obvious negative indicator was that Stratex was not registered for VAT in the UK, but was charging VAT.

549. The JMLSG Guidance does not require that firms check that a client company is VAT registered. Nevertheless, CFE had available ample legal, tax, invoicing, compliance and credit advice internally which could have confirmed that the invoices were invalid without a VRN.

550. Any reasonable business even of comparatively small size should have known that a first step would be not to pay any VAT upon an invoice without requesting a VRN from the invoice provider and an explanation for its omission. In the absence of any reasonable explanation for the lack of VRN or a later provided VRN, thereafter the CFE should then have checked any VRN that was provided was valid. CFE took none of these steps and paid out over £5.6 million in VAT on seventeen invalid invoices.

551. While the invoices would not have been sent to CFE at the time Stratex was being checked on 13 and 14 May 2009, as it had not traded with Stratex at that time, CFE should have reacted to their contents upon receipt. Officer Ball accepted in evidence that a possible explanation for a lack of VRN might be that an application for registration was pending, however CFE did not ask for any explanation let alone test the reasonableness of the explanation provided.

552. Stratex had no financial or trading history, and the director Avi Alkobi was unknown in the field of environmental trading. While this was not required as part of standard CDD, and while one explanation was that it was a very new market so it would not be unusual for companies not to have a track record, CFE should have weighed this up against the lack of VAT registration which pointed towards a nefarious reason for its trading.

553. Stratex had no permanent premises in the UK, instead relying on a third party to provide postal and office services. The Companies House Current Appointments Report shows that Stratex's business address was Suite 2, 23-24 Great James Street, London WC1N 3ES. Ms Mills' evidence was that the fact that the address was that of a corporate service provider was not necessarily something that would be taken into consideration if other indicators did not show that it needed to be investigated. Officer Ball agreed in oral evidence that there was nothing inherently wrong about relying on an incorporation agent to provide third party postal and office services. However other indicators, apart from the lack of VRN, did show this needed to be investigated. This chain of enquiry should reasonably have been followed once the lack of VRN had been established.

554. Stratex could purchase large volumes of EUAs at a price less than CO2e would purchase. While this would not have formed part of a standard CDD check, it should reasonably have formed part of enhanced due diligence in questioning Stratex once ascertained that it was a high-risk trader.

555. The documents listed as having been considered for the standard CDD check did not include details of the bank account for Stratex. The payments made by CantorCO2e (including VAT) were being paid to an account at Marfin Popular Bank in Cyprus. There is no reason in itself to be suspicious of a bank account being located in an EU Member State. EU Member States are regulated by the EU Money Laundering Directives. Marfin Popular Bank is a listed bank, and Officer Ball accepted that there was nothing inherently wrong with making payments to Cyprus or with using a foreign bank account (provided there were no third party payments).

556. However, when combined with all the other negative indicators set out above, Stratex's direction for payment to be received in a foreign bank account when Stratex was a UK incorporated company and the transactions were taking place in the UK should have presented CFE with serious cause for concern.

557. CFE made very few third-party checks such as independent financial credit checks from Dunn and Bradstreet or similar providers. Mr Buchan stated in his evidence that there were no

external agencies or companies that could have provided a relevant independent report on the counterparties in question but it does not appear CFE ever investigated or confirmed this assertion. There is no good reason that a third-party independent report may not have come in useful in performing due diligence on Stratex.

558. CFE did not obtain any annual accounts, independent references or banking references on Stratex. Annual accounts, independent references or banking references are not required by the JMLSG Guidance as part of a standard CDD check. Stratex was accepted as a client by CantorCO2e in May 2009 and so the first set of accounts would not have been due to be filed at that stage as Stratex was incorporated on 6 October 2008. However, given that the Companies House Current Appointments Report accessed on 13 May 2009 shows that no accounts had been filed for Stratex and CFE should have assessed Stratex as high risk and completed enhanced due diligence, obtaining financial references would have been of value.

559. CFE did not provide any checks on Stratex's director, his background or experience. As noted above, the JMLSG Guidance requires the names and addresses of the directors as part of a standard CDD check which were obtained from the Companies House Current Appointments Report. There was no requirement for a firm to check the *"background and experience"* of a director. However, as above, all of the objective indicators available should reasonably have driven CFE to seek these types of checks as part of enhanced due diligence.

560. CFE did little more than confirm the existence of Stratex and carry out basic AML checks – standard CDD. There was no enhanced due diligence. CFE did not question how Stratex could supply such large volumes of carbon credits, at a price that CFE could not beat despite its experience in the market, when it had filed no accounts, had no net worth to speak of and had recently been taken over.

561. The only documentation that CFE provided in relation to the Stratex transactions themselves were the invalid invoices and the due diligence documents listed above. For the reasons discussed in the First and Second Issues, HMRC reasonably refused to exercise their discretion to allow the input tax claimed by CFE on the invalid invoices.

562. CFE's e-mail correspondence and records of calls with Stratex were disclosed. There are no discussions in the e-mails about the carbon credits market or Stratex's background. CFE had no concerns about trading with Stratex despite being told that it was a new company whose website was under construction. Stratex appeared willing to supply CFE with carbon credits without any reference to what the market for them was doing.

563. On 3 June 2009, following the provision of the seventeen invalid invoices, Mr Bush of CFE finally requested Stratex's VRN. Despite this request, CFE continued to trade with Stratex, allowing it to issue further invoices on 3 and 6 June 2009 without a VRN being supplied.

564. The Tribunal finds that CFE should have had reasonable grounds to suspect the transactions with Stratex (for which invalid VAT invoices were provided) were connected to VAT fraud. CFE failed to conduct reasonable and proportionate (ie. enhanced) due diligence in response to the heightened threat presented by an absence of VRN and Stratex's lack of VAT registration.

565. However, the Tribunal stops short of finding that the Appellant knew or should have known that the transactions between 18 May and 3 June 2009 were connected with VAT fraud.

566. By 3 June 2009, when CFE and Stratex completed their final transaction and before it requested the VRN, CFE did not have objective material available to it to make it aware that there was a general risk of fraud in the market. The train of events beginning on 3 June 2009 with the blog containing rumours of fraud in the market (see below) had not yet occurred. CFE had no good reason by this time to discover all the other indicators of fraud in respect of its other suppliers – eg. Westis etc. (see below) which would have heightened its awareness.

567. HMRC has conceded that 8 June 2009 is the date by which CFE knew or should have known its transactions with all other counterparties were connected with fraud. Despite the absence of VRN and the multiple invalid invoices, the Tribunals is not satisfied CFE should have known that its transactions with Stratex between 18 May and 3 June 2009 were connected with fraud and that the only reasonable explanation for its transactions was fraud.

June 2009

568. In June 2009 CFE traded 8,418,000 carbon credits of which: 186,000 (2.2%) came from Adduco, 720,000 (9%) came from ADE, 514,000 (6%) came from AHMD, 433,000 (5%) came from Aristo Partners Ltd ("Aristo"), 260,000 (3%) came from Axle Ltd ("Axle"), 1,628,000 (19%) came from BMC, 839,000 (10%) came from Duntai, 50,000 (0.6%) came from Ayres, 832,000 (10%) came from NCL, 1,290,000 (15%) came from Stratex, 126,000 (1.5%) came from SVS Securities Plc ("SVS") and 332,000 (4%) came from Westis.

569. Aristo, Axle and SVS were new suppliers to CFE in June 2009.

570. Aristo and Axle were not registered for VAT (although they should have been) and yet they charged VAT to CFE. CFE did not pay the VAT to Aristo and Axle and therefore has made no input tax reclaim on the purchases. Aristo's and Axle's intentions in charging VAT whilst not registered are accepted to be fraudulent.

571. SVS received the carbon credits that it sold to CFE from V&A, who fraudulently failed to account for the VAT paid to it.

1-2 June 2009

572. On 1 June 2009 Mr Rose received an email from Mr Emanuel asking him to consider an extension to the new €5m funding facility which had been implemented that day for the EU Carbon Desk. Mr Emanuel was reporting to Mr Rose how he had spent the $5 million funding facility for CFE's carbon credit trading *"...pretty early and had to take our foot off the pedal"*.

573. The new funding facility was intended to enable CO2e to pay counterparties on the day they delivered carbon credits. Mr Emanuel suggested that counterparties might be taking business elsewhere if CO2e could not promise payment on the day the counterparty delivered the carbon credits and that the €5m funding facility had been quickly exhausted that day. Mr Rose therefore needed to consider whether to support an increase to the funding facility so as to enable the EU Carbon Desk to meet demand within the market. He had been supportive of seeking approval for the €5m funding facility.

574. On 2 June 2009 the BlueNext Carbon Credits exchange in Paris reported handling a record daily volume of carbon credits. CFE also had a record day, dealing with some €40 million pounds worth of carbon credits. That led Mr Emanuel to suggest a $50 million funding facility to Mr Rose.

575. On 2 June 2009 Mr Rose received a Bloomberg article entitled *"BlueNext's EU Carbon Permit Trading Volumes Rise to Record"*. On the same day Mr Craib emailed Mr Rose speculating as to whether this was a temporary peak. Mr Rose linked the record trading that CO2e was experiencing with the Bloomberg report.

576. On 2 June 2009 Mr Von Butler emailed a contact at Statkraft (a Norwegian Electricity company) regarding engaging in matched principal trading of EUAs. In the email Mr Von Butler referred to the fact that CO2e had embarked on a marketing campaign across Europe and was now reaping the rewards by seeing good numbers of matched principal trades. Mr Von Butler also cited a benefit in the matched principal model namely that CO2e was giving small and medium sized enterprises ("SME"s) access to the market by purchasing from them and then onward selling to other market participants who would prefer to deal only with CO2e / CFE (rather than directly with the SME).

577. There is no evidence from Mr Butler, Mr Emanuel or any of the traders involved as to whether this email was a fair reflection of the general thinking within the business at the time regarding the reasons for the increase in trading. There is a section in Mr Von Butler's email in which he refers to managing risk and there is no mention of risk of VAT fraud. As of 2 June 2009, the Tribunal finds there is insufficient evidence to prove that there was any contemplation within CO2e / CFE's business of the possibility of VAT fraud having infiltrated the carbon credit market.

578. On 2 June 2009 Mr Rose received two further emails from Mr Emanuel on the subject of extending the funding facility which had been implemented for the EU Carbon Desk. Mr Rose was willing to work with the EU Carbon Desk, the finance department and the risk/credit team to discuss an appropriate level of increase beyond the level which had already been implemented.

3 June 2009 – Rumours of VAT fraud

579. The following took place on 3 June 2009.

580. On 3 June 2009 Mr Emanuel read and forwarded a blog page to Mr Ross Tanton, CFE's compliance officer saying "*Something interesting has been circulating in the carbon market today. It is only a blog and not sure how much credence to give it…*". The blog was entitled "*BlueNext: VAT Scams or Simple Money Laundering?*" and said:

"'BlueNext and the Vat Scammers'

…

It IS a title for a discussion on the recent flurry of trading activity that has many suspicious elements, but no one can quite put their finger on it.

And the only ones that seem to be interested in it are a bunch of financial regulatory Frenchmen with the investigative power of Inspector Clouseau from the Pink Panther Movies. However, I do not expect the ending will be amusingly happy as in the Pink Panther movies, with culprits behind bars and the imbecile/hero getting the lovely girl at the end.

Rather, I am worried that the integrity of the EUA market in the whole of the EU will decline suddenly and become a market full of money laundering menaces, devoid of even the most

basic controls: a breeding-den for corruption that will cost the European union billions of Euros.

So what am I referring to?

First let's look at the EUA…

…

And nowadays, in France, this seems to make it ripe for a further level of abuse: VAT scams.

VAT scams work like this: if an invoice is issued in one EU? Country, the payer in the same country has to pay the invoice with the additional 10 to 20 percent for VAT. But if the paying party is in a different country, there is a double taxation clause which means they are exempt from paying VAT.

And if you are able to do false invoices from country to country, in some connected ring, then there is a chance that one link will fall away and the 10 to 20% will never be seen again by the collective states of the EU ever again. A few years ago this was used for real factory orders. Now, it is believed that the transactions will be used with EUA movements.

But are all these transactions originated by real purchases of EUAs?...I think not.

It could also be a function of money laundering. The movement of the EUA is actually done within minutes by a simple internet website transaction…

But what is the proof you ask?

All I have seen thus far is anecdotal evidence and I am hoping to provoke the real investigators into action after they read these:

1. Recent volume on Bluenext has increased significantly, and it was thought that it was the reaction of selling compliance companies looking to cash in on surplus sales as the market decreased in value since December 2008 (a valid argument) or even perhaps the tightened credit lines that have affected all areas of finances have also constrained forward trading lines and even cash deposits for futures trading, making more transactions move to the spot market (also a valid point).

2. And a recent drop in fees for BlueNext to draw in more business (very, very low costs). This isn't a factor that is suspicious, but shows that the procedural costs to scams also dropped a lot. But these don't answer all the curiosities.

3. Recently a spate of Frenchmen have been opening new and newer accounts, seemingly replicating themselves. This is similar to some poorly regulated IPO market seekers that wanted better allocations. But why would a large bunch of Frenchmen open accounts with an inept Dutch trading house with no regulatory control, or with starved-for-business English brokers, only to trade BACK into the French exchange?

4. A few investigations have arisen lately regarding some specific deals in the market, asking the brokers if they had the correct KYC (Know Your Client) Documents. KYC is basically due diligence that hopefully avoids money laundering and perhaps even terrorist money, as well as making it more difficult for tax avoidance.

5. The administrators of BlueNext have been unusually tight lipped lately, when asked about volumes and procedures. As a trader with 20 years of experience in a wide range of securities, my instinct says they are hiding something: the response claiming confidentiality and 'anonymity' rang hollow in my opinion. I believe that they are undergoing some sort of internal and external investigation and are well scared of the result.

...

A final thought, should efforts be made to delve further into the origin of this surge in activity, I suspect we could see precipitous drop in volume on the BlueNext.

Note to self: Look further into compliance activities and oversight of the exchange and trades of carbon credits."

581. Mr Rose understands that this blog article was the first report speculating that VAT fraud may have infiltrated parts of the EUA market. Mr Emanuel stated in the accompanying email to Mr Tanton that *"It is only a blog and so not sure how much credence to give it"*.

582. Mr Von Butler of CFE had received a copy of the blog from a contact at Nomura. Mr Von Butler responded shortly after commenting *"what do you think"*.

583. The contact at Nomura had received it from the Head of Emissions Trading at Citibank – Garth Edward. Later, on 24 July 2009, Mr Edward was minuted at a meeting of the UK Emissions Trading Group, as commenting that most traders would say that the spot trading market was driven by VAT fraud – the issue was already in play in the market and affecting companies like his.

584. Bloomberg circulated a press release from the London Energy Brokers Association announcing that emissions trading handled by brokers had increased 82% in the first 5 months of 2009, with trade in EUAs (the type of carbon credit traded by CFE in the majority of its transactions) increasing 75% for the period January to May 2009 compared to the same period in 2008. Mr Rose was not aware of the blog article on 3 June 2009; he was not made aware of this until 5 June 2009. But he did receive the Bloomberg article.

585. CO2e contributed to the content of the London Energy Brokers' Association announcement, and the statistics included in it provided further confirmation that the vast increase in trading volumes experienced by the EU Carbon Desk was well above that provided by the wider market.

586. CFE's press release on 22 May 2009 announcing that its volumes and revenues were up 500% on that same five-month period a year earlier meant that CFE had been outperforming the 75% market increase by a very large factor. Despite this, Mr Rose stated in his witness statement:

"…it provided further confirmation to me that the increase in trading volumes experienced by the EU Carbon Desk was consistent with the wider market."

587. Mr Rose was expecting some improvement from the EU Carbon Desk simply due to the change in focus to matched principal trading; if the performance of the desk had been dramatically inconsistent with the market this would perhaps have given Mr Rose cause for investigation. However, the Tribunal finds he honestly but wrongly believed the reports about the performance of the wider market were entirely consistent with the performance of the EU

Carbon Desk. Mr Rose's mistake appears to have been motivated by a wish to see a growth in profits.

588. Mr Rose messaged Mr Craib saying:

"*Spot euas is a great business...easy and huge mkt*."

589. It is noteworthy that Mr Rose himself was commenting on how easy the business was.

590. As referred to above, at 11:29 on 3 June 2009 Mr Bush of CFE finally requested Stratex's VAT registration number ("VRN"). Despite this request CFE continued to attempt to trade with Stratex, allowing it to issue further invoices on 3 and 6 June 2009.

591. At 16:03 Agnes Lasceaux ("AL") of a different supplier, Axle, spoke with Mr Emilio Weldon ("EW"), one of the traders of CFE in a conversation which included the following:

"AL: I just wanted to tell you that about the VAT number I don't have it yet but promise to you I will send it to you as soon as possible.

EW: Yes, no problem at all.

AL: And I wanted to tell you that as you are a UK company we are too a UK company I think it's not a problem if I don't have it just now, but I promise you I will send it as soon as I have it, okay?

EW: Okay that's absolutely fine…"

592. At 16:23 Mr Weldon e-mailed Agnes Lasceaux of Axle saying:

"It is very important that you provide us with your VAT number, otherwise we won't be able to pay you tomorrow. This is because CantorCO2e includes 15% tax in the payment and then CantorCO2e reclaims this tax from the U.K Government. Please try to get hold of the number as soon as possible.

It was good to do the first trade with you!"

593. Thus, by 3 June 2009 at the latest there was a widely circulated rumour of VAT fraud in the market. Mr Wheldon had queried the absence of Axle's VRN and Mr Bush had finally requested Stratex's VRN. It is likely that these requests regarding VRNs were connected to the rumour connected to the circulation of the blog.

4 June 2009

594. The following took place on 4 June 2009.

595. At 10:38 Mr Weldon of CFE sent Agnes Lasceaux of Axle revised payment figures for the first deal with Axle saying:

"…This is because we do not have your VAT number and so CantorCO2e cannot send out the 15% of VAT without any guarantee of being repaid. This is in fact not a problem for two reasons:

- If you have a VAT number, you would need to send that 15% VAT to the U.K. government in any case. Therefore Axle Ltd is not losing anything if we send you the above sum of money.

- When you do provide CantorCO2e with a VAT number we will be able to pay you the accrued VAT…"

596. At 11:38 Mr Agnard of another supplier, Adduco, told Mr Bush of CFE that the French registry had been blocked. Mr Bush said that business had been very quiet today.

597. At 12:24 Mr Stork of another supplier, Westis, e-mailed Mr Bush of CFE in relation to Westis' VRN saying:

"As requested our vat number is 915 7270 21, please proceed with paiement now and send me copy of the swift so I can send you more allowance for trade today.

Also I ask my back office to go ahead with adding the vat number in all the invoices did to you.

Finally for your information my back office confirm to me that sales within the same country do no need vat number for invoicing and collecting the taxes…Anyway were following your policy."

598. At 12:40 Mr Emanuel verified Adduco's VRN with HMRC and the VRN provided by Westis (which belonged in fact to Epicure Business Solutions Ltd). The record of the contact states:

"Caller wished to verify a VRN –

915 7270 21 [Epicure] – valid number – name and address incorrect

893 9840 57 [Adduco] – valid number – name correct – address not provided.

Also advised called on invoicing prior to receiving VRN but after EDR.

Caller also wished to verify a further 12 VRNs. Spoke to Tech who advised to pass as a call-back. Caller said he will ring back to verify numbers later today."

599. From 4 to 16 June 2009 there were numerous e-mails and telephone conversations between Agnes Lasceaux of Axle, Mr Weldon and others at CFE in relation to whether CFE could pay Axle inclusive of VAT if proof of application for a VRN was provided.

600. The calls between CFE and Axle show CFE changing its position between potentially paying the VAT over (5 June 2009) and not (12 June 2009).

601. Mr Emanuel of CFE replied to the e-mail of Mr Stork of Westis at 12:52 saying:

"Thank you for the VAT number that you sent. However it appears to be incomplete. A VAT number has two letters at the beginning…Please send me a complete VAT number for Westis Ltd. Also, may I correct your back office who seem to have misadvised you. As a matter of law, if you are invoicing for VAT then the invoice must also contain a VAT number.

If there is no VAT number on the invoice then we cannot pay you VAT and you will need to send us a new invoice without the VAT element included.

Since the invoices that you have sent us to date do not have a VAT number on them, we should not have paid you VAT on those invoices. As a result, the current situation is that we have overpaid you on past invoices and will need to make an adjustment in relation to the amount that is outstanding today.

If however, you are able to amend and resend all of the past invoices to include your complete VAT number then no adjustment will be made.

Please confirm how you would like us to proceed."

602. Mr Stork replied at 12:58 saying:

"Sorry GB 915 7270 21

Ok I will send you all the invoices again but please in the mean time process with paiement due. I try to send all invoices corrected with the vat number within 3 hours."

603. The invoices then sent by Westis contained the VRN of Epicure. At 14:05 Mr Emanuel of CFE e-mailed Mr Stork of Westis saying:

"There is a problem with these invoices.

The VAT number that they contain is not registered to Westis Limited.

Either the VAT number is wrong or else the invoice needs to be made in the name of the company that has that registration number.

Please amend and resend accordingly."

604. Mr Stork replied at 15:33 saying:

"Dear james,

As discuss please find all set of document of Epicure business solutions limited owner of the vat number GB 915727021.

I will send you all amend invoices in the next 30 mns, please start proceeding in order for us to have the paiement made today."

605. At 15:59 Mr Stork then provided replacement invoices in Epicure's name rather than Westis'.

606. Thus, by this point on 4 June 2009 Mr Emanuel of CFE was aware there were serious issues with Westis' VRN, which was said to be that of another company Epicure. As a result of his questioning Westis' invoices were re-cast as deriving from Epicure. This is in itself should have set alarm bells ringing as to the regularity and the legitimacy of the trade Mr Emanuel was entering into.

607. An undated internal CFE note states:

"It has been claimed by Westis that the VAT number they supplied was a group number for Epicure Business Solutions Limited with themselves being part of the group. There is no available evidence to link Westis with Epicure, as Franck Stork is sole shareholder of Westis.

Also there is no mention of Franck Stork or Westis in the available company information."

608. A further note of CFE states:

"On 3/6/2009, James Emanuel, a CantorCo2e Limited manager, forwarded an internet blog concerning spot EUA trading on the Bluenext market and a VAT fraud. Further investigation by the Legal and Tax department raised suspicions about a number of CantorCo2e clients, Westis Limited being one of them.

It was found that Westis Limited had supplied a UK VAT number for another entity (Epicure) claiming that this was their parent company. No evidence could be found for this. AT 8/6/09, €2,781,133 VAT had been paid to Westis, although €3,987,165 was still being held on account by Cantor leaving Westis owed €1,206,031 by Cantor.

The account has been frozen pending further legal and regulatory reports."

609. CFE's own notes evidence there being reasonable grounds to suspect irregularity concerning the VAT claimed by Westis. Coupled with the blog report, the Tribunal is satisfied that at this early point there were reasonable grounds to suspect these Westis transactions were connected to VAT fraud.

610. There is an explicit link in the above note between the risk of VAT fraud and the enquiries that were being made. By the end of 4 June 2009 CFE was on notice of potential fraud in the market and how that could affect its own business. Pursuant to that it had checked the VRN provided by Westis, which was not verified.

611. On 4 June 2009 Mr Rose remained based in Toronto remote from and unaware of these trades. He liaised with Mr Craib further regarding the performance of the EU Carbon Desk. Mr Rose expected that volumes within the EUA market would continue to grow and that the change of focus for CO2e from carbon credit generating projects to brokering EUAs had been a success.

612. Mr Rose also anticipated the possibility of a similar carbon credit growth when emissions trading commenced in the United States; and the Blackberry messenger conversation between Mr Rose and Mr Craib refers to there being an estimate that the US market would be five times the size of EU ETS. Mr Rose's intention at the time was for CO2e to be a success in the US market in the same way as had been the case with the EU ETS.

613. By 4 June 2009 CFE had begun to make the link between the rumours of VAT fraud in the carbon credits market and the position in relation to the CFE suppliers that it had looked into. By the end of 4 June 2009 CFE, at least through its compliance officer, its traders and their head Mr Emanuel, was on notice of potential fraud in the market and how that could affect its own business. Pursuant to this it had checked the VRNs of two of its suppliers, one of whom, Westis, had been using another person's VRN. CFE had also been told that Axle, a further supplier, had no current VRN.

5 June 2009

614. The following took place on 5 June 2009.

615. At 06:56 Mr Emanuel e-mailed the CFE operations team stating:

"IMPORTANT please make NO payments today from our blotter until we give you the green light to do so."

616. Thus, early on 5 June 2009 Mr Emanuel had emailed the operations team asking that they make no payments to counterparties unless given the green light to do so.

617. At 07:11 Mr Emanuel e-mailed Mr Stork of Westis in relation to the Epicure documents saying:

"There is no documentation in this information pack that states that Westis Ltd is part of a group owned by Epicure as you told me earlier. Please provide me with evidence of the group if my understanding is correct.

If not, due to money laundering legislation, we cannot retrospectively change past trades into the name of Epicure Ltd when payment has been made to a bank account of Westis Ltd when there is no evidence of a relationship between the two companies.

One possible solution is that we approve Epicure as a client (subject to due diligence, etc) and then book these trades in the name of Epicure then we will need to make payment on those trades direct to Epicure. As such, Westis will have to return all money that we have paid to it to date, we will cancel the trade booked to Westis and we will then pay that same money to Epicure. Please confirm that this is agreeable to you and I will seek the necessary internal approvals for this to happen."

618. The Tribunal is satisfied that the indicators of serious irregularities with Westis' VRN together with lack of objective evidence to link Westis to Epicure, would have given CFE reasonable grounds to suspect fraud in relation to Westis at this time.

619. This conclusion is supported by the context of the rumour of VAT fraud in the market generally, problems with other suppliers such as a lack of VRN for Axle and large increase in trade in EUAs. These factors, at the very least, should have driven CFE to perform enhanced due diligence and not to trade further with Westis unless they had obtained satisfactory answers. Mr Emanuel had already indicated that there should be a temporary suspension of payments from the blotter. In contrast, Mr Emanuel was content to seek approval of Epicure as a CFE client and enterntain an alternative process or 'solution' to complete the trade instigated by Westis.

CFE's internal investigations into the potential for fraud in its trading

620. At 10:22 Mr Emanuel forwarded the blog post of 3 June 2009 regarding potential fraud in the market to Mr Craib and Mr Rose. As noted above, the 3 June 2009 blog article referred to above was brought to Mr Rose's attention by Mr Emanuel on the morning of Friday 5 June 2009.

621. Mr Rose asked Mr Emanuel to send the blog to him, and Mr Emanuel emailed the blog article to Mr Rose and Mr Craib early on the 5 June 2009**.** Mr Rose's recollection is that Mr Emanuel asked him to call him, which he did, whereupon Mr Emanuel relayed the message from the blog to him.

622. Mr Rose's recollection was that Mr Emanuel was sceptical about the blog article. The Tribunal has not heard from Mr Emanuel but Mr Rose's recollection as to scepticism appears inconsistent with Mr Emanuel's actions in raising the issue with Mr Rose, putting a temporary stop on payments to counterparties and Mr Rose's reaction to get on a flight to London.

623. Also, despite Mr Rose's claim as to Mr Emanuel's scepticism, Mr Emanuel had also chosen to forward a link to the blog article to Mr Tanton on 3 June 2009.

624. Having learnt about the blog article and having had conversations with Mr Emanuel, Mr Rose escalated the matter with the senior executives in New York. Mr Lutnick instructed Mr Rose to travel to London. Mr Rose was instructed to fly to London from Toronto to deal with the matter.

625. Mr Rose's evidence was that on Friday 5 June 2009 he decided to fly to the UK and he boarded a flight that weekend. Notwithstanding the fact that the blog could have been unreliable, Mr Rose took the view that it was something that needed to be investigated further. Given that Mr Drummond was no longer in charge in the UK, Mr Rose believed that it was prudent to fly over to assist and look into the matter further. Mr Craib also flew to London over that weekend to assist him.

626. The Tribunal is satisfied that Mr Rose's trip to London was significant – it was made to pursue an investigation in response to the objective indicators of fraud in the market and CFE's experience with its own suppliers. The Tribunal is satisfied that Mr Rose sought to downplay or minimise the significance of his visit. Mr Rose, holding a senior position within CFE, would not have flown all the way to London based only upon a rumour in the market unless there were those in CFE who believed that the blog should be given some credence and their trade in the market be investigated. The direction from Mr Lutnick came from the highest authority within CFE. Mr Emanuel had already put a temporary halt to payments based on active suspicion regarding at least one trader.

627. This was not simply a flight to London to verify an internet blog but the beginning of an internal investigation into CFE's carbon credit trading business. The blog post was the spark which started that internal investigation. The Tribunal is satisfied that CFE / CO2e's management above Mr Emanuel and his traders, ie Mr Rose, Mr Cooper and Mr Buchan knew nothing of the issue before this time and had no grounds for suspecting that there was any VAT fraud in the market.

628. On 5 June 2009 Mr Emanuel alerted Mr Cooper, as General Counsel, and Steve Treanor, the Head of Tax in the London office of Cantor Fitzgerald, about his concerns that CO2e might have been exposed to risks of VAT fraud in EUA spot trading.

629. Mr Cooper, CFE's General Counsel, became aware of concerns that CFE might have been exposed to risks of VAT fraud on 5 June 2009.

630. At 11:56 Mr Emanuel sent Mr Cooper's PA a spreadsheet setting out CFE's potential exposures where it had paid VAT out and did not currently hold sums to cover those payments.

631. Five counterparties were noted as creating potential exposures exceeding £3 million each: Adduco, BMC, Duntai, NCL and Stratex. It was clear to Mr Cooper *"…that the matter needed urgent further investigation in the light of the blog article which James Emanuel had*

discovered and the possible irregularities on some of the VAT invoices for these counterparties."

632. Mr Cooper recalls that, at this stage, that there was no assumption by him that any of these counterparties were necessarily engaged in VAT fraud. However, it was clear to him that the matter needed urgent further investigation in light of the blog article which Mr Emanuel had discovered and the possible irregularities on some of the VAT invoices for these counterparties. Mr Cooper and his colleagues in the legal department gave consideration on how to request third parties to provide evidence of their VAT registration, due to concerns that, in the event that any of the counterparties did in fact turn out to be engaged in VAT fraud (which was not clear), it could have the effect of causing them to disappear.

633. At 12:40 Mr Emanuel again verified Adduco's VRN and was told that it was no longer a valid VRN.

634. Despite knowing that Adduco's VRN was invalid, Stratex not having supplied any VRN, having had reasons to suspect Westis (based on the lack of VRN and attempt to transfer invoices to Epicure) and knowing of the rumours of fraud, CFE continued to attempt to trade with Adduco.

635. Mr Bush, one of CFE's traders, telephoned Mr Agnard at 14:22 trying to get Adduco to sell carbon credits to CFE. Mr Agnard said that Adduco would not trade that day, despite the fact that it could be paid the same day (something that Mr Agnard had repeatedly asked for).

636. At 14:40 Mr Stork of Westis replied to Mr Emanuel's e-mail of the previous day saying:

"please find attached the share certificate that is evidence that Westis belongs to Epicure Business Solutions, you will also find attached minutes and form j30. Also my agent would like to speak to you in order to arrange agreement with the 3 parties for resolving right now the problem and for you to be able to pay those 2 invoices immediately in a legal way."

637. Mr Emanuel should have treated this reply far more cautiously and asked further questions of and sought further documentation from Mr Stork than he did by way of enhanced due diligence. Mr Emanuel did not investigate the Westis / Epicure relationship and how the original invoices came to be presented to him by Westis. As is set out in his later emails to Mr Stork, below, his only focus was on the commercial imperative to complete transactions.

638. Mr Emanuel wrote back to Mr Stork of Westis at 16:00 saying:

"I am seeking approval to make payment of money without VAT as you suggested.

…

This issue has taken up my whole day so far and as a result of having paid you VAT when I shouldn't have paid you VAT I am also fighting to keep my job. I am sorry if this is not happening quickly enough for you, but honestly this problem was created by you claiming VAT when you were not registered to do so. As a result you will have to allow us to sort out the mess that has been caused and that will take as long as it takes. Hopefully it will be resolved on Monday."

639. Mr Stork replied at 16:03 attaching a draft agreement for CFE to pay Epicure using its Marfin bank account and saying:

"Find attached draft made by my agent, apparently you didn't find the time to call me. I sent you the evidence that you asked me and I tried to reach you all day, I will appreciate that you call me ASAP, also our lawyer ask me how you clear companies that don't have vat number and paid them the vat, so apparently we are not the only one that made mistakes, hopefully I believe that we can find a solution together with the help of the holding so take a quick decision on my paiement, without answer from you we will understand that you don't wanna pay and that you are trying to keep money that on one side is states money and on the other side is our client money and we will proceed and react on it."

640. And:

"…I think that you want easily put the fault on our side, cantor is one of the biggest finance company and is not my fault if your clearance department never asked us vat information, as you can notice, as soon as you realise YOUR mistake we immediately react and sent to you required information. You are the one hiding from the phone and the responsibility, I would like you to phone me to know the position of cantor before us to take any decision, we are not worry about scandal as we are not publicly known but we are worry about not paying our client for 3 days. The draft agreement sent to you before is a legal way for you to be covered and to pay us our due."

641. At 15:22 Mr Emanuel had e-mailed *inter alia* Mr Cooper, Mr Kevin Taylor (CFE Head of Compliance) and Mr Rose updating them on the "VAT situation" attaching a spreadsheet showing CFE's net exposure in relation to VAT on previous trading.

642. Mr Emanuel had sent the revised spreadsheet containing updates of the VAT situation to Mr Rose, Mr Cooper, Mr Craib, Graham Sadler (Chief Financial Officer), Mr Taylor and Mark Morris (Head of Operations for Europea and Asia). This revealed that a significant trade had taken place with BMC, so that CO2e was no longer potentially exposed in respect of trades with that client. The potential exposure on trades with BMC earlier in the day had been €8.6m.

643. The revised spreadsheet also appears to contain the rationale for identifying those counterparties who required further checking. In particular the list included all those counterparties who had engaged in spot EUA trading with CO2e. However, three groups were excluded from the 12 counterparties identified. These were:

(1) those to whom CO2e had only sold EUAs and from whom it had not acquired EUAs;
(2) those who were based outside the UK and to whom CO2e had not accounted for VAT on purchases; and
(3) those who were "known entities", for example Barclays Capital. These appear largely to be entities who were regulated.

644. Errors in the VAT invoices of the remaining 12 counterparties were also discovered. It appears that checks had begun to be made by CO2e on 4 June 2009.

645. At 18:58 Mr Cooper forwarded the blog post to Mr Stephen Merkel, Global General Counsel to Cantor and of the BGC Group. Therefore, Mr Cooper decided to alert Cantor Fitzgerald's headquarters in New York. He also forwarded the latest spreadsheet to Stephen Merkel, the Global General Counsel. This demonstrates that Mr Cooper recognised these were issues that required a very senior level of attention and management.

646. Mr Cooper recalls that he was unsure of what to make of the discussion in the article, it being based on anecdotal evidence and essentially inviting further investigation. Mr Cooper was of course divorced from the day to day trading of CFE's traders and their communications.

647. During that day it is said that, Steve Treanor, head of Tax, had also been checking whether the VAT numbers shown on the counterparties' invoices were valid. Mr Cooper believes that Mr Treanor and his team were checking invoice numbers through a combination of the HMRC telephone line and the Europa Validation website. The Tribunal did not hear from Mr Treanor or his team but accepts this explanation.

648. An email from Steve Treanor provides an example of these checks which were made on 10 June 2009, five days later, using the Europa Validation website (for GW Deals, AH Marketing and Northumberland Consultants) and using the HMRC telephone line for some other counterparties (BMC, Duntai and Mettec).

649. On 5 June 2009 itself CFE purchased hundreds of thousands of carbon credits from: BMC, GWD, AHMD, ADE and Duntai. In three of the BMC deals, CFE made a loss on the margin between its purchase and its sale.

650. The Tribunal is satisfied that CFE already knew that it had been paying VAT to either unregistered traders (Adduco) or traders using others' VRNs (Westis / Epicure) and had reasonable grounds to suspect some fraud but nonetheless CFE decided to keep trading with other traders to build up money on account to cover the VAT liability that might accrue to it.

651. A strategy was decided within CFE that, where money was held on account in respect of a counterparty, those sums would be offset against VAT paid on prior transactions unless a counterparty could meet the requirements for the release of funds (which was the provision of valid VAT invoices).

652. Although payments to counterparties were frozen, the EU Carbon Desk continued during the day to buy credits from some counterparties. The strategy was to buy further credits from those counterparties (without making payment for them at that point in time), sell those credits on, and then hold the sales proceeds on account until the VAT invoicing issues had been resolved. The money on account could then, if necessary, be used to offset any money that CFE had paid out to these counterparties by way of VAT if it transpired that CFE was otherwise unable to resolve the VAT invoicing issues with them. CFE had determined that it would continue trading so as to avoid a VAT liability. The commercial imperative was primary.

653. Mr Cooper stated this strategy was designed to limit CFE's potential VAT liabilities, but it also protected HMRC by effectively reducing the amount of money that had been paid out to these counterparties by way of VAT. The Tribunal is not satisfied that it was any part of CFE's strategy to protect the Revenue but only a by-product.

654. This was the strategy for all 12 of the counterparties identified on the list which developed as some anomalies in their invoicing were discovered.

655. Mr Emanuel referred in a later email on 5 June 2009 to waiting for Stratex to come to market. Attempts were also made to contact Stratex to obtain a corrected invoice. Stratex had not supplied a VRN in any of its 17 invoices from 18 May to 3 June 2009 which charged over £5 million in VAT. This in light of the difficulties with Adduco and Westis and the blogspot should now have put CFE on further notice that any suspected fraud might be widespread.

656. The idea was to put the company in a stronger position to ask the relevant counterparties to rectify their invoicing errors. At that time, Mr Cooper's evidence was that they did not know whether the counterparties were simply badly organised and had poor administration, which was typical for smaller counterparties, or whether something more sinister was afoot. Again, this evidence came from Mr Cooper and Mr Rose and, while the Tribunal accepts their explanations, it ignores the material before the traders and the accumulating grounds for suspicion collectively available to CFE as set out above.

657. According to Mr Rose, the understanding within the company at this time was that there was an obligation merely to ensure that the counterparty had a valid VAT registration and the correct paperwork was in place for each transaction. There was an acknowledgement of a VAT invoice compliance issue and the steps taken at this time were primarily to address this. However, as far as the company's personnel were aware, he stated there was nothing known to them at the time which led them to think that these matters were connected to any VAT fraud.

658. The Tribunal accepts Mr Rose's explanation in so far as it relates to his own state of knowledge and that of Mr Cooper at this date, but does not accept it in so far as it relates to state of knowledge of Mr Emanuel and the traders at this time. The Tribunal has not received any evidence from those traders, first amongst them Mr Emanuel. The information that was available to CFE collectively by this time should have led them to suspect a connection to VAT fraud for the reasons set out above.

659. The Tribunal is satisfied that the commercial motive for trading resulted in CFE, through its officers, agents, employees including managers and traders, failing to explore fully at this time whether these transactions were connected with the fraudulent evasion of VAT.

660. By trading with BMC on 5 June 2009, CFE converted a potential VAT liability of €8.6 million, to net monies held on account of more than €0.5 million.

661. Late on 5 June 2009 Mr Treanor of CFE contacted Mr Martin Sharratt, the Head of Tax at Smith and Williamson ("S&W"), CFE's external tax advisors, to say that CFE had identified a problem whereby some of the counterparties with whom CFE had been trading carbon credits had provided VRNs which did not appear to be valid and other counterparties might not be registered for VAT at all.

662. Mr Treanor also told Mr Sharratt that CFE had become aware of rumours of MTIC VAT fraud in the carbon credits market and that this had prompted them to check, or recheck, the VAT invoices of some of their counterparties. Mr Treanor asked Mr Sharratt to provide an advice on the requirement for CFE to obtain valid VAT invoices.

663. At 19:05 Mr Sharratt e-mailed Mr Treanor saying:

"Where a company has purchased any goods or services in good faith from an unconnected business, and holds a tax invoice from the supplier showing a valid UK VAT registration number, there should in principle be no problem in covering the VAT on your return, even if it is subsequently discovered that the supplier did not pay the VAT over to HMRC. If you checked that the VAT number on the invoice is genuine I can confirm that you would not normally be expected to carry out further checks in order to prove (for example) that the VAT number quoted on the invoice belongs to the person or organisation to which the payment was made; indeed, there is no easy way for any taxpayer to do so.

…

…**Optigen** – Case C-354/03) considered the position of an innocent party in a supply chain where MTIC fraud took place. In **Optigen** the court ruled that "the right to deduct input VAT of a taxable person who carries out such transactions cannot be affected by the fact that in the chain of supply of which those transactions form part another prior or subsequent transaction is vitiated by value added tax fraud, without that taxable person knowing or having any means of knowing." HMRC confirmed their acceptance of this principle in Business Brief 01/06 (copy attached)."

664. Mr Sharratt states in his witness statement:

"I had several conversations with CantorCO2e during the following weeks and my primary contacts were Steve Treanor and Mark Cooper, the General Counsel for Europe and Asia. My recollection of these conversations is that the business was aware that they were dealing with new entrants to the EUA market. However, they were unable to tell whether the anomalies on VAT invoices which they had discovered had arisen from a lack of business sophistication and back office functions or whether their counterparties might be in fact involved in VAT fraud. The suppliers were saying that their main concern and driver for their threats of legal action was the effect on their cash flow - if CFE withheld the VAT they would be unable to pay their own suppliers and would be placed in financial difficulty, for which they would blame CFE. Until there was clearer evidence of fraud, there was no assumption that CantorCO2e's supply chains might be tainted by VAT fraud. As a result, the principal focus of my advice was on the requirement to obtain a valid VAT invoice in order for CantorCO2e to recover its input VAT and, subsequently, on the question of whether HMRC might exercise their discretion in favour of CantorCO2e's claim for recovery if the suppliers were unable to rectify their invoices."

665. Mr Sharratt's evidence was read as agreed. The Tribunal accepts that this was what Mr Sharratt was told at the time. This does not mean that it was that it was reasonable for CFE to take the position that it was too early to suspect fraud in their trade. It was in CFE's commercial interest to take the most cautious approach possible to concluding there was fraud before taking determinative action, rather than the approach it should have taken – taking action as soon as there were reasonable grounds to suspect fraud. The Tribunal is satisfied that CFE set the bar too high for taking determinative action (implementing enhanced due diligence or ceasing trade).

666. At 20:05 Mr Craib found a twitter message saying "French BlueNext exchange 'desynchronized' preventing EUA carbon credits being delivered. Odd, especially on the day that correction is starting." Mr Craib forwarded the message to Mr Rose.

667. Ms Tracey Anne Mills, Head of Compliance at CFG since 2011, confirms that the broad objective of the JMLSG guidance for the financial sector, that CFE purported to apply, was that CFE *"… 'should know who their customers are, what they do, and whether or not they are likely to be engaged in criminal activity.' It accepts that the profile of customers' financial behaviour will build up over time, allowing the firm to identify transactions or activity that may be suspicious."*

668. Mr Sharratt's evidence reveals that CFE did not comply with this broad objective. Ms. Mills is unable to speak to events that actually occurred in 2009 having only joined the company in 2011.

669. Mr Cooper says in his first witness statement:

"28. Following checks carried out by CO2e by the end of Friday 5 June 2009, the counterparties appeared to break down into a number of separate groups at this stage:

(a) There were those who appeared to be validly VAT registered, whose VAT registration numbers had been checked. These were:

- GW Deals;

- AH Marketing;

- Northumberland Consultants;

- ADE International Limited ("ADE");

- Mettec; and

- Duntai.

(b) There were four businesses who had not supplied any VAT information on their invoices, meaning that it was not possible to confirm whether they were validly VAT registered. These were:

- Stratex;

- Axle Limited ("Axle");

- BMC; and

- Aristo Partners Limited ("Aristo").

Of these four, Cantor CO2e was potentially financially exposed to Stratex and Axle. However CantorCO2e held sufficient funds on account to cover any potential liabilities in respect of trades with BMC and Aristo.

Of the remaining counterparties, Adduco had provided an invalid VAT number on their invoice. Westis Limited ("Westis") had provided a VAT number which belonged to another entity, Epicure Business Solutions Limited, which Westis had stated was its parent company…"

670. At this stage, Mr Cooper records that they were therefore most concerned about potential exposures to Adduco, Axle and Stratex due to their possible VAT irregularities and the fact that CO2e did not hold sufficient funds on account to cover such exposures. There was also concern that Westis had provided a VAT number belonging to another company.

671. If, by 5 June 2009, CFE was unsure as to whether its counterparties were engaged in VAT fraud or the facilitation thereof, the proportionate response was that CFE should reasonably have ceased trading with them or suspended trade and taken other steps, such as enhanced due diligence, until it was satisfied that they were not. CFE erred on the side of continued trade rather than caution.

672. CFE did not do so but actively traded with counterparties on 5 June 2009 with whom there were now grounds to suspect fraud, in order to cover its potential liabilities to pay VAT in the event that that VAT was subsequently denied.

673. In doing so CFE failed to undertake further reasonable and proportionate investigation and action, such as suspending trading until it implemented enhanced due diligence. If CFE had conducted enhanced due diligence at this stage, such investigations may have reduced their claimed state of ignorance and increased any suspicion it held regarding suppliers. It may have increased CFE's state of mind to one of belief or knowledge as to their suppliers' connection to fraud.

674. For all the same reasons set out above, the Tribunal must also conclude that CFE failed to take reasonable care in dealing with a number of its EUA suppliers by 5 June 2009. Its prime motive was that commercial position was covered and secured. It is unknown if CFE also feared that in taking reasonable steps, it would affix itself with knowledge that would render it unable to recover VAT it had paid out so delayed doing so until its VAT position was secured.

6 June 2009 – Board meeting and suspension of trading

675. The following occurred on Saturday 6 June 2009.

676. At 1:08am Mr Emanuel had circulated a further version of his spreadsheet. At 01:08 Mr Emanuel reported that CFE's trades on 5 June 2009 had additionally: reduced the liability for AHMD's trades to €21,590.00, converted the Duntai liability of €3 million to monies held on account of €5.8 million and converted the GWD liability of €716,054.50 to monies held on account of €352,535.50. This indicated that sufficient funds were held to offset any potential risk of irrecoverable VAT in respect of trades with these counterparties.

677. The directors of CFE held a board meeting to discuss the findings of the previous day. Therefore, the board met at 13:00 on a Saturday. An unsigned copy of the board minutes state it was noted that, as a result of the blog article, CO2e had investigated recent EUA transactions and VAT payments made by CFE and that it appeared that CFE had paid VAT to some counterparties without being in receipt of invoices which properly complied with the relevant VAT legislation. It was further noted that in respect of some counterparties, CFE appeared to be holding a balance on account which exceeded the amounts already paid to those counterparties in VAT.

678. CFE's board resolved that no further payments would be made to any seller of carbon credits whilst CFE investigated further and CFE would set off the balances held against the VAT paid to sellers with potentially invalid VAT invoices. It was resolved not to make any further payments to any client until the matter had been investigated further and to set off the balances held by CFE against the VAT previously paid to those counterparties pending further investigations.

679. As concluded above, this suspension was only effected after the commercial position was protected.

680. The board also resolved to apply the same approach to any other client who traded further EUAs with CFE. At this stage the Tribunal accepts that none of the Board, the senior management or traders of CFE *knew* that the counterparties were committing VAT fraud.

681. Mr Cooper also obtained further external legal advice. He was concerned to ensure that CFE would not be committing any offence under the Proceeds of Crime Act 2002 ("POCA") by retaining sums due to counterparties. He was also concerned to ensure that CFE was compliant in respect of CFE's reporting obligations to the UK's Serious Organised Crime Agency ("SOCA") in accordance with the obligation to report suspicions of money laundering pursuant to section 330 of POCA. The decision whether or not to make a Suspicious Activity Report rested with Mr Taylor, who was the group's Compliance Officer and who reported to Mr Cooper.

682. Mr Cooper had several conversations with Mr Taylor over the following days. They were aware that they had a duty to report to SOCA where they knew or had reasonable grounds for suspecting that one of CFE's counterparties had engaged in VAT fraud. They were also aware that suspicion needed to amount to more than speculation as to whether an event had occurred.

683. Mr Cooper relied on the suggestion that most of the counterparties who had been approached about VAT anomalies on their invoices had indicated that this was something they were in the process of resolving. Mr Cooper also believes from his conversations with him at the time that Mr Taylor shared this view. Mr Cooper believes that Mr Taylor was extremely conscientious in his role and liked to be prepared and that he was a pro-active compliance officer who would have gathered information from all relevant sources within the group.

684. Mr Cooper's view at the time, and throughout the relevant period, was that it was not clear that the test of reasonable grounds for suspicion was satisfied and hence the need to make a report was not made out. The Tribunal accepts Mr Cooper's subjective view that he did not believe there to be reasonable grounds to suspect that one of more of CFE's counterparties had engaged in VAT fraud.

685. Nonetheless, the Tribunal is satisfied for the reasons set out above that there were objectively reasonable grounds to suspect that the counterparties were engaged in VAT Fraud. This conclusion is made without applying hindsight and in light of all the material available to CFE at the time which should have been available to Mr Cooper.

686. Further, the Tribunal must consider the state of knowledge or means of knowledge attributable to CFE as a whole and not simply to Mr Cooper or Mr Taylor.

687. The Tribunal places little weight on what Mr Cooper believed Mr Taylor's view was in the absence of evidence from Mr Taylor himself and in light of the contemporaneous written emails and documents produced by Mr Taylor as considered below in relation to 12 June 2009. The Tribunal does not need to make any finding of Mr Taylor's view as to fraud prior to 8 June 2009.

7 June 2009

688. On Sunday 7 June Mr Cooper also sought external legal advice as to whether it might be possible to obtain a worldwide freezing order against Stratex and Adduco along with their shareholders. These were the two counterparties in respect of whom the business appeared to be most financially exposed at that stage and Mr Cooper wanted to explore all possibilities to protect the group. Although some preparatory work was carried out with external advisers, the companies did not in the end apply for an injunction.

689. One reason for this was a concern that it might be difficult to prove loss at that stage, since it was not clear whether the input VAT incurred on trades with Stratex and Adduco was indeed at risk.

690. Mr Cooper records that, as a result of looking more closely at the counterparties, those within the business did notice certain similarities between some of them. In particular, they had established that many counterparties operated with a sole non-UK national as a director. They had also noticed that several counterparties banked with the Marfin Popular Bank in Cyprus, which was not a well-known bank in the market and was located outside the counterparties' jurisdiction.

691. In addition, they had become aware that the counterparties were all new to the market and had a limited corporate history, although CFE did not consider this to be particularly surprising. It is material to note, however, that none of the negative features listed in the preceding paragraph appear to have applied to Mettec, GW Deals or AH Marketing, who were the only three of the twelve identified counterparties with whom CO2e traded between 8 June 2009 and 18 June 2009.

692. The shareholders and directors of these companies were all resident in the UK. However, as noted at below, CO2e did identify some errors in the invoices of these counterparties and requested that these be corrected in the week commencing 8 June 2009.

8 June 2009 – suspension of BlueNext exchange and date from HMRC allege knowledge or means of knowledge of VAT fraud

693. This is the date from which HMRC alleges CFE knew or should have known that its transactions with Mettec, GW Deals, AH Marketing and Westis were connected to the fraudulent evasion of VAT.

694. The following occurred on 8 June 2009.

695. At 07:36 Bloomberg reported:

"BlueNext – the biggest exchange for spot carbon transactions, said it halted European Union emissions permit trading in Paris today. The exchange plans to make a statement to members shortly,…"

696. Mr Rose forwarded the announcement to CFE employees including Messrs. Craib and Cooper.

697. Mr Rose attended Cantor Fitzgerald's main London office (where the EU Carbon Desk was based). That morning he had received the Bloomberg report by email entitled *"BlueNext Exchange Halts Emissions Permit Trading in Paris"*. The Bloomberg report stated that BlueNext had announced it had halted the trading of carbon credits in Paris and that it would be making a statement shortly.

698. At 07:40 Mr James Bitton of ADE e-mailed Mr Bush of CFE stating:

"Dear John,

Find attach the 5 invoices that haven't been paid, please provide copy of the swift this morning so I can send you 300k that we will have to sell today.

Also my accounting department asked me to re-do all the past invoices with our vat number on it, so I will send them to you in 5 minutes, please replace the old ones with them in your files."

699. On 8 June 2009 at 09:02 Mr Stork of Westis e-mailed Mr Emanuel saying:

"I am glad that I had spoken with you, this morning and that you found the solution of the problem, please confirm to me per return if the 2 unpaid invoices will finally be paid on westis or epicure business solutions for to forward your mail to my back office.

Also don't hesitate to contact me if you need any help from our agent to make agreement or paperwork for your accounting, and please let us know which will be the 26 invoices that you will keep in files for us to keep the same in our declaration of taxes."

700. CFE has not provided a call on 8 June 2009 between Mr Emanuel and Mr Stork which may have contained Mr Emanuel's explanation of how he 'found the solution of the problem'.

701. At 09:30 "Dimitri" from Duntai raised an identical issue in an e-mail to Mr Bush stating:

"Dear john,

find attached all the invoices where we ad vat number on it, please replace with existing one, also please send me copy of the swift of Friday deals. …"

702. At 10:21 Mr Emanuel asked Mr Treanor to check that BMC's, ADE's and Duntai's VRNs corresponded to the companies using them. Mr Treanor replied at 10:37 saying that he had checked BMC and that he had checked ADE and Duntai on the previous Friday (5 June 2009).

703. Later Mr Emanuel emailed to Mr Rose a BlueNext Front Office announcement. This announcement confirmed BlueNext had started delivering delayed trades executed on 4 and 5 June 2009. The announcement also stated that new orders were forbidden and that BlueNext would keep members informed as to when trading would resume.

704. A further BlueNext announcement followed later that same day. It stated that the French authorities had made EUAs and CERs exempt from VAT and that the decision would only affect French members. The announcement also stated that the exchange would be closed for two days to allow members to make changes to their systems and inform customers. The announcement stated that the exchange would re-open on Wednesday 10 June at 8am and that all other market rules for the exchange would remain the same.

705. BlueNext therefore closed for two days on 8 June 2009 in the wake of the French authorities making carbon credits exempt from VAT. As above, Bluenext issued a statement to its members concerning the same. Reuters reported the move by the French authorities on 8 June 2009 at 15:53 citing French government sources as saying:

"There is a risk of VAT carousel fraud so as a preventative measure, we are changing the VAT regime on (emissions exchange) BlueNext's transactions… There has been no evidence of VAT fraud. It is only a rumour…but it could have potentially hurt BlueNext's ability to compete, so we had to react."

706. The Reuters article continued:

"Through carousel fraud, also called missing trader fraud, fraudsters import goods VAT-free from other countries, then sell the goods to domestic buyers, charging them VAT. The sellers then disappear without paying the collected tax to the government collection agency.

Emissions traders said rumours were circulating that a recent surge in volumes in European Union emissions permits traded over BlueNext, Europe's main exchange for spot permit trading, were suspicious.

"Part of this volume was sound, coming from the market expanding and new players entering, but a share of it might be hard to explain," said one emissions analyst.

…"

707. Those at CFE and other companies trading EUAs were quickly aware of the move by the French Authorities and the Reuters article.

708. Messages between traders from CarbonDesk Ltd ("CD") and Standard Bank showed their reactions to the move by the French authorities, with a CD trader saying: *"We'll find out who was doing the VAT round trip now…;)"*.

709. At 16:34 Mr Lynch, one of CFE's traders, e-mailed Mr Rose in relation to Westis, providing a contact number of 01887 858 110 and an e-mail address of westisltd@gmail.com.

710. At 16:35 Mr Emanuel e-mailed Mr Necov of ADE saying:

"I have been investigating the issue of your payment today.

It seems that the delay has been caused today because we have surprisingly received a new set of invoices from you today in respect of prior deals.

We now need to compare details of all invoices with all records on our files in order to ensure that we have reconciliation with prior invoices and with out [sic] systems…"

711. At 20:03 on 8 June 2009 Messrs. Emanuel and Taylor of CFE received an e-mail containing a copy of a further blog from the same source entitled *"VAT Problem on Bluenext: What kind of gaping hole did it make in the French budget?"* which stated:

"As hinted at in my earlier post, there seems to be a real VAT problem in France.

I did not claim to have all the details, but it seems that VAT is a factor. And if I am correct, the main victim was the Le Ministere du Budget.

…

But to what extent are they victims?

It is thought that the last leg of the VAT scam would be when the last player in the chain claims the money back from the government. And going by the amounts traded over the last few months (daily 4 to 8 million, and one day over 19 m) it can be assumed that there is now a very big snafu in the Budget Ministry.

But as I say, I am not sure of these details and would APPRECIATE any emails with theories. I must add that my peers simply have a contemptuous view of Bluenext on normal days, and this would only compound the contempt.

Also, it seems that reporting on this has been taboo. Methinks I must be more prudent before levelling accusations.

In the end, however, it is hoped by many that the carbon trading will rise above these manipulations and become a bit more transparent."

The disputed transactions with AH Marketing & Distribution and GW Deals

712. On 8 June 2009 CFE purchased 70,000 carbon credits from AH Marketing and Distribution ("AHMD") at a net cost of €903,000.00. On 8 June 2009 CFE also purchased 25,000 carbon credits from GW Deals ("GWD") at a net cost of €326,250. CFE engaged in only these two trades, the purchases from GWD and AHMD, on 8 June 2009.

713. HMRC have subsequently linked them to a fraudulent tax loss which is not in dispute. HMRC denied input tax in relation to them on the basis they allege CFE had knowledge or means of knowledge that the transactions were connected to the fraudulent evasion of VAT. These deals are in dispute as the Appellant denies it had knowledge or means of knowledge as to their connection to VAT fraud.

714. Both companies had valid VAT numbers. Mr Rose recalls that the understanding within CFE continued to be that it was only obliged to ensure that the counterparty had a valid VAT registration and that the correct paperwork was in place for each transaction.

715. In advance of doing these two trades CFE had identified that certain VAT invoices these counterparties had previously provided for trades which had occurred prior to 8 June 2009 had contained errors.

716. In line with the previous approach, CFE decided in such circumstances that it would do these additional trades and then hold the amounts payable to GWD and AHMD until it had received corrected invoices for all prior transactions. If these counterparties did not correct the errors then CFE would have the option of setting off the payment due to GWD and AHMD for the two latest trades, against VAT previously paid to these counterparties on prior transactions.

717. At this point it is necessary to consider the background to GWD, its involvement in fraud and HMRC's subsequent investigations into it.

GW Deals Ltd – VRN 884 9920 60 – supplier to CFE

718. GW Deals Ltd ("GWD") was incorporated on 2 March 2006 in the name Crestdawn Solutions Ltd, provided dormant company accounts to Companies House for the year ending 31 March 2009 and was dissolved on 19 October 2010. On 12 March 2009, Mr Gary Fuge was appointed a director and Anees Ahmed, the company secretary of GWD. Mr Fuge had no apparent background in trading commodities. Saleh Hamid was appointed a director of GWD on 1 July 2009.

719. Siva Reddy applied for GWD (in the name Crestdawn Solutions Ltd) to be registered for VAT with effect from 24 July 2006 declaring a main business activity of "*software consultancy and supply*" and an estimated turnover in the next 12 months of £250,000.00. GWD was

registered for VAT between 24 July 2006 – 14 January 2010 and declared little trading until 2009.

720. On 25 March 2009 Mr Fuge advised HMRC that GWD had moved address to 268 Bath Rd., Slough, Berks., SL 4DX. On 1 June 2009 Mr Fuge advised HMRC that GWD's bank details had changed to National Westminster Bank on Whitechapel Road, London and that GWD was now trading in carbon emissions.

721. This notification was only provided to HMRC after GWD had already started trading carbon credits with CFE.

722. On 14 July 2009 HMRC Officers visited GWD at 268 Bath Rd. where they were advised by Ms. Amreen Haroon that both Messrs. Fuge and Hamid were out of the country. The Officers asked Ms. Haroon what her role was and she said that it was to call traders about emissions and ask them how GWD could engage with them to sell emissions. When the Officers returned to the office they received a call from an accountant, Menzies, who advised that they were in possession of a Regulation 25 letter foreshortening GWD's VAT period (which had been left on the visit) and indicated that they had some records for collection. The following day, all of the invoices were collected.

723. The invoices showed that GWD was purchasing from: Bilta, SVS Securities PLC, Pan 1 and Ambron Ltd and selling to: Caron Capital Markets Ltd, SVS Securities PLC, CFE, Pan 1 and Royal Bank of Scotland.

724. On 20 July 2009 Mr Hamid completed two VAT returns for April 2009 to June 2009 and 1 July 2009 to 14 July 2009. On 3 August 2009 a further visit was carried out by HMRC Officers who were told by Mr Hamid that no deals were being undertaken with either the Royal Bank of Scotland or CFE because GWD was not FSA registered. Following the introduction of the reverse charge in the carbon industry GWD ceased trading in carbon credits.

725. On 4 November 2009 HMRC Officers again spoke with Mr Hamid who said that GWD had not traded in carbon credits since the introduction of the reverse charge on 31 July 2009 and confirmed that GWD had always been paid by its customer before it was required to pay its supplier. Mr Hamid claimed not to be aware of any problems with fraud in the carbon credits market. This appears incredible given the level of information that was published about fraud in the carbon market, particularly following the BlueNext closure (an exchange which GWD was in fact using at the time).

726. Between 19 May and 8 June 2009 GWD made 17 sales of carbon credits to CFE totalling 734,000 units with a gross purchase value of €12.1 million. The transaction on 8 June 2009 (25,000 units at a gross price of €372,312.50) remains subject to input tax denial. The documentation in relation to the deal was provided by Officer Ball.

727. GWD received the carbon credits that it sold to CFE from Bilta, accepted to be a fraudulent defaulting trader. GWD requested that payments to it be made to its account at HSBC Hong Kong. Bilta requested that payments be made to it at another branch of HSBC in Hong Kong.

728. GWD had neither experience in nor repute for dealing in carbon credits, its ability to sell such volumes of them to CFE was commercially incredible and its lack of financial worth made it a poor candidate to enter into such transactions. GWD's turnover went from a standing start

to £54 million for the three month period from 1 April to 30 June 2009 alone. All of GWD's transactions traced to tax losses.

CFE's due diligence on GWD

729. CFE's due diligence documentation in relation to GWD was provided to the Tribunal. CFE did little more than confirm the existence of GWD and carry out standard AML checks. CFE's due diligence in relation to GWD was standard CDD. It applied no enhanced due diligence.

730. The documents which CFE obtained from GWD showed that: GWD was dormant to its 31 March 2008 accounts, it had an overdue return at Companies House, it had a declared Standard Industrial Classification of "other wholesale" and capitalisation of £2. GWD failed the "glove test" which CFE later applied on 12 June 2009. As Mr Buchan accepted, CFE should have been satisfying itself that the counterparty could have legitimately obtained what it was providing. CFE did nothing in relation to GWD. Instead, CFE entered a further, and final deal with GWD on 8 June 2009.

731. CFE did not question how GWD could supply such large volumes of carbon credits, at a price that CFE could not beat despite its experience in the market, when it had been dormant, no net worth to speak of and had recently been taken over. CFE did not verify GWD's VRN until 12 June 2009, after the deals had been completed.

732. CFE's disclosed e-mail correspondence and records of calls with GWD was provided. There are few discussions in the e-mails about the carbon credits market or GWD's background. GWD appeared willing to send carbon credits to CFE regardless of market conditions.

733. None of the e-mails after 8 June 2009 show CFE making enquiries with GWD about their trading until 8 July 2009 when CFE sent revised KYC and supporting documentation requests to GWD. There are minimal disclosed records of telephone call between CFE and GWD.

734. Between 18 May – 8 June 2009 GWD supplied CFE with 734,000 carbon credits at a net cost of €10,561,880.00. The largest deal was on 26 May 2009 with a net purchase cost of €1,189,080.00. It should have been apparent that GWD could not have paid for these credits up front. The Tribunal is satisfied that no reasonable business would have granted in excess of €1 million of credit to a company such as GWD.

735. CFE also had available its collective knowledge of the following matters which gave it reasonable grounds to suspect VAT fraud in the EUA fraud as a whole: the very large increase in the EUA market; the recognition of the risk of VAT fraud in the market from the blog and suspension of the Bluenext exchange; the irregularities of invoices or lack of VRN provided by Stratex, Adduco, Axle and Westis; the suspicious explanation given by Westis about its VRN and links to Epicure; the advice CFE had sought and received from Smith and Williamson on VAT fraud; its own decision to make no payments on 5 June 2009; the ongoing internal investigation being conducted by Mr Rose; and an internal decision on 6 June 2009 only to trade on to avoid VAT losses.

736. In essence, the information available to CFE from which it should reasonably have drawn inferences emanated from the market, the executive action in France, its own internal

investigations, the irregularities in its dealing with other suppliers in this market and its lack of enhanced due diligence on suppliers.

737. These generic factors about the market should have been considered alongside the specific indicators regarding GWD such as the information that enhanced due diligence (which should have been performed by 8 June 2009 given the risk apparent by then) would have revealed. Therefore, the Tribunal is satisfied that there were (and CFE should have had) more than reasonable grounds to suspect that CFE's transaction with GWD on 8 June 2009 was connected to the fraudulent evasion of VAT. Further, objectively there were reasonable grounds to believe the same.

738. The Tribunal is also satisfied that CFE should have known that its transaction with GWD on 8 June 2009 was *more likely than not* connected to the fraudulent evasion of VAT.

739. Nonetheless, and despite HMRC's decision to deny input tax from this date, the Tribunal is not satisfied that these were factors were so compelling as of 8 June 2009 that CFE knew or should have known this transaction with GWD was connected with the fraudulent evasion of VAT. It is not satisfied that CFE knew or should have known that the only reasonable explanation on this date was that the transaction was connected to the fraudulent evasion of VAT. While there was a significant amount of material available to CFE by 8 June 2009 which should have informed its means of knowledge as to its transaction with GWD, the picture was still developing. While it should have been aware of a risk of fraud based on the generic features of the trade in carbon credits and the specific features of its trade with GWD, HMRC have not proved CFE should have known that the only reasonable explanation for this trade at this time was the fraudulent evasion of VAT.

740. This in contrast to the cumulative material that CFE was in possession of by 15 June 2009 which became overwhelming as is set out below, for example: the glove test applied to counterparties; the draft suspicious event report prepared; further press reports of VAT fraud in the market; further suspicious contacts with various counterparties; the categorisation of the trading as high risk etc.

741. For the same reasons, the Tribunal is not satisfied that CFE knew or should have known that its transaction with AHMD on 8 June 2009 was connected to the fraudulent evasion of VAT. This conclusion is addressed in further detail below.

742. The Tribunal is satisfied that by 15 June 2009 there were further factors that provided a compelling and overwhelming picture such that it should have known its transactions from 15 June 2009 with AHMD were connected with the fraudulent evasion of VAT. These factors include: the further contact with suppliers indicating irregularity in their VAT status between 9 and 15 June; AHMD failing CFE's own 'Glove test' and AHMD's position being queried in a draft Suspicious Event Report (which also collated the concerns with many suppliers on 12 June 2009); CFE's decision to treat its carbon credit trading as high risk on 15 June 2009; yet not applying enhanced due diligence to AHMD or any other counterparty by that date which would have revealed further negative indicators as to the high risk of fraud in trading with them.

743. The Tribunal is satisfied that by 8 June 2009, and throughout all the periods under examination, CFE sought to rely on the most innocent explanations for their trade. CFE's management and traders approached the matter from a skewed perspective. Rather than trading

and applying reasonable and proportionate safeguards which would have protected the Revenue from risk, they were driven by profit motive and failed to take reasonable care.

9 June 2009

744. The following occurred on 9 June 2009.

745. At 05:50, Mr Graham Sadler, Cantor's Chief Financial Officer (CFO), e-mailed Mr Treanor, head of the tax department saying:

"I understand we may pay out BMC today (14mUSD). Howard [Lutnick] has asked for us to confirm directly to him that there is no risk in doing so. Please can you double check VAT registrations with HMRC, invoices etc. Also I would like written advice that paying out to someone who checks out ok but subsequently does not pay HMRC does not expose us to a claim from HMRC. We are on notice that there may be an issue in the market and these are big numbers."

746. At 08:52, despite CFE knowing that Adduco's VRN was invalid, there was the following conversation between Mr Bush (JB) of CFE and Mr Agnard (EA) of Adduco:

"JB: Yes, I'm alright. So how's things, are you looking to do some trading with us today? Are you going to send me loads of allowances?

EA: I don't think to be honest with you (Inaudible) I don't think.

JB: Why's that?

…

EA: No problem to do this because the new law, because of the new – I have to search everything with my (inaudible). So for one month we don't send.

JB: Okay

…"

747. By 9 June 2009 there was an implied link between the executive action taken in France and whether or not Adduco would trade. CFE knew that one of its suppliers was hesitating or suspending before continuing trading. This matched CFE's own decision made at the board meeting on 6 June 2009 not to continue trading without further investigation.

748. On the morning of 9 June 2009 Mr Emanuel had sent Mr Rose a link to a further blog article that had appeared on 8 June (and had been sent to Mr Emanuel at 20.03 on 8 June 2009). This blog article suggested that there was a VAT problem on BlueNext. It is worth noting that the author of the blog stated he/she was not sure of the details of the potential fraud and welcomed emails with theories.

749. That same morning Mr Rose emailed various senior Cantor Fitzgerald individuals a Reuters report entitled *"France makes CO2 credits VAT-exempt to avoid VAT scam"*. The Reuters report stated that the French authorities had made carbon credits exempt from VAT in order to prevent a potential tax scam linked to a French emissions exchange, although the report included a comment from a source at the French authorities who expressly stated that *"There*

has been no evidence of VAT fraud. It is only a rumour...” and comment from a BlueNext spokesman who stated that any rumours that VAT fraud was occurring on the exchange were unsubstantiated.

750. At 11:14 Mr Taylor of CFE compliance asked Mr Emanuel for examples of invoices provided by *inter alia* Adduco, bank account details of where Adduco payments were to be sent, an explanation of CFE’s involvement in the spot trading flows and to be kept posted of any potential movement in the Adduco account including CFE being approached for pricing information.

751. At 12:24 Mr Emanuel replied to Mr Taylor’s e-mail of 6 June 2009 stating “*no substantive communication with clients so far.*”

752. Mr Emmanuel’s reply was inaccurate. Adduco’s decision to stop trading with CFE for a month as communicated to Mr Bush earlier that morning, having sold some 3 million carbon credits to CFE at a gross cost of more than €45 million between 11 March – 3 June 2009, qualified as a “*substantive communication*.”

753. CFE has not provided a witness statement from Mr Emanuel, Mr Bush nor Mr Taylor nor any evidence as to why they are not available to give evidence. The Tribunal has not been provided with an explanation for why Mr Emanuel replied to Mr Taylor in this way. The innocent explanation is that Mr Bush did not pass on the nature of his conversation with Mr Agnard to Mr Emanuel. The alternative is that Mr Emanuel was aware of the conversation but failed to share it to Mr Taylor.

754. The Tribunal draws an adverse inference and finds that Mr Emanuel was aware of the position but failed to disclose it to Mr Taylor. It is unlikely that Mr Bush would not convey to Mr Emanuel, his head of desk, that a supplier of such a significant proportion of their business was no longer willing to trade for a significant period of time.

755. The fact is that Adduco’s reluctance to continue trading from 9 June 2009 was yet one further matter that should have indicated to CFE that trading in this market carried a real risk of participating in transactions connected to the fraudulent evasion of VAT.

756. At 12:28 Bloomberg reported that the French authorities had found evidence of carousel fraud relating to VAT in trades of carbon credits. Mr Emanuel e-mailed the report to Messrs. Rose and Cooper at 12:35.

757. Mr Rose circulated to various senior Cantor Fitzgerald individuals the Bloomberg report entitled *“France Finds 'Carousel' Tax Fraud in Carbon Emissions”*. The content of this article differed from the above Reuters report in that it suggested the French government had found evidence of carousel fraud.

758. At 12:51 Mr Tanton of CFE compliance department e-mailed Mr Taylor saying:

“... On 3/6/2009, James Emmanuel, a CantorCo2e Limited manager, forwarded an internet blog concerning spot EUA trading on the Bluenext market and a VAT fraud. Further investigation by the Legal and Tax department raised suspicions about a number of CantorC02e clients, Adduco Consulting being one of them.

It was found that Adduco Consulting had supplied an invalid UK VAT number after trading. At 8/6/09, €6,075,931 VAT had been paid to Adduco exposing Cantor group as this could not be claimed back.

The account has been frozen pending further legal and regulatory reports."

759. There was no mention that one of CFE's own traders had that very morning attempted to extract further trade from Adduco. It appears that the trading department was not sharing with its compliance department exactly what action it was taking in respect of suspected suppliers.

760. At 16:12 Mr Emanuel wrote to Mr Necov of ADE in relation to the reissued invoices saying:

"Please see the attached invoices that you have sent to us.

Please would you explain what they relate to.

We did not execute these deals for ADE International Ltd."

761. Mr Necov replied at 16:31 saying:

"Dear Emmanuel, sorry this was a mistaken invoice that we sent you with all invoices but that was not trade, please disregard them. …"

762. In light of the previous mistakes and irregularities that CFE was aware of in relation to its suppliers, and the absence of any evidence from Mr Emanuel, the Tribunal infers that Mr Emanuel would be unlikely to accept the innocent explanation provided for the mistaken ADE invoices. He should not reasonably have accepted the innocent explanation if he did.

763. At 16:38 Bloomberg updated its report to state that the French authorities found a risk of carousel fraud. There was a correction to the report later that day to clarify that France had found a risk of fraud rather than evidence of fraud. Mr Rose circulated this correction to various senior Cantor Fitzgerald individuals (including Mr Cooper) commenting that it was an interesting correction. Mr Cooper noted in his evidence that this article, together with the Bloomberg article and the BlueNext announcement received the previous day, were further indications of rumour in the market, but that there was no confirmation of any VAT fraud.

764. At 16:38 Mr Rose also e-mailed Mr Wayne Buchan, Chief Risk Officer for CFE. The subject of the e-mail was: *"FW: Business Management Consulting Ltd"* and simply states *"I will call you to discuss.*" Neither Mr Rose nor Mr Buchan provided any material evidence as to the content of that later conversation.

765. At 17:48 Mr Emanuel wrote to Mr Necov of ADE:

"Will you please re-issue these invoices with the words CANCELLED across them.

They appear to be Westis trades.

Could you please explain how ADE International are related to Westis Ltd?

Would you please disclose any other companies in the carbon market to whom you are affiliated?"

766. ADE replied at 18:09 saying:

“These invoices have nothing to do with westis, they are just an error that we made doing invoices on past trades that was saved on the computer and that was resend to you per mistakes. We are not affiliate with any other companies working with you.

767. Mr Emanuel replied at 18:29 saying:

“It is curious that you say you are not affiliated to any other company working with us because your invoices are exactly the same, with the same spelling errors as four other companies. The only difference is the company logo at the top. How would you explain this?”

768. ADE’s response at 18:38 was evasive:

“Dear james, what do you mean by affiliates companies, we have no lien with those companies, I am ADE international limited and that s’it, I am worry just about ADE and my paiements in order to be able to pay my clients and maybe be able to keep working with you if you assure me that this kind of problem will not happen any more.”

769. From ADE’s submission to CFE of the duplicate invoices for Westis deals on 8 June 2009, it was obvious that there was something seriously amiss with ADE’s, and Westis’ trade with CFE. CFE never raised the issue of ADE’s invoices with Westis. ADE’s responses effectively confirmed James Emanuel’s evident distrust yet CFE never raised the issue of ADE’s invoices with Westis or took positive action.

770. Instead of cutting all ties with both ADE and Westis, Mr Emanuel sought to carry on business as usual with ADE and with Westis once the latter was registered for VAT.

771. Mr Rose recalls that he had various conversations with Mr Emanuel regarding the market commentary at the time and Mr Emanuel reassured him. According to Mr Rose, Mr Emanuel stood very strongly behind the business model which had been introduced and was of the view that the rumours of fraud which were then circulating did not mean the EU Carbon Desk was dealing with fraudsters. Mr Rose also recalls Mr Emanuel commenting on the lack of any notice or warning coming from HMRC.

772. The Tribunal accepts Mr Rose’s evidence but finds that Mr Emanuel was not being candid and open with Mr Rose about the extent of his knowledge of the trade. The examples of the communications regarding ADE and Westis, in light of all the other evidence such as that concerning Epicure, support a finding that Mr Emanuel actually suspected there was VAT fraud being committed by CFE’s supplier Westis.

10 June 2009

773. The following occurred on 10 June 2009.

774. At 09:53 Mr Bush of CFE again telephoned Mr Agnard seeking to trade with Adduco. Mr Bush also asked Mr Agnard to confirm Adduco’s VRN, saying that the one CFE had been given did not tally with Adduco.

775. In light of the rebuff just the previous morning this demonstrates that CFE’s traders were determined to carry out transactions regardless of the regulatory risks.

776. At 14:12 Mr Emanuel circulated within CFE an example to clients of what a VAT invoice needed to contain with a covering letter. This was then sent to CFE's suppliers.

777. On 10 June 2009 Mr Emanuel emailed Mr Cooper, Mr Treanor and Mr Sadler suggesting new VAT invoice requirements to prescribe to counterparties. These were discussed within CO2e and sent by the settlements team to the counterparties on 10 and 11 June 2009.

778. On 10 June 2009 Mr Rose also received an email regarding the release of the official announcement (in French) from the French government report relating to the VAT change for carbon credits.

The Mettec (Ayres) transactions

779. CFE engaged in one trade on 10 June 2009 namely a purchase of carbon credits from Ayres Ltd, trading as Mettec. HMRC have subsequently proved this was linked to tax loss and have denied input tax alleging that CFE had knowledge or means of knowledge of VAT fraud.

780. The Mettec trade was again apparently undertaken to offset VAT already wrongly paid out to Mettec. As part of the approach already described above Mr Rose recalls that it was thought prudent to do this additional trade with Mettec on 10 June so that CFE could hold sufficient money on account pending Mettec providing a corrected invoice in case the VAT on the previous trade needed to be clawed back. Mettec had provided invoices for prior trades with which there were some issues.

781. In the morning of 10 June 2009 CFE purchased 50,000 units from Mettec at a net cost of €645,000.00.

782. The Tribunal finds that the purchase was made despite CFE knowing of the risk of fraud in the market, the problems with Mettec's invoices and without making proper checks into Mettec.

783. Had CFE looked at the data available to it in its registry account it might have been able to discover that previous transactions with Mettec had involved carouselled credits.

784. CFE's due diligence documentation in relation to Mettec was standard CDD similar to that obtained for Stratex and GWD as set out above. CFE did little more than confirm the existence of Ayres Ltd and carry out basic AML checks. The documents included: a letter of introduction saying that Ayres was developing its carbon credits business, a certificate of incorporation dated 26 November 2008, a status report showing nominal capital of £1 and a Companies House report showing that no nature of business had been provided, no accounts had been filed, and Mr Ayres had been appointed to the company on incorporation.

785. The positive indicators were that the counterparty had a valid VAT number; it had also provided a letter of introduction when completing the due diligence process at the outset of CO2e's trading relationship with it.

786. Nonetheless, no enhanced monitoring or due diligence had been undertaken on Mettec in response to all the negative indicators apparent to CFE about the market by 10 June 2009. CFE did not carry out any check to satisfy itself that Mettec could have legitimately obtained what it was providing to CFE. CFE did not question how Mettec could supply such large volumes of carbon credits, at a price that CFE could not beat despite its experience in the market, when it had no net worth and had just been taken over.

Background Ayres Ltd t/a Mettec VRN 943 9490 85 – supplier to CFE

787. Ayres Ltd t/a Mettec ("Mettec") was incorporated on 26 November 2008 and provided Companies House with the SIC code for "*other business activities*." Ayres's address registered with Companies House was Winton House, Winton Square, Basingstoke, Hants., RG21 8EN.

788. Mr Mark Ayres applied for Mettec to be registered for VAT from 19 January 2009 declaring a main business activity of *"commodities trading and associated services"*, an address of 3 Alderney Avenue, Basingstoke, RG22 4UA and an estimated turnover in the next 12 months of £500,000.00.

789. HMRC Officers visited Metttec on 13 August 2009 but Mr Ayres was not present.

790. On 18 August 2009 HMRC Officers visited Mettec at Winton House. Mr Ayres was asked how he came to trade in carbon credits and said that an acquaintance of his (Mr Steve Sands of Acme Direct Ltd ("Acme")) had approached him as he had contacts in Manchester who had a client in London. Mr Ayres stated he had attended a meeting in Warwick on 10 June 2009, after his first two deals, with three males where he was told to set up an account with CFE and K O Brokers to sell carbon credits to and that a lot of money would be put through both Acme and Mettec. Mr Ayres was told that he would be given a target price by CFE and would then be told the price at which he would purchase from Acme by another man. Mr Ayres said that CFE had sent him due diligence forms after the first deal which he had completed. Mr Ayres said that ethnicity and bank problems prevented his counterparties dealing directly with one another and that he had received threats to his family should he not carry out further deals. Mr Ayres further said that he paid Acme via a global escrow service in the Seychelles. Mettec's VAT registration was cancelled with effect from 11 June 2009.

791. Even though it is hearsay and the Tribunal has not had an opportunity to hear from Mr Ayres, this evidence has been agreed and the Tribunal accepts what Mr Ayres said about his meeting on 10 June 2009 and being told to deal with CFE. The Tribunal will return to this significance of this.

792. Ayres' e-mail address info@ mettecltd.co.uk was registered to Adworks at Unit 16, Chestergate, Stockport, SK3 0AL, the address of an MTIC trader called Saladuk.com whose VRN was applied for by Nadim Lodhi and which was denied the right to deduct input tax in VAT period 06/06. Mr Ayres had said that one of the men he met in Warwick was called Nadim.

793. Between 12 May and 10 June 2009 Mettec made 3 sales of carbon credits to CFE totalling 78,000 units with a gross purchase value of €1.2 million. The details of the Mettec transactions were set out in Officer Ball's witness statement. Mettec received the carbon credits that it sold to CFE from Acme who in turn purchased them from Japek (UK) Ltd ("Japek"). Japek is accepted to be a fraudulent defaulting trader. On two of Acme's invoices the payment instruction was to pay Global Escrow in the Seychelles and the remaining invoice carries an instruction to pay Alliance Universal in the Seychelles.

794. Mettec had neither experience in nor repute for dealing in carbon credits, its ability to sell such volumes of them to CFE was commercially incredible and its lack of financial worth made it a poor candidate to enter into such transactions.

795. HMRC also appear to place some reliance on the fact that the address provided by Mettec turned out to be a residential address. This was not known to CFE at the time, but in any event, given the nature of the business (which did not necessarily require any particular type or size of premises), this on its own may not be cause for suspicion. Mr Rose recalls examples of hedge fund managers who manage billions of dollars of assets from their living rooms. However, this is likely to be the exception rather than the norm and CFE should have examined all the relevant factors – it is not possible to view them in isolation. Even if, when viewed in isolation, the residential premises may have an innocent explanation, the total picture when considered may be overwhelming.

796. CFE's due diligence documentation in relation to Mettec was again standard CDD. CFE did little more than confirm the existence of Mettec and carry out basic AML checks. CFE did not question how it could supply such large volumes of carbon credits, at a price that CFE could not beat despite its experience in the market, when it had no net worth to speak of and had just been taken over. CFE only verified Mettec's VRN on 5, 6 and 10 June 2009. By 10 June 2009 CFE had failed to respond proportionately to the high risk the trade in EUAs now presented by conducting enhanced due diligence. Had it done so, the material it would have gleaned would have revealed further negative indicators as to the legitimacy of its trade.

797. CFE's disclosed e-mail correspondence and records of calls with Mettec were provided. There are no discussions in the e-mails either about the carbon credits market or Mettec's background, aside from Mr Ayres' statements in his initial correspondence. Mettec appeared willing to send carbon credits to CFE regardless of market conditions and persisted in trying to sell carbon credits to CFE.

798. The focus of many of the conversations is moving the carbon credits through CFE regardless of market price so that the money could be re-used to fund further transactions in what must have appeared to be an incredible never-ending stream of carbon credits available to Mr Ayres.

799. None of the e-mails after 8 June 2009 evidence CFE making enquiries with Mettec about their trading until 17 June 2009 when a meeting was arranged between Messrs Emanuel and Mettec and 8 July 2009 when CFE sent revised KYC and supporting documentation requests to Mettec.

800. In the meantime, on 10 June 2009 CFE made a further purchase of 50,000 carbon credits from Ayres at a gross cost of €645,000.00, shortly before CFE told Mettec that they were not taking any further orders.

801. It should have been apparent that Mettec could not have paid for these credits up front. It should have been apparent that no reasonable business would have granted credit of €645,000 to Mettec.

802. Mr Bush of CFE has provided no evidence nor has CFE provided a reasonable explanation justifying an innocent explanation for its purchase from Mettec on 10 June 2009. Having completed one deal for 50,000 units on 10 June 2009 Mr Bush of CFE telephoned Mr Mark Ayres of Mettec at 14:16 saying of the next deal for 50,000 units:

"JB:…Don't send those allowances at the moment, I'll call you back. Something's going on at the moment, I'll call you straight back, all right?

ME: Problems?

JB: Yes, there's problems, okay. I'll call you back in a short while but don't send me allowances at the moment okay?

…"

803. Once CFE knew of the risk of fraud in the market its conduct in continuing to deal with Mettec demonstrates that it should have known, that any trade with Mettec on 10 June 2009 was *more likely than not* to be connected with the fraudulent evasion of VAT. CFE pursued its "strategy" of trading with those that on its own case, at the very least, it suspected prior to carrying out proportionate risk assessments and checks.

804. Nonetheless, the Tribunal is not satisfied that at the time of its trade with Mettec on 10 June 2009, CFE knew or should have known this transaction was connected with fraudulent evasion of VAT.

805. When looked at in total, the generic evidence of fraud in the market and indicators available specifically in relation to Mettec were so compelling that CFE should have known that the only reasonable explanation for any trade with Mettec from 15 June 2009 would be connected to the fraudulent evasion of VAT. This is for the same reasons as set out above in relation to GWD. However, the trade on 10 June 2009 was CFE's final transaction with Mettec.

806. The Tribunal also takes into account that the material available from the later conversation on 11 June 2009 between Mr Emanuel and Mr Ayres (see below) which gives an insight as to CFE's state of mind after 10 June 2009, but it avoids applying hindsight as to CFE's knowledge on 10 June 2009.

Other events on 10 June 2009

807. At 17:29 Mr Bush requested from CFE's Help Desk a voice recording of a call said to have been made by CFE to Stratex between 16:00 – 16:20 that day. The calls were then sent. No records of telephone calls between CFE and Stratex have been disclosed.

808. At 18:22 Mr Treanor circulated the results of VAT checks that he had undertaken on: GWD, AHMD, NCL, BMC, Duntai, Ayres and ADE. Mr Treanor had checked GWD, AHMD and NCL's details on the Europa website for validating VAT numbers as opposed to with HMRC, with whom Mr Treanor had checked the other traders.

809. The rationale for this difference in treatment of the three companies is set out in the draft Suspicious Event Report completed by Mr Taylor of CFE compliance and bearing a manuscript date of 12 June 2009, these words appear as underlined and capitalised in the text:

"We have not chosen to determine whether the VAT number is valid to Northumberland Consulting Ltd as the concern is that if it isn't then we are on notice and would have to account for the overpayment.

WHAT IF ANYTHING ARE WE DOING WITH GW DEALS LTD AH MARKETING?"

810. The likely person this 'we' can be referring to is Mr Treanor, of his own compliance department.

811. This is an example of CFE's deliberate attempt to refrain from making proper enquiries into its counterparties, lest what it found confounded its attempts to continue trading with those it had wrongly paid VAT to until it had traded sufficiently with them to build up money on account covering the liability.

812. At 23:27 on 10 June 2009 Mr Tom Anzalone (Global Head of Operations) of CFE e-mailed Mr Rose and Mr Emanuel requesting that he should be called before any further matched principal trades were done.

813. On 10 June 2009, CFE had also purchased 226,000 carbon credits from Axle but there was no VAT loss associated with this transaction.

11 June 2009 – CFE's suspension of matched principal trading

814. The following occurred on 11 June 2009.

815. There was a further conversation between Mr Emanuel (JE) of CFE and Mr Ayres (MA) of Mettec on 11 June 2009 at 07:34 which included the following:

"JE:…I mean, the issue for our guys is this, we're obviously paying out VAT to you.

MA: Of course, and we're paying it out as well, yeah I know.

JE: You're paying it out the other side and you've got to account for it to HMRC. Now if for whatever reason that chain breaks down then there's a chance that HMRC come to us and say, "Right, you know, you've got the VAT liability."

MA: This is because of the French (Inaudible) isn't it?

JE: Exactly, they would say to us, "You've got to pay the liability because you should never have paid it out to x, y, z company?" So the only defence we've got to that is to say, "Well, they gave us a valid VAT invoice."

MA: That's right.

JE: That is a full and complete defence but of course, we don't have any valid VAT invoices because the invoices haven't been prepared properly. So at the moment, we're on the hook, potentially, for a liability of all the VAT that we've ever paid out, which is tens and tens of millions."

816. The issues with the Mettec invoices concerned: (i) the rate used to convert the VAT amount into sterling; (ii) the lack of a net unit price on the invoices; and (iii) a balancing item for bank charges that did not show any VRN. These issues were raised on 11 June 2009 (see the emails from Mr Emanuel and from "#CO2e – Settlements". An internal email from Mr Treanor also suggests that the Mettec invoices lacked a VRN. In fact, only the very first invoice that Mettec had issued (on 12 May 2009) had lacked a VRN, and that invoice had been reissued with a VRN the same day.

817. At 08:54 Mr Emanuel replied to Mr Anzalone's e-mail of 10 June 2009 stating:

"Following this email we are not doing any matched principal trades until we receive explicit instructions to do so. My feeling is we get comfortable with our process first and settle all

outstanding trades before entering into new ones. We have already refused to accept allowances to sell from two clients: GW Deals and Mettec."

818. Mr Emanuel thus stated that following this the EU Carbon Desk would not be doing any matched principal trades until they received explicit instructions to do so.

819. Mr Rose stated in evidence that it is evident from the email that Mr Emanuel's feeling was that the business needed to get comfortable with the new processes before entering into new trades. Mr Cooper considered that this might be a response to the potential credit risk of the counterparties, although trading with smaller companies of the nature of these counterparties was not uncommon.

820. The Tribunal accepts that Mr Rose and Mr Cooper were honestly trying to assist with explaining Mr Emanuel's state of mind but finds that the real reason for the suspension of trade is that Mr Emanuel was well aware of the risk of VAT fraud concerning any further transactions at this time.

821. On 11 June 2009 at 09:32 Mr Bush e-mailed Mr Rose stating:

"Laurence, I spoke to Avi at Stratex at approximately 09.25 this morning. He assured me he would be sending me his VAT application today, and also that he was very happy as he had signed contracts for three million tonnes of spot EUA's which he would be bringing to the market in a week to ten days"

822. CFE has not disclosed any records of telephone calls between CFE and Stratex.

823. Contact was also made with Stratex. The email correspondence from 11-12 June 2009 indicates that Mr Bush had spoken to Mr Avi Alkobi at Stratex and that Stratex had assured him they would be sending over details of their application for VAT registration.

824. It appears from this correspondence that similar promises were repeated in a further discussion. In the event, no such documentation was ever received from Stratex and their invoices were not rectified.

825. Again, this failure by Stratex to comply and provide to CFE the VRN requested in respect of the previous 17 invoices from 18 May to 3 June 2009 worth over £40 million with over £5 million in VAT should have put CFE on notice that there was something seriously amiss with this trading.

826. On 11 June 2009 Mr Adcock emailed the Risk team attaching a list of CO2e's clients and requesting "LE ids". This is an abbreviation for Legal Entity Identifier.

827. These are codes which are normally given to each counterparty that Cantor Fitzgerald trade with. The codes are used in the trading and settlement systems for the purpose of identifying the correct entity.

828. Mr Buchan subsequently emailed Tom Anzalone (Global Head of Operations), Mark Morris (Head of Operations for Europe and Asia) and Mr Rose attaching the list provided by Mr Adcock and stating that the Risk team would be verifying full legal entity names. This was on the basis there appeared to be a few abbreviated names in the list.

829. At 10:32 Mr Bush telephoned Mr Agnard of Adduco again to "get an update on the market". Mr Agnard said "…when we start on our VAT number and I manage – I work on it today."

830. At 16:38 Bloomberg had updated its report to state that the French authorities found a risk of carousel fraud.

831. At 18:30 Mr Treanor e-mailed Mr Cooper saying:

"For the record I took the liberty of checking the ADE situation with our external adviser Martin Sharratt.

Considering all the circumstances, as discussed concerning the company address and so on, he agreed that there was no technical tax reason why the company should not be paid."

832. At 19:43 Mr Buchan of CFE emailed Messrs. Anzalone, Morris and Rose stating that he wanted his team to verify the names on the CFE client list.

833. Reuters reported that the Paris prosecutor's office had confirmed that a probe was underway into a suspected multi-million Euro VAT fraud in the French carbon credits market. By 11 June 2009 therefore, there could be no doubt that there was an active investigation into VAT fraud in France. This was a state intervention and apparent escalation from the rumour of fraud as had been circulated on 3 June 2009 or suspension of the BlueNext exchange between 8 and 10 June 2009.

834. Mr Emanuel forwarded the report to Messrs. Cooper, Rose and Taylor on 12 June 2009 at 17:14.

835. Kingsley Napley solicitors sent a pre-action warning to CFE in respect of the €6 million then outstanding to ADE. On 11 June 2009, Mr Emanuel sent Mr Cooper an email he had received from Kingsley Napley, sent on behalf of a partner, Gerard Cukier, which stated that they acted on behalf of ADE and were demanding an outstanding payment of €6,770,370.50. The email stated that, unless full payment of the outstanding sum was made by close of business that day, they would be instructed to take appropriate steps, including service of a statutory demand, as a prelude to winding up proceedings. Mr Rose asked Mr Cooper, Mr Emanuel and others whether it would be possible to mitigate this issue by sending over payment that evening.

12 June 2009

The implementation of new procedures

836. On 12 June 2009 at 07:02 Mr Emanuel e-mailed inter alia Mr Morris with the subject line: "Please don't make any payments to Aristo Partners or Axel or Westis before speaking to me" saying:

"I don't believe that we have the green light to pay any of these yet anyway. However, if the green light is given, we need first to offset past overpayments against money currently owed. The blotter doesn't reflect that so we need to speak before payment is made to any of these companies."

837. At 08:39 Mr Emanuel wrote to ADE saying:

"I apologise for the inconvenience of the last few days, but from a legal and regulatory perspective it was unavoidable.

We are now back to business as usual and as a gesture of goodwill we would like to offer you the ability to use CantorCO2e today FREE of brokerage charges."

838. Despite the obvious unresolved issues in relation to ADE, and his suggestion of suspended trading the previous day, for Mr Emanuel it appeared to be business as usual.

839. At 08:57 Mr Morris e-mailed Messrs Emanuel, Adcock and Buchan saying:

"James you do not have authority to approve any release of payments or emissions units to external clients, the procedure, which should have been made crystal clear over the last 48 hours is thus:

1) Outstanding settlements/Obligations

Customer Wire transfers must be approved by:-

Finance and reconciled by Financial Control, Blotter vs Client invoice and sign off

Tax – Check all data vs HMRC web site or phone call and validate format and authenticity of invoice from client and sign off

Legal – Double check all of the above and sign off

Operations – check all data and approve wire or registry release and sign off

All authentication data to be held by Mark Morris

2) New Trades

1 – Laurence Rose must approve Client and Trade

2 – Wayne Buchan or delegate must approve any free of payment or Emission transfer instruction

3 – Tax validate invoice

4 – Operations release Cash or Units

We must have a meeting today to close out these procedures I have a draft Operations check point which I will distribute we need a new AML/KYC/Onboarding procedure from Compliance/Credit/Tax before any new customers can trade.

Operations Management I must sign all CO2e payments do not release anything without my approval respond to this mail as confirmation of this."

840. The email stated that any outstanding settlement (where CO2e was effectively holding funds owed to the counterparties) could only be made where the customer wire transfers were approved by:

(1) the Finance Team having reconciled the numbers on the trade blotter against the client's invoice;
(2) the Tax team having checked the data against HMRC's website or through a phone call to HMRC and also having validated the VAT invoice from the client;
(3) the Legal team having double checked this data and approved it; and
(4) the Operations Team having then checked all the above data and approved the wire or registry release with all authentication data to be held by Mark Morris.

841. This email also indicated that, for any new trades, Mr Rose would have to approve the client and the proposed trade; Mr Buchan or one of his team would have to approve any free of payment or emission transfer instruction; the Tax team would have to validate any invoice; and the Operations team would then approve the release of the cash. The email also stated that a meeting was needed that day to formalise these procedures and that new written procedures were needed from the Compliance, Credit and Tax teams before any new customers could trade.

842. Mr Treanor had confirmed the VAT registration numbers for AH Marketing and GW Deals on 12 June 2009. Their registered names, numbers and addresses were as per their invoices.

843. CFE was not however successful in obtaining funds on account for all counterparties. Attempts were made to contact Adduco to carry out further trades in order to obtain money on account so that CFE would then be in a stronger position to require it to obtain a valid VAT registration and rectify its invoices. Adduco had responded that they were in the process of investigating VAT matters with their accountant and would not be trading again until the matter was resolved.

844. Contact was also made with Stratex. The email correspondence from 11-12 June 2009 indicates that Mr Bush had spoken to Mr Avi Alkobi at Stratex and that Stratex had assured him they would be sending over details of their application for VAT registration. It appears from this correspondence that similar promises were repeated in a further discussion. In the event, no such documentation was ever received from Stratex and their invoices were not rectified.

845. On 12 June 2009 Mr Emanuel sent an email to the CO2e settlements team regarding the release of payment to Mettec. Mr Morris emailed Mr Emanuel in response to emphasise that Mr Emanuel did not have authority to release payments or emissions. This exchange demonstrated the heightened sensitivities within the company at the time and that different employees were taking different approaches – the traders being prepared to take risks that their senior management either did not authorise or prevaricated upon. There were now various units and individuals who needed to undertake checks prior to the release of payment to counterparties.

The Glove Test

846. On 12 June 2009, Mr George Dixon, one of the credit analysts in the Risk team, undertook a credit review of CFE's counterparties. None of the impugned parties passed what was referred to in the document reporting the credit review as the "Glove Test".

847. The reference to "Glove Test" (a metaphor referring to a white glove which might be used to detect dust) in the spreadsheet appears to refer to whether the counterparty passed Mr

Dixon's initial review (in which case *"OK"* was noted on the spreadsheet). Those marked *"OK"* were recognisable names: Derby NHS Trust, the Natural History Museum and Uskmouth power station.

848. If a counterparty did not pass this initial test then the account was re-reviewed and other factors examined. Unlike the initial checks conducted when "on boarding" clients, this process involved seeking to establish a positive picture of the counterparty.

849. CFE thus belatedly began to attempt to conduct further due diligence and react to the rumours of a risk of fraud in the market. However, the nature of the checks and the steps taken were still not proportionate or reasonable in the context of the activity. The response was inadequate to what should have already been categorised as high-risk trading where either enhanced due diligence should have been applied or the decision made to put an immediate stop on trading with the counterparties concerned.

850. The Appellant's witnesses, such as Mr Buchan, stated there were no external agencies or companies that could have provided a relevant independent report on the type of retail counterparties with which the review was concerned. The Tribunal does not accept this. Further, CFE never even considered using or contacted any external agency to assess whether they could investigate their clients or conduct enhanced due diligence. The Tribunal has already examined above the type of enhanced due diligence that would have been appropriate for high risk clients. If CFE was not to use an external agency, then it should have made the enquiries directly of and about its clients.

851. At 09:45 Mr Bush e-mailed Mr Lynch saying:

"Things looking fairly positive mate we've paid out to bmc/duntai/ade stratex claim they are sending VAT application docs today, and we have hmrc on tape telling us adducos VAT number was ok. Stratex also claim to have 3 mio tonnes to do in the next 10 days, so fingers crossed…."

852. Mr Lynch replied:

"We could get through this after all, if we do lets go pound some beers. If we sign off on all these guys, will we be paid out?"

853. Mr Bush replied:

"Haven't thought it appropriate to ask about bonio at the moment !!! but I absolutely believe we should be if we get through this with money intact, and then lets go pound some beers."

854. These emails reveal that the traders were well aware they were dealing in high risk transactions which may not be permitted but that their personal concern was their bonuses ('bonio').

855. At 10:29, despite the fact that NCL's VRN had not been properly verified, Mr Bush telephoned NCL to see if NCL was looking to get back into the market.

856. At 11:23 Mr Weldon (EW) of CFE told Agnes Lasceaux (AL) of Axle during a telephone conversation:

"EW: Right, okay, that's one thing. So were you aware that – do you remember, like, the discussion we had last week about the VAT number and whether we can invoice you? Okay, so what's happened us in the last week – I don't know if you are aware that with Blue Next – and there'd been these VAT issues in France and all this stuff and Blue Next closed for a few days.

AL: Yes.

EW: What's happened is that our back office has – well, we obviously spoke to the back office to let them know about it and they've just been looking through, well people's VAT status and things and they've become a bit more strict. What happened last week is they said, "Well, if you promise that you're going to give us the VAT number in the future we can then invoice you with the full amounts", but because there are now these issues they've become very strict. So what we have to do, I'm afraid – and we can't change our position on this – is to do what we originally agreed which is that we can now only charge you less VAT until you provide us with a VAT number.

AL: Oh. So it means that you cannot send me the totality but just less the VAT because you don't have the VAT number?

EW: Yes, because this is such a new market the spot market and, you know, traditionally we've dealt with let's say bigger, bigger companies that I guess the whole procedure has been a bit more relaxed but in the last week because – and therefore historically we might have been able to, I guess, give some sort of leeway, some sort of benefit of the doubt, you know as we did last week. Because of this whole thing has changed, you know, with Blue Next closing down for a few days this week …"

857. There is a recognition within this conversation that CFE had previously operated a procedure that had been 'a bit more relaxed' including paying out on VAT invoices on the promise that a 'VAT number' (a VRN) would be supplied by the counterparty in due course.

858. Such a procedure failed to take reasonable care in that it involved paying out very large sums of VAT on invalid or unverified VAT invoices and failed reasonably to respond to the level of risk of fraud, which was apparent at least from 8 June 2009 when the Bluenext exchange had been suspended.

859. The new procedure now operated from 12 June 2009, and even if it had been employed in full, it was still not proportionate to the risk of fraud apparent.

860. Mr Treanor had also confirmed the VRNs for AH Marketing and GW Deals on 12 June 2009. Their registered names, numbers and addresses were as per their invoices.

861. Having paid out over £5 million in VAT to Stratex between 18 May and 3 June 2009 it should have caused CFE serious alarm that no VRN had been provided even at this stage. However, it appears that the obvious alarm bells were not ringing loudly in the draft Suspicious Event Report dealing with Stratex as set out below.

862. At 12:38 Mr Treanor e-mailed the results of further VAT checks, saying:

"To confirm HMRC checks today

AH Marketing and GW Deals checked exactly the name, number and address per their invoices.

Northumberland – VAT number checks against the company name but not against the address on the invoice nor the address on Companies House

I suggest that we therefore need to validate further who/where they are.

…"

863. At 16:51 Mr Stork of Westis e-mailed Mr Emanuel saying that Kingsley Napley LLP solicitors would be contacting CFE about the unpaid sums.

864. Kingsley Napley proposed re-rendering the invoices without VAT pending the group VAT registration for Epicure being processed, after which invoices for the VAT element would be separately rendered.

865. At 19:08 Mr Emanuel e-mailed Messrs. Rose, Cooper and Taylor stating:

"ADE International already told us voluntarily that they are in the same offices as Westis when they wanted their money and asserted that they knew that we were holding the money of others too. They used the same incorporation agent and share an office infrastructure apparently in the same way that many UK trading houses provide a trading environment for individual proprietary traders. This explains the common invoice style."

866. As set out at above, this was *not* what ADE had told Mr Emanuel, which was that its invoices had nothing to do with Westis and ADE was not affiliated with any other company working with CFE.

867. It was noted that Mr Cukier was also engaged by ADE. Mr Rose commented on this; and Mr Emanuel had replied that this was not surprising as ADE had already told CFE voluntarily that it used the same offices as Westis, it used the same incorporation agent and appeared to share office infrastructure in the same way that many UK trading houses provide a trading environment for individual proprietary traders. It may be that if viewed in isolation this could be an innocent connection, but this view failed to take account of the negative indicators.

868. Mr Rose appears to have actively focused on positive indicators which would justify continued trade rather than balancing these against the evidence of potentially fraudulent trade.

869. There had been previous connections between Westis and ADE made by Mr Emanuel when he had noted on 9 June 2009 that some of ADE's invoices appeared to relate to Westis trades which he had then raised with ADE. CFE tried to undermine the inconsistency in the statement made by Mr Emanuel in his email about what ADE had said, and the contradictory statement of what ADE had said to Mr Emanuel on 9 June about not being affiliated with any company.

870. The Appellant submits that there was no contradiction – persons can share office infrastructure and support services without being affiliated. The Tribunal does not accept this explanation – it was not supported by any evidence. The inconsistency is obvious – there is no explanation for the contradictory evidence about the common invoicing style.

871. The Tribunal was not given any material that supports Mr Emanuel's claim in any of the disclosed correspondence in relation to ADE. No explanation has been provided for Mr Emanuel's claim. The Tribunal has seen no evidential basis for it. Mr Emanuel was not called as a witness on behalf of CFE so HMRC could not cross examine him.

872. The Tribunal regretfully reaches the conclusion that Mr Emanuel was lying to Mr Rose, Mr Cooper and Taylor so as not to disclose to them his awareness of the real risk of fraud in the transactions with ADE / Westis. Mr Rose, in turn was naïve not to further question the explanations given by Mr Emanuel and prevaricated as to the extent of the action he was prepared to take given the profitable nature of the trade.

873. Around close of business on Friday 12 June 2009 Mr Emanuel sent Mr Rose and Mr Cooper a Reuters report entitled *"French probe into VAT fraud"*. The report stated that a French Budget Ministry Source had said there had been no evidence of a VAT fraud despite rumours circulating. Mr Rose recalls feeling that matters had become more uncertain as time went on.

874. The Tribunal does not accept that Mr Rose's recollection is a fair reflection of the material emanating from France. The rumours and reports had been escalating over days and executive action had been taken by first the suspension of trading and then through the criminal investigation.

875. The Tribunal finds that Mr Rose's evidence minimised or sought to downplay the evident awareness of real risk of VAT fraud in the market. The flurry of activity around 12 June 2009 in laying down (if not implementing) a new procedure and checking existing counterparties' VRNs demonstrates a belated acknowledgement of the seriousness of the problem.

876. Mr Emanuel also sent Mr Cooper an email from Franck Stork of Westis, which was copied to Gerard Cukier of Kingsley Napley. The email stated that Westis had instructed Mr Cukier to pursue payment and that he would look to start proceedings the following Monday (15 June 2009). Mr Cooper was aware that Westis were one of the counterparties who did not yet appear to be validly registered for VAT and had provided the VAT number of another company, Epicure Business Solutions Ltd.

877. Mr Cooper suggested that Kingsley Napley were a reputable law firm and that ADE appeared to have a valid VAT registration number, based upon the checks which had been carried out and that Westis were now threatening legal action and had appointed *"well known legal firm"*, Kingsley Napley LLP who were also being used by ADE, a company which was validly registered for VAT.

878. The Tribunal is satisfied that by 8 June 2009 in light of all that it had seen collectively through its traders and management, CFE should have categorised its carbon credit trading as high risk for AML and CDD purposes. It should reasonably have begun to operate the most advanced form of enhanced due diligence that it could follow. In any event, the procedure CFE itself belatedly laid down on 12 June 2009 was not followed as is evident below.

879. For all the reasons set out above, CFE had actively collated evidence available to it by 12 June 2009 that meant that objectively it had reasonable grounds to believe the majority of its trading in EUAs was connected to the fraudulent evasion of VAT. Further there is evidence that various employees, in addition to Mr Emanuel and the traders, actively suspected, with

good reason, that this was the case. These other employees include Mr Kevin Taylor, Head of Compliance for Europe and Asia.

The Draft Suspicious Event Report – the draft report

880. An important document was created on behalf of CFE on 12 June 2009. Mr Kevin Taylor of CFE compliance completed "*Draft 1*" of a document titled 'Suspicious Event Report' (otherwise known as the 'draft report'). Mr Taylor's handwriting at the bottom of the first page reads 'Draft 1. 12/6/09' and each page is watermarked as a 'DRAFT'. No second or final version of the document, if it exists, has been disclosed.

881. The reporting obligations in Proceeds of Crime Act 2002 ("POCA") are applicable to anyone in the UK that may interact with an individual or business, whereby they may commit a money laundering offence. Those working in the 'regulated sector' (such as CFE) commit an offence if they do not submit a 'Suspicious Activity Report' or 'SAR' to the appropriate authority (in 2009 it was the Serious Organised Crime Agency "SOCA") if they know or suspect, or have reasonable grounds to know or suspect, that another individual or person is engaged in money laundering; and the information came to them in the course of their business in the regulated sector.

882. Mr Taylor's draft report was six pages of densely typed written script. The draft provided to the Tribunal contained his handwritten comments upon it. The most significant of these was the handwritten comment at the top of the first page 'Offense (sic): Ought to have known'. Thus, it is clear that the author was aware of the means of knowledge test on the denial of input tax as had been previously advised by Mr Sharratt.

883. The draft report began by reciting Mr Emanuel's reading of the blog, the previous checks by CFE into its counterparties, the basic mechanism of MTIC VAT fraud and the need "*to consider whether CFE has been the victim of a VAT fraud and if so what other implications follow including SOCA reporting obligations.*"

884. The draft report noted in its considerations section on the third page:

"If a SAR is made no further action should be taken on the account including the receiving of additional credits without informed consent. This would extend to accepting further credits for the affected accounts as we may be caught by s329 of POCA."

885. Such a procedure (making a SAR report to SOCA and awaiting their consent to complete transactions) would have conflicted with CFE's plan to continue to trade with the counterparties until it held sufficient monies on account to meet the potential VAT liability.

886. The draft report went on to state on the third page:

"**Findings**

All the UK accounts have only recently been opened with CFE. Most of companies comprising one individual who is the shareholder of the company and in many cases the individuals are resident in France. Westis Ltd, Stratex Alliance Ltd and Aristo Partners Ltd are operating from the same premises. Separately Adduco Consulting Ltd, Business Management Consulting Ltd and Northumberland Consultants Ltd also operate out of the same premises.

Several clients have bank accounts in Marfin Popular Bank Co Ltd, a listed registered bank in Cyprus (Westis and Adduco).

Volumes traded are on context albeit at the upper end. These firms are often set up by sole traders and therefore the trading activity being undertaken which of itself is not suspicious."

887. The Tribunal does not accept the reasonableness of the conclusion that the trading 'of itself is not suspicious' given the factors that Mr Taylor has outlined. This early conclusion does not follow from the facts he has highlighted and the specific problems he goes on to describe which CFE had encountered with its clients' VRNs and VAT invoices. The type of trade cannot only be considered in isolation from the specific trades which had occurred.

888. The report went on to consider specific suppliers in turn.

889. The draft report noted in relation to Adduco:

"**INVALID VAT NUMBER SUPPLIED**

Adduco Consulting Limited

Became invalid around time of trading was dormant company [written in Mr Taylor's handwriting next to the name of the company].

….

Sole director and beneficial owner is a French national, Mr Eric Agnard…The company is registered to the same address as Axle Ltd and Northumberland Consultants Ltd.

…

Company filed dormant accounts: 31/10/2007…

….The client is insistent that the VAT number provided was valid and expressed surprise when told that HMRC had indicated otherwise. On the 11 June client stated he was going look into the matter and respond.

When we first spoke to HMRC about the validity of the VAT number on 3 June they confirmed that it was a valid number assigned to Adduco Consulting Ltd. However, when HMRC was again contact(ed) on 4 June they stated it was invalid. It would appear that there is a delay with the HMRC computer records being updated and accordingly it was possible that the VAT number was valid on 3 June but not on 4 June. We understand that if quarterly returns are not filed with HMRC the VAT number becomes automatically invalid. We are aware that Adduco was dormant for a while and this might be a logical explanation for the confusion."

890. The Tribunal finds that the last paragraph is an illogical and self-serving attempt to explain away a VAT irregularity that is apparent. VAT numbers do not automatically become invalid only on a quarterly return not being filed and the explanation assumed of dormancy (without reference to the information upon which it is based) does not explain why a number would be invalid on 4 June when it was valid on 3 June. Indeed, dormancy was not the explanation that CFE had been given, whether it had sought one, from Adduco.

891. The author of the report appears directed to providing only innocent explanation for those matters which were difficult for CFE to explain rather than a balanced view of what a less innocent explanation may be. The wealth of material available to CFE by this time is not reflected in the conclusions.

892. CFE had access to internal and external expert VAT advice which would not have supported the dormancy explanation. The author of the report, like others in CFE, sought to concentrate on the most innocent explanation (dormancy) rather than accepting that there may be a fraudulent explanation.

893. The draft report noted in relation to Westis:

"**VALID VAT NO. SUPPLIED BUT FOR PARENT COMPANY**

Westis Ltd

…

Sole director and beneficial owner was a French national, Mr Franck Stork. Westis. The company is registered to the same address as Stratex Alliance Ltd and Aristo Partners Ltd.

We received invoices including the VAT consideration but without any VAT number. On speaking to the client he stated that he had a valid VAT number and come back with the details. We investigated the details and HMRC confirmed it was valid but not against Westis Ltd.

We consulted the client who stated that it was the number of his parent company Epicure Solutions Limited which had bout Westis Ltd on the 9 May 2009. Client submitted Tax certificate of Epicure Solutions and resubmitted the invoices in that name…

JE is uneasy about this client."

894. The fact that it is acknowledged that JE (Mr Emanuel) was uneasy about Westis is obvious from all the evidence that the Tribunal has examined. Here Mr Taylor has recorded Mr Emanuel's unease in black and white.

895. The draft report noted in relation to Stratex:

"**NOT** (sic) **VAT INFORMATION SUPPLIED**

Stratex Alliance Ltd

…Registered to the same address as Aristo Partners Ltd and Westis Ltd. Owner of the company is Frank Stork resident in France. We have paid VAT to the amount of €6,376,039 but the client is not VAT registered. We called the client on 10 June asking for his VAT number and the client said he would call back which he didn't. We again called the client and he stated that the VAT application was currently with HMRC. Client seemed nervous when discussing his VAT status. We phoned the client again to discuss business and the client volunteered a discussion on his VAT status reminding himself that he still owed us a document. Client stated that he was in the process of concluding several deals in Romania implying that there would be a number of credits for us to sell on his behalf."

896. As noted above, there is no sense that there was a serious problem with the Stratex transactions. There should have been real alarm expressed that CFE had paid out over £5 million in VAT to a company for whom there had been no VRN supplied and who seemed ‘nervous when discussing his VAT status’. The Tribunal is satisfied that the obvious is underplayed because of the commercial damage that might be incurred by taking an objective view of the seriousness of the VAT irregularities.

897. Under the same heading of ‘Not VAT Information Supplied’ the draft report went on to address Axle Limited and noted in relation to Axle:

"…Registered to the same office as Adduco Consulting Ltd and Northumberland Consultants Ltd. Company owner Maxime Arlani, a French national…Company has only being trading with us since 3 June. …

As the first day of trading was also the day we received the blog the invoices were scrutinised in more detail and it appeared that the invoices contained no VAT number despite including the VAT consideration.

The client stated that he was registered but subsequently came back to the broking desk and confirmed that he had made a mistake and that the VAT application had been made. However we had already paid the invoices. …"

898. Again, the explanation provided by CFE’s client, Axle, is suspicious on its own terms but when read together with all the other evidence from other clients CFE should have known there was widespread fraud in the trade.

899. Under the same heading the draft report considered Aristo Partners Ltd. The draft report noted in relation to Aristo:

"…Registered to the same address as Stratex Alliance Ltd and Westis Ltd. Owner of the company is Anthoiny Muthot resident in France….Business consider client incompetent.

The invoices received contained no VAT number and we became more conscious of the VAT situation once the blog was issued on 3 June 2009. The client indicated that they had a VAT number and would look into it which they did stating that a VAT application had been made…"

900. This is another example of the cumulative evidence available to CFE regarding their clients’ VAT problems.

901. The draft report noted in relation to Northumberland Consultants Ltd ("NCL"):

"**VALID VAT NUMBER BUT NOT CONFIRMED WHETHER IT IS ASSIGNED TO CLIENT**

Northumberland Consultants Ltd

We haven’t confirmed [in Mr Taylor’s handwriting next to the company name]

…The company is registered to the same address as Adduco Consulting Ltd and Business Management Consulting Ltd. Owner is a French national Yamina Berrehill. We have paid a total VAT consideration €3,431,994. Client has a valid VAT number but we are unable to confirm whether it belongs to the client. Legal advice has stated that the VAT invoices don’t

strictly contain the correct information (for example should show a currency conversion where relevant in order that the VAT consideration is show in sterling.

We have not chosen to determine whether the VAT number is valid to Northumberland Consulting Ltd as the concern is that if it isn't then we are on notice and would have to account to the HMRC for the over payment.

WHAT IF ANYTHING ARE WE DOING WITH GW DEALS LTD AH MARKETING?"

902. The words underlined and in capitals in the final paragraphs appear in this format in the text. The Tribunal infers from this highlighting that Mr Taylor was concerned and seeking assistance from others within CFE. The Tribunal will return to the further inferences which can be drawn from these paragraphs in due course. It will conclude that these paragraphs give real insight into the thinking of both Mr Taylor and those with whom he was dealing within CFE. The Tribunal finds that Mr Taylor, like Mr Emanuel and the traders, had active suspicion that a number of counterparties were involved in VAT fraud by 12 June 2009.

903. The draft report concluded:

"**Proposal**

[Based on the information gathered and taking into account the reporting obligations, I believe that there is sufficient foundation to submit a suspicious activity report in respect of [ ]. Informed consent will be requested to continue to accept credits for trading and in the case of [ ] also to release the net surplus funds.]

Recommendations

Enhanced Customer Due Diligence is recommended for the business on the basis that carbon emissions credits are subject to VAT and the fact that credits are in bearer form. Further given the nature on many of these clients involve one trading companies it would be appropriate to apply the same requirements imposed on applicants from individuals.

It is also recommended that the client take on process be formalised for the CO2e business.

Changes to the confirmation and disclaimer language have been made to provide clarity on the roles of CFE and CO2e.

New rules around permissioned trading of Spot credits have been introduced to ensure that we are either always flat or have a net VAT surplus from the matched principal activity."

904. The Tribunal is satisfied that the contents of this document support HMRC's case on means of knowledge.

905. The draft report actively records a large number of negative indicators regarding a number of counterparties and its EUA trading that were available to CFE. These were acknowledged in the report but both underplayed by the author and in CFE's response to the report thereafter. Further, while the draft report does not make any proposal as to whether to submit a SAR (the alternative options are not selected) it does recommend the implementation of enhanced due diligence.

906. While it justifies the recommendation simply on the basis that 'carbon emissions credits are subject to VAT and the fact that the credits are in bearer form' these were not new facts in relation to CFE's carbon credit trade. The implication is obvious but not stated, that it is apparent and obvious from the analysis of the counterparties that there was a high risk of VAT fraud being connected to the trade with these companies and hence enhanced due diligence should be employed.

907. Here, collected in one document, are the results of investigations conducted by CFE and material evidencing both its subjective suspicion its previous trades were connected to VAT fraud and the objective material justifying reasonable grounds for the same.

908. The document begins with the handwritten recitation of the means of knowledge test in *Kittel* 'offence: ought to have known'. CFE had received external advice from Mr Sharrat on 5 June 2009 as to its legal obligations concerning means of knowledge. It is apparent that this advice had been taken on board not simply by the tax and legal departments of CFE.

909. As above, the document records several instances of the author, and hence CFE management and to all whom it was disseminated, being aware of reasons to be suspicious about suppliers: 'JE is uneasy about this client' (Westis), 'Client seemed nervous when discussing his VAT status' (Stratex) as well as highlighting the lack of regularity that applied to the VAT affairs of so many of its suppliers.

910. Perhaps the most damaging statement is that 'we have not chosen to determine whether the VAT number is valid to Northumberland Consulting Ltd'. It reflects a settled will on the part of at least the author and unnamed others in CFE, 'we', to whom it refers, to turn a blind eye to damaging or adverse information to avoid being fixed with actual knowledge. CFE sought to protect its commercial position without due regard to the risk to the Revenue. This evidence amplifies the earlier example of CFE's decision of 5 June 2009 to trade its way out of its potential VAT liabilities.

911. The Tribunal is satisfied that by continuing to trade after this point without submitting a report, CFE was not a company seeking to assist law enforcement authorities prevent money laundering, as required under POCA, nor seeking to protect the Revenue by assisting HMRC in preventing fraudulent tax loss, but a company seeking to maximise profit despite the obvious risk of VAT fraud within much of its EUA trading.

912. The Tribunal is satisfied that the document evidences not simply the objective reasonable grounds to suspect that CFE's transactions with its suppliers were connected to VAT fraud. It also evidences that CFE was aware it had subjectively reasonable grounds to suspect the same.

913. CFE's evidence regarding the draft is also noteworthy.

914. Mr Cooper's evidence is that he had several conversations with Mr Taylor regarding the report, who reported to him, the details of which are omitted. Mr Cooper's evidence is no substitute for that of Mr Taylor, who wrote the draft.

915. Having completed a seven-page report detailing conclusions but leaving undecided the matter of whether to file the SAR, the Tribunal finds it incredible that the matter was simply left, with no final version of the report prepared with a recorded conclusion. There was no evidence provided to the Tribunal of any record or any written or definite decision taken as to whether a SAR should be submitted. No SAR ever was submitted to SOCA.

916. This lack of final report, conclusion or other written decision by CFE, is again significant. If CFE really had considered there were no grounds on which to submit a SAR, any reasonable company would have recorded it. The Tribunal draws an adverse inference from the silence of both Mr Taylor and CFE's records of any decision taken in respect of the SAR.

917. The Appellant argues that whilst the draft indicates that CFE had decided not to determine whether the VAT registration number for Northumberland Consultants was valid, Mr Cooper does not believe this to be accurate and refers to an email from Mr Emanuel to him of 12 June 2009. This email indicates that the VAT number for Northumberland Consultants had been verified as valid but that the recorded address did not match the address CO2e had on record.

918. The Tribunal does not accept this explanation. Mr Taylor has not been called to give evidence so as to explain his clear statement in the draft report. There is no record of anyone writing to Mr Taylor to correct any 'misapprehension'. It does not provide any explanation for the mindset expressed in the document to avoid asking difficult questions.

919. Mr Treanor proposed that CFE carry out further enquiries to determine where Northumberland Consultants' principal place of business was located. Mr Emanuel suggested instead that they should wait for Northumberland Consultants to trade with CFE again before asking these questions. Mr Cooper does not recall why Mr Emanuel suggested this, but at that stage no money was being held on account for Northumberland Consultants, so CFE would not have been able to rectify the position with Northumberland Consultants had its answer raised suspicions. In the event, Northumberland Consultants declined to undertake any further trades with CFE.

920. Mr Cooper's evidence misses two points. First that Mr Taylor clearly wrote that 'we have' decided not to check the VRN. This indicates that CFE were prepared not to comply with their AML / VAT obligations to avoid being fixed with knowledge. Second that this document cannot have been created in a vacuum - it must have been the result of internal conversations within CFE and communications between employees. The collective intention is clear and revealing.

921. The section headed *"Findings"* notes that CFE had at this stage identified other similarities between some of the counterparties, including that Westis, Stratex and Aristo were operating from the same premises and that Adduco, BMC and Northumberland Consultants were also operating from the same premises.

922. The Appellant now argues that, one plausible explanation for this was that they had used the same incorporation agents and the Cantor Fitzgerald personnel believed that the entities were small independent operators. As Mr Emanuel suggested in his email of 12 June 2009 many UK trading houses provide a trading environment and shared infrastructure for individual proprietary traders. This could have also explained the common invoice style and similar errors in the VAT invoices provided by some of these counterparties.

923. Mr Cooper recalled that it was speculated at the time that these might be traders who had left their employers (financial institutions) and were trying to make a go of it on their own; traders often need assistance with administration or support functions and it was speculated that these individuals had come together to use common support facilities.

924. This speculation was unsupported by actual evidence and was inconsistent with the common understanding of who their clients were as told to them by Mr Emmanuel (local consultants for emitters). This was new evidence introduced by Mr Cooper during the hearing and not previously relied upon as an explanation for the trade. It was a further example of CFE's attempts to find innocent explanations at all costs and ignore negative information for fear of the inevitable consequence that it would lead to the loss of trade and profit for CFE.

Draft SOCA disclosures

925. Two related documents are also in evidence, exhibited to Mr Cooper's second witness statements. These are draft SARs and are entitled *"Disclosure Report Details: Standard Report"* (the "draft SOCA disclosures") and are addressed to SOCA in relation to Adduco and Westis.

926. The draft SOCA disclosures are handwritten and only partially completed. They include the company details for Adduco and Westis, but the section in which to describe the reporting officer's reasons for suspecting criminal conduct is blank. Each of these draft reports tick the box for the suspected offence to be Missing Trader Inter(tra) Community (VAT) fraud. They were never filed with SOCA.

927. Mr Cooper believes that the handwriting on the draft SOCA reports again belongs to Mr Taylor. The documents are undated but have "Your ref" of "01/2009" and "02/2009" respectively, which suggests that they were created in 2009, and Mr Cooper believes that they are likely to have been drafted at some point in early to mid-June 2009 when the group was considering whether to make any report to SOCA.

928. The JMLSG Guidance (para 6.31) requires the designated officer to make a report as soon as reasonably practicable after the relevant information giving rise to a reasonable suspicion comes to him. Mr Cooper believes that the draft reports represented Mr Taylor being prepared to act in order to meet that obligation if he reached the stage of concluding that the test was met.

929. Mr Cooper stated that in his conversations with Mr Taylor around this time, they discussed all of CFE's counterparties in respect of whom VAT invoicing issues had been identified. The existence of the draft SOCA disclosures suggests that Adduco and Westis may have been discussed in the most detail. This is supported by the fact that those two counterparties had provided VAT numbers to CFE which had been identified as (1) invalid (in respect of Adduco); or (2) belonging to a different company (in respect of Westis).

930. Mr Cooper's evidence is that these factors would not have been viewed as providing, in and of themselves, sufficient reasonable grounds for suspicion that those counterparties were engaged in criminal conduct which met the threshold for reporting them to SOCA (and Mr Cooper's evidence was that Mr Taylor reached the same view). Those factors could simply have indicated that these counterparties lacked strong administrative controls and tax expertise. This was not uncommon for smaller counterparties of this type.

931. The Tribunal accepts that Mr Cooper's evidence is honest but does not accept that this was a reasonable conclusion to reach for all the reasons set out above. It ignored a large number of negative indicators available by 12 June 2009 about the EUA trade generally, EUA's counterparties and the specific counterparties in particular. None of this could be viewed in isolation.

932. The Appellant also relies on the following: that Mr Cooper believed that Mr Taylor continued to keep the issue of potentially submitting a report to SOCA under review, and this is supported by an email from Mr Taylor to Mr Rose on 15 June 2009 which suggests that Mr Taylor was still reviewing the position. Mr Taylor was gathering new information all the time, including from Mr Cooper and Mr Rose. In the event, Mr Cooper believes that no report was ever ultimately submitted.

933. The difficulty with this evidence from Mr Cooper, which the Tribunal accepts, is that it leaves the trail cold. There is no evidence as to when and why any decision was reached not to submit a report. If Mr Cooper could not explain it, then the absence of evidence from Mr Taylor is striking.

13 June 2009

934. The following occurred on 13 June 2009.

935. On 13 June 2009, a Saturday, Mr Rose circulated a further Bloomberg report to senior Cantor Fitzgerald individuals, including Mr Craib. This report was entitled *"no easy fit EU may challenge France CO2 Tax cut*". Mr Craib emailed Mr Rose in response to this stating he was finding it difficult to understand what if anything was really going on.

936. Mr Craib e-mailed Mr Rose in relation to speculation that the EU may challenge the decision of the French authorities to exempt carbon credits from VAT saying:

"Its so hard to understand what if anything is really going on or not."

15 June 2009

Classification of CFE's carbon credit trade as high risk and implementation of new procedures

937. The Tribunal is satisfied that by the close of play on 14 June 2009 CFE, and hence the Appellant, should have known that any further transactions to be carried out with the counterparties mentioned in the draft report (Adduco, Westis, Stratex, Axle, Aristo, NCL, GWD and AHMD) were connected to the fraudulent evasion of VAT. CFE had rightly anticipated the problems with each of these companies – they were each involved in or connected to VAT fraud.

938. The only transactions that CFE conducted after 14 June 2009 with these parties were AHMD on 15-18 June 2009 and Westis on 28-29 July 2009. As the Tribunal will outline, CFE should have known the only reasonable explanation for these transactions was VAT fraud.

939. By 12:13 on 15 June 2009 the CFE had paid the following counterparties the sums outstanding to them: ADE, AHMD, BMC, Duntai, GWD and Ayres.

940. On 15 June 2009 the roll-out of new matched principal compliance risk and operations processes and controls continued as part of the company's attempted implementation of more robust procedures. Mr Emanuel engaged in a number of email exchanges with Mr Morris regarding a new standard proforma CFE deal ticket. In addition, Mr Taylor circulated more detailed due diligence document requests which were to be used in future.

941. CFE had determined that the business should be reclassified as high risk for AML purposes. This change of classification meant that more documentation would be required from potential counterparties.

942. On 15 June 2009 at 13:10, one hour after paying outstanding sums to counterparties, Mr Taylor e-mailed several of those in CFE confirming that the carbon credits trading business had been re-classified as high risk for AML purposes.

943. Mr Chatterton (from the compliance team) emailed Mr Dixon to provide him with access to the documentation that the compliance team had collated during their approval of new clients. This facilitated a fuller review.

944. Threats in respect of withheld payments were also being made by other counterparties: see the email from Mr Emanuel to Mr Rose and Mr Cooper, which indicates that Axle and Aristo were seeking payment. Axle had asked for payment to be made without the VAT and Mr Emanuel said that Aristo's accountant had telephoned him.

945. On 15 June 2009 Mr Rose circulated a revised spreadsheet showing the outstanding client balances. From this it was clear that ADE, AH Marketing, BMC, Duntai, GW Deals and Mettec had all received payment having satisfied the VAT invoicing requirements made of them by CFE.

946. Nonetheless the enhanced due diligence document requests were not followed in relation to the further deals conducted that day and thereafter (with AHMD) and the procedures did not involve asking serious questions of their clients regarding their business, funding, access to market, business model or rationale or visiting their offices etc. This was now accepted to be a high-risk business CFE was engaged in.

947. At 14:43 Mr Taylor e-mailed Mr Rose stating:

"I have spoken tonight with MC [Mark Cooper] to bring him up to speed with my thoughts on whether we have to report anything to SOCA. He told me there were further updates from the work you have been doing today which may well alter the situation for me. Please can we catch up tomorrow?"

948. The most natural interpretation of the words "altering of the situation", since no SAR was ever submitted to SOCA, is that Mr Taylor was intending to submit a SAR but that his conversation with Mr Rose "altered" that view. Mr Rose's witness statement is silent on the issue and he was unable to recollect matters in detail in his oral evidence.

949. Mr Cooper stated that had Mr Taylor wished to submit a report then Mr Cooper would not have stood in his way and whilst Mr Cooper and Mr Taylor discussed the subject matter with which the draft report was concerned, Mr Taylor was free to make the decision as to whether to do so on his own assessment, as per the JMLSG Guidance (para 3.12). Mr Cooper stated he had no input into his decision whether to submit the report.

950. Likewise, Mr Rose stated he had no input into a decision to submit a SAR at all - the front office was deliberately not a decision-maker in the process. Mr Taylor took information from the front office, but the decision whether to submit a report was not one for the front office. Mr Rose stated Mr Taylor would have known that the decision whether to submit a report was one for Mr Taylor alone.

951. Mr Cooper's belief is that no reports were ever submitted to SOCA. It is not in dispute that this is the case – there is no evidence that reports were ever submitted to SOCA. No internal AML report was prepared. No final version of the Suspicious Event Report was provided with any positive conclusion one way or the other whether to make a report. If there was no recorded decision not to make a report, then the absence of such a record is in breach of the JMLSG as is set out elsewhere.

952. CFE was under a duty to keep proper records and a decision of this importance one would expect to see recorded. For the reasons set out above, the decision not to make a report was not a reasonable one.

953. Mr Rose's evidence in cross-examination was that he had had no input into the decision as to whether to submit such a report. He was also clear that he did not try to persuade Mr Taylor not to make such a report. Mr Cooper was also clear that Mr Taylor had not been lent on one way or the other. Mr Cooper also advised senior management, and possibly also Mr Rose on the group's reporting obligations on 12 June 2009. He stated no conclusion had been reached by that time as to whether the counterparties (even those who appeared not to be VAT registered at all) were acting dishonestly or simply had poor administration.

954. The Tribunal accepts the evidence of Mr Cooper and Mr Rose that they did not actively intend to talk Mr Taylor out of, directly instruct him or expressly 'lean on him' not to submit a Suspicious Activity Report to SOCA. The Tribunal accepts the evidence that the ultimate decision was Mr Taylor's. Nonetheless, the Tribunal is satisfied that they did have conversations with him about the report and the influence exerted by Mr Rose and Mr Cooper as a result, while more subtle, contributed to Mr Taylor not making any reports.

955. Mr Taylor was persuaded that he should not make a report by the communications he had with Mr Rose and Mr Cooper and any others in CFE with whom he spoke, against his initial (and better) instincts. This was without the need from them to give any direct instruction not to make a report. Whilst Mr Taylor had a separate and independent function from front office he was dealing with staff who were more senior and influential than him in the company. He would also be aware of the commercial and reputational ramifications of his decision.

956. Therefore, it is understandable, though not excusable, that he might not have stood up for his point of view when questions were asked or counter information was provided. This led to poor decision making.

957. The Tribunal comes to this conclusion when drawing reasonable inferences from the following:

i. the e-mail above;

ii. the partially completed draft SOCA disclosure reports;

iii. the absence of any SAR being submitted;

iv. CFE's failure to call Mr Taylor to give evidence;

v. one proposal in the draft report to submit a SAR (consistent with the recommendation to employ enhanced due diligence) being an effective bar to CFE's agreed strategy of continuing to trade with the relevant counterparties until it held enough monies to cover the potential VAT liability;

vi. the submission of a SAR effectively being an end of CFE's trade in carbon credits;

vii. the absence of disclosure of detailed records of conversations around the issue;

viii. the fact that later Mr Taylor committed to writing in the annual money laundering report for 2009 that CFE suspected that it was the victim of a VAT fraud.

958. As above the conclusion is that Mr Taylor was persuaded by his conversations with others in CFE including Mr Rose and Mr Cooper not to submit a SAR.

959. As is set out above, it is likely that there was no direct instruction made to Mr Taylor but he felt aggregated pressure against his better instincts not to submit a report. The lack of explanation for the decision not to submit the SAR strongly implies that Mr Taylor has no innocent explanation for his change of mind ie. that it was reasonably based on the objective indicators. Rather the Tribunal infers that the true explanation for his change of mind would not reflect well upon Mr Taylor or those in CFE.

960. Further, the decision not to make a report should have been documented and there has been no explanation of why this did not occur.

961. CFE had no meeting or engagement with the authorities (such as HMRC, let alone SOCA) to explain their concerns for three weeks after Mr Emanuel read the blog on 5 June 2009. It only contacted HMRC to arrange any meeting on 19 June one week after this draft report.

962. Instead the senior management at CFE sought to protect its commercial position and to avoid at all costs the conclusion that it should have known, namely that its trade in EUAs was connected to the fraudulent evasion of VAT by others including its suppliers. The lack of action over the SAR illustrates this effectively.

963. By 15 June 2009 the issue as to Adduco's VRN had still not been resolved.

AH Marketing and Distribution Ltd disputed deals

964. Between 15 and 18 June 2009 CFE purchased 336,000 carbon credits from AHMD at a net cost of €4,240,210.00. CFE did this between 15-18 June 2009 despite the decision to implement enhanced due diligence, after the draft Suspicious Event Report and despite AHMD not passing the the Glove test. In answer to the question in the draft report 'What if anything are we doing about GW Deals Ltd and AH marketing?' CFE was doing nothing by way of further or enhanced due diligence but purchasing large amounts of carbon credits.

965. CFE completed the deals despite the clearly advertised risk of fraud in the market, the multiple issues with other counterparties raising concerns, and without performing enhanced due diligence in relation to the two companies. CFE had not even verified GWD and AHMD's VRNs with HMRC (as opposed to checking them on the Europa website).

966. The MLRO's report for the year ending 2007 suggested that enhanced monitoring should be carried out on unregulated parties such as AHMD. That enhanced monitoring was never done on AHMD. Ms. Mills accepted that enhanced monitoring was for high-risk accounts.

967. Mr Buchan accepted that when CFE became aware of a risk of fraud that would then be taken into account by the risk team and would change how it assessed risk. Mr Buchan accepted

that once CFE knew of the risk of fraud it wanted to satisfy itself that the counterparty could have legitimately obtained what it was providing. CFE, however, did not carry out reasonable and proportionate checks to the risk involved (only standard customer due diligence) to satisfy itself that AHMD could have legitimately obtained what they were providing to CFE.

968. CFE's due diligence documentation in relation to AHMD was only standard Customer Due Diligence. That showed little more than that AHMD existed, Mr Malhi had been on an emissions trading course, the SIC at Companies House was that of a hardware consultancy, the last accounts were those for a small company, and just 2 months before it contacted CFE it changed its director and company secretary.

969. Despite being recently taken over, with little track record in trading carbon credits other than a 2-day course and previous research, AHMD had managed to get credits at a cheaper price than Cantor Fitzgerald could, despite its experience in the market and despite Mr Emanuel, the desk head, being an authority on the market.

Background to AH Marketing and Distribution Ltd – VRN 889 8806 33 – supplier to CFE

970. AH Marketing and Distribution Ltd ("AHMD") was incorporated on 7 August 2000 in the name AH Technology Ltd, failed to render any accounts to Companies House after those for the year ending 31 October 2007, and provided Companies House with the SIC code for "*hardware consultancy*." AHMD had little apparent financial worth. AHMD's address registered with Companies House was 732 Greenford Road, Middx., UB6 8QR. On 30 March 2009 Mr Imran Malhi was appointed a director of AHMD, replacing Mr Amjad Hussain. AHMD supplied CFE with carbon credits that it had purchased from Pan 1 Ltd ("Pan 1"). Pan 1 purchased from Bilta (UK) Ltd ("Bilta"). Bilta is accepted to be a fraudulent defaulting trader.

971. Amjad Hussain applied for AHMD (in the name of A H Technology Ltd) to be registered for VAT on 14 August 2006 declaring a main business activity of *"IT consultancy"*, an address of 123 Foxholes Rd., Rochdale, OL12 OEF and an estimated turnover in the next 12 months of £100,000.00.

972. On 13 December 2006 AHMD notified HMRC that it wished to change its trade classification to wholesale and distribution. On 24 April 2009 Mr Malhi competed a variations form stating a change of main business activity to "*establishing to trade at European climate exchange in carbon emissions".*

973. AHMD was registered for VAT with effect from 1 August 2006 and only declared sales on its 07/07 return.

974. HMRC Officers later visited AHMD on 9 July 2009 at a serviced office address in Staines but Mr Malhi was said by an employee to be in Dubai. A Regulation 25 direction shortening AHMD's VAT period was served.

975. On 25 July 2009 HMRC Officers returned to AHMD. Mr Malhi told the Officers that when he first began to trade he was advised by a Mr Nick Eagle at Carbon Capital who told him how to trade but could not explain why Carbon Capital did not deal directly with AHMD's supplier Bilta.

976. HMRC Officers returned to AHMD on 30 July 2009 and spoke with Mr Malhi who said that: he had purchased the business for £4,000.00, he had begun researching carbon credits 8

months ago and he was acting as a broker. Mr Malhi confirmed that he was aware of MTIC fraud and the Officer provided a detailed explanation of the fraud to him. Mr Malhi said that AHMD's bank account was in Hong Kong because UK banks were not prepared to provide a service to him.

977. AHMD was notified on 5 May 2010 that it had been deregistered for VAT because it failed to answer a series of letters from HMRC.

978. Between 20 May and 18 June 2009 AHMD had made 17 sales of carbon credits to CFE totalling 829,000 units with a gross purchase value of €12.9 million. The details of the AHMD transactions were set out in Officer Ball's witness statement.

979. AHMD received the carbon credits that it sold to CFE from: Bilta (10 transactions) and Pan 1 (7 transactions) who in turn purchased them from Bilta. Bilta is agreed to be a fraudulent defaulting trader. Bilta mainly requested payment be made to its account at HSBC in Hong Kong, as did Pan 1. However, on one occasion, Bilta requested that Pan 1 pay monies to its supplier Jetivia SA's account (a third-party payment). Bilta was assessed by HMRC in respect of the VAT for the transactions tracing to CFE through AHMD.

980. AHMD had neither experience in nor repute for dealing in carbon credits, its ability to sell such volumes of them to CFE was commercially incredible and its lack of financial worth made it a poor candidate to enter into such transactions.

981. CFE's due diligence documentation in relation to AHMD was not enhanced due diligence. CFE did little more than confirm the existence of AHMD and carry out basic AML checks. CFE did not question how AHMD could supply such large volumes of carbon credits, at a price that CFE could not beat despite its experience in the market, when it had no net worth to speak of and had just been taken over.

982. CFE did no more than verify AHMD's VRN on 12 and 16 June 2009. HMRC was not provided with evidence during the extended verification that AHMD had been KYC approved by CFE.

983. CFE disclosed e-mail correspondence and records of calls with AHMD. There are no discussions in the e-mails about the carbon credits market or AHMD's background aside from Mr Malhi's statements in his initial correspondence. AHMD appeared willing to send carbon credits to CFE regardless of market conditions.

984. None of the e-mails after 8 June 2009 show CFE as making enquiries with AHMD about their trading until 19 June 2009 (after the transactions in question were completed) when a meeting was arranged between Mr Lynch and Imran Malhi and 8 July 2009 when CFE sent revised KYC and supporting documentation requests to AHMD. After CFE had received the further documentation from AHMD it never traded with it again.

985. In the meantime, on 18 June 2009 Mr Emanuel sought permission to pay €1.2 million to AHMD without having received payment from Citibank for the relevant transaction. On 22 June 2009 Mr Emanuel informed Mr Rose that CFE had turned business away from AHMD.

986. CFE has only disclosed the record of one telephone conversation between it and AHMD.

987. Between 20 May – 18 June 2009 AHMD supplied CFE with 829,000 carbon credits at a net price of €11,306,810.00. Prior to 8 June 2009 the largest deal by AHMD was for 68,000 carbon credits at a net purchase price of €992,800.00.

988. As Mr Buchan accepted, CFE should have been satisfying itself that the counterparty could have legitimately obtained what it was providing. CFE did nothing in relation to AHMD. It was apparent that AHMD could not reasonably have paid for these credits up front. It was apparent that no reasonable commercial entity would have granted in excess of €1 million of credit to AHMD or provided these "on trust".

989. AHMD had failed the "Glove Test" applied by CFE's risk team on 12 June 2009.

990. CFE has provided no specific explanation other than fraud for these purchases from AHMD which is reasonable. It has relied on its generic explanation (local consultants for local emitters) for why it believed that the transactions were legitimate.

991. Once CFE knew of the risk of fraud in the market its conduct in continuing to deal with AHMD shows that it either knew, or should have known, that dealing with AHMD would be connected with the fraudulent evasion of VAT. CFE pursued its "strategy" of trading with those that on its own case, at the very least it suspected prior to carrying out risk assessments and proper checks.

992. CFE has been denied input tax claimed on these transactions and the Tribunal finds that the Appellant should have known these transactions between 15 and 18 June 2009 were connected to the fraudulent evasion of VAT.

993. No explanation has been provided as to why CFE entered these transactions knowing that it had failed its own initial screening. CFE did not obtain any additional information or enhanced due diligence on AHMD prior to these transactions other than looking at its website. By 15 June 2009 when this set of transactions occurred, CFE's demonstrable suspicions of its counterparties had been heightened even further, as shown by the draft Suspicious Event Report.

994. There is no reasonable explanation for these AHMD trades other than fraud. The Tribunal is satisfied that CFE should have known by 15 June 2009 that there was no reasonable explanation for the trades other than fraud, it should have known these transactions were connected to fraud.

995. CFE had recognised it was involved in high risk trading but failed to respond reasonably, proportionately or progressively to the threat of fraud the trading presented as is set out in detail above. The Tribunal takes into account the failure to conduct enhanced due diligence by this stage because it would have revealed further negative indicators as to the nature of AHMD's trade. This is considered in light of all the material set out above. The factors include the collective knowledge of the organisation about all the traders and their VAT irregularities (VRNs, invoices, suspicious explanations), the draft report, SARs, the commercial profit motive, the Glove Test, CFE's business model, its decision to trade on out of VAT liability, suspension of the Blue Next exchange and investigation into VAT fraud in France etc.

16 June 2009

996. On 16 June 2009 CFE continued to trade with AHMD in two transactions.

997. On 16 June 2009 Mr Craib of CFE e-mailed Mr Rose with a subject line: "You have a right to identity of emissions trading blogger (if UK based)".

998. AG Kakouris Ltd, accountants used by several of CFE's suppliers, wrote a letter stating:

"1) Westis Ltd is wholly owned by Epicure Business Solutions Ltd.

2) Epicure Business Solutions Ltd as per the agreements in place can invoice on behalf of Westis Ltd.

3) Westis Ltd is entitled to use the Group Vat registration of the Group which currently Epicure Business Solutions Ltd is the responsible member.

4) Epicure Business Solutions Ltd VAT number is 915 2720 21."

999. At 18:37 Westis wrote to CFE saying:

"Please understand what's going on.

We don't have any problem by sending you all paperwork in our possessions and we don't need to hide you anything.

Here's the point.

Epicure just bought Westis one month ago, before that date, epicure didn't had (sic) the necessity of having a vat group number has she was not owning companies. All applications had been done and we are waiting the certificate from custom…"

17 June 2009

1000. On 17 June 2009 Mr Rose received an email from Westis forwarding an email from Kingsley Napley. CFE had not traded with Westis since 3 June 2009 because it had been identified as one of the counterparties who had provided deficient invoices in respect of prior trades. CFE was refusing to release payments for prior trades until Westis could provide evidence of valid VAT registration and corrected invoices.

1001. The email stated that amounts of VAT owed to Westis had remained outstanding for two weeks. It stated that Westis was a subsidiary of Epicure Business Solutions Ltd, which was registered for VAT under registration number 915727021 and that an application was presently being processed for a group VAT registration number to include Westis. The email proposed that the two outstanding invoices should be paid without VAT, which would be invoiced separately once group VAT registration had been obtained. The email stated that, in the absence of payment by 10am the following morning, Kingsley Napley were instructed to take appropriate steps, including the service of a statutory demand as a prelude to winding up proceedings.

1002. On 17 June 2009 at 07:17 Mr Emanuel e-mailed Mr Rose in relation to Westis' assertions. Mr Rose raised the issue with Messrs. Treanor and Cooper.

1003. Mr Cooper's evidence was that the threat of a statutory demand was, in his view, extremely aggressive and one they would have taken very seriously. Later on the same day an

email was received from Mr Stork by the settlements team attaching invoices without VAT being charged on them.

1004. On 17 June 2009 Mr Emanuel also circulated the first draft of a new KYC questionnaire to key stakeholders, including Mr Rose, for comment in advance of it being rolled out as part of the new controls and processes which were suggested to be put in place for CFE's business in response to what they perceived as 'rumours of fraud'.

1005. Mr Rose passed on a further Bloomberg article to Mr Cooper in which an analyst from Barclays plc speculated whether the figures showing a marked increase in the total number of Spot trades for EUAs related to VAT fraud in France and stated that *"it's impossible to know"*.

1006. Mr Craib e-mailed Mr Rose in relation to the article headed "*Fraud Risk Clouds Surge in Carbon Day Trading, Barclays*" saying:

"Just keeps things cloudy. No clarity."

1007. This email again gives an insight into the way of thinking of some of CFE's management and employees – that they did not wish the high risk of fraud of which they were aware to be considered to be clear. Such an approach justified in their mind their prevarication and prioritising of their profit margin and bonuses in the face of an obviously high risk.

1008. Mr Sharratt issued a note of advice, which was concerned principally with three unnamed suppliers, referred to as "Supplier 1", "Supplier 2" and "Supplier 3". The advice was focussed on whether CO2e would be able to recover its input VAT on transactions which had already taken place with these three suppliers. Mr Sharratt also recommended to the group that they should contact HMRC and raise this issue with its Customer Relationship Manager ("CRM") as soon as possible.

1009. Mr Sharratt e-mailed Mr Treanor a finalised copy of his advice to CFE. As well as iterating the principle in *Optigen* the advice noted in relation to the spectre of VAT fraud:

"HMRC will use the questions set out in the guidance as a starting point to their enquiries, in particular those questions dealing with how the client relationship came into existence and what checks were carried out before setting them up as a client and/or before paying them large sums of money. I would therefore advise that **before contacting HMRC we ensure that the facts are clear and we have the answers to the questions listed**." **(emphasis added)**

1010. The strategy of avoiding any engagement with HMRC until CFE had prepared its account is here made explicit. This was a defensive strategy to avoid risking its commercial position not a strategy to inform HMRC openly about all the information it had available to it.

18 June 2009 - Mr Dixon's review of counterparties

1011. On 18 June 2009 CFE continued to trade with AHMD in three transactions which HMRC have subsequently linked to tax losses. As noted above, CFE had not undertaken enhanced due diligence in relation to this company. An email from Susi Luard to Steve Adcock and Steven Treanor confirms that the VAT invoice for one of the trades (36,000 units) was checked by the tax team prior to payment.

1012. On 18 June 2009 Mr Cooper had a telephone conversation with Mr Cukier of Kingsley Napley regarding Westis and this was followed by an email from him to Mr Cooper on the

following day. The email stated that Alex Christofi - Westis' accountant and a VAT expert - would send a letter fully explaining the position together with a copy of the application for a group VAT registration made on behalf of Epicure.

1013. The email concluded by again pushing for payment of the outstanding invoices (without VAT), stating there was no reason why they could not be settled immediately and that he would commence proceedings if payment was not made by close of business that day. However, Mr Cooper was not prepared to pay any amount to Westis until he had at least established whether they were validly VAT registered.

1014. Mr Sharratt had a further conversation with Mr Treanor on 18 June 2009 concerning Axle Ltd. Mr Sharratt agreed that it was perfectly reasonable for CFE to withhold the VAT element on Axle Ltd's invoices until it had issued a valid VAT invoice.

1015. Mr Sharratt also spoke with Mr Cooper on 18 June 2009 about Westis and the fact that Westis had provided a VAT number belonging to its parent company, Epicure. Mr Sharratt confirmed that Westis could not use another company's VAT registration number unless Westis and Epicure had formed a VAT group and obtained a new registration as a group, in which case both of their old VAT registration numbers would be cancelled. Mr Sharratt also confirmed to Mr Cooper that it would be reasonable for CFE to withhold the VAT element on recent unpaid invoices, since it would otherwise be at risk of being substantially out of pocket.

1016. On 18 June 2009 Messrs Rose, Emanuel, and Morris were supposed to meet Mr Ayres of Ayres t/a Mettec. There is no account of what occurred at this meeting provided by CFE's witnesses.

1017. Mr Emanuel tried to drum up business from ADE on 18 June 2009. Mr Emanuel also sought permission to pay €1.2 million to AHMD without having received payment from Citibank for the relevant transaction.

1018. Mr Dixon provided a further credit review of CFE's counterparties. The review appears to have been substantially based on what those counterparties had said on their websites. The only deals subject to this appeal that were carried out after 18 June 2009 were with Westis (on 28 and 29 July 2009). This review noted that no financial information had been obtained on Westis and that further information needed to be obtained on Westis' rationale for carbon trading.

1019. At 14:52 Mr Rose e-mailed Mr Buchan saying:

"Hi Wayne.

I would like your group to do credit checks on the attached list of CO2e clients [which contained all of the impugned suppliers]. Until I hear back from you on this, I will not be approving trading for these clients (with a few exceptions).

…"

1020. Mr Rose has not explained why he waited until 18 June 2009 to request credit checks. The inference is that, again, CFE did not want to know full answers to the questions it asked in case those answers affixed it with knowledge that would see it deprived of its VAT reclaim.

There is no good reason why this document should not have been prepared by 8 June or 12 June (the same time as the Suspicious Event Report) at the very latest.

1021. In the evening of 18 June 2009 Mr Rose emailed Mr Emanuel requesting a meeting with him to discuss strategy going forward. In the same email Mr Rose instructed that Mr Emanuel should not execute any further retail matched principal EUA transactions until further notice.

1022. At 19:36 Mr Rose e-mailed Mr Emanuel stating:

"I would like to meet with you in the morning to discuss strategy going forward. In the interim, please do not execute any matched principal EUA transactions (except in the unlikely case that we receive orders for any of the 3 clients with exposures – you may transact that business)."

1023. Thus, by 18 June 2009 some progress was being attempted to be made by CFE on the formulation of new controls and processes to be used for matched principal carbon credit trading, again with the instruction to suspend trade except for those to whom CFE was exposed. Meanwhile, issues with prior VAT invoices and paperwork had been settled in the case of a large number of counterparties.

1024. On 18 June 2009 Mr Rose began to give further consideration to the future of the business. He requested copies of the documentation on a number of counterparties from the compliance team. Mr Rose also instructed the Risk team to commence a review of the financial position of the counterparties.

1025. At 22:34 Mr Buchan replied to Mr Rose saying:

"Laurence,

My group did a simplified search of public data using Companies House and web searches of the 23 accounts that had recent activity on the retail trade blotter.

<u>The preliminary assessment is not encouraging</u>. The financial statements posted on Companies House are largely from 2007 and admittedly stale and could have materially changed in the last 18 months given the growth in the carbon market.

The summary from the attached worksheets is as follows: Negative Equity	*4*
Under £15K Equity	*5*
£500K-1Mil. Equity	*1*
Sub of Large Co.	*1*
Established Co., Not on Companies House	*5*
Dormant Company	*1*

New Companies, no financials (started 008-09) *5*
Total *23 clients*
Based upon this data, the brokers need to get us recent financials (2008 or 2009) to have me feel comfortable we are not dealing with insolvent, or nominee companies. We can do the same public search for the other accounts on the list you provided which have not traded recently. However, I don't think it would be productive. I suggest that the brokers go out to their clients and proactively obtain financials."
[Emphasis added]

1026. Mr Buchan's team's document (drafted by Mr Dixon) noted that Westis was a new company with no known assets despite which CFE had conducted £ millions of trade, that no financials had been obtained and that further information needed to be obtained as to its rationale for carbon trading.

1027. The document also noted that:

i. Axle, Duntai and ADE were technically insolvent despite which CFE had carried out maximum trades with each of £476,920, £4.8 million and £5.3 million;
ii. Adduco had net assets of £100 against a maximum trade carried out by CFE of more than £3 million and an average trade of more than £1 million and its last accounts were for a dormant company;
iii. BMC had net assets of £1,755 against a maximum trade carried out by CFE of more than £12.6 million and an average trade of more than £2.6 million;
iv. AHMD had net assets of £3,621 against a maximum trade carried out by CFE of £1.1 million and an average trade of some £725,000;
v. GWD had net assets of £100 against a maximum trade carried out by CFE of £1.9 million and an average trade of nearly £900,000 and was dormant; and
vi. CD, Aristo, NCL, Stratex and Westis were new companies with no known assets despite which CFE had conducted £ millions of trade with them.

1028. Mr Dixon's report does nothing but confirm the entirely negative picture built up as to the lack of bona fides or financial sustainability of the counterparties with which CFE had been trading. There is no good reason why this report should not have been prepared before (say, by 12 June 2009 at the latest) except that it would have committed to paper what CFE already should have known.

1029. Mr Buchan notes in evidence that Mr Dixon approved a number of counterparties, including AH Marketing, notwithstanding the low net worth of the counterparties. Mr Buchan's recollection is that the low net worth counterparties were still understood at that time to be akin to brokers and aggregators who sold excess allowances provided as payment for consultancy services or on trust (i.e. to the counterparty as agent) by emitters.

1030. This understanding is reflected by entries on the spreadsheet, for example the description of GW Deals as a *"provider of independent analysis and consulting services for European and global power, gas and carbon markets"*.

1031. However, as the Tribunal finds, there was no objective evidence which supported this understanding – it was simply understood on the say so of Mr Emanuel. There was no attempt

to investigate the explanation or confirm it with the counterparties in writing, let alone seek independent support for the explanation.

1032. For parties selling as agent, which Mr Buchan considered was perhaps the most likely position of these counterparties, he considered their financial position was not material and had no bearing on their ability to consummate a transaction. Mr Buchan also did not rule out the possibility that credit might have been extended to the counterparty.

1033. However, Mr Buchan did not arrange for CFE to conduct proportionate or reasonable investigations – by this time it should have been obvious to CFE that they were not simply looking at credit risk in relation to ability to consummate a transaction but that there was an AML focus – to investigate the bona fides of the counterparties.

1034. Mr Buchan stated his understanding as to the nature of the counterparties' business was consistent with the names of several of them, their financial positions, and the fact that they had, and had been able to deliver, the carbon credits. It was also consistent with CO2e's dealings with them: see the email exchange on 9 June 2009 between Mr Emanuel and ADE which refers to the latter's requirement to be paid *"in order to be able to pay my clients"*.

1035. Furthermore, Mr Buchan stated they each had perfect track records of transaction completion, i.e. when a transaction was promised the credits were delivered and there was the onward counterparty sale and the completion of the matched principal trade. He stated that this was itself positive indicator, particularly bearing in mind that a person can build up a positive credit profile by establishing a track record of successful transactions.

1036. However, this evidence was not to the point – this type of credit review was not the reasonable or proportionate focus – it was nothing like enhanced due diligence and only narrowly focused on CFE's commercial objectives to complete deals, it did not counter the risk of fraud.

1037. Furthermore, Mr Buchan accepted that in light of the risk of fraud, it was determined that CO2e should be more critical in their assessment of the counterparties and that it was prudent to establish a positive affirmation and gather more data.

1038. Mr Buchan, on behalf of the Appellant, suggested it was the responsibility of the risk function to be fair and balanced and not jump to conclusions. The risk of fraud is not a certainty of fraud and there were lots of rationales for what CO2e was seeing that had nothing to do with fraud. He stated it had to be fair and balanced in its analysis and not just *"see shadows everywhere where they may not exist"*; that would not have been prudent. He stated it would also have been unfair and unbalanced to make assumptions about fraud, which is a very serious matter, without having undertaken proper analysis. Assuming that a counterparty has been fraudulent based upon an anonymous blog would not have been appropriate. Mr Buchan noted that there have been many instances where traders and people with various vested interests have written things that have no basis in fact because it may help them in some way that cannot be fully understood.

1039. Mr Buchan suggested that at this stage there was an ongoing investigation involving enhanced due diligence. It was important for CO2e to be balanced in its approach - terminating trading relationships was a serious matter which would have had repercussions on people's careers and CO2e's revenue. Moreover, to do so on the basis of an unproven allegation of fraud could have had further ramifications for CO2e.

1040. On 18 June 2009, following a request by Mr Rose, Mr Buchan provided a preliminary analysis of the financial position for the relevant CO2e counterparties, which he considered was not encouraging. Mr Buchan noted that many of the financials were out of date and suggested he applied a particularly cautious approach given the sensitivities regarding the rumours of potential fraud in the market. He stated he recommended that more recent financials be obtained in order to ensure that CO2e was not dealing with insolvent or nominee companies (meaning a front for another kind of business). He stated he was clearly not happy to base conclusions on old financial statements which could have materially changed over the last 18 months given the growth in the carbon market.

1041. Mr Buchan stated that even where low net worth counterparties were identified, based on the more recent financial information, this may not necessarily have involved fraud and led to rejecting the counterparty provided there was evidence to support the explanation that the counterparties were acting effectively as brokers or aggregators.

1042. Mr Buchan's evidence was honestly given and is accepted as being a fair recollection of his beliefs and actions at the time. However, those belief and actions are not accepted as being reasonable. His view was narrowly focused on credit risk rather than AML / tax risk and divorced from the large range of negative indicators of which CFE was aware from its various internal departments which obviously indicated widespread VAT fraud. The Tribunal provides more reasons within the discussion section below why it does not accept that Mr Buchan's approach or evidence was reasonable.

19 June 2009

1043. On 19 June 2009 Mr Emanuel e-mailed Mr Craib in relation to the blog saying *"How do you go about revealing their identity?"* and there was a subsequent discussion about the removal of the blog.

1044. On 19 June 2009 Mr Rose also engaged in an email exchange regarding one of the rationales for the trade put forward by Citibank. In the same exchange Mr Craib informed Mr Rose that the author of the emissions trading blog referred to above had removed three recent blog entries referencing VAT fraud in the emissions market.

1045. Importantly, on 19 June 2009, after the final deals with AHMD were completed, Mr Cooper contacted HMRC and requested a meeting to discuss issues that would impact upon the period 06/09 VAT return. This was the meeting that took place on 25 June 2009.

1046. At 09:11 Mr Emanuel sent an e-mail to Messrs Cooper and Rose, saying that he had spoken with unnamed individuals at Citibank who said that they had come up with four legitimate explanations for the swathe of recent companies that had approached them to trade Spot emission allowances and had concluded that there was nothing to suggest that this was driven by illegitimate activity.

1047. Citibank had been investigating the possible motivation behind the increase in counterparties that had approached them to trade carbon credits. They put forward five possible reasons for the activity, only one of which was illegitimate.

1048. Mr Rose considered that this was helpful information for the purpose of considering strategy for CO2e's approach to matched principal trading going forward.

1049. In contrast, a month later at a meeting of the UK Emissions Trading Group on 24 July 2009, Garth Edward, Head of Emissions Trading at Citibank was minuted as commenting that most traders would say that the spot trading market was driven by VAT fraud – the issue was already in play in the market and affecting companies like his.

1050. At 09:52 Mr Emanuel forwarded the Swift confirmation for the previous day's AHMD deals to Mr Rose. Mr Rose replied saying: "*Anything happening? Aducco, stratex, numberland? Wholesale?*" Mr Emanuel replied saying:

"*AH wanted to send us more to sell*
We told them that our systems were down for maintenance and couldn't do anything more today
Aducco and Stratex same story… you never called and made a note of the Israeli number
Northumberland said that they may have something to do on Monday."

1051. There is no record supporting Mr Emanuel's assertion that Adduco had tried to trade with CFE after June 2009 and that CFE had to turn their business away.

20-23 June 2009

1052. On 20 June 2009 Mr Emanuel e-mailed Mr Rose requesting permission to buy a further 57,000 carbon credits from AHMD. Mr Rose replied saying:

"*I am not comfortable with them yet.*
Were you able to get them to send over updated financials?
We need to put them through a proper credit check to ensure we are not dealing with insolvent or nominee companies.
Also, why are they only selling through us?"

1053. Mr Rose says in his witness statement:

"*…Like any good broker he* [James Emanuel] *was keen to do deals but in light of the rumours within the market I was not willing to sign off on further trading until more information was obtained from AH Marketing & Distribution. …*"

1054. It is therefore unclear why between 15 – 18 June 2009 CFE purchased 336,000 carbon credits from AHMD, apparently with Mr Rose's authorisation. Nothing had changed in the period between 18 and 20 June 2009, or since 15 June 2009 in fact. AHMD remained obviously suspect and Mr Rose's statement is a tacit admission he was aware of this.

1055. The fact is that Mr Rose was both deliberately kept out of the loop by Mr Emanuel and his traders in relation to the transactions and avoided intervening in the trade unless specifically requested to authorise it or it was so obvious that he had no choice but to intervene.

1056. Between 20 June 2009 and 22 June 2009 Mr Rose and Mr Emanuel engaged in further exchanges regarding future trading and Mr Emanuel's desire to deal with AH Marketing. Mr Emanuel was keen to do deals but in light of the rumours within the market Mr Rose was not willing to sign off on further trading until more information was obtained from AH Marketing. Mr Emanuel however was holding off requesting additional information until the new procedures for matched principal trading had been finalised; his explanation is that he did not

want to ask AH Marketing for information piecemeal. The reality is that he was not deterred from trading despite everything that had gone before.

1057. After 18 June 2009 CFE did not purchase any carbon credits until July 2009. CFE's carbon credit trading business virtually disappeared until it purchased a further 773,000 carbon credits from Westis on 28-29 July 2009.

1058. On 22 June 2009 there was a meeting of a CFE Risk Policy Committee. A note shows the following discussion item:

"CO2e Business
Retail Business – Risk has begun a review of the CO2e retail client base (i.e. client pre-delivers or pre-pays). Initial review of the recently active clients was not encouraging. The financial statements posted on Companies House are from 2007 and largely reflect recently formed or nominally capitalized companies. Based on this review, any client wishing to trade will be required to submit recent financial statements to be reviewed and approved by risk and L. Rose prior to trading."

[emphasis added]

1059. On 22 June 2009 Mr Cooper received a letter dated 22 June 2009, which was addressed to Kingsley Napley from AG Kakouris Limited, the accountants acting for Westis. AG Kakouris are a firm of certified chartered accountants who are based in Winchmore Hill in North London.

1060. AG Kakouris wrote stating that a group registration application had been made for Epicure and Westis. AG Kakouris stated that there should be no reason why the application for group registration to enable Westis to be VAT registered should be rejected. They also acknowledged that their clients had applied for registration in the knowledge that there may be penalties for late notification and further surcharges for late submission of VAT returns. The letter also asserted that in their view, there should be no reason why CFE was not now able to settle invoices rendered to it by Westis on which no VAT had been claimed, pending group registration.

1061. Mr Cooper, however, was not prepared to release any sums to Westis until he had received more comfort that there would be no risk to the ability to recover input VAT having made the payment.

1062. On 23 June 2009 at 08:26 Mr Emanuel had e-mailed Mr Rose in relation to attempts to trace the Israeli numbers for Adduco and Stratex, saying:

"*I wonder if the private investigators or anyone that we know in Israel is able to trace the owners of these numbers.*
It could be that they people aren't as smart as they thought they were…perhaps it didn't occur to them that if they didn't answer the London forwarding number that it would divert to their Israeli voicemail.
It has to be worth a try."

1063. Adduco and Stratex's disappearance troubled Mr Emanuel sufficiently to write the above e-mail, private investigators having become involved in attempt to trace the owners. Some of CFE's suppliers, whom they already had grounds to suspect were fraudulent, became

uncontactable. The seriousness of the problems with fraud in the trade were now obvious. Yet despite this CFE was apparently content to trade with Westis in July.

24 June 2009

1064. On 24 June 2009, Mr Cooper sent an email to Mr Cukier rejecting a proposal made by Kingsley Napley to pay over the outstanding amounts owed to Westis, less an amount equal to 50% of the VAT amount previously paid to them.

1065. Mr Cooper did, however, agree to pay the balance CFE was holding which exceeded the amount of VAT chargeable on all previous invoices received from Westis. This payment was made on 25 June 2009. But Mr Cooper refused to pay any further amounts until Westis had obtained a valid VAT registration number for the period in question.

1066. Mr Cukier replied to this email on 24 June 2009, stating that there was no question of dishonesty on the part of his client and that it was an administrative error. He stated that his instructions were now to serve a statutory demand on CFE.

1067. The statutory demand was received by Mr Cooper on 24 June 2009. The statutory demand claimed payment from CFE of €3,989,280, which was the amount outstanding on the two unpaid invoices, exclusive of any VAT.

25 June 2009 meeting with HMRC

1068. On 19 June 2009 Mr Cooper had arranged a meeting with HMRC to take place on 25 June 2009. On 25 June 2009 Mr Cooper of CFE, Mr Sadler and Mr Sharratt of Smith & Williamson (CFE's advisors) met HMRC Officers Marian Drakes and Ian Edgson (BGC/Cantor Fitzgerald's customer relationship manager or 'CRM').

1069. Mr Cooper records that, in light of the large input VAT repayment claim that the Appellant would be making in its 06/09 VAT return, it wished to be upfront with HMRC about the issues that the group had experienced with VAT invoicing in respect of 12 of CFE's counterparties.

1070. He also records that the group discussed with HMRC at the meeting (1) the information that it had obtained through its enquires into the 12 counterparties; (2) the measures that it had taken to address these issues; and (3) the state of the group's understanding as regards the counterparties at that time.

1071. Mr Sharratt took a handwritten note (which was transcribed). HMRC also produced a note after the meeting.

1072. The HMRC note of the meeting states (IE being Ian Edgson):

"The business reviewed some of their suppliers for carbon emissions trading they invited HMRC in as they wanted to bring some invoices to the attention of HMRC as the next return was due.
They noticed an upward spike in their trends of their emission trading as a result they reviewed some of their suppliers and compiled a list of 12 companies.
They noticed that these businesses were independently run but had poor controls with regards to running a business. Eg vat not translated into sterling. The last 3 businesses on the list were

highlighted – Westis Ltd/Aristor Partners and Axle. To regulate the VAT position Cantors withheld some of the Vat in respect of some of these companies.
IE explained the process of MTIC fraud to the business.
- Vat registration numbers are needed for the 12 companies
- A sample of invoices should be provided
- Need to consider tax point issues for the last 3 businesses
- Registration.

Mark Cooper agreed to keep HMRC updated. …"

1073. Martin Sharratt's evidence in relation to the meeting was:

"…Mark [Cooper] highlighted the suspension of the BlueNext Exchange and the rumours of MTIC fraud in the market. He also explained the actions which CantorCO2e had taken. In particular this had included revisiting some of the invoices received from their counterparties and the anti-money laundering (AML) due diligence which had been undertaken. As I recall, Mark Cooper provided a clear message to HMRC that he wished to draw their attention to the problem and alert them to the possible risks in this market."

1074. According to Mr Sharratt, whose statement was read as agreed:

(1) The meeting with HMRC lasted for approximately 45 minutes.

(2) Mr Cooper opened the meeting by explaining that CFE wished to share with HMRC its concerns at certain recent developments. He explained the business of CFE as a broker in EUAs and noted that CFE had seen an increased volume in trading in these products, which, unlike most of the group's business, were standard rated for VAT purposes.

(3) Mr Cooper also highlighted the suspension of the BlueNext Exchange and the rumours of MTIC fraud in the market and also explained the actions which the group had taken. In particular, this had included revisiting some of the invoices received from CFE's counterparties and the AML due diligence which had been undertaken.

(4) Mr Cooper provided a clear message to HMRC that he wished to draw their attention to the problem and alert them to the possible risks in this market. Mr Sharratt recalls clearly that Mr Edgson indicated that this was the first time he had heard of the problem and that he expressed his gratitude to those on the CO2e side for bringing it to the attention of HMRC.

(5) Mr Cooper explained that a list of 12 "problematic" counterparties (i.e. those where VAT concerns had been raised) had been compiled by CFE. The list was passed to Mr Edgson and Ms Drakes at the meeting.

(6) The parties then discussed the 12 clients who appeared on the list. This included ADE and Mettec, who had appeared to have corrected some errors in their earlier invoices. The parties discussed Northumberland Consultants, Stratex and Adduco, and it was noted that the transactions carried out with these counterparties appeared to have been valid, i.e. there was clear evidence that the transactions had genuinely taken place. The parties then discussed a further group of three counterparties, Westis, Aristo and Axle. These counterparties were the three in respect of whom CO2e was withholding amounts of VAT, as they had not yet provided evidence of a valid VAT registration.

(7) Mr Edgson made some general comments about HMRC's policy with regard to allowing input VAT deduction and general guidance about VAT invoicing requirements. This is also consistent with Mr Cooper's evidence about the meeting.

1075. HMRC asserted that the Appellant withheld information at this meeting as to particular counterparties or its proposed actions.

1076. It was submitted on behalf of the Appellant that there was no evidence that the Appellant withheld information from HMRC at the June 2009 meeting. Two points were made on behalf of the Appellant. Firstly, Officer Ball who made these assertions was not at that meeting. Mr Cooper and Mr Sharratt who were at that meeting gave evidence of what took place. Secondly, the meeting notes demonstrate albeit in brief terms, what was discussed, and it is plain from those notes that all relevant counterparties and all relevant actions were disclosed.

1077. The Appellant relies on the following evidence in support of its case:

(1) HMRC's note of the meeting records the Appellant as having *"noticed that these businesses* [presumably a reference to the 12 relevant counterparties] *were independently run but had poor controls with regard to running a business"*.

(a) HMRC now refer to correspondence between Mr Emanuel and ADE on 9 June 2009 in which he asks ADE whether it was *"affiliated"* with any other companies dealing with CFE, based on factors that that had been noticed, such as similarities in the invoicing format used by a number of different counterparties.

(b) Mr Cooper stated in his second witness statement that the group's understanding at the time was that the similarities in the invoices were likely to be the result of these companies sharing office space and infrastructure, but that they were nonetheless independent operators (i.e. not in common ownership or otherwise formally affiliated).

(c) Accordingly, the comment recorded in the meeting note was an accurate statement of the group's understanding of these companies at the time of the meeting.

(2) As regards Northumberland Consulting Limited:

(a) HMRC allege that CFE did not inform them at the 25 June meeting that "it had decided not to make enquiries of the validity of the details of Northumberland Consulting Ltd's VAT registration to avoid being "on notice" of any difficulties arising from the answer" (as alleged in Officer Ball's second witness statement). For the reasons outlined above the Appellant submitted that this was not an accurate characterisation of CFE's response.

(b) Further, Mr Sharratt's note of the 25 June meeting shows that Northumberland Consultants (*"NCL"*) was in fact discussed with HMRC during the course of the 25 June meeting and the note groups Northumberland Consultants with the counterparties Adduco and Stratex, being the counterparties in respect of whose VAT registrations CO2e had identified issues: this is apparent from the handwritten note and a transcribed version.

(c) This is also supported by the evidence of Mr Sharratt.

(3) HMRC also alleges that the group did not disclose at the 25 June meeting that it intended to carry out further trades with the counterparties in respect of which CO2e had a net exposure. Mr Cooper cannot recall whether this was mentioned, but in any event, given the effect and

intent of the strategy CFE deployed, namely to avoid VAT loss in the transactions, and thus VAT loss to HMRC, it was not a particularly material point.

(4) As regards Westis, HMRC allege that CO2e did not disclose its concerns or what it knew about Westis at the 25 June meeting.

(a) First, HMRC do not particularise what they say was omitted.

(b) Secondly, Mr Sharratt's meeting note (see the handwritten note and the transcribed version) shows that Westis was discussed. Whilst Mr Cooper cannot recall exactly what was discussed, he is confident that the group would have been upfront with HMRC regarding the state of its knowledge in respect of Westis.

(c) Thirdly, in the disclosure provided by HMRC was an email dated 6 December 2012 from Officer Edgson, who was present at the meeting, to various of his HMRC colleagues, including Officer Ball. An earlier draft of the decision letter issued by Officer Ball on 6 December 2012 asserted *"Nor is there any evidence that CO2e queried this anomaly* [namely that an early Westis invoice contained Epicure's VRN] *or investigated it further"*. Officer Edgson said of this:

'I am not sure whether it is strictly accurate to say that "…there is no evidence that CO2e queried this anomaly or investigated it further".'

'I visited Cantor Fitzgerald's office on 25 June 2009 at the meeting, Mark Cooper explained that an internal VAT review exercise had been carried out, prompted by news that the Blue Net [sic] trading exchange in France had been suspended on 4 June 2009 as a reaction to unusual patterns of CO2 emission trading. He showed me a list of 12 suppliers which he said had warranted a more detailed review based on the quality of their invoicing paperwork. One of these was Westis. He said that Cantor's [sic] engaged with the 12 businesses to help them regularise their invoices, which he said was necessary because some of their invoices lacked the necessary information required on tax invoices. This included in some cases not displaying VAT registration numbers and/or not showing the VAT amounts in sterling. He said that Cantor's had decided to withhold VAT payments from Westis as a precaution until they had obtained satisfactory VAT invoices. Westis did subsequently obtain its own VAT registration number at the end of June 2009.'

'So, there was some activity to get a valid VAT registration for Westis at the end of June 2009, which infers that CO2e were querying an anomaly and investigating it further (albeit after the event). Also, by then HMRC did have some awareness that there had been a problem with (at least some of) Westis' invoices.'

1078. Officer Rod Stone of HMRC responded very shortly after that email was sent to say that he had discussed the point with Officer Ball and that they were in agreement that the sentence which Officer Edgson had highlighted should be removed.

1079. Further, the Appellant relied on Mr Cooper's evidence that the Cantor group valued its relationship with HMRC, and its practice was and is to deal with them openly and honestly.

1080. The Tribunal does not accept the Appellant's characterisation of the meeting on 25 June 2009 for the reasons submitted by HMRC. While Mr Cooper was honest with the Tribunal,

his evidence was not reasonable and the picture presented on behalf of the Appellant was one-sided.

1081. In evidence Mr Cooper accepted that as at 5 June 2009 there were several companies that CFE had real concerns about. Mr Cooper accepted that Westis appeared to have told a number of lies to CFE in that it had: provided a VRN that it claimed to be proper to it when it belonged to Epicure; then provided Epicure invoices showing that the supplies from Westis were made by Epicure; then claimed that there was a group VAT registration in existence and that Epicure's VRN was a group registration; and then asserted that a group VAT registration application was being made when one was not.

1082. Mr Cooper's evidence was that he did not think that any of the senior team were aware that Mr Emanuel had engaged in the above series of correspondence with Westis and that Mr Emanuel did not inform him of the chain of events in relation to Westis. He said that the directors' knowledge was different to that of Mr Emanuel. Mr Cooper further said that ADE issuing invoices for Westis trades and subsequent denial of any affiliation to Westis was not brought to his attention at the time by Mr Emanuel.

1083. Mr Cooper accepted that HMRC had not been provided with the full account of what Westis had been up to prior to registering it for VAT by reference to what Mr Emanuel knew. Mr Cooper did not believe that HMRC had been provided with the four sets of Westis invoices after the meeting of 25 June 2009.

1084. These concessions stand in contrast to what was said in the Appellant's submissions when it was said that there was no evidence of the very things that were conceded by Mr Cooper. The witness, Mr Cooper, who was to give the evidence that HMRC had been provided all relevant information on behalf of CFE, failed to do just that. In fact, the concessions support the allegation that Officer Ball is said to have wrongly made.

1085. HMRC alleged in relation to this meeting that those on the Cantor side withheld material information from them.

1086. The Tribunal accepts that CFE did not disclose relevant material to HMRC. This was not necessarily part of a deliberately misleading strategy on the part of Mr Cooper. Much of that information he himself was not aware of and the meeting was short. Nonetheless, the Tribunal does accept HMRC's submission that the focus on the part of CFE and Mr Cooper was not to primarily to assist HMRC in detecting fraud in the market but to ensure that their VAT returns would be accepted by HMRC. Therefore, the material Mr Cooper chose to select or highlight was the material that would naturally support his client in this aim.

1087. Following the meeting, Mr Cooper emailed Mr Edgson to confirm that he had spoken to Westis' accountant (Alex Christofi) and inform him that Mr Christofi was going to call him the following morning to set out the current state of affairs for his client.

1088. Finally, on 25 June 2009 Mr Quentin Bradshaw, part of the VAT and International Excise Team in HM Treasury, invited Mr Sharratt to a "stakeholder's meeting" to be held on 30 June 2009 to discuss the VAT treatment of emissions allowance trading following the changes made to the same by the French government in response to concern about VAT fraud in the market. Mr Sharratt attended that meeting (see below). It is material to note that Mr Bradshaw ended his invitation by saying *"Rest assured we have no plans to announce sudden changes to the current system operating in the UK!"*.

1089. It is fair to observe that HMRC and the Treasury were slower than they might have been to act on the apparent risk of VAT fraud in the carbon credit trade as far as it affected the UK. They would have been assisted if the likes of CFE had given them full and open disclosure as to the extent of their problems with the trade.

26-29 June 2009

1090. On 26 June 2009 Mr Rose circulated within CFE draft replacement KYC and account opening process documents for comment.

1091. The response from Mr Lynch (one of CFE's traders) was (LR being Laurence Rose):

"*I can see why LR etc. want to be vigilant against unsavoury customers.*
However this seems over the top, we will not have any customers if bona fide clients are asked to jump through this many hoops, why would they bother when other brokerage houses and banks are offering a similar service and only asking them for documents to pass the KYC and AML checks.
We should be doing KYC and AML checks as were are required to by law – Not putting it on ourselves to investigate farther than is reasonable to do so.
I was talking to Barclays yesterday – they are still trading direct with these companies as the have passed their KYC checks and AML checks.
We are not the Knights of the carbon market – it is not our job to police it.
I agree we should be vigilant – have a compliance team who carry out KYC and AML checks. Have a VAT department that knows what a VAT invoice should look like. This New Account Process looks to me like it has the propensity to encourage the market to shy away from Cantor CO2e and hand the bona fide lucrative sport market Trade elsewhere."

1092. Mr Emanuel agreed with Mr Bush, saying to Mr Rose:

"…Either we want this lucrative business and find a way to make it work while ensuring that our business is legally and economically secure, or else we don't want it. This is a decision that I feel you now need to make."

1093. The brokers on the EU Carbon Desk raised concerns about the proposed new procedures. In particular, they felt they did not strike a good balance between commercial sense and the exercise of caution. Moreover, and as an aside, the brokers' natural inclination to trade and do business is not a surprising one: that is why institutions like Cantor separate out their risk and compliance functions from their trading function.

1094. Nevertheless, these concerns demonstrate what had been evident throughout June – that the traders' priority was to keep trading to support CFE's profit margins and their personal bonuses. The traders did not support reasonable investigations and proportionate procedures made into counterparties who had demonstrated themselves to be unreliable and operating in a high risk market. This tension between trade and compliance departments was never finally resolved because Mr Rose never made the reasonable decision that compliance should take priority. The fact that Mr Rose was torn is obvious from his prevarication.

1095. The Appellant submits two things: (1) that the due diligence hitherto carried out by CO2e (namely AML and KYC checks) was in line with market standards; and (2) that the new procedures went above and beyond market standard: see the email from Mr Lynch of 26 June 2009, which evidences that Barclays Capital operated the same checks that CO2e had and a

concern that clients in the market would go to Cantor's competitors to do business in light of the more robust checks.

1096. The Tribunal does not accept these submissions for all the reasons set out above. Further, it is not the job of the Tribunal to make any comparative analysis – the standard of reasonable and proportionate due diligence is not to be judged as a relative standard to a company's competitors. Reasonable and proportionate due diligence is to be judged in relation to the risk factors that are or should be apparent to a company in its trade based upon the market generally and the specific counterparty involved.

29 June 2009

1097. On 29 June 2009 Westis' accountant faxed an application for VAT registration to HMRC.

1098. On 29 June 2009 Officer Drakes of HMRC emailed Mr Cooper to update him with regards to the VAT registration status for Westis. She stated that Alex Christofi had faxed her a copy of the application that afternoon and that it had been forwarded on to the registration team. Officer Drakes also asked for confirmation as to when Mr Cooper would send the VAT registration numbers for the other companies and the sample invoices which had been discussed on 25 June 2009.

1099. Mr Cooper replied the same day to say that they would be sent to her shortly and Mr Cooper believes that they were sent.

30 June 2009 - meeting at the Treasury

1100. On 30 June 2009 Mr Sharratt and Kamlesh Chauhan (from the Appellant's advisors Smith & Williamson) attended a Carbon Credit Stakeholders meeting hosted by HM Treasury.

1101. At that meeting attendees were alerted to: HMRC's awareness of the potential for fraud using carbon credits, the French zero-rating of carbon credits, the risk of unusual trading patterns, offers of trades in credits which looked too good to be true and large movements or bundles of credits being made available. Mr Sharratt states that he provided an update to Mr Treanor afterwards.

1102. Neville Trout at HM Treasury highlighted at the meeting the suspension of the BlueNext Exchange and the steps the French Government had taken to head off a significant threat of VAT fraud involving carbon credits. Mr Trout noted that the UK was not in the same position, but most of the meeting was concerned with policy options as to how best to deal with the risk of VAT fraud in this market, should it emerge.

1103. Mr Sharratt spoke to Mr Trout at the end of the meeting and mentioned to him that he had recently attended a client meeting with their customer relationship manager (CRM) to discuss concerns about VAT fraud in the carbon credit market. Mr Trout confirmed that CRMs had not yet been briefed on this issue.

1104. This meeting thus suggests that the view of HM Treasury as at 30 June 2009 was that evidence of VAT fraud in the UK market had not been confirmed; and this was confirmed by the follow-up email from Mr Trout on 3 July 2009, which stated:

"At the meeting, I outlined what actions we understood the French had taken to head off a significant fraud threat involving carbon credits. The UK is not in the same position but as part

of our planning we were considering policy options should a problem emerge. The early identification of fraud was important in an effective response and I accordingly invited you to consider sharing with HM Revenue and Customs (HMRC) what you might consider to be indications of changes in trade in carbon credits that might not be driven by market forces, along with any information on unusual trading patterns or out of the ordinary activity."

1105. Mr Trout sent a further email to attendees on 15 July 2009 asking for further feedback from the attendees of the meeting on the proposed changes to the VAT system in order to combat possible MTIC fraud.

CFE's Money Laundering Report for 2009

1106. CFE's Money Laundering Reporting Officer's Report for the year 2009 said at [6.4]:

"In June 2009, following press commentary on carousel fraud in the spot emissions market, CFE suspected that it had been the victim of VAT fraud. Although nothing was proven policy and procedures were reviewed around the types of clients with whom such activity would be undertaken. As a consequence more stringent KYC requirements were implemented and the level of ALM/CFE/Sanctions checks was increased."
[Emphasis added]

1107. CFE's own report contains an admission that in June 2009 CFE suspected that it had been the victim of a VAT fraud following the press commentary which led to it introducing more stringent procedures. This evidence supports the Tribunal's own finding that CFE had more than reasonable grounds to suspect its counterparties were involved in VAT fraud and subjectively, it reasonably suspected the same at the relevant time.

1-2 July 2009

1108. On 2 July 2009 Messrs Bush (JB) and Lynch (HL), traders in CFE, had the following messenger conversation referring to Laurence Rose (LR) and James Emanuel (James):

"JB: have you thought any more about the bonus, or talking to LR?
HL: not yet will send an email to james
JB: well get a grip then!
HL: did you get an email back from Stratex
JB: funnily enough.....no."

1109. The reference to 'funnily enough…no' suggests that the traders were not expecting any reply from Stratex because they already believed that Stratex had not been acting lawfully. Any e-mail sent to Stratex by CFE does not appear to have been disclosed.

1110. Between 1 and 2 July 2009 Mr Rose exchanged emails with Mr Von Butler (another trader) regarding certain trading conditions that the risk team were insisting on for matched principal sales: not that there was any trade going on by this time.

1111. Mr Von Butler was querying why CFE would insist on payment being received for carbon credits before releasing the carbon credits to the purchaser. Mr Von Butler was of the view that if counterparties such as Barclays and Citibank did not eventually pay for the carbon credits CFE would be able to sue them under the trading contract. Mr Von Butler also

emphasised in his email that morale on the EU Carbon Desk was low on the basis it was having to turn away clients on a daily basis.

1112. The Tribunal is satisfied that CFE was too late in applying effective controls to combat fraudulent trading such as implementation of the procedures decided on 15 & 26 June 2009 and the turning away of clients for carbon credits.

3 July 2009

1113. On 3 July 2009 Mr Cooper responded to the statutory demand issued on behalf of Westis, claiming a right of set off of the amounts owed to Westis against the amounts CFE had paid to it in VAT. Further correspondence ensued on the issue.

7 July 2009

1114. On 7 July 2009 at 22:31 Mr Emanuel e-mailed the traders on the CFE carbon desk, saying:

"*I spoke to Laurence tonight. This overhaul to our business has been dragging on for too long. While the company want to introduce many new hoops for clients to jump through before we are able to deal with them, we fear that such procedures may inhibit our business.*
Rather than try to fine tune the procedure to something that we are all happy with, an exercise that may take weeks contrary to our wishes to resume spot business ASAP, we have agreed the following.
We will implement a revised version of the procedures wanted by the company from tomorrow (Wednesday). Laurence will send you an email with the new protocol.
If the clients comply, then everyone is happy. If not, then the company will have to re-think and dilute the new client procedures that it is presently introducing. …"

1115. On 7 July 2009 at 23:44 Mr Rose circulated an e-mail around CFE attaching: a revised KYC Client Questionnaire, a list of required supporting documents, a revised New Client Take On Order Form and a memo setting out the new client take on process that was said to be effective immediately.

1116. On 7 July 2009 therefore there had been further internal exchanges regarding the roll out of new procedures for matched principal carbon credit trading with a view to lifting the temporary halt that had been in place in respect of most counterparties. Although there had been concern from the brokers that the new enhanced procedures may force clients to look elsewhere, Mr Rose had finally decided to introduce reasonable and proportionate client questionnaires in light of the rumours of fraud in the market.

1117. Despite the concerns of the brokers, Mr Emanuel was willing to see whether the clients would comply with the new procedures and defer any discussion about diluting them on the basis that this would cause delay and may not have proved necessary.

1118. After 7 July 2009 the brokers therefore started liaising with counterparties in accordance with the new procedures with a view to recommencing trading with counterparties who complied with them. An example of an exchange between CFE's EU Carbon Desk and Mettec can be seen in evidence; and an example of an exchange between CFE's EU Carbon Desk and AH Marketing, where their compliance department was liaising with brokers on the EU Carbon

Desk in order to provide information requested under the new procedures. Mr Rose had in fact already met Mettec on 18 June 2009.

1119. None of these attempts to revive the trade with CFE's previous or existing counterparties was successful now that appropriate procedures were finally in place.

1120. On 14 July 2009 Westis' lawyer advised CFE that his client's accountants had been advised that Westis' VAT registration number had been posted to them. Mr Cooper received an email from Mr Cukier at Kingsley Napley stating that Westis' accountants (AG Kakouris) had been advised that Westis' VAT registration number had been posted to them. This, however, did not arrive until on or before 20 July 2009.

15 July 2009

1121. On 15 July 2009 the Netherlands authorities introduced a reverse charge on carbon credit which was reported by Reuters as being predicated on clear indications of fraudulent activity, specifically carousel fraud, in the Dutch emissions market.

1122. At 11:47 on 15 July 2009 Mr Emanuel forwarded Messrs Rose, Treanor and Cooper the Reuters article.

17 July 2009

1123. Mr Rose understands that on 17 July 2009 a meeting took place at Barclays Capital and that it was at that meeting that HMRC made their first official public acknowledgement that VAT fraud was affecting the UK emissions market.

1124. On 17 July 2009 one of the brokers from the EU Carbon Desk emailed Mr Rose, copying in Mr Emanuel, Mr Weldon and Mr Bush, attaching documentation for a new client (Kaplan Ltd) to be approved. They were ultimately not approved as a client due to issues with their VAT number. The Tribunal will return to Kaplan below.

20 July 2009 – the spreadsheet recording the response to the new procedures

1125. On 20 July 2009 Mr Emanuel e-mailed Mr Rose a spreadsheet setting out the response of CFE's counterparties to the new procedures:

Adduco Consulting Ltd	Gone AWOL
Ade International Ltd	Refused to deal with us because we held onto their money
AH Marketing and Distribution Ltd	Re-applied to be a client by completing our new account opening docs
Aristo Partners Ltd	Refused to deal with us because we held onto their money
Axle Ltd	Refused to deal with us because we held onto their money
Business Management Consulting Ltd	Refused to deal with us because we held onto their money
Duntai Ltd	Refused to deal with us because we held onto their money

Green & Blue Co	Dealt with us once but has never had any repeat business: still have €2.5k of their money on account
GW Deals Ltd	Sent them the new client approval docs, they have other avenues to market and haven't had time to complete them
KO Brokers	Dealt with us once but has never had any repeat business: still have €16k of their money on account
Mettec	Sent them the new client approval docs, they have other avenues to market and haven't had time to complete them
NLT	Dealt with them a few times but haven't had anything to do recently
Northumberland Consultants Ltd	Dealt with them a few times but haven't had anything to do recently
Stikito	Sent them the new client approval docs, they have other avenues to market and haven't had time to complete them: we have €4.5k on account
Stratex	Gone AWOL
Westis	Refused to deal with us because we held onto their money
SVS	Dealt with us once but has never had any repeat business. They were brokers themselves and using us for liquidity.

1126. It should have been apparent by this time that the vast majority of CFE's counterparties were not prepared to trade in carbon credits when faced with reasonable and proportionate procedures that reflected enhanced due diligence. There was no other reasonable explanation put forward for the almost universal end to trade. This should have indicated that their previous trade was infected by fraud.

1127. On 20 July 2009 AG Kakouris Ltd e-mailed CFE a copy of Westis' VAT certificate with an effective date of 1 July 2009, stating that they were seeking to have it backdated to 1 May 2009. HMRC confirmed on 20 July 2009 that the registration would be backdated to 11 May 2009.

1128. On 20 July at 14:52 Bloomberg reported that the UK government had found what it called the first attempt at tax fraud in the market for carbon credits. Mr Rose forwarded the article to Messrs. Cooper and Treanor.

1129. The value of the potential fraud was not disclosed in the report. As noted above, on or before 20 July 2009 Mr Christofi at AG Kakouris received a VAT certificate for Westis from HMRC. He sent a copy to Mr Cooper on 20 July. However, the effective date of registration had not been backdated to 1 May 2009; AG Kakouris had requested HMRC to amend the VAT certificate to backdate the effective date. This would enable CFE to reclaim VAT from the dates on which the trades were undertaken.

1130. By letter dated 20 July 2009 HMRC agreed to amend the date of registration to 11 May 2009 (being the date of the first trade with CFE). This was sent to Mr Cooper by email from Mr Cukier the following day.

21 July 2009

1131. On 21 July 2009 HMRC issued CFE with an MTIC warning letter which stated:

"VAT Status Verification Facility For New Carbon Credit Suppliers/Customers

Please be aware that HM Revenue & Customs are experiencing problems with Missing Trader Intra Community (MTIC) VAT fraud involving businesses that are trading in carbon credits.

MTIC fraud may involve all types of VAT standard rated goods and services including carbon credits….For information purposes please find enclosed the leaflet "How to spot VAT Fraud."
…
Although the Commissioners may validate VAT registration details, it does not serve to guarantee the status of suppliers and purchasers. Nor does it absolve traders from undertaking their own enquiries in relation to proposed transactions. It has always remained a trader's own commercial decision whether to participate in transactions or not and transactions may still fall to be verified for VAT purposes.

For your information I also enclose a copy of our Notice 726 – "Joint and Several Liability" which may also be viewed on our website www.hmrc.gov.uk…"

1132. The Appellant's assertion in cross-examination that HMRC *"didn't publish any warnings as to the presence of MTIC fraud in the carbon credits market prior to introducing the zero rate"* is therefore inaccurate. Nonetheless, it is fair to state that HMRC were slow finally to confirm the existence of fraud and give the appropriate warnings which they did not give to CFE until 21 July 2009. However, CFE was not reliant upon HMRC's warnings for its means of knowledge of the widespread VAT fraud in the carbon credit market. Further, CFE traded with Westis eight days later despite this warning.

1133. HMRC's warning letter dated 21 July 2009 formally confirmed that there was a potential for fraud in the carbon credit market. It enclosed a copy of Notice 726 and also stated that where one wished to verify the VAT status of new customers, these should now be faxed to the Wigan HMRC office and not to the Local Office or the National Advice Service.

1134. On 21 July 2009 Mr Emanuel asked Mr Rose to chase the Risk and Operations teams in respect of their review of a number of potential new counterparties who had already been approved by Compliance under the new process.

24 July 2009

1135. On 24 July 2009 Mr Treanor emailed Officers Edgson and Drakes at HMRC to confirm that Westis had now reissued its invoices correctly showing its new VAT registration number. It noted that the trades with Westis would be included in the VAT return for the period ending 06/09 and that (as had been discussed with Officer Edgson) CFE had not submitted Westis through the new Wigan clearance procedure.

1136. At a meeting of the UK Emissions Trading Group on 24 July 2009, Garth Edward, Head of Emissions Trading at Citibank was minuted as commenting that most traders would say that the spot trading market was driven by VAT fraud – the issue was already in play in the market and affecting companies like his. Citibank had traded carbon credits with CFE.

27 July 2009

1137. On the morning of Monday 27 July 2009 Mr Cooper telephoned Andrew Milner at HMRC, who was the author of the letter confirming Westis' VAT registration. Mr Cooper wrote a manuscript note on his copy of the letter. The note stated that Mr Cooper had spoken to Andrew Milner on 27 July 2009 at 12.53pm and that Mr Milner had confirmed that the letter was valid and expressed his view that Westis had a valid VAT number. This number was effective from 11 May 2009 and Mr Milner stated that CFE would be able to recover the VAT amount paid over to Westis.

1138. Further to the confirmation of Westis' VAT registration and a number of internal approvals (including invoice checks), on 27 July 2009 CFE finally paid Westis the money it was holding.

1139. Despite the difficulties in relation to Westis and confirmation of fraud in the carbon credits market, on 27 July 2009 Mr Emanuel e-mailed Mr Stork of Westis saying:

"…I do hope that once this matter is behind us we will be able to resume business once again in the successful manner than we dealt with each other in the past."

Trades with Westis on 28-29 July 2009 in respect of which input tax has been denied

1140. On 28 July 2009 CFE paid Westis the outstanding sums due to it. Thereafter Westis had an immediate change of heart about trading with CFE, with Mr Stork saying to Mr Emanuel in an e-mail at 09:38:

"*Thanks!!*
I will call you in half an hour to discuss about trade today."

1141. Following the release of funds to Westis, Mr Emanuel had emailed Mr Rose and Mr Cooper on 28 July 2009 about recommencing trading with Westis.

1142. Mr Emanuel stated that he had done his best to repair the relationship and that Westis had initial reservations about trading with CFE again. He also said that he was keen not to present them with the new process as he expected this would send them elsewhere in light of previous events regarding withholding of payment.

1143. Mr Rose stated he decided to approve trading on the basis that HMRC had chosen to register Westis and had approved CO2e's releasing of payments on its earlier trades to Westis. Mr Emanuel therefore traded with Westis on 28 July.

1144. HMRC had expedited Westis' VAT registration at CFE's request.

1145. It is material to note that the application for registration that had been made by Westis to HMRC on 15 June 2009 (and received by HMRC on 3 July 2009) had made clear that:

(1) Westis was a broker for buyers and sellers of greenhouse gas emissions.

(2) Westis had started trading allowances on 11 May 2009 and that Westis considered that it should have been registered from that date.
(3) Westis had charged VAT from the point at which it issued its first invoice to CFE (without being registered for VAT) and had received payments including VAT.
(4) That CFE had realised that it should not have paid the output VAT from a number of invoices and was withholding funds for the last two invoices issued due to the fact that Westis was not VAT registered.

1146. Further, the VAT application form revealed to HMRC:

(1) Westis' date of incorporation (08 December 2008);
(2) Westis' address, with an accompanying contract showing a different address for Westis, being Suite 2, 23-24 Great James Street;
(3) Westis' email address (a Gmail address);
(4) That Westis had no website;
(5) That Westis' nominated bank was with Marfin Popular Bank, with an accompanying contract showing a prefix "CY" to the account number, a designation for Cyprus.

1147. Thereafter CFE has sought to rely on the fact of HMRC registering Westis for VAT as somehow being *in lieu* of it carrying out proper due diligence on the company. The mere fact of HMRC registering Westis for VAT was not equivalent to enhanced due diligence and relied on the provision of basic information by the company. CFE's attempt to rely on this as a shield to means of knowledge was unreasonable.

1148. CFE's witnesses argue that, notwithstanding the concerns initially raised on review of the invoices from Westis, a combination of Westis appearing to be legitimate from the use of reputable advisers and HMRC's decision to register it for VAT provided Mr Cooper with the comfort that they had sought and it therefore appeared that Westis were not entering into EUA spot allowance transactions for reasons of VAT fraud. Mr Rose's position was similar. The Tribunal does not accept this.

1149. CFE, through Mr Cooper, had not disclosed the vast majority of the information that it knew about Westis (eg. the invoice corrections and substitutions, links with ADE and Epicure etc), such as that set out in the contact and emails before that date, at the meeting of 25 June 2009. CFE wished to present itself as a "good corporate citizen" whilst not disclosing to HMRC the extent of its knowledge and concerns about its counterparties. This was in line with CFE's general attitude towards what it had discovered, which was to seek to continue to protect its profit margin in carbon credit trading without giving adequate consideration to the risk of loss this caused for the Revenue.

1150. The Appellant suggested in cross-examination of Officer Ball that Westis' previous behaviour was attributable to *"administrative error"*. The Appellant has accepted that Westis was a fraudulent defaulting trader, it is not open to it to now suggest that Westis was not.

1151. By 12:05 on 28 July 2009 Mr Emanuel was seeking clearance to trade with Westis again without presenting the company with the enhanced due diligence documents. Mr Rose approved this.

1152. In his live evidence Mr Rose did not recall whether he approved Mr Emanuel to trade with Westis without going through the new procedures that had been put in place. This is an important gap in his memory. Mr Rose's approval of these trades is stated in his witness

statement at paragraph 135: ‘I decided to approve trading on the basis that HMRC had chosen to register Westis and had approved Cantor COE2e’s releasing of payments on its earlier trades to Westis’.

1153. Mr Rose was cross examined on this topic as follows:

‘Q. An email from James Emanuel to Laurence Rose.

28 July:

"Gentlemen ..."

He outlines that Westis have received the payment made by Cantor, that Westis are willing to trade again.

The middle paragraph:

"On the basis that they were able to provide all the requisite documentation for us to be comfortable to release payment to them of the retained money, are we clear to resume trading with them? If we present them with a questionnaire and further document request package, I fear they will lose their patience and we will never see them again. This is not a decision I am authorised to make."

Did you authorise Mr Emanuel to go ahead without the new procedures that you had put in place?

A. I don't recall whether I gave him those instructions or approved trading with Westis. I recall in and around this time, I believe Mark Cooper was dealing with some of the elements of Westis, and I believe, I am happy to be corrected, that we got information from HMRC that said that Westis was approved, or they gave us the okay to release a payment. There was something I am recalling.

Q. Right. Because of that, you didn't require documentation that Mr Emanuel is alluding to here, the questionnaire and document request?

A. I don't recall whether I required it from him or not. I was certainly seeking it.’

1154. The Tribunal finds that Mr Rose’s failure to remember whether he approved the trades without going through the new procedures is significant. The Tribunal finds that a lapse in memory was motivated by a desire not to admit his omission under cross examination. Mr Rose was aware that his approval of the trade without following the new procedures would not be seen to be reasonable in light of all the information that was before him.

1155. The Tribunal does not accept Mr Rose had a lapse of memory, notwithstanding the events taking place many year ago. The Westis trades were the final impugned transactions and for very large sums of money. His memory was clear and specific that he approved the trades set out in his witness statement. The statement was prepared with ample time and care taken to provide specific details and the contents approved much closer to the events (in February 2015) than when he gave oral evidence (March 2018).

1156. The Tribunal is satisfied Mr Rose allowed the trades with Westis to occur without going through the new procedures that had been in place since at least 7 July 2009. This demonstrates Mr Rose did not have a firm oversight and was often conflicted (torn in two opposing directions) about the extent of oversight and willing to concede when there was pushback from traders. In the end he was not prepared to enforce red lines in respect of these trades at the expense of commercial profitability.

1157. Some of the time Mr Rose was driven by the profit motive above the need to enforce red lines and prevent CFE taking part in fraudulent transactions, at other times he was kept out of the loop by Mr Emanuel and his traders and sometimes he failed to make the necessary detailed enquiries in response to the cumulative material and obvious risk presented. That is not to say that Mr Rose took no action, as is clear from the various steps set out above, it is just that it was too little too late.

The Westis transactions

1158. On 28 and 29 July 2009 CFE purchased a total of 773,000 carbon credits from Westis at a net cost of €10,397,710.00 in four transactions (two on each day). These are the four July 2009 transactions upon which input tax has been denied.

1159. The DG Environment records obtained by HMRC show that 557,000 of the carbon credits that were the subject of the July purchases from Westis were actually transferred to CFE by another entity, Kalestesia (UK) Ltd t/a Kaplan Ltd ("Kaplan") on 29 July 2009. This was obviously uncommercial, since it had the potential for Westis to be disintermediated from any future transactions.

1160. More importantly, it also occurred despite Kaplan being unapproved by CFE to trade with it. Kaplan had just been rejected as a counter party by CFE the day before. At 18:22 on 28 July 2009 Mr Rose e-mailed Mr Emanuel in relation to Kaplan, saying:

"*OK, so it seems we cannot approve them yet as they are waiting on a response from HMRC for a new valid VAT number as the company director has changed. This is likely because this is a new corporate arrangement for the purposes of transacting in EUA spot markets.*
This accounting firm is the same as used by Westis and others.
I think we need to get more info about the accountant and the firm.
James, I would like to discuss this with you on our next call."

1161. CFE's explanation for Mr Emanuel trading with Westis again on 29 July 2009 was that it was only after the trade that it was noticed that some of the carbon credits purchased had come from a different registry account (unknown to CO2e at that time). Mr Emanuel therefore queried this with Westis who then provided a letter confirming the registry account was managed by them. In light of everything that had gone before concerning Westis and in light of not following the 7 July 2009 procedures this explanation is not reasonable.

1162. On the same day, having seen the volume of trades undertaken with Westis that day, Mr Rose claimed he was unable to recall whether he asked Mr Emanuel to request that Westis complete the new processes. He stated he asked Mr Emanuel to clarify what Westis' business was and where they were getting their allowances. Mr Rose stated he was cautious in view of the risks in the market and the fact that CO2e had entered into some large trades with Westis. The Tribunal has not accepted the evidence that Mr Rose had a lapse of memory – he approved the trade on the basis of HMRC's registration without asking further questions. If Mr Rose did not approve the trade, as the Tribunal finds and he originally stated, then Mr Emanuel would have acted alone.

1163. Paragraphs 6.38 - 6.40 of the Pinsent Masons' Report prepared on behalf of the Appellant are illuminating because they appear to accept Mr Rose was aware of a connection between Kaplan and Westis at the time through their common accountant (rather than they being a third party transferring the credits). The paragraphs state:

"6.38 On 28 July, Ben Pink of Kaplan chased up their account opening application. They had provided this two weeks previously. The matter was investigated and Laurence Rose confirmed that they had not been approved by him for KYC checks as they had not provided a valid VAT number. Laurence Rose also noted that Kaplan used the same accounting firm as Westis and wanted more information on the accountant."

"6.39 On 28 July, Franck Stork expressed his disappointment at the delayed payment, but offered to trade again. James Emanuel emailed Laurence Rose to say he thought the relationship with Westis was damaged but could be repaired and asked for permission to trade given the requisite paperwork had been received. Two trades were undertaken with Westis later that day. The buyer on the other side of the trade was Citibank."

"*6.40 On 29 July, Mark Cooper emailed lan Edgson at HMRC noting that Ian's colleague, Andrew Milner had said he did not foresee any problems with releasing the monies to Westis on the basis that they had been registered retrospectively. Compliance emailed James Emanuel saying they could not pay the invoice raised by Westis for the 28 July trades without seeing the "checklist etc." Later that day, James Emanuel asked Westis to provide written confirmation that the registry account used for the 28 July trades was an account managed by Westis. A letter on Westis headed paper was provided, confirming that the registry number DK-121-9395-0 was an account managed by Westis."*

1164. Despite the Westis carbon credits being supplied directly by Kaplan, who had failed CFE's checks, CFE paid out funds to Westis without further investigation.

1165. By 17:26 on 29 July 2009 James Emanuel had noticed that some of the carbon credits for the Westis deals had come from another registry account and asked Westis to confirm that it managed the account. Westis did so. The account was that of Kaplan. As per Officer Stone's unchallenged evidence, Mr Emanuel could (even though there is no evidence he did in fact do so) have identified the owner of the registry account as belonging to Kaplan.

1166. He did not even need to do that.

1167. On 14 July 2009 Kaplan had told CFE that the account DK-121-9395-0 was their registry account. CFE therefore knew that Westis was apparently transferring carbon credits from Kaplan's registry account, the account of a company that it had not approved for trade.

1168. The Daily Check Point for these transactions, circulated on 12 June 2009 included:

"If client is selling units we must print or download from the Registry the status reflecting the credit position in our account and confirm that the Transferor matches the clients standing instructions on the Client Details tab of the blotter."

1169. In relation to the Westis July deals, yet again, CFE had failed to follow its own procedures. By now the risk of MTIC carousel fraud was plain and stated to be so. CFE still did no enhanced monitoring on Westis, conducted no enhanced due diligence checks, failed to obtain any financial information on Westis and failed to comply with its own procedure for ensuring that it was being supplied with carbon credits from the party that it was meant to be purchasing them from. The registry account did not match that which CFE held on its records for Westis.

1170. At 23.10 on 29 July 2009 Laurence Rose e-mailed James Emanuel in relation to the Westis deals, saying:

"*I see they came in with some big volume at the end of the day. Please can you fill in the new client form and questionnaire on them and email to me in your morning, so that I can review in my morning and then we can discuss?*
What is their business? How/where are they getting the allowances?
Please don't tell me it doesn't matter – I want to know, or at least try and find out."

1171. The email is revealing as it highlights the tension between Mr Rose and Mr Emanuel and that Mr Emanuel was at the very least obstructive in either not making enquiries of counterparties or not sharing them with his management. It also illuminates that Mr Rose failed to take sufficient control of Mr Emanuel's trading and allowed him to operate outside CFE's own agreed procedures. He also only sought the client form and questionnaire *after* the deal was completed.

1172. The Tribunal has not been made aware of a response to this e-mail. Mr Rose's enquiries were, consistent with his other enquiries, made long after the event and the transaction being completed.

1173. Mr Rose's apparent exasperation with Mr Emanuel illustrates the contradiction in CFE's approach to its carbon credits business. On the one hand it had vast resources in terms of compliance, risk and legal expertise which could have been deployed proactively to recognise the trade in EUAs for what it was, i.e. infected with fraud, but on the other hand after 15 June 2009 it allowed the traders to carry on business as usual, trading with counterparties whom it obviously should not have done.

Westis Ltd – VRN – 973 3510 17

1174. CFE's due diligence documentation in relation to Westis was inadequate and disproportionate to the risk which it presented.

1175. CFE did little more than confirm the existence of Westis and carry out the standard AML checks without any enhanced due diligence as was obviously required by the history of their dealing by 15 June 2009 at the latest and in any event, well before 28 July 2009.

1176. The AML documents that CFE completed showed that Westis had been incorporated on 1 December 2008, had declared no nature of its business to Companies House and had not filed any accounts. The documents further showed that Mr Storck, resident in France, bought the entire share capital of Westis (£1) on 1 December 08 and sold it on 6 May 2009 to Epicure. The documents further showed that prior to 1 December 2008 Westis had never traded.

1177. CFE's disclosed e-mail correspondence and records of calls with Westis reveal few discussions in the e-mails about the carbon credits market or Westis's background.

1178. Westis Ltd ("Westis") was a direct supplier to CFE and fraudulent defaulter. Westis was incorporated on 1 December 2008, provided an address of 105 St Peters St., St. Albans, AL1 3EJ (the same address as Duntai), has never filed accounts with Companies House and is now in liquidation.

1179. Mr Franck Stork was appointed a director of Westis on 1 December 2008, giving an address in Nanterre, France. Westis had no apparent financial worth. Nantia Efstathiou (also company secretary of Stratex and Aristo) was appointed company secretary of Westis on 18 May 2009.

1180. Mr Stork applied for Westis to be registered for VAT with effect from May 2009 giving the company's main business activity as "*brokers of EU emissions allowances*", an address of 4th Floor, Southpoint House, 321 Chase Road, Southgate, London, N14 6JJ, a bank account with Marfin and Mr Stork's address in Nanterre, France. The application was submitted by AG Kakouris ("AGK") under cover of a letter dated 15 June 2009 and in support of it was provided a contract with Duntai, which was at that time said to be the sole supplier of carbon credits to Westis. The contract was signed for Duntai by Mr Volodarsky on 12 May 2009, describing himself as a director when he had in fact ceased to be a director on 19 March 2009.

1181. AGK's letter stated that Westis should have been registered for VAT from 11 May 2009 but that it had *"inadvertently charged VAT from the first invoice issued to Cantor Fitzgerald EU and has received payments including VAT. Cantor Fitzgerald EU have now realised that they should not have paid the output VAT from invoice 20090501 to 20090524 (as per spreadsheet)…Cantor Fitzgerald EU will only release the withheld funds if a VAT number is allocated which makes renders our client unable to operate.*"

1182. HMRC Officers visited Westis at South Point House on 10 September 2009. The receptionist at the building did not recognise the name Westis. An unknown female said that there was no one from Westis in the building. The building was also said to be home to Epicure Business Systems. The Officers spoke to AGK who said that they had had no contact with Westis since mid-August.

1183. The report noted of the documents provided by AGK:

"n.b. The "Westis" invoice used by A G Kakouris in order to get the VAT registration is almost identical to the invoices from Epicure Business Solutions. Also the schedule of transactions – Duntai to Westis to Cantor Fitzgerald that appears at sheet 17 of the VAT 1 pack shows 24 sales amounting to 12,820,000 tonnes of CO2 between 11th May and 2nd June 2009. None of the unit prices shown for the Westis sales agree with the figures that appear on the sales invoices, all of the sales invoice prices being 5p/tonne more than on this schedule. This schedule also shows the purchases from Duntai. The unit price for these sales are all 5p less than the Westis sale price to Cantor regardless of the size of the package of CO2 allowances being sold. This is indicative of fraud as in any free market there would not be this uniformity or conformity of mark-up."

1184. Between 11 May and 29 July 2009 Westis made 30 sales of carbon credits to CFE totalling 1,564,000 units with a gross purchase value of €37 million. The details of the Westis transactions are set out in Officer Ball's witness statement.

1185. The input tax incurred on the four CFE purchases from Westis that took place on 28 and 29 July 2009 remains denied. Despite Officer Ball meeting with CFE in August 2009 the July transactions were not brought to his attention. Officer Ball only discovered them in 2011. That in itself is significant and is dealt with as part of the Fifth Issue.

1186. The DG Environment records show that the carbon credits that were the subject of the July purchases from Westis were actually transferred to CFE by a company called Kaplan Ltd.

Westis's schedule of transactions that it undertook between 11 May and 2 June 2009 produced in support of its application to be registered for VAT showed that all of its purchases were from Duntai. DG Environment data shows that companies other than Duntai transferred the majority of these carbon credits to Westis.

1187. On 14 October 2009 a Notice of Assessment was issued to Westis in the sum of £3,017,070 for unpaid VAT on 26 sales from Westis to CFE between 11 May 2009 and 3 June 2009 (the 06/09 period). This was subsequently reduced to £527,004.

1188. Four additional transactions were identified subsequently with a total value of £1,322,800 in the 09/09 VAT period. These were not assessed against Westis as HMRC were out of time to do so. Nonetheless, the VAT went unpaid and therefore there is a tax loss. These are the remaining denied transactions. Despite the sales purportedly being by Westis the carbon credits were provided to CFE directly by Kaplan who had not passed CFE's KYC checks.

1189. Westis' invoices to CFE requested that payments to it be made to its account at Marfin. Some of Westis' early invoices carried the same spelling error as those from Aristo in relation to CFE's address ("Canary Whars"). Westis subsequently applied for VAT registration and the invoices were reissued. CFE then paid Westis the VAT that it had withheld.

1190. Westis made third party payments to companies including Solimaxco, Primark and Lovania (Cyprus).

1191. Westis had neither experience in nor repute for dealing in carbon credits, its ability to sell such volumes of them to CFE was commercially incredible and its lack of financial worth made it a poor candidate to enter into such transactions.

1192. CFE's due diligence documentation in relation to Westis reveals that CFE did little more than confirm the existence of Westis and carry out standard AML checks with no enhanced due diligence. Such due diligence would have been required by 15 June 2009 at the latest in proportionate response to the categorisation of the trading as high risk trading and the specific negative indicators that its contact with CFE had produced.

1193. CFE did not question how Westis could supply such large volumes of carbon credits, at a price that CFE could not beat despite its experience in the market, when it had no net worth to speak of and had recently been formed. CFE did not verify Westis' VRN until 4 June 2009 when CFE was informed that the name and address provided did not match that held by HMRC. CFE tried to verify Westis' VRN again without success on the morning of 11 June 2009 and finally successfully verified it that evening.

1194. Enhanced due diligence would have revealed further negative indicators regarding Westis which would have added to the means of knowledge of their transactions being connected to fraud.

1195. CFE had done nothing to enquire as to how Westis could have legitimately acquired the credits sold by it. In the context of CFE's state of knowledge as at the end of July 2009, this failure by CFE is inexplicable other than by reference to means of knowledge that the transactions were connected with fraud.

1196. The Tribunal is satisfied CFE should have known that these four transactions on 28 and 29 July 2009 with Westis were connected with the fraudulent evasion of VAT and that this was the only reasonable explanation for them.

Other events on 29 July 2009

1197. On 29 July 2009 Mr Emanuel e-mailed Mr Anzalone complaining that he had changed his mind about releasing money to Westis which had lost CFE more than $70,000 in brokerage fees and saying:

"Laurence and I have a call with Howard next week in which Howard wants to know about the future of this business…I have no clue what to tell him. To be honest the business is in a mess."

1198. On 29 July 2009 Mr Rose sent Mr Emanuel some draft EU Desk VAT trading rules for comment. Further on 29 July 2009 Mr Buchan contacted Mr Rose regarding the credit review of proposed new counterparties.

1199. On 29 July 2009 Mr Rose agreed some thoughts on the events in the carbon credit market with Mr Emanuel for publication in an article for Carbon Finance.

30 July 2009

1200. On 30 July 2009 the UK decided to zero rate carbon credit trades.

1201. Mr Buchan reported to Mr Emanuel on the results of the Risk team's full review of pending CO2e new client approvals. Two clients which were approved were Pan Energy and KO Brokers.

1202. HMRC have asserted that KO Brokers was a perpetrator of VAT fraud. Mr Buchan states, in paragraph 27 of his witness statement, that KO Brokers was approved even applying a higher standard of review. The Appellant argues this indicates that even if the enhanced credit and financial checks had been carried out on the relevant counterparties at an earlier stage, they would not have been identified as suspicious. In light of all the negative indicators raised in relation to the relevant counterparties as set out above, the Tribunal does not accept this.

31 July 2009

1203. Officer Edgson replied to Mr Cooper's email on 31 July 2009, stating that he was *"pleased that the Westis situation was resolved in time"*.

The extended verification, CFE's counterparties and the connection with the fraudulent evasion of VAT

1204. The Appellant's 03/09, 06/09 & 09/09 period VAT returns were ultimately subjected to extended verification.

1205. On 26 August 2009 HMRC Officers met with representatives of the Appellant including Messrs Treanor, Cooper and Rose. The Officers were told that in the current year the business had switched from being mainly on a name give up basis as opposed to a matched principal

basis (70% / 30% to 30% / 70%), the business was now mainly spot trading and this had dropped off since the UK zero-rated carbon credits.

1206. The Officers were told that CFE came into contact with the counterparties for carbon credit trading from: expos (e.g. Barcelona), general contacts at banks, cold calling, broker companies and using the internet.

1207. The Officers asked for details of how CFE came into contact with those on a list of customers that was provided at the meeting. The Officers were told that Know Your Customer ("KYC") checks were undertaken for all customers but that financial checks on them were not carried out. The Officers asked whether serial numbers for carbon credits were recorded and were told that they were recorded at the registry and could also be obtained from the Community Independent Transaction Log ("CITL") which logged the transactions.

1208. On 27 November 2009 HMRC Officers again met with representatives of CFE including Messrs Treanor, Cooper and Rose. The Officers explained that to date around £20 million of the Appellant's claimed input tax had been traced to tax losses and that HMRC expected to trace a further £20 million again to losses. HMRC requested the following records and information:

i. Structure of and information on emissions trading;

ii. Names of traders and how many there were;

iii. Risk and Marketing analysis;

iv. Levels of authorisation for the trading desk;

v. Daily Value at Risk;

vi. Transaction monitoring process under FSA and money laundering requirements;

vii. KYC documents in relation to emissions counterparties;

viii. Business relationships and third party agreements;

ix. Third party reports – SARS (suspicious activity reports);

x. Any reports to the FSA;

xi. Any concerns that may have been raised with head offices;

xii. Deal documents including certificate numbers, invoices, settlement details; and

xiii. Incentivisation for the traders.

1209. The representatives of CFE were informed that after HMRC had received and reviewed the requested records and information that further questions may need to be asked.

1210. The result of the verification of the Appellant's 03/09 period VAT return was that of the £1,686,809.39 input tax claimed on the 03/09 return £690,294.29 incurred on 13 purchases from Adduco Consulting Ltd was traced to fraudulent tax losses.

1211. The result of the verification of the Appellant’s 06/09 period VAT return was that of the £44,749,475.65 input tax claimed on the 06/09 return, £41,054,429.58 (92%) was traced to fraudulent tax losses through the suppliers as set out in **Table 1** below:

Table 1: Tax losses traced in to the Appellant 06/09 VAT Reclaim and Amounts Now Denied (Input tax on the deals highlighted in bold remains denied.)

Supplier Name	VAT Amount	Number of deals	Denied VAT Amount	Denied Deals and Dates
1.Adduco Consulting Limited	£4,687,455.38	50		
2.ADE International Limited	£3,140,341.76	20		
3.AH Marketing And Distribution Limited	£1,480,143.38	17	**£675,488.54**	**7 deals between 08 – 18.06.09**
4.Business Management Consulting Limited	£14,655,252.65	65		
5.Carbon Desk Limited	£15,291.61	1		
6.Duntai Limited	£3,727,139.59	25		
7.G W Deals Limited	£1,381,598.24	17	**£42,477.82**	**1 deal on 08.06.09**
8.Mettec (trading name of Ayres Limited)	£139,232.46	3	**£84,926.28**	**1 deal on 10.06.09**
9.Northumberland Consultants Limited	£3,007,575.23	7		
10.Stratex Alliance Limited* (*not registered for VAT*)	**£5,605,119.77**	**17**	**£5,605,119.77**	**17 deals (between 18.05.09 - 03.06.09)**
11.SVS Securities PLC	£242,533.91	1		
12.Westis * Limited N.B.	£2,972,745.60	27		

Total £41,054,429.58

*N.B. TB's 09/09 VAT return was also verified. Of £2,287,029.59 input tax claimed on the 09/09 return, **£1,322,800.16 incurred on 4 purchases from Westis Ltd on 28 and 29 July 2009 was traced to fraudulent tax losses**.

1212. In VAT period 06/09 CFE also purchased carbon credits from the following two UK companies who were not registered for VAT but charged it on their invoices. CFE did not pay the VAT and therefore did not reclaim input tax:

Supplier Name	VAT Amount	Number of deals
13.Aristo Partners Limited	€910,200.78	6
14.Axle Limited	€449,643.78	7
Total in Euros	€1,359,844.56	

1213. The Appellant's reclaimed input tax that traced to fraudulent tax losses in periods 03/09 – 09/09 inclusive totalled £43,067,524.03.

1214. HMRC's denial of CFE's right to deduct input VAT on the basis of the principle in *Kittel* is now limited to those that took place from 8 June 2009 (apart from Stratex). Nonetheless, the Tribunal is satisfied that CFE's history of tax losses prior to 8 June 2009 (the date from which HMRC assert that CFE knew, or should have known that the denied transactions were connected with the fraudulent evasion of VAT) remain relevant to: (i) whether there was an overall scheme to defraud the Revenue in existence, and (ii) CFE's cumulative means of knowledge as to the transactions that remain denied.

1215. The Tribunal only set out the evidence above in relation to CFE's five counterparties for which HMRC has denied input tax (counterparties in deals prior to 8 June 2009 – Stratex; counterparties in deals after 8 June 2009 - GWD, Mettec/Ayres, AHMD and Westis) and CFE's due diligence in relation to each direct counterparty. In relation to the remaining nine counterparties, HMRC served evidence of their involvement in VAT fraud which was accepted by the Appellant.

The Suppliers to CFE in respect of which HMRC has denied input tax

1216. HMRC provided evidence in relation to the fourteen suppliers to CFE in the period 06/09 establishing that their supplies were connected to the fraudulent evasion of VAT. This was not in dispute.

1217. From the twelve suppliers set out in Table 1 above, there are five suppliers (highlighted in bold) in respect of whom HMRC denied input tax and hence form the subject matter of this appeal, namely Stratex, GW Deals, Mettec/Ayres, AHMD and Westis.

1218. HMRC denied CFE input tax in respect of 17 deals in period 06/06 taking place between 18 May and 3 June 2009 with the supplier Stratex Alliance Limited on the basis that it knew or should have known of the connection to fraudulent tax loss.

1219. HMRC denied CFE input tax on the same basis in respect of transactions between 8-18 June 2009 with three suppliers:

AH Marketing and Distribution Limited;

Mettec (trading name of Ayres Limited); and

GW Deals.

1220. HMRC also continues to deny CFE input tax in respect of the supplier Westis Limited on the same basis in the period 09/09 for four supplies on 28 and 29 July 2009.

1221. As above, the Tribunal has only recorded the evidence in relation to these five suppliers to CFE.

CFE's transactions with other UK traders who were not registered for VAT

1222. CFE also purchased carbon credits from two UK companies that were never registered for VAT but charged it on their invoices: Aristo Partners Ltd and Axle Ltd. CFE did not pay the VAT charged.

The Law on the Third Issue

The right to deduct and Kittel

1223. Articles 167 and 168 of the Principle VAT Directive and Sections 24 to 26 of the Value Added Tax Act 1994 ("VATA"), as set out above, provide for the right to deduct input VAT. If a taxable person has incurred input tax that is properly allowable, they are entitled to set it against their output tax liability and, if the input tax credit due to them exceeds the output tax liability, receive a payment.

1224. However, the European Court of Justice ("the ECJ"), in its judgment dated 6 July 2006 in the joined cases of *Axel Kittel v Belgium & Belgium v Recolta Recycling SPRL* (C-439/04 & 440/04) ("*Kittel*") has confirmed that taxable persons who "knew or should have known" that the purchases in which input tax was incurred were connected with fraudulent evasion of VAT will not be entitled to deduct that input.

1225. At [56] of *Kittel*, the ECJ stated: *" ...a taxable person who knew or should have known that, by his purchase, he was taking part in a transaction connected with fraudulent evasion of VAT must, for the purposes of the Sixth Directive, be regarded as a participant in that fraud, irrespective of whether or not he profited by the resale of the goods."*

1226. Conversely, the ECJ had stated at [51]:

" …traders who take every precaution which could reasonably be required of them to ensure that their transactions are not connected with fraud…must be able to rely on the legality of these transactions".

1227. The rationale for the above approach was set out by the ECJ at [57-58]:

"That is because in such a situation the taxable person aids the perpetrators of the fraud and becomes their accomplice." [57]; and "In addition, such an interpretation, by making it more difficult to carry out fraudulent transactions, is apt to prevent them." [58]

1228. At [59], the ECJ therefore concluded:

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

1229. At [61], the ECJ reiterated:

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

1230. In *Mobilx Limited (in Liquidation) v HMRC* [2010] EWCA Civ 517, the Court of Appeal considered *Kittel*. At [52], Moses, LJ. stated:

"If a taxpayer has the means at his disposal of knowing that by his purchase he is participating in a transaction connected with fraudulent evasion of VAT he loses his right to deduct, not as a penalty for negligence, but because the objective criteria for the scope of that right are not met. It profits nothing to contend that, in domestic law, complicity in fraud denotes a more culpable state of mind then carelessness, in the light of the principle in Kittel. A trader who fails to deploy means of knowledge available to him does not satisfy the objective criteria which must be met before his right to deduct arises."

1231. At [59], Moses, LJ. went on to state in relation to the "should have known" aspect of the test:

"The test in Kittel is simple and should not be over-refined, it embraces not only those who know of the connection but those who "should have known". Thus it includes those who should have known from the circumstances, which surround their transactions that they were connected to fraudulent evasion. If a trader should have known that the only reasonable explanation for the transaction in which he was involved was that it was connected with fraudulent evasion of VAT then he should have known of that fact..."
[emphasis added]

1232. At [64] of *Mobilx*, Moses, LJ. then said:

"If it is established that a trader should have known that by his purchase there was no reasonable explanation for the circumstances in which the transaction was undertaken other than that it was connected with fraud then such a trader was directly and knowingly involved in fraudulent evasion of VAT."

1233. Before, at [82], warning:

"..Tribunals should not unduly focus on the question whether a trader has acted with due diligence. Even if a trader has asked appropriate questions, he is not entitled to ignore the circumstances in which his transactions take place if the only reasonable explanation for them is that his transactions have been or will be connected with fraudulent evasion of VAT..."

1234. Moses, LJ. also gave guidance as to the sort of circumstances that might be relevant to the "should have known" question:

i. In [79], Moses, LJ. drew attention to the significance of the fact that Mobilx, aware that the CPU business in which it was engaged was "rife with fraud", nevertheless chose to ignore HMRC's warnings that its own transactions had, upon extended verification, been shown to trace back to fraud.

ii. In [83], Moses, LJ. adopted the passage from paragraph 110 of *Red 12 Trading v HMRC* [2009] EWHC 2563 in which Christopher Clarke J highlighted the following indicators of fraud:

(a) *"compelling similarities between one transaction and another."*
(b) *"pattern[s] of transactions."*
(c) *"transactions all of which have identical percentage mark ups ..."*
(d) *"... made by a trader who has practically no capital ..."*
(e) *"... as part of a huge and unexplained turnover ..."*
(f) *"... with no left over stock."*
(g) *"A tribunal could legitimately think it unlikely that the fact that all 46 transactions in issue can be traced to tax losses by HMRC is a result of innocent coincidence."*

1235. In [84] the Court of Appeal commented as significant the fact that:

"... a trader has chosen to ignore the obvious explanation as to why he was presented with the opportunity to reap a large and predictable reward over a short space of time."

Knowledge or means of knowledge

1236. As noted, the burden of proving knowledge or means of knowledge rests upon HMRC: *Mobilx Ltd (in admin) v HMRC* [2010] STC 1436, at [81].

1237. In terms of what HMRC must prove:

(1) The threshold they must cross is high - *Davis & Dann Ltd and another v HMRC* [2016] STC 1236, at [4].

(2) They must demonstrate either:

(a) that the taxpayer actually knew that he was participating in a transaction connected with fraudulent evasion of VAT; or

(b) that the taxpayer had the means at his disposal of knowing that he was participating in such a transaction: see *Mobilx*, at [52]. It is now accepted that this requires HMRC to show that the taxpayer ought to have known that *the only reasonable explanation* for the transactions was that they were connected to a VAT fraud: see *Mobilx*, at [59] and [75]; and *Davis & Dann Ltd*, at [4].

(3) It is thus not sufficient for HMRC to show that the taxpayer knew or should have known that he was *running the risk* that by his purchase he might be taking part in a transaction connected with fraudulent evasion of VAT: *Mobilx*, at [56].

(4) Nor is it sufficient for HMRC to show that a taxpayer knew or should have known that such transactions *might* be connected with fraudulent evasion, or even that it was *more likely than not* (i.e. probable) that his transaction was so connected: see *Mobilx*, at [56] and [60].

(5) It follows from the nature of what HMRC must prove that the focus is on only what the taxpayer actually knew at the time of the relevant transaction and/or the means of knowledge he had at his disposal at that time. Whilst that can include obvious inferences from the facts and circumstances in which he has been trading (*Mobilx*, at [61]), it cannot, by definition, include information not known to him if he had no means at his disposal

of knowing during the relevant period or matters known only with the benefit of hindsight: see *Aria Technology Ltd v HMRC* [2016] UKFTT 98 (TC), at [13].

(6) Nor is it sufficient for HMRC to show that *a* reasonable explanation for the relevant transaction was that it was connected with fraudulent evasion of VAT. It must be the *only* reasonable explanation.

Attribution of Knowledge to a corporate appellant

1238. HMRC's case is that from all the evidence in the case the Tribunal both can, and should, conclude that at least one of CFE's directors or employees who undertook or authorised the transactions for CFE, had the relevant state of knowledge to engage the principle in *Kittel*. The Tribunal is satisfied that HMRC are not required to identify that individual, merely to prove that there was one. That individual's knowledge is then to be imputed to the corporate body CFE using the ordinary principles of attribution.

1239. The judgment of Hoffman, LJ. (as he then was) in the Privy Council decision in *Meridian Global Funds Management Asia Ltd v Securities Commission* [1995] 2 A.C. 500 remains the guiding decision in relation to attribution. The principles of attribution are summarised thus by Hoffman, LJ. at pages 506-7.

1240. A company as a legal person requires natural persons to act for it as its agents and servants. The rules of attribution are those by which acts of the company's agents and servants are attributed to the company. The company's primary rules of attribution are generally to be found in its constitution supplemented by those inferred by the operation of company law. The primary rules of attribution are insufficient for a company to go out into the world and do business and the company therefore builds upon those primary rules by using general rules of attribution, the principles of agency. By a combination of the general principles of agency and the company's primary rules of attribution the acts of a company's servants and agents will count as an act of the company.

1241. The combination of the primary rules of attribution and those of agency are normally sufficient to determine the rights and obligations of the company but exceptionally they are not e.g. when reliance on primary rules of attribution would defeat the intention of legislation. Hoffman, LJ. then went on to set out how a court should proceed in determining how such substantive rules are to be applied to a company in such a situation (at p.507D-G):

"In such a case the court must fashion a special rule of attribution for the particular substantive rule. This is always a matter of interpretation: given that it was intended to apply to a company, how was it intended to apply? Whose act (or knowledge, or state of mind) was for this purpose, intended to count as the act etc. of the company? One finds the answer to this question by applying the usual canons of interpretation, taking into account the language of the rule (if it is a statute) and its content and policy."

1242. Hoffman. LJ, having considered examples of the fashioning of special rules of attribution based on particular substantive rules did so for the facts of *Meridian*. In *Meridian*, Messrs Koo and Ng, employees of Meridian, had authority to enter into transactions in relation to the acquisition of securities but used their authority improperly with the ultimate net result that they caused Meridian a loss (pp.503-4). The acquisitions were not disclosed by notice as required by the New Zealand Securities Amendment Act 1988 ("NZSAA") and proceedings for breach of the Act were begun.

1243. Hoffman, LJ. analysed the reasoning behind why the NZSAA demanded the attribution to the company of the knowledge of the person who had the authority to carry out the transaction (at p.511D-F):

"In the case of a corporate security holder, what rule should be implied as to the person whose knowledge for this purpose is to count as the knowledge of the company? Surely the person who, with the authority of the company, acquired the relevant interest. Otherwise the policy of the Act would be defeated. Companies would be able to allow employees to acquire interests on their behalf which made them substantial security holders but would not have to report them until the board or someone else in senior management got to know about it. This would put a premium on the board paying as little attention as possible to what investment managers were doing. Their Lordships would therefore hold that upon the true construction of section 20(4)(e), the company knows that it has become a substantial security holder when it is known to that person who had authority to do the deal. It is then obliged to give notice under section 20(3). The fact that Koo did the deal for a corrupt purpose and did not give such notice because he did not want his employers to find out cannot in their Lordships' view affect the attribution of knowledge and the consequent duty to notify."

1244. In a VAT context, *Meridian* was followed by Dyson, J. (as he then was) in his judgment in the High Court in *McNicholas Construction Co Ltd v Commissioners of HMCE* [2000] STC 553 ("*McNicholas*").

1245. In *McNicholas* the Commissioners had alleged that the company had, through its employees, perpetrated an input tax fraud involving sub-contractors failing to make invoiced supplies. It was common ground that the knowledge of the employee site managers who had been dishonest could not be attributed to the company by virtue of the primary rules of attribution, the general rules of agency of the ordinary principles of vicarious liability. In applying Meridian at [44-49] Dyson, J. considered that the knowledge of the site managers ought to be attributed to the company because failure to do so would frustrate and seriously undermine the policy of the relevant provisions which was to discourage the dishonest evasion of VAT, concluding:

"48. In my view, the Tribunal were correct in attributing the acts and knowledge of the site agents to MC. I start with section 60(1) and 77(4) simply because the Tribunal's reasoning in paragraph 24 is directed to those provisions. The policy of those provisions is to discourage the dishonest evasion of VAT, and to give the Commissioners an extended period in which to make assessments where VAT has been lost as a result of the dishonest evasion of VAT. That policy would be frustrated if the acts and knowledge of all those employees who have a part to play in the making and receiving of supplies were not to be attributed to the company for the purposes of section 60(1) and 77(4). If the only persons whose acts and knowledge may be attributed to a company are those who are responsible for running the affairs of the company as a whole, and those involved in its VAT activities, then the policy to which I have referred would be seriously undermined. As Mr Parker points out, it would encourage those prepared to engage in fraud or turn a blind eye to fraud to set up separate VAT accounts departments for that purpose. Moreover, it would discriminate against small companies that do not have separate accounts departments insulated from what happens on site or in contracts departments.

49. I would hold, therefore, that the acts and knowledge of all those employees of a company who have a part to play in the making and receiving of supplies, as well as those involved in its VAT arrangements, are to be attributed to the employing company for the purposes of section 60(1) and 77(4)."

1246. When *Meridian* is applied to *Kittel,* the rule in *Kittel* demands attribution to the company of the knowledge of the person who, with the authority of the company, entered into the

transaction connected with the fraudulent evasion of VAT, authorised it, supervised it, instigated or encouraged it.

1247. Absent such attribution, a key objective of the Principal VAT Directive and the will of the European Court of Justice to prevent tax evasion would be frustrated. Companies bent upon the commission of MTIC fraud would be able to use employees authorised to carry out transactions entering transactions connected with the fraudulent evasion of VAT in full knowledge of what they were doing but at the same time rely upon an absence of attribution of knowledge to enable them to recover their input tax.

1248. Company officers would simply be able to turn a blind eye to the activities of their employees and attempt to insulate the company from wilful acts of engaging in transactions connected with fraud by the very employees or agents that they had authorised to carry out the transactions. An absence of attribution to the company of the knowledge of such persons would destroy the very purpose of *Kittel* and therefore *Kittel* demands that such a rule of attribution be applied and enforced.

1249. *Meridian* and *McNicholas* were cited in the Court of Appeal's judgment in *Bank of India v Morris & Ors* [2005] EWCA Civ 693 where an employee of the bank had knowingly entered into fraudulent transactions. The Court of Appeal found that a combination of: the employee's level of responsibility, the policy of the substantive rule, justice and common sense combined to justify the treatment of the employee's knowledge as the knowledge of the company (at [126]).

1250. The Court of Appeal considered that failure to attribute the knowledge of the employee to the company would risk emasculating the relevant substantive rule. The Court then noted that it would be wrong to attribute to a company the knowledge of any agent without reference to the facts and then laid down factors to be considered in relation to the relevant rule which will be of assistance in this case in deciding whether to attribute knowledge held by employees to the Appellant company:

i. the seniority of the agent;
ii. the significance of the agent and his freedom to act in the context of the transactions;
iii. the degree to which the board of the company was put on enquiry; and
iv. whether questions were not raised or answers were too easily accepted by the board.

1251. The Court concluded at [131]:

"When one considers these factors in the present case, we are of the clear opinion, for the reasons we have given, that this is plainly an appropriate case for attribution. Mr Samant had a very senior position in BoI, he brought the transactions to BoI, he was given a free hand to negotiate them, they were plainly suspicious, there was no questioning, save in relation to the first transaction, and Mr Samant's unconvincing answer was too readily accepted by the board. Further the fact that it was not a "one-off" transaction but a series serves to underline the point."

1252. That the knowledge of *those other than* the director(s) of a company can be attributed to the company in the context of *Kittel* cases is plain from the judgment of Lewison, J. (as he then was) in *The Commissioners for HMRC v Livewire Telecom Ltd* [2009] EWHC 15 (Ch) at [123]:

"The taxable person was Olympia (the company). The question therefore for the Tribunal was not what a director of Olympia knew or ought to have known, but what the company itself

knew or ought to have known. The knowledge of a director of the company may, to be sure, be attributed to a company, but there may be other knowledge (for example that of a senior employee) which, on the facts ought also to be attributed to the company: Meridian Global Funds Management Asia Ltd v Securities Commission [1985] AC 500."

1253. Warren, J. addressed the issue of attribution in the context of the principle in *Kittel* in *The Commissioners for Her Majesty's Revenue & Customs v Greener Solutions Ltd* [2012] UKUT 18 (TCC). From [23] Warren. J, cited the relevant parts of *Meridian* etc. At [47] Warren, J. made plain that even if an employee (compared with say, a director) had the relevant state of knowledge for the *Kittel* principle to apply, that state of knowledge would be attributed to the corporate taxpayer for the purpose of the Kittel principle:

"I agree also with Mr Foulkes' observations about the context of the substantive rule which gives rise to the issue: it is the objective of combating fraud within the context of the VAT legislation. A parallel objective was to be found in Bank of India which led the Court of Appeal, in agreement with Patten J at first instance, to conclude that the application of section 213 required a special rule of attribution in order to make the policy effective. The purpose, or at least a major purpose, of the Kittel principle is to combat fraud. The Tribunal's decision would make a serious in-road into that principle: in cases where there were innocent shareholders or directors who had been deceived by a fraudulent employee or director, the company might be able to escape liability notwithstanding that it was able to profit considerably from the transactions conducted on its behalf."

1254. In *Jetivia SA & Anor v Bilta (UK) Ltd & Ors [2015] UKSC 23* the Supreme Court at [41] at p.249 AB suggested that, "the key to any question of attribution is ultimately always to be found in considerations of context and purpose." Importantly at paragraph 39 of the judgment in *Bilta* it was said:

"Rules of attribution are as relevant to individuals as to companies. An individual may himself or herself do the relevant act or possess the relevant state of mind. Equally there are many contexts in which an individual will be attributed with the actions or state of mind of another, whether an agent or in some circumstances an independent contractor. But in relation to companies there is the particular problem that a company is an artificial construct and can only act through natural persons."

1255. A similar stance was adopted in *Moulin Global Eyecare Trading Ltd (in liquidation) v Commissioner of Inland Revenue* [2014] HKCFA 22, (2014) 17 HKCFAR 218 at [41] page 211AB where it was stated that, "*[o]ne of the fundamental points to be taken from Meridian is the importance of context (including, as in this case, statutory context) in any problem of attribution.*"

1256. In *Meridian* the Court of Appeal did not limit how the rules of attribution might apply to a company alone. At page 506F (page 7AB) the Privy Council (Lord Hoffman delivering the judgment on behalf of the Court) found that:

"These primary rules of attribution are obviously not enough to enable a company to go out into the world and do business. Not every act on behalf of the company could be expected to be the subject of a resolution of the board or a unanimous decision of the shareholders. The company therefore builds upon the primary rules of attribution by using general rules of attribution which are equally available to natural persons, namely, the principles of agency. It will appoint servants and agents whose acts, by a combination of the general principles of agency and the company's primary rules of attribution, count as the acts of the company…." (Emphasis added)

1257. In *Bilta* [191] p.297AB it was stated (in the context of attributing the state of mind of an individual to a company) that the relevance of the context in which the question was asked was not limited to Lord Hoffman's third category. Bowstead and Reynolds on Agency is quoted; "*Before imputation occurs there needs to be some purpose for deeming the principal to know what the agent knows*."

1258. Following the decision in *Bilta*, the Upper Tribunal determined the case of *Mobile Sourcing Ltd -v- Revenue and Customs Commissioners* [2016] UKUT 274 (TCC). Principally, the Upper Tribunal considered whether *Bilta* had materially changed the law since it decided *Greener Solutions Limited -v- Revenue and Customs Commissioners* [2012] STC 1056 (a case specifically about attribution of knowledge in MTIC cases). Mr Justice Morgan and Judge Sinfield (President of the FTT) considered the earlier authorities before turning to *Greener Solutions* where they stated as follows:

"30. In Greener Solutions, the FtT held that the principle it should apply was as follows:

The principle we derive from these authorities is that the Hampshire Land principle is of general application and applies to prevent the knowledge of the agent in breach of his duty to the company being attributed to a company where the company is a victim of his fraud. In determining whether there is a fraud against the company "one should consider the effect of the acts themselves, and not what the position would be if those acts eventually prove to be ineffective." And "In judging whether the fraud was in fact harmful to the interests of [the company], one should not be too ready to find such harm."

Extent of knowledge, identification of individuals with knowledge and cumulative knowledge

1259. HMRC do not have to prove that CFE knew or should have known either the details of the fraud or the identities of the fraudulent defaulters (*Megtian Ltd (In Administration) v The Commissioners for Her Majesty's Revenue & Customs* [2010] EWHC 18 (Ch) at [37-38] *per* Briggs, J. (as he then was).

1260. HMRC neither allege nor have to prove that those at CFE who undertook or supervised the transactions were dishonest - see *The Commissioners for Her Majesty's Revenue and Customs v Citibank NA, E Buyer UK Limited* [2017] EWCA 1416 (Civ) at [90] *per* The Chancellor.

1261. HMRC do not have to identify or select individuals and accuse them of having the requisite state of knowledge, rather than running a case that by inference that there must have been such a person and that person's knowledge should be attributed to the relevant Appellant, would be. HMRC do not, in the context of a large organisation, have to identify a specific individual by name to make good their case.

1262. It is sufficient for the Tribunal to conclude that:

i. There must have been at least one such person;
ii. That person(s) must have been an employee of the Appellant; and
iii. That person(s) must have had sufficient responsibility within the Appellant such that it is proper to impute their knowledge to the body corporate.

1263. In *McNicholas*, Dyson, J. found no requirement to identify by name "*all those employees of a company who have a part to play in the making and receiving of supplies, as well as those*

involved in its VAT arrangements" for the knowledge of those individuals to be attributed to an Appellant itself accused of the fraudulent evasion of VAT.

1264. In the First-tier Tribunal decision of *Citibank NA v Revenue & Customs* [2014] UKFTT 1063 (TC) (*"Citibank"*) Judge Mosedale developed this point at [85] saying:

"85. But I do not think identification would be required: otherwise a corporate entity could avoid allegations of actual knowledge by simply refusing to cooperate with HMRC's enquiry or call any witnesses, making it impossible to identify which particular person had actual knowledge. If the circumstantial evidence was sufficient to justify it, I think a Tribunal could draw the inference that at least one person, albeit unidentified, acting on behalf of the bank had actual knowledge."

1265. In *Citibank* Judge Mosedale also agreed with HMRC's submissions on cumulative knowledge of matters relevant to the "should have known" limb of *Kittel*, saying at [87]:

"87. I agree with HMRC that to prove merely constructive knowledge they would only have to prove that various persons individually had separate elements of knowledge, which, when collectively attributed to Citibank, would mean that Citibank as an entity had constructive knowledge of the connection to fraud."

Approach to an allegation of an overall scheme to defraud the revenue

1266. HMRC allege that the denied transactions were part of an orchestrated scheme to the Revenue and that, in consequence, the Appellant knew that the transactions were connected with fraud.

1267. Newey, J. (as he then was) addressed just such an issue in *Regent Commodities Limited v HMRC* [2011] UKUT 259 (TCC) at [46], stating:

"I should have thought, moreover, that, in the circumstances of the present case, the evidence given by Mr Humphries [overall contra-trading scheme] and Mr Mendes [FCIB circularity] (as to which, see paragraphs 17-31 above) would of itself have sufficed to entitle the Tribunal to make a finding of actual knowledge. As already mentioned, the Tribunal considered (with justification, in my judgment) that that evidence indicated that Regent knew to whom it was supposed to sell."

1268. Thus, an objective factor may be that a series of transactions took place as part of an overall scheme to defraud the Revenue. Inferences may then be drawn from the existence of the overall scheme to defraud the Revenue. Those inferences are not precluded simply because the Appellant did not know the facts that underpinned that scheme.

1269. The Court of Appeal addressed this issue in *Fonecomp Ltd v Revenue & Customs Commissioners* [2015] STC 2254 at [51] where Arden, LJ. (as she then was) stated:

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

1270. The Upper Tribunal addressed (i) the failures of the First Tier Tribunal to draw inferences from the existence of an overall scheme to defraud the Revenue and features thereof, and (ii) the error in ignoring the evidence about fraud and connection simply because those matters are no longer in issue, in *The Commissioners for Her Majesty's Revenue & Customs v Pacific Computers Ltd* [2016] UKUT 350 (TCC) (*"Pacific"*).

1271. HMRC's first broad complaint before the Upper Tribunal in *Pacific* was ([6]):

"…that the FTT treated the evidence in relation to the overall scheme to defraud as incapable of being probative of PCL's state of knowledge as to the impugned transactions. In doing so, HMRC submit that the FTT erred in law…"

1272. The Upper Tribunal began (at [10]) by setting out the well-established approach that what was required to answer the questions before the FTT was a consideration of all the circumstances of the transactions, the totality of the evidence of those circumstances and consideration of what inferences ought properly to be drawn from that evidence.

1273. The Upper Tribunal picked up on HMRC's first broad complaint at [49]:

"49. Although HMRC point to numerous examples within the FTT's decision where they submit the FTT failed to have regard to the evidence, the overriding submission is that the FTT failed to have proper regard to the evidence of contrivance in the deal chains, including through the fraudulent conduct of participants in the chains, the circularity of fund flows and carouselling of products, and the control which HMRC argued the orchestrators of the fraud would need to have exerted over all the transactions in the deal chains. The FTT, say HMRC, either refused to place any or any proper weight on certain of the evidence or discounted it as relevant only to the facts of fraud and connection to fraud, which were accepted by PCL, and did not have regard to that relevant evidence when assessing the evidence of PCL, including the credibility of its witnesses."

1274. The Upper Tribunal ("UT") at [78] held the existence of an overall scheme to defraud the Revenue was relevant to the knowledge of the Appellant and not simply to whether there had been a fraudulent evasion of VAT:

"78. From a review of the case as put by HMRC in their written closing submissions to the FTT, we are satisfied that the FTT was wrong to describe HMRC's case in this way. The FTT went on, at [225], to say that the carousel argument did not assist in considering whether the only reasonable explanation for PCL's transactions was fraud "when PCL has accepted that there was fraud in the chain which caused a tax loss". The FTT was thus saying that the evidence of orchestration and contrivance was relevant only to the existence of the fraud (which had been conceded), and failed to appreciate the relevance of contrivance and the submissions based on it to the question of knowledge."

1275. At [79] the UT described this as an error of approach. At [80-81] the UT said:

"80. The FTT failed to appreciate, and thus failed to address, the link that HMRC was seeking to make between the evidence of fraudulent behaviour on the part of the three companies through the submission that the deal chains in which PCL's transactions had been orchestrated by fraudsters to the submission that all companies involved, including PCL, must have been instructed so as to facilitate the fraud, and PCL must therefore have known, or should have known, of the connection to fraud. It did not connect the evidence and submissions in relation to the three companies with the question of PCL's knowledge that it had to address. It simply considered whether PCL had been aware of the involvement of the three companies in the 2005 fraud. It said, at [218], that that involvement did not go to PCL's actual knowledge or that the only reasonable explanation for PCL's transactions was fraud; and at [219] it

remarked, rather caustically, that "whilst this may be interesting information we do not see that it helps us answer the question was the only reasonable explanation for the transactions PCL took part in fraud? It does not go to what PCL did or did not know."

81. It is regrettable that the FTT failed to appreciate the inferences which HMRC was inviting the FTT to make from the orchestrated and contrived nature of the fraud and the presence of fraudulent companies within the deal chains at issue in the appeal. The FTT was keenly aware, it appears, of the need to consider whether inferences could be drawn from the evidence. But in the FTT's decision that awareness manifests itself, not in a proper consideration of whether inferences could be drawn, weighing the evidence on both sides and reaching a reasoned conclusion, but in a number of statements by the FTT of a general nature that there was no evidence on which to found any inference.

82. Although, as for example at [140], when describing its conclusion that PCL had no actual knowledge of fraud in the chains, the FTT stated that it had carefully considered all the evidence before it in reaching that conclusion, and that it had done so "because there was no evidence before us to show otherwise and no evidence laying a foundation from which such an inference could be drawn", it is evident from how the FTT later addressed the question of orchestration and contrivance that it did not consider, or did not properly address, the evidence before it. Where there is evidence, and it is evidence from which the tribunal is invited to make an inference, the tribunal must address that question and explain its reasons either for drawing an inference or refusing to do so. It is not sufficient simply to say that there was no evidence. The failure by the FTT properly to address the submissions of HMRC by reference to the available evidence was an error of law."

1276. Thus, as a matter of law the Tribunal is entitled to draw inferences from the entirety of the circumstances of the relevant transactions in deciding whether the Appellant knew or should have known that the transactions were connected with fraud. The Tribunal is not restricted to facts demonstrably within the knowledge of the Appellant. That is to confuse what is known to someone with what should have been known or should reasonably have been known, an objective factor. The Tribunal is not precluded from considering facts that only came to light after the HMRC investigation so long as they are facts that could reasonably have been known or discovered at the relevant time of the transactions. That is not applying hindsight.

1277. Therefore, the Tribunal should not be persuaded that the existence of an overall scheme is irrelevant to knowledge or means of knowledge.

1278. But for the exclusion of hindsight properly understood (which is not the same as reliance on fact established after the event), the Tribunal should not be persuaded to confine itself in answering the two key questions in *Kittel* to facts only demonstrably known to the Appellant at the time of the transactions. To do so would, on the binding authorities of *Mobilx* and *Pacific*, be an error of law.

1279. Moses. LJ. endorsed the approach of Christopher Clarke, J. in *Red 12* in *Mobilx* at [83]:

'83. The questions posed in BSG (quoted here at § 72) by the Tribunal were important questions which may often need to be asked in relation to the issue of the trader's state of knowledge. I can do no better than repeat the words of Christopher Clarke J in *Red12 v HMRC* [2009] EWHC 2563:-

"109 Examining individual transactions on their merits does not, however, require them to be regarded in isolation without regard to their attendant circumstances and context. Nor does it require the tribunal to ignore compelling similarities between one transaction and another or preclude the drawing of inferences, where appropriate, from a pattern of transactions of which the individual transaction in question forms part, as to its true nature e.g. that it is part of a fraudulent scheme. The character of an

individual transaction may be discerned from material other than the bare facts of the transaction itself, including circumstantial and "similar fact" evidence. That is not to alter its character by reference to earlier or later transactions but to discern it.

110. To look only at the purchase in respect of which input tax was sought to be deducted would be wholly artificial. A sale of 1,000 mobile telephones may be entirely regular, or entirely regular so far as the taxpayer is (or ought to be) aware. If so, the fact that there is fraud somewhere else in the chain cannot disentitle the taxpayer to a return of input tax. The same transaction may be viewed differently if it is the fourth in line of a chain of transactions all of which have identical percentage mark ups, made by a trader who has practically no capital as part of a huge and unexplained turnover with no left over stock, and mirrored by over 40 other similar chains in all of which the taxpayer has participated and in each of which there has been a defaulting trader. A tribunal could legitimately think it unlikely that the fact that all 46 of the transactions in issue can be traced to tax losses to HMRC is a result of innocent coincidence. Similarly, three suspicious involvements may pale into insignificance if the trader has been obviously honest in thousands.

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

Adverse inferences

1280. HMRC rely on the absence of a number potential witnesses for the Appellant who may have been able to give relevant evidence regarding the transactions of the Appellant which form the basis of the appeal.

1281. The law in relation to the issue of adverse inferences is that summarised in Lord Sumption's speech in the Supreme Court in *Prest v Prest* [2013] 2 AC 415 at [44], and that in *Wisniewski v Central Manchester Health Authority* [1998] PIQR P324 (*"Wisniewski"*). There is no difference between the two, *per* Morgan, J. in *British Airways PLC v Airways Pension Scheme Trustee Ltd* [2017] EWHC 1191 (Ch) (*"British Airways"*) at [141-143]:

"141. The consideration which a court should give to the fact that a potentially relevant witness has not been called is well established. I can take the principles from the judgment of Brooke LJ in *Wisniewski v Central Manchester Health Authority* [1998] PIQR P324 at P340 where, having reviewed the authorities, he said:

"From this line of authority I derive the following principles in the context of the present case:
(1) In certain circumstances a court may be entitled to draw adverse inferences from the absence or silence of a witness who might be expected to have material evidence to give on an issue in an action.
(2) If a court is willing to draw such inferences, they may go to strengthen the evidence adduced on that issue by the other party or to weaken the evidence, if any, adduced by the party who might reasonably have been expected to call the witness.
(3) There must, however, have been some evidence, however weak, adduced by the former on the matter in question before the court is entitled to draw the desired inference: in other words, there must be a case to answer on that issue.
(4) If the reason for the witness's absence or silence satisfies the court, then no such adverse inference may be drawn. If, on the other hand, there is some credible explanation given, even if it is not wholly satisfactory, the potentially detrimental effect of his/her absence or silence may be reduced or nullified."

142. This statement of principle is in accordance with the earlier decisions of the House of Lords in *R v IRC ex p. T C Coombs & Co* [1991] 2 AC 283 and Murray v DPP [1994] 1 WLR 1 and the comments of Lord Sumption in the Supreme Court in *Prest v Prest* [2013] 2 AC 415 at [44].

143. These principles mean that before I draw an inference and made a finding of fact adverse to a witness who was not called, I need to ask myself:
- is there some evidence, however weak, to support the suggested inference or finding on the matter in issue?
- has the Defendant given a reason for the witness's absence from the hearing?
- if a reason for the absence is given but it is not wholly satisfactory, is that reason "some credible explanation" so that the potentially detrimental effect of the absence of the witness is reduced or nullified?
- am I willing to draw an adverse inference in relation to the absent witness?
- what inference should I draw?"

1282. The issue here is not whether the party gives evidence, it is whether the party calls a relevant witness. The authorities canvassed in *Wisniewski* make this clear. At p.337 Brooke, LJ. began dealing with issue of adverse inferences by saying:

"Mr Grime accepted that there is a line of authority which shows that if a party does not call a witness who is not known to be unavailable and/or who has no good reason for not attending, and if the other side has adduced some evidence on a relevant matter, then in the absence of that witness a judge is entitled to draw an inference adverse to that party and to find that matter proved."

1283. Thereafter, Brooke, LJ. cited *McQueen v Great Western Railway Company* (1875) LR 10 Q.B. 569, where Cockburn, CJ. had said:

"If a prima facie case is made out, capable of being displaced, and if the party against whom it is established might by calling particular witnesses and producing particular evidence displace that prima facie case, and he omits to adduce that evidence, then the inference fairly arises, as a matter of inference for the jury and not a matter of legal presumption, that the absence of that evidence is to be accounted for by the fact that even if it were adduced, it would not displace the prima facie case. But that always presupposes that a prima facie case has been established; and unless we can see our way clearly to the conclusion that a prima facie case has been established, the omission to call witnesses who might have been called on the part of the defendant amounts to nothing."

1284. Brooke, LJ. also cited *Chapman v Copeland* (1996) 110 S.J. 569, where an inference was drawn against a defendant driver when he failed to give evidence, followed by *Herrington v British Railways Board* [1972] A.C. 877, where an inference was drawn against a defendant company for failing to call evidence. Brooke, LJ. then cited Gillard, J. in *O'Donnell v Reichard* [1975] V.R. 916 (*"O'Donnell"*) in the Supreme Court of Victoria Full Court (the equivalent jurisdiction to the England and Wales Court of Appeal):

"Looking at the authorities from Blatch v. Archer (1774) 1 Cowp. 63 right up to Earle v. Eastbourne District Community Hospital [1974] V.R. 722 , it may be accepted that the effect of a party failing to call a witness who would be expected to be available to such a party to give evidence for such party and who in the circumstances would have a close knowledge of the facts on a particular issue, would be to increase the weight of the proofs given on such issue by the other party and to reduce the value of the proofs on such issue given by the party failing to call the witness."

1285. Gillard, J. himself had said the following in *O'Donnell*:

"In *Jones v Dunkel*, (1959) 101 CLR at p. 320; [1959] ALR at p. 381; Windeyer, J, cited Wigmore on Evidence, 3rd. ed. (1940), vol. 2 s285, p. 162, which reads as follows: "The consciousness indicated by conduct may be, not an indefinite one affecting the weakness of the cause at large, but a specific one concerning the defects of a particular element in the cause. The failure to bring before the tribunal some

circumstance, document, or witness, when either the party himself or his opponent claims that the facts would thereby be elucidated, serves to indicate, as the most natural inference, that the party fears to do so, and this fear is some evidence that the circumstance or document or witness, if brought, would have exposed facts unfavourable to the party. These inferences, to be sure, cannot fairly be made except upon certain conditions; and they are also open always to explanations by circumstances which make some other hypothesis a more natural one than the party's fear of exposure. But the propriety of such an inference in general is not doubted."

1286. Lastly, Brooke, LJ. cited Lord Lowry in *R v IRC ex p T. C. Coombs & Co.* [1991] 2 A.C. 283 at p.300:

"In our legal system generally, the silence of one party in face of the other party's evidence may convert that evidence into proof in relation to matters which are, or are likely to be, within the knowledge of the silent party and about which that party could be expected to give evidence. Thus, depending on the circumstances, a prima facie case may become a strong or even an overwhelming case. But, if the silent party's failure to give evidence (or to give the necessary evidence) can be credibly explained, even if not entirely justified, the effect of his silence in favour of the other party may be either reduced or nullified."

1287. If the Tribunal accepts that there are no good reasons why adverse inferences ought not to be drawn in this case, Morgan, J.'s order of questions set out in *British Airways* (*above*) provides a convenient route for the Tribunal to follow:

"- is there some evidence, however weak, to support the suggested inference or finding on the matter in issue?
- has the Defendant given a reason for the witness's absence from the hearing?
- if a reason for the absence is given but it is not wholly satisfactory, is that reason "some credible explanation" so that the potentially detrimental effect of the absence of the witness is reduced or nullified?
- am I willing to draw an adverse inference in relation to the absent witness?
- what inference should I draw?"

HMRC's submissions on the Third Issue

1288. Mr Puzey, on behalf of HMRC, submits that the sixteen factors summarised below are compelling to prove CFE's actual knowledge that the denied transactions were connected with the fraudulent evasion of VAT.

1289. First, the extent of the overall scheme to defraud and the commonalities of the participants therein, as known to CFE, made its existence obvious once CFE knew of the risk of VAT fraud in the carbon credits market. Once CFE knew of the risks of fraud in the carbon credits marketplace it was obvious, if it did not already know, that its counterparties were part of an orchestrated scheme to defraud the Revenue. The commonalities between them were too many, their financial status was too parlous and their attempts to mislead CFE too blatant for CFE not to have known.

1290. Second, CFE was a money losing failure, the celerity of its success in early 2009 was far too good to be true. CFE knew that its first 5 months of trading in 2009 represented a 500% increase on the same period the previous year when the wider market increase for brokerage of EUAs was 75%. There was no commercial explanation for CFE's increased turnover and profits.

1291. Third, Mr Emanuel has invented an explanation for the volumes of carbon credits traded (local aggregators) for which there is not a shred of evidence and compelling evidence to the contrary. No one at CFE questioned this or asked Mr Emanuel to provide any evidence to support his claim. That Mr Emanuel needed to invent an explanation for the trade shows that CFE knew that it was connected with fraud. Mr Emanuel also invented a reason for ADE to have submitted invoices for the Westis trades. The same logic applies.

1292. Fourth, once the risk of fraud was known to CFE it was obvious that CFE's suppliers of carbon credits could not be trading on an ordinary commercial basis. CFE did not question how its suppliers could supply such large volumes of carbon credits, at a price that CFE could not beat despite its experience in the market, when the vast majority of them had no net worth to speak of, had either just been taken over or were recently formed companies and had no apparent prior connection to carbon credits trading. Their financial status, plus the requirement for them to provide the credits to CFE before they were sold and paid for, meant that they were extended an absolutely extraordinary level of credit by their suppliers. CFE, a giant of the financial sector, would not to do the same with its customers yet made no proper enquiry as to how the minnows it was trading with could possibly have been provided such a level of credit.

1293. Mr Emanuel again invented reasons *viz.* they were sold "on trust" or the sellers were consultants paid in carbon credits. No evidence was provided for either claim and they make no sense. It would be commercially reckless to have trusted the likes of CFE's suppliers with millions of Euros of carbon credits at a time. Had the sellers been consultants being paid in carbon credits they would have been earning incredible amounts of money. CFE knew that its suppliers appeared willing to send carbon credits to CFE regardless of market conditions and simply wanted payment the same day above anything. Once CFE was aware of the risk of VAT fraud in the carbon credits market it was obvious that its trade from March 2009 with such counterparties had been nothing more than a commercial fantasy.

1294. Fifth, Mr Ayres' account that even at 10 June 2009 he was being told to open an account with CFE suggests that the fraudsters knew that CFE could be relied upon not to make searching enquiries or ask difficult questions.

1295. Sixth, CFE deliberately refrained from making proper checks into e.g. Northumberland Consultants Ltd so as to affix itself with knowledge about that counterparty; that is a classic example of Nelsonian blind-eye knowledge.

1296. Seventh, had CFE checked the unique numbers of the carbon credits that it was trading when it knew of the risk of carousel fraud in the market, then it would have immediately become apparent that the same credits were being traded time and time again, for which there was no commercial explanation. That CFE did not is consistent with its approach of deliberately failing to make enquiries.

1297. Eighth, Mr Rose followed the same approach in asking pertinent questions long after the horse had bolted. Mr Rose, having flown to the UK in great urgency was supposedly conducting an investigation into CFE's carbon trading fiasco yet he failed to ask pertinent questions or act on the information in front of him. What he did was far too little too late.

1298. Ninth, there is a compelling inference from CFE's failure to call Mr Emanuel, the traders (Mr Bush, Mr Weldon, Mr Von Butler and Mr Lynch), Mr Taylor, Mr Tanton and Mr Treanor that their evidence would not withstand scrutiny.

1299. Tenth, there is a compelling inference from CFE's failure to retain (which HMRC no longer alleged to be deliberate destruction) e-mails and telephone records that those records would have significantly undermined its case. Even if the Tribunal is persuaded that the assumption in relation to spoliation of evidence is rebutted because the destruction was carried out through negligence, large parts of CFE's evidence, such as how the transactions took place or the explanations for the trading generally, remain wholly uncorroborated and therefore should not be accepted.

1300. Eleventh, CFE made a decision deliberately to carry on trading with obviously suspect suppliers so as to offset the VAT it believed that it had wrongly paid out to them; regardless of the clear indicators of fraud that they presented.

1301. Twelfth, despite the knowledge of the risk of fraud, CFE continued to trade with traders unregistered for VAT who continued to charge them VAT on invoices (Aristo and Axle) and continued to try to trade with Stratex. Despite knowing that Adduco's VRN was invalid, and knowing of the rumours of fraud, CFE continued to try to trade with Adduco.

1302. Thirteenth, on 8 June 2009 CFE purchased carbon credits from GWD and AHMD despite the known risk of fraud, without making proper checks into them, without undertaking any enhanced monitoring, and without obtaining financial information.

1303. Fourteenth, from ADE's submission to CFE of the duplicate invoices for Westis deals on 8 June 2009 it was obvious that there was something seriously amiss with ADE's, and Westis' trade with CFE. CFE never raised the issue of ADE's invoices with Westis. Stratex was linked to Westis and disappeared. The reasonable trader would not have touched the likes of Westis in July 2009. Even when CFE undertook the July Westis trades it did not undertake its own enhanced due diligence and CFE knew that credits had come from a different account to that used by Westis but made no independent enquiry into the origin, simply having Westis draft up a note saying that it was theirs.

1304. Fifteenth, the suppression of the draft Suspicious Event Report and draft SARs drafted by Mr Taylor.

1305. Sixteenth, the incredible evidence given by those witnesses called on behalf of the Appellant and their near complete amnesia as to the most important events that this case concerns.

1306. In the alternative, HMRC relied on the above submissions to assert that CFE should have known that its transactions were connected with the fraudulent evasion of VAT, because the cumulative circumstances thereof permitted of no reasonable explanation other than a connection with fraud. CFE has not put forward any reasonable explanation for the transactions that has any evidential basis. CFE had available to it information that it did not use. CFE should have known, looking back from 8 June 2009, that its previous transactions were part of a carousel fraud. It then went on to trade with the same parties involved in those carousels, when it must have been obvious, for the reasons set out above, that they could not have legitimately acquired them.

1307. Mr Puzey, on behalf of HMRC, invited the Tribunal to dismiss CFE's appeal against the *Kittel* denials for 06/09 and 09/09 and the consequential assessments that follow.

Appellant's submissions on the Third Issue

1308. Ms Shaw QC submitted on behalf of the Appellant that HMRC's case on this issue, amounted to wide-ranging discussion of the evidence, peppered with unsubstantiated allegations of dishonesty and deceit made against various individuals. Moreover, she submitted that large swathes of HMRC's submissions were simply irrelevant to the point in issue.

1309. Ms Shaw QC on behalf of the Appellant responded to HMRC's sixteen points as follows.

1310. First, as noted above, material not known to the taxpayer at the time of the transaction in question and material known only with the benefit of hindsight is not relevant when examining whether the *Kittel* test is met. But HMRC's case is very heavily based on such material. More particularly:

(1) The material set out in numerous paragraphs of HMRC's written submissions contained assertions about:

(a) counterparties with whom CFE did not transact;

(b) events which occurred, including HMRC investigations, after the relevant transactions took place; and

(c) matters which were not known to CFE even at the time of the relevant transactions.
Such material is irrelevant to the issue in dispute.

(2) The material regarding circulation of carbon credits was not known to CFE at the time of the relevant transactions, and HMRC do not contend otherwise.

(3) Similarly, the nature of the "scheme" alleged by HMRC, and the description of the VAT losses contained was not known to CFE at the time of the relevant transactions and relies mainly on hindsight or events which occur after that time.

(4) Further, and contrary to the submission made by HMRC, whether the transactions in question were part of an *"overall scheme to defraud"* HMRC in and of itself tells one nothing about a person's state of knowledge. The question to be answered is whether the taxpayer knew or should have known that his transaction was connected to VAT fraud. That is not answered by demonstrating that the fraud took place (whether or not as part of an *"overall scheme"*). Indeed, they are recognised as being discrete matters. - See *Blue Sphere Global Ltd v HMRC* [2009] STC 2239, at [29]. The decision in *Edgeskill Ltd v HMRC* [2014] STC 1174, in particular the passage at [55] quoted by HMRC, is consistent with this.

(5) The use of the term "spike" when referring to CFE's carbon trading in HMRC's written submissions, and the reference to its trading performance after July 2009 both rely on a form of hindsight which is not permissible when applying the *Kittel* test.

(6) The "commonalities" referred to and relied on by HMRC in its written submissions rely in part on matters not known to CFE at the time of the relevant transactions, for example the number of other customers CFE's counterparties had.

(7) What Mr Ayres was being told by third parties on 10 June 2009 (referred to by HMRC in its written submissions) is irrelevant to the issue.

(8) Even in the context of the section of HMRC's written submissions, which supposedly deals with CFE's awareness, HMRC have relied on material which could not, on any realistic view, have been known to CFE at the time of transacting: see paragraphs about links to attendees at the Carbon Expo and paragraphs which refer to the movement of credits *after* the last transaction in issue occurred.

1311. Second, HMRC submit in their written submissions that they "neither allege nor have to prove that those at CFE who undertook or supervised the transactions were dishonest", but neither statement is correct. Ms Shaw QC submitted:

(1) Later in their submissions HMRC make allegations of dishonesty in respect of various individuals who undertook or supervised the transactions. More specifically:

(a) HMRC allege that Mr Emanuel deliberately deceived, *inter alia*, Mr Rose in relation to (i) his suggestion that CFE's counterparties were local consultants and aggregators of carbon credits; and (ii) the explanation provided by ADE about the apparent links between itself and Westis. These allegations are baseless.

(b) HMRC also allege that CFE made *"cynical and deliberate attempts to refrain from making proper enquiries into its counterparties"*. The only bases put forward in support of this allegation are:

(i) a statement made in the draft "Suspicious Event Report" about not checking the VRN of Northumberland Consultants Ltd. But this point is addressed in paragraph 39 of Mark Cooper's first witness statement: '*I do not believe this is accurate and refer to an email from James Emanuel to me of 12 June 2009.....This indicated that Steve Treanor had confirmed that the VAT registration numbers of GW Deals and AH Marketing were valid. The VAT registration number for Northumberland Consultants was also valid, but the recorded address did not match the address we held. Steve Treanor proposed that we should carry out further enquiries to determine where Northumberland Consultants' principal place of business was located. James Emanuel suggested instead that we should wait for Northumberland consultants to trade with us again before asking these questions.....*'. HMRC's written submissions makes clear, enquiries were actually made by CFE.

(ii) An allegation by HMRC that CFE deliberately failed to check the unique numbers on carbon credits. Whilst CFE did not carry out such checks, there is no evidence to suggest that this was done deliberately to avoid acquiring knowledge.

(iii) An allegation by HMRC that Mr Rose deliberately waited until 18 July 2009 to ask Mr Buchan to undertake a credit check on CFE's counterparties. There is no evidential basis for the suggestion that Mr Rose deliberately, and in bad faith, delayed making such enquiries. If HMRC were correct about his motives, Mr Rose would surely have refrained from checking at all. Furthermore, the allegation is inconsistent with the various steps taken and checks carried out by CFE once rumours of fraud started to circulate and in response to what it considered to be irregularities in respect of some of its transactions. Why, if HMRC's theory were correct, would CFE have taken any such steps if they were so keen to "turn a blind eye"?

(c) HMRC further allege that CFE suppressed the making of a Suspicious Activity Report. Again, there is no proper evidential basis for such an allegation and indeed the explanation as to why no such report was ever submitted (namely, "nothing was proven") is set out in HMRC's written submissions.

(d) Lastly, HMRC allege in their written submissions that Mark Cooper, then Cantor Fitzgerald's General Counsel, deliberately concealed information CFE had about Westis from HMRC at the 25 June 2009 meeting. Mr Cooper responds to this allegation in paragraph 29 of his second witness statement. As he says there, the meeting note exhibited by Mr Sharratt makes clear that Westis was discussed, and HMRC do not specify what information they consider was withheld. Moreover, Mr Cooper is confident that CFE would have been upfront with HMRC regarding the state of its knowledge in respect of Westis.

(2) Having made what are clearly allegations of dishonesty, of one form or another, HMRC must prove them or withdraw them.

1312. Third, HMRC summarised the conclusions they say should be drawn from the evidence into sixteen factors as set out above. Ms Shaw QC, for the Appellant, submitted that the factors advanced by HMRC do not, whether individually or cumulatively, cross the threshold of showing either that CFE actually knew or had the means at its disposal of knowing that its transactions were in fact connected to fraudulent evasion of VAT or that the only reasonable explanation for the circumstances in which the transactions took place was that they were in fact connected to such fraud.

1313. She addressed each in turn:

1314. First, in terms of the commonalties amongst the various counterparties, as known to CFE:

(a) By 7 June 2009 CFE had established that many counterparties operated with a sole non-UK national as a director. CFE had also noticed that several counterparties banked with the Marfin Popular Bank in Cyprus, which was not a well-known bank in the market and was located outside the counterparties' jurisdiction (see para 45 of Mr Cooper's first witness statement). In addition, CFE had become aware that the counterparties were all new to the market and had a limited corporate history.

(b) These aspects were not considered to be particularly surprising, however, as Mr Rose explained in his witness statement (paras 53 to 55).

(i) Mr Emanuel suggested that the counterparties were businesses set up as environmental consultants acting for small and medium sized emitters in various different European Countries. The consultants would give advice to the emitters on matters such as their carbon footprint projections, use of green energy and compliance requirements. The consultants may have been paid by the emitter in EUAs. The consultants would also provide a liquidity service selling excess allowances on behalf of these small and medium size emitters who would not otherwise have necessarily been able to access the market easily.

(ii) Mr Rose did not think it unusual or suspicious that many of the new counterparties were operating through a UK entity even though the directors and features of the counterparty may have been linked to other countries. The carbon market is a global one. In addition, Mr Rose

regarded London as the financial centre of Europe and assumed therefore that many businesses linked to a number of European countries might choose to use a UK entity.

(iii) The use of a foreign bank account would also not have been a cause for suspicion. Cantor Fitzgerald dealt with plenty of legitimate businesses who use offshore bank accounts. It would only be a cause for concern if the bank account was in the name of another entity or was based in a jurisdiction which was subject to international sanctions.

(c) On 12 June 2009 CFE noted further features amongst its counterparties, including that Westis, Stratex and Aristo were operating from the same premises and that Adduco, BMC and Northumberland Consultants were also operating from the same premises. However, one plausible explanation for this was that they had used the same incorporation agents and Cantor Fitzgerald personnel believed that the entities were small independent operators. As Mr Emanuel noted in his email of 12 June 2009, many UK trading houses provide a trading environment and shared infrastructure for individual proprietary traders.

(d) Moreover, and in any event, after 8 June 2009 CFE only transacted with 4 of the 12 identified counterparties: Mettec, GW Deals, AH Marketing and Distribution and Westis. None of the features listed appears to have applied to the first three of those, the shareholders and directors of which were all resident in the UK. As to Westis, CFE undertook checks into its status, which culminated in HMRC not only confirming that they had registered Westis for VAT but that CFE could recover the VAT it had paid to Westis (see paragraphs 98 and 101 of Mr Cooper's first witness statement).

(e) Accordingly, the common features of which CFE was aware were reasonably explicable on grounds other than fraud, and, in any event, they were not relevant to the transactions entered into by CFE after the point at which it had that information, either because it did not apply (in the case of Mettec, GW Deals and AH Marketing and Distribution) or because subsequent information obtained by CFE changed the picture (in the case of Westis).

1315. Second, there was a reasonable explanation for CFE's increased turnover and profits, namely the change in focus to the "matched principal" model of trading driven by Mr Emanuel and in line with the business plan that Mr Emanuel had presented in mid-2008 as explained by Mr Rose in his witness statement. Moreover, this growth was in line with both market commentary and the carbon credit market generally (see Mr Rose's witness statement and the Bloomberg press release to the effect that trading in EUAs had increased 75% in the first 5 months of 2009). Indeed, even the author of the 3 June 2009 blog article speculating about possible fraud, wrote:

"Recent volume on Bluenext has increased significantly, and it was thought that it was the reaction of selling compliance companies looking to cash in on surplus sales as the market decreased in value since December 2008 (a valid argument) or even perhaps the tightened credit lines that have affected all areas of finances have also constrained forward trading lines and even cash deposits for futures trading, making more transactions move to the spot market (also a valid point)."

1316. Given the store HMRC placed in this article, it is difficult to understand why they did not also accept as valid the two arguments set out above as to why trading volumes had increased. Moreover, as HMRC acknowledged in their written submissions, by reference to the

"boastful" press 18 release of 22 May 2009, CFE regarded itself as having outperformed the market.

1317. Third, for the reasons already set out above, the allegation that Mr Emanuel *"invented"* an explanation for the increase in the volume of carbon credits traded is baseless, as is the allegation that he fabricated an explanation as to why ADE had submitted invoices for Westis trades, namely that it used the same incorporation agent and appeared to share office infrastructure in the same way that many UK trading houses provide a trading environment for individual proprietary traders.

1318. Fourth, HMRC's contention that *"once the risk of fraud was known to CFE it was obvious that CFE's suppliers of carbon credits could not be trading on an ordinary commercial basis"* lacks any logical foundation. Moreover, as already noted, CFE had credible reasons in mind as to why its counterparties would have carbon credits available to trade, and the general market data available at the time supported the conclusion that credits were being traded in high volumes. It is also material to note in this regard that at the relevant time the carbon credit market was relatively new and that unlike, say, the mobile phone or CPU markets, was not traditionally associated with fraudulent VAT evasion.

1319. The basis for leaping to the conclusion that the *only* reasonable explanation for the presence of several new willing sellers in the market and the growth of both CFE's business and the market as a whole was VAT fraud simply is not there.

1320. Fifth, as to the reference to an account given by Mr Ayres to HMRC officers on 18 August 2009, that information was plainly not known to or available to CFE at the time it entered into the relevant transactions. Further, insofar as HMRC seek to contend that it evidenced that CFE was considered a "soft" target: (a) the account relied on by HMRC does not record that; and (b) the due diligence carried out by CFE was in line with market standards: this is shown by the email from Mr Lynch of 26 June 2009 referred to by HMRC in their written submissions, which evidences that Barclays Capital operated the same checks that CFE had.

1321. In respect of the sixth, seventh and eighth factors relied upon by HMRC, Ms Shaw QC submitted:

(a) As already set out above, HMRC's contention that CFE deliberately, in bad faith, refrained from carrying out proper checks into counterparties is unfounded, and their point about Northumberland Consultants Ltd is a bad one. CFE carried out, as a minimum, the Anti-Money Laundering ("AML") and Customer Due Diligence ("CDD") checks it was required to do: see the first witness statement and evidence of Ms Mills.

(b) Once it became aware of the 3 June 2009 blog article speculating about possible VAT fraud in the market it acted by notifying senior personnel within Cantor Fitzgerald, increasing its checks into its counterparties and by implementing more robust compliance checks (see Mr Rose's witness statement and evidence and Mr Cooper's first witness statement and evidence).

(c) These steps are plainly not the actions of a person deliberately trying to "turn a blind eye" and they undermine HMRC's contention to the contrary.

(d) Further, the ultimate question is not whether the trader exercised due diligence but rather whether he should have known that the only reasonable explanation for the circumstances in

which his transaction took place was that it was connected to fraudulent evasion of VAT: see *Mobilx*, at [75].

1322. Ninth, as regards HMRC's invitation to the Tribunal to draw adverse inferences from the fact that the Appellant has not called various individuals to give evidence:

(a) First, HMRC do not specify what adverse inferences they invite the Tribunal to draw in the circumstances. But in any event, as was said by Lord Sumption in *Prest v Petrodel Resources Ltd* [2013] 3 WLR 1, at [44], it is not permissible to *"convert open-ended speculation into findings of fact. There must be a reasonable basis for some hypothesis in the evidence or the inherent probabilities, before a court can draw useful inferences from a party's failure to rebut it"*. HMRC have not established any basis to support the suggestion that the evidence of the individuals mentioned "will not withstand scrutiny".

(b) Secondly, the correct statement of the law in respect of adverse inference in the circumstances of this case is that set out by Lord Lowry in *R v IRC, Ex p Coombs (TC) & Co* [1991] 2 AC 283, at 300 (see *Prest*, at [44]):

> "In our legal system generally, the silence of one party in face of the other party's evidence may convert that evidence into proof in relation to matters which are, or are likely to be, within the knowledge of the silent party and about which that party could be expected to give evidence. Thus, depending on the circumstances, a prima facie case may become a strong or even an overwhelming case. But, if the silent party's failure to give evidence (or to give the necessary evidence) can be credibly explained, even if not entirely justified, the effect of his silence in favour of the other party, may be either reduced or nullified."

(c) In this case, HMRC have not established, or even suggested, a *prima facie* case in respect of any given particular which they seek to prove by adverse inference.

(d) Thirdly, HMRC appear to overlook the fact that they have the burden of proof in respect of this issue and could themselves have called those individuals to give evidence. HMRC say that they could not call them to impugn them (see their written submissions), but it is not clear why that is so. If what HMRC are saying is that they anticipate that their evidence would not in fact support HMRC's case then it tends to undermine their assertion that general, adverse inferences should be drawn from the fact they are not being called.

1323. Tenth, as to HMRC's allegations surrounding the destruction of data, they are unfounded and excessive as evidenced by the fact they were later withdrawn:

(a) HMRC originally alleged in their opening written submissions that the Appellant's disclosure of emails is lacking. They had not made this allegation before. The only specific email in the Submissions that they appear to say is missing is one sent to Stratex referred to by Messrs Bush and Lynch of CFE on 2 July 2009. Other than this, it is unclear what this allegation is based on.

(b) The Appellant's methodology for disclosing emails was explained in Pinsent Masons' letter of 31 May 2016, and that disclosure is understood to have caught all emails between the Cantor traders and the 10 nominated counterparties (which included Stratex) between 9 March 2009 to 30 July 2009. HMRC have not suggested that that methodology was in any way flawed or taken issue with this aspect of the disclosure.

(c) HMRC also alleged in their original opening submissions that the Appellant's disclosure of telephone calls is lacking. This was previously raised in David Ball's second witness statement, and it is responded to within Mark Snelling's witness statement (paras 9 to 11). Again, the 31 May 2016 letter sets out the extent of the disclosure, and the reasons why the calls were overwritten in 2013 as a result of a group-wide implementation of record retention periods. It is also acknowledged in the letter that some audio files appear to be incomplete.

(d) Furthermore, HMRC are perfectly well aware that the ordinary position regarding the disclosure of documents in the Tribunal is for each side to disclose the documents on which they rely. There is no standard disclosure rule in the Tribunal. It is, however, relevant to note that HMRC commenced enquiries into these transactions back in 2009 and in the course of which requested large amounts of information. The first time that HMRC requested disclosure of telephone calls was in March 2015 some 6 years after the transactions in question took place. In the circumstances, it is not unreasonable for the Appellant, in line with its standard data retention policy, to no longer have access to those calls.

(e) Nor is there any basis for alleging that the Appellant deliberately destroyed the records in order to prevent their disclosure.

1324. Eleventh, as to HMRC's allegation that CFE traded with suspect suppliers *"regardless of the clear indicators of fraud that they presented"*:

(a) As explained in the witness statement of Mr Rose and the first witness statement of Mr Cooper, once CFE had notice, on 3 June 2009, of the potential risk that there might be fraud in the market, it took steps to assess and reduce its potential exposure.

(b) It was determined that where money was held on account in respect of a counterparty, those sums would be offset against VAT paid on prior transactions unless a counterparty could meet the requirements for the release of funds, which was the provision of valid VAT invoices. In the absence of such invoices, CFE would neither pay VAT to the counterparty in question, nor claim any VAT.

(c) Where CFE did not hold sufficient sums on account, it sought to increase the amounts held on account with that counterparty in question but with the clear intention of not paying over any sums on account of VAT unless the counterparty could produce a valid invoice.

(d) By taking those steps CFE was in fact reducing the risk of VAT loss in the transaction chains, by effectively cancelling any payments in respect of VAT which had been made without a valid invoice.

(e) This does not evidence knowledge of VAT fraud, or even (which is not sufficient in any event) knowledge that VAT fraud was probable. It was merely a protective measure taken by CFE to reduce its exposure in the event that it was unable to obtain a valid invoice or it transpired that it had wrongly been charged VAT.

(f) Moreover, at the time this occurred there were no circumstances of which CFE was aware which could only be reasonably explained as being connected to VAT fraud. It was perfectly possible that the invoice and other irregularities were simply the result of administrative oversights.

1325. Twelfth, HMRC further contend that CFE continued to trade with Aristo and Axle, who were unregistered for VAT, *"despite knowledge of risk of fraud"*. As to this:

(a) As HMRC themselves state within their written submissions, CFE did not pay any VAT to Aristo or Axle and therefore did not reclaim input tax. This is therefore not a disputed transaction because it did not give rise to any tax loss: see Officer Ball's first witness statement.

(b) Furthermore, as HMRC record in their written submissions, CFE was told by Axle that it would provide a VAT number *"as soon as possible"*.

(c) Moreover, it is difficult to see how the circumstances of CFE's trades with Aristo and Axle could be said to lead to the conclusion in respect of its transactions with *other* counterparties that it knew or should have known that the only reasonable explanation for the circumstances in which those other transactions took place was that they were connected to fraudulent evasion of VAT.

1326. Thirteenth, as to HMRC's contention concerning Adduco, the Appellant repeats its submissions above.

1327. Fourteenth, HMRC do not specify what they say the *"proper checks"* into GW Deals and AH Marketing and Distribution ought to have been. As already noted:

(a) CFE carried out, as a minimum, the AML and KYC checks it was required by law to do. This was in line with other major institutions operating in the market.

(b) Once it became aware of the 3 June 2009 blog article speculating – and only speculating – about possible VAT fraud in the market it acted by increasing its checks into its counterparties and by implementing more robust compliance checks.

(c) CFE undertook background checks into their existing counterparties and discovered certain similarities between some of them (see above), but these did not apply to GW Deals or AH Marketing and Distribution.

1328. Fifteenth, as regards Westis:

(a) Having had initial concerns about Westis after 5 June 2009 because it had provided a VAT number for a different company, CFE undertook checks into Westis' status, which culminated in late July 2009 in HMRC not only confirming that they had registered Westis for VAT but that CFE could recover the VAT it had paid to Westis.

(b) Moreover, Westis had instructed Kingsley Napley, a reputable law firm, to collect sums due from CFE. That firm persisted in its efforts to collect the money until CFE finally released the sums due having taken comfort from the actions of HMRC mentioned above.

(c) Thus, notwithstanding the concerns initially raised on review of the invoices from Westis, a combination of Westis appearing to be legitimate from the use of reputable advisers and HMRC's decision to register it for VAT, together with the confirmations given to Mr Cooper by HMRC on 27 July 2009 (see Mr Cooper's first witness statement) gave CFE comfort that Westis was not entering into EUA spot allowance transactions for reasons of VAT fraud.

(d) In those circumstances, HMRC's contention that *"the reasonable trader would not have touched the likes of Westis with the proverbial bargepole in July 2009"* is, with respect, untenable.

1329. Sixteenth, as to HMRC's allegation that CFE suppressed a Suspicious Activity Report, there is no proper evidential basis for what is, on any view, a very serious allegation and one which is contradicted by their own submissions which records CFE's Money Laundering Reporting for the year 2009:

"In June 2009, following press commentary on carousel fraud in the spot emissions market, CFE suspected that it had been the victim of VAT fraud. Although nothing was proven policy and procedures were reviewed around the types of clients with whom such activity would be undertaken. As a consequence more stringent KYC requirements were implemented and the level of ALM/CFE/Sanctions checks was increased."

1330. In assessing the probability of the Appellant either knowing or having the means at its disposal of knowing that from 8 June 2009, the only reasonable explanation for its transactions was that they were connected to fraudulent evasion of VAT, it is material to note that it took HMRC until 17 July 2009 to publicly announce a threat of VAT fraud and introduce measures to counteract it. The assertion in HMRC's Submissions that after the closure of the BlueNext Exchange it was "clear" and one only needed to "scratch the surface" to reveal "orchestrated VAT fraud on an industrial level" in the carbon credit market seems implausible in light of their own inaction.

1331. For all those reasons, Ms Shaw QC invited the Tribunal to determine the Third Issue in the Appellant's favour and cancel HMRC's denial of input tax and consequent assessments on the basis that the Appellant did not know and should not have known its transactions were connected to the fraudulent evasion of VAT.

Discussion and Decision on the Third Issue

Knowledge or Means of Knowledge – 'should have known'

1332. The Tribunal is satisfied that HMRC has proved that CFE, and hence the Appellant, should have known by 15 June 2009 that its transactions purchasing carbon credits from AHMD and Westis from that date on (15-18 June 2009 AHMD; 28-29 July 2009 Westis) were connected with the fraudulent evasion of VAT.

Attribution

1333. It is not clear that the law requires the attribution of means of knowledge (whether the Appellant should have known its transactions were connected to fraud) to specific individuals within CFE as opposed to the requirement to attribute actual knowledge to specific individuals within any company.

1334. In any event and to the extent necessary, the Tribunal finds that several employees of CFE had sufficient information reasonably available to them by the relevant date that they should have known that the AHMD and Westis transactions from 15 June 2009 were connected to VAT fraud.

1335. The employees to which the Tribunal attributes means of knowledge are: the senior managers or directors Mr Rose and Mr Cooper who were heavily involved in investigating the company's transactions throughout June and July 2009; Mr Emanuel and the traders in his team, Mr Bush, Mr Lynch, Mr Von Butler and Mr Weldon, who were responsible for conducting the impugned or prior transactions; and Mr Taylor, head of the compliance department who authored the draft Suspicious Event Report on 12 June 2009 identifying irregularities in previous trades which was circulated to others. These officers and employees were of sufficient seniority and responsibility to represent the company for the purposes of means of knowledge.

1336. The Tribunal has made specific factual findings set out above regarding the roles of these individuals in connection to the transactions and / or the amount of information available to them at the time which justify the attribution of means of knowledge.

Actual knowledge

1337. The Tribunal is not satisfied to the requisite standard that CFE, hence the Appellant, actually knew that any of its transactions with which this appeal is concerned were connected with the fraudulent evasion of VAT.

1338. In summary, and despite the compelling evidence that CFE should have known its transactions were connected to VAT fraud from 15 June 2009, the Tribunal is not satisfied to the requisite standard that any of the witnesses called on behalf of the Appellant such as Mr Rose or Mr Cooper actually knew the transactions of CFE were so connected. The Tribunal has doubted the reasonableness of some of their evidence and found some of it to be unsatisfactory or unreliable but has not made active findings that they have lied about material matters or been dishonest. It accepts their evidence that they did not know the transactions in question were connected with the fraudulent evasion of VAT.

1339. Nor is the Tribunal satisfied to the requisite standard that any of the other relevant employees of CFE who did not give evidence, such as Mr Emanuel and the traders, nor Mr Taylor, knew the transactions were so connected. However, the Tribunal has found that Mr Emanuel did not always tell the truth to the management in CFE about his awareness of the risk of VAT fraud in conducting the transactions.

1340. Further, the Tribunal is not satisfied that the circumstantial evidence, upon which it relies to make the finding as to means of knowledge, was sufficiently compelling to make the inference that any specified or non-specified individual within CFE actually knew of the transactions being connected to VAT fraud.

1341. Officer Ball on behalf of HMRC accepted that VAT fraud in the carbon credit market was a phenomenon that manifested itself reasonably quickly. Officer Ball also accepted in cross-examination that there was no evidence that CFE or CO2e had actual knowledge that the transactions in question were connected to fraud.

1342. It is also material that at no point during the period under review did HMRC offer any specific guidance to carbon credit traders as to what to look out for in terms of MTIC fraud in the carbon credit market or as to reasonable steps for traders to take prior to entering into carbon credit trades. HMRC only issued a warning letter and Notice 726 as to the risk of MTIC VAT fraud in carbon credit trading on 21 July 2009.

1343. In any event, it is unnecessary to make findings of actual knowledge where the Tribunal is satisfied that means of knowledge has been proved.

Means of knowledge

1344. The Tribunal therefore turns to concentrate upon CFE's means of knowledge.

1345. HMRC originally denied the Appellant input tax on transactions from 18 May 2009 and then, on review, from 8 June 2009. The Tribunal is not satisfied that the Appellant knew or should have known its transactions in this period were connected to the fraudulent evasion of VAT as of either of these earlier dates. For the reasons set out above and below it has concluded that 15 June 2009 is the relevant date.

The Stratex transactions

1346. The Tribunal is not satisfied that the Appellant had knowledge or means of knowledge in respect of the Stratex transactions conducted between 18 May 2009 and 3 June 2009 (although it does find that there were reasonable grounds to suspect the same at the time - see the factual findings at paragraphs 530-533 & 564-567 above).

1347. The only reasonable explanation for the Stratex transactions is that they were connected with the fraudulent evasion of VAT. However, the Tribunal is only able to come to that conclusion with the benefit of hindsight.

1348. At the time in question, any reasonable trader, such as CFE, presented with an invoice charging VAT and no VAT number should have been concerned to rule out fraud and should have suspected this to be the case. There were undoubtedly reasonable grounds to suspect the same. It matters not what trade sector the invoice was issued in. The basic requirements for VAT invoices and what needs to be held to deduct input tax are set out in VAT Notice 100.

1349. Between 18 May – 3 June 2009 Stratex made 17 sales of carbon credits to CFE totalling 2,914,000 units with a gross purchase value of €48.9 million. The largest deal was on 2 June 2009, for 300,000 units at a net price of €4.5 million.

1350. CFE's due diligence documentation in relation to Stratex is set out above. Stratex had been incorporated 7 months prior to contacting CFE and had filed no accounts. Stratex's director was resident in Israel and its company secretary was resident in Cyprus. They had been appointed 6 days before Stratex contacted CFE.

1351. Despite being a brand-new entity with no track record in trading carbon credits whatsoever, Stratex had managed to obtain this implausible volume of carbon credits at a cheaper price than Cantor could, despite its experience in the market and despite James Emanuel, the desk head, being an authority on the market. Mr Rose did not know where Stratex was obtaining its carbon credits from, did not make any enquiry as to the source and did not recall asking anyone else to make that enquiry. Mr Rose's account was that no one even told him that that Stratex was not registered for VAT.

1352. CFE never obtained any financial information on Stratex, because none existed. CFE was totally unwilling to sell these carbon credits on trust due to the risk of transferring a bearer product without payment having been made. CFE's standards applied to its suppliers. Cantor had these carbon credits predelivered into its registry to mitigate risk. That left only two

reasonable possibilities for Stratex: (1) it paid for them in advance, or (2) someone gave it credit. There was no evidence held by CFE that Stratex was acting as an "agent".

1353. There can have been no reasonable conclusion that Stratex paid for the carbon credits up front. There can have been no reasonable conclusion that someone was going to give Stratex credit in the relevant sums. That is not likely to have been commercially realistic. That Stratex should have been in possession of €48.9 million of carbon credits in 17 days in May and June 2009 was extremely unlikely to be based on true commercial trade.

1354. CFE, on receipt of the invoices, should have required a VRN and checked that it was valid. Thereafter, or in the absence of such confirmation, it should have undertaken enhanced monitoring and due diligence. Had CFE investigated how a private unregulated company such as Stratex could have provided the carbon credits to it, and properly analysed the most basic elements of Stratex's carbon credit business, the conclusion it *may* have come to was that Stratex's supplies of EUAs to CFE were connected to fraud.

1355. That CFE failed to pick up on and instead paid out millions of pounds of VAT on the Stratex invoices which bore no VRN yet charged VAT in the millions was the result of CFE's failure to take reasonable care. Had it conducted reasonable (ie. enhanced) due diligence it should not have dealt with Stratex. With the benefit of hindsight, the only explanation for the transactions was that they were connected with fraud.

1356. Nonetheless, for the reasons set out in within the fact-finding section above, the widespread infection of fraud within carbon credit trading was not known about until 3 June 2009 and so the Tribunal finds that CFE should not have known the Stratex transactions were connected to fraud at the time. It was not on sufficient notice.

1357. However, after 8 June 2009 it should have re-investigated these Stratex transactions, as it appears it did by seeking news from private investigators, and these transactions should have formed part of its cumulative means of knowledge when proceeding to conduct the impugned transactions from 15-18 June and 28-29 July 2009.

GWD/Mettec/AHMD – 8-10 June 2009 transactions

1358. Likewise the Tribunal is not satisfied that CFE had means of knowledge in relation to the GWD/Mettec/ AHMD transactions between 8 and 10 June 2009, although the Tribunal has found that the Appellant should have known that these transactions were *more likely than not* connected with the fraudulent evasion of VAT (see paragraphs 737-743 for GWD & AHMD on 8 June and paragraphs 803-805 for Mettec/Ayres on 10 June). The Tribunal has set out its reasons above in the fact- finding section as to why there was insufficient evidence by 8 and 10 June 2009 to cross the requisite threshold.

1359. The further factors that distinguish CFE's means of knowledge as to AHMD's transactions at 8 June 2009 from that at 15 June 2009, such that by the later date it should have known the transactions were so connected include: the further contact with suppliers indicating irregularity in their VAT status between 9 and 15 June; AHMD failing CFE's own 'Glove Test' and AHMD's position being queried in a draft Suspicious Event Report (which also collated the concerns with many suppliers both on 12 June 2009); and CFE's decision to treat its carbon credit trading as high risk on 15 June 2009 yet not apply enhanced due diligence by that date.

1360. The Tribunal also relies on the summary of the chronology set out below to justify the difference in means of knowledge available to CFE on 8 June 2009 as opposed to that available on 15 June 2009.

Reasons

1361. The Tribunal is satisfied that the Appellant had reasonable grounds to suspect at least by 8 June 2009 that the transactions conducted in the period up to this date were connected to the fraudulent evasion of VAT – see, for example, paragraphs 737 to 743 of the chronology above.

1362. Nonetheless, it was only by 15 June 2009 that the evidence became compelling so as to provide CFE with overwhelming grounds such that it should have known its transactions with AHMD and Westis from that date were connected to the fraudulent evasion of VAT.

1363. The Tribunal takes into account the following reasons in coming to its means of knowledge conclusion and arriving at the date of 15 June 2009:

1) The facts it has found in the chronology in respect of the accumulating evidence as to CFE's carbon credit trading: a) cumulative evidence as to VAT or other irregularities in CFE's counterparties both specifically and collectively; b) CFE's awareness of information as to risk of VAT fraud in the market; c) CFE's inadequate response to the risk it encountered which if it had responded proportionately should have revealed further negative indicators or led to it ceasing trade;
2) The relevance of an overall scheme to defraud the Revenue;
3) A commercially inexplicable increase in carbon credit trading;
4) CFE's failure to follow its own procedures, in particular to implement enhanced due diligence, when doing so would have revealed that the trade was non-commercial;
5) The decision to carry on trading with counterparties in order to protect CFE's own VAT liability;
6) The contents of the draft Suspicious Event Report and SOCA disclosures and decision not to submit a SAR;
7) The contents of CFE's own money laundering report which accepted it suspected it was the victim of VAT fraud;
8) The nature of the contact and the trades with the specific counterparties, in particular AHMD and Westis; and
9) Adverse inferences drawn in relation to employees or former employees who might have been able to give relevant evidence.

1364. In relying upon the reasons set out below, the Tribunal has adopted many, but not all, of HMRC's arguments and submissions.

(1) The Chronology – accumulating evidence as to CFE's carbon credit trading a) cumulative evidence as to VAT or other irregularities in CFE's counterparties both specifically and collectively; b) CFE's awareness of information as to risk of VAT fraud in the market; c) *CFE's inadequate response to the risk it encountered which, if it had responded proportionately, should have revealed further negative indicators or led to it ceasing trade*

1365. There is no need to repeat the findings of facts set out at length within the chronology. The Tribunal relies on all the facts found in coming to its conclusion that 15 June 2009 was the date from which CFE should have known its transactions with AHMD and Westis were connected to the fraudulent evasion of VAT.

1366. To assist the reader, the Tribunal attempts to summarise the evidence of the means of knowledge available to CFE as of 15 June 2009 as follows (with reference to the paragraphs in which the relevant facts are found):

a) cumulative evidence as to VAT or other irregularities in CFE's counterparties both specifically and collectively;

i) 18 May - 3 June 2009 - absence of VRN on invoices and lack of VAT registration of Stratex (see paras 523-567);

ii) 3 & 6 June 2009 – attempt to trade with Stratex without it having provided a VRN as requested by CFE (para 590);

iii) 3 June 2009 – conversation with Axle who promised to send a VAT number and awareness in email that CFE could not pay them without it (paras 591-592);

iv) 4 June 2009 – incomplete verification of VRNs for Adduco and Westis (para 598);

v) 4 June 2009 – querying of Mr Stork of Westis regarding the provision of Epicure's VRN – and indication CFE could not pay VAT without a valid VRN (paras 601-604);

vi) 4 June 2009 - replacement invoices of Westis provided in Epicure's name (para 605);

vii) 4 June 2009 - acceptance internally within CFE as to lack of link between Westis and Epicure and suspicion (paras 607-609);

viii) 5 June 2009 – decision to make no payments to counterparties that day without authorisation (paras 615-616);

ix) 5 June 2009 – reasons communicated to Westis for why past trades could not be changed into the name of Epicure (para 617);

x) 5 June 2009 – Adduco's VRN remains invalid yet CFE continued to attempt to trade (para 633-634);

i) 8 June 2009 – ADE, Westis and Duntai all email with similar issues over correcting and reissuing VAT invoices (paras 698-701);

ii) 8 June 2009 – trade with GWD and AHMD despite previous identified invoicing errors with the counterparties (paras 715-716);

xi) 9 June 2009 – further attempt to trade with Adduco despite knowing the VRN was invalid and Adduco's suspension of trade linked to French executive action (para 746-747);

xii) 9 June 2009 – Mr Emanuel queries ADE's reissued invoices for deals not preformed and receives explanation they were a 'mistake' (paras 760-761);

xiii) 9 June 2009 – Mr Emanuel queries the link of ADE to Westis and the similarities of invoices and receives unsatisfactory reply (paras 765 to 769);

xiv) 9 June 2009 – Mr Emanuel failing to disclose the extent of his suspicions about ADE and Westis with Mr Rose (para 772) and failing to disclose the conversation about Adduco's suspension of trade with Mr Taylor (paras 750-754);

xv) 10 June 2009 – the attempt to trade again with Adduco despite previous rebuff (paras 774-775);

xvi) 10 June 2009 – the trade with Mettec/Ayres – that was undertaken to attempt to offset VAT and in light of a previous invoice which needed correcting (para 780);

xvii) 10 June 2009 – the failure to have conducted enhanced due diligence on Mettec before this transaction (paras 784-786);

xviii) 10 June 2009 – the decision not to conduct a further trade with Mettec (para 802);

xix) 11 June 2009 – the conversation between Mr Emanuel and Mr Ayres regarding accounting for VAT and lack of valid VAT invoices (para 815);

xx) 11 June 2009 – the continued lack of any VAT registration application for Stratex despite CFE's request and lack of valid VAT invoices (paras 821-824);

xxi) 11 June 2009 – the same lack of VAT registration number promised by Adduco (para 829);

xxii) 12 June 2009 – the continuing lack of required information from Stratex and Adduco (paras 843-844);

xxiii) 12 June 2009 - evidence of attempted trade with NCL despite absence of VRN (para 855);

xxiv) 12 June 2009 – conversation with Axle regarding further trades without VRN provided (paras 856-857);

xxv) 12 June 2009 – Mr Emanuel emails management uncritically relaying innocent explanation for common invoice style of ADE and Westis when this was not ADE had told Mr Emanuel. Mr Emanuel was lying (paras 865-872);

xxvi) 12 June 2009 – communications between Mr Cooper and Kingsley Napley regarding Westis suing on invoices despite not being validly registered for VAT and attempting to use Epicure's VRN (para 876);

xxvii) 12 June 2009 – the draft Suspicious Event Report (paras 880 to 924) – this is considered separately and in detail below – it contains very damaging comments and findings regarding specific counterparties and the trade generally. There was no conclusion as to whether a SAR should be made but the recommendation was for enhanced due diligence in response to a high risk of fraud. This

document collates in one place much of the objective material justifying the means of knowledge that CFE that its trade with these counterparties was connected to the fraudulent evasion of VAT and that CFE suspected the same;

xxviii) 12 June 2009 (presumed) – draft SOCA disclosures in relation to Adduco and Westis which specifically identify the suspected offence as VAT fraud (paras 925-926);

xxix) 15 June 2009 – the lack of enhanced due diligence proportionate to the high risk applied to AHMD before its deals between 15 and 18 June 2009 which would have revealed the trade to be non-commercial (paras 964-993).

b) CFE's awareness of information as to risk of VAT fraud in the market;

i) 3 June 2009 – circulation of blog re rumours of fraud in the market (para 579),

ii) particularly in light of awareness of CFE's massive increase in business on 2 & 3 June 2009 (see paras 574-575 & 588);

iii) 5 June 2009 – Mr Rose's preparedness and decision to visit London to investigate its trade in reaction to the blog (para 624-627);

iii) 5 June 2009 – involvement of legal and tax departments (para 628);

iv) 5 June 2009 – creation of spreadsheet identifying VAT exposure and errors of VAT invoices in the 12 counterparties (checks having been made from 4 June 2009 (paras 630-632);

v) 5 June 2009 – advice from Mr Sharratt on valid VAT invoices and the 'should have known test' in relation to denial of input tax (para 663);

vi) 8 June 2009 - Suspension of BlueNext exchange trade in Carbon Credits for two days while investigating VAT fraud (paras 695-705);

vii) 9 June 2009 – email from Mr Sadler CFE is 'on notice there may be an issue in the market' (para 745);

viii) 9 June 2009 – circulation of blog re French making carbon credits VAT exempt in order to prevent a risk of potential VAT fraud (para 748);

ix) 9 June 2009 – report that French government had found a risk of carousel fraud (para 763);

x) 11 June 2009 – updated report from Bloomberg regarding the risk of carousel fraud (para 830);

xi) 11 June 2009 – Reuters report regarding Prosecutor's office probe into VAT fraud in French carbon credits market forwarded to Mr Cooper, Rose and Taylor (paras 833-834);

c) CFE's inadequate response to the risk it encountered;

i) 5 June 2009 - preparedness to offer an alternative solution to approve Epicure as a client to complete the trade instigated by Westis (para 617-619);

ii) 5 June 2009 – creation of spreadsheet as to CFE's large VAT exposure to various counterparties (para 630-631);

iii) 5 June 2009 – failure to investigate the Epicure – Westis connection (paras 637-641);

iv) 5 June 2009 – strategy decided to carry on trading to offset VAT against prior transactions (paras 651-654);

v) 6 June 2009 – decision of board meeting to suspend trading with parties once the offsetting of VAT liability had been effected – ie. CFE continued to trade with counterparties to protect its VAT position (paras 678-679);

vi) 8 June 2009 – trade with GWD without having performed enhanced due diligence and the available information which was ignored (paras 718-734);

vii) 9 June 2009 – Mr Emanuel's failure to report to Mr Taylor the conversation Mr bush had with Adduco regarding suspending trade that morning (paras 751-754);

viii) 10 June 2009 – VAT verification only takes place in relation to many counterparties after trade has concluded (para 808);

ix) 11 June 2009 – CFE's suspension of matched principal trading unless explicit instructions to do so (para 817);

x) 12 June 2009 – instruction from Mr Emanuel not to pay Aristo, Axel or Westis without speaking to him (para 836);

xi) 12 June 2009 – Mr Emanuel's offer to ADE to use CFE free of further brokerage charges for further transactions (para 837-838);

xii) 12 June 2009 - instigation of new procedures to be followed for trades (para 839- 840) which did not equate to enhanced due diligence and was not followed in any event;

xiii) 12 June 2009 – dispute between Mr Morris and Mr Emanuel regarding release of payment to Mettec – that instructions to seek authority were not followed without question (para 845);

xiv) 12 June 2009 – the 'Glove Test' which the impugned counterparties failed (para 846);

xv) 12 June 2009 – the belated or inadequate due diligence generally (para 849-850);

xvi) 12 June 2009 – evidence that the traders' prime motivation was protecting the company's profit and their own bonuses (paras 851-854);

xvii) 15 June 2009 – the categorisation of the carbon credit trade as high risk and belated implementation of compliance risk and procedures which still fell short of asking the right questions (paras 937-946);

xviii) 15 June 2009 – that Mr Taylor did not submit a SAR following discussions with Mr Rose and Mr Cooper (paras 947-957).

1367. The additional facts which further evidence the means of knowledge available to CFE regarding the Westis transactions on 28-29 July 2009 are:

i) 16-17 June 2009 – the continued unsatisfactory correspondence regarding the connection between Westis and Epicure (paras 998-999);

ii) 17 June 2009 – the first draft of a new KYC questionnaire (para 1004);

iii) 18 June 2009 – the continued withholding of VAT payment on the basis that Westis was not VAT registered (para 1015);

iv) 18 June 2009 – Mr Emanuel's attempt to solicit business from ADE (para 1017);

v) 18 June 2009 - Mr Dixon's further credit review – noting no financial information had been obtained on Westis and further information was required on its rationale for carbon credit trading, that it had no known assets despite conducting £ millions of trade (paras 1018 and 1026);

vi) 18 June 2009 - that the further credit checks were only requested on 18 June 2009 (para 1020);

vii) 18 June 2009 - the results of the review were negative for all impugned parties including AHMD (paras 1027 & 1029);

viii) 20 June 2009 – that Mr Rose declined to allow Mr Emanuel to buy further credits from AHMD on the basis he was 'not comfortable with them yet' despite CFE buying between 15 and 18 June 2009 and nothing material having changed in that time (paras 1052-1054);

ix) 22 June 2009 – that Westis had still not obtained a VRN but was still requesting payment and continuing to take legal action through solicitors Kingsley Napley (paras 1059-1061);

x) 25 June 2009 – that CFE did not disclose everything that it collectively knew about Westis at the meeting with HMRC (paras 1081-1083);

xi) 26 June 2009 – CFE's traders' reluctance to follow the new draft KYC documents (para 1091-1093);

xii) 7 July 2009 – the fact that a new KYC questionnaire was only finally devised on 7 July 2009 (paras 1114-1116);

xiii) 20 July 2009 – the provision of Westis' VAT certificate did not contain a backdating to May 2009 as promised (para 1127);

xiv) 21 July 2009 – HMRC finally issue an MTIC fraud warning letter (para 1131);

xv) 28-29 July 2009 – CFE conducted the impugned trades with Westis (paras 1140-1143 & 1158);

xvi) 28-29 July 2009 – CFE did not conduct enhanced due diligence even in light of Westis' very chequered history but relied on HMRC registering Westis for VAT (paras 1146-1147);

xvii) 28-29 July 2009 – Mr Rose cannot recall remember approving the transactions in contrast to his witness statement (para 1152-1156). He only sought copies of due diligence after the deals completed (paras 1170-1172);

xviii) 28 July 2009 – CFE had information that most of the credits purchased from Westis were actually transferred from Kaplan – a third party – which should have been discovered and acted as an adverse indicator. Not only this but CFE had rejected Kaplan as a counterparty on 28 July 2009 (paras 1158-1160);

xix) 28 July 2009 – by this time CFE had still failed to complete enhanced due diligence on Westis which would have revealed its trade not to be commercially justifiable (paras 1174-1195).

(2) The relevance of an overall scheme to defraud the revenue

1368. For the reasons set out below the Tribunal has concluded that CFE's impugned transactions formed part of an overall scheme to defraud the Revenue.

1369. The Tribunal accepts HMRC's submission that the presence of an overall scheme to defraud the Revenue may be relevant not simply to the existence of a fraud but to a party's knowledge or means of knowledge of such a fraud.

1370. The objective factors demonstrating a lack of proper commercial explanation for the trade should have formed some of the indicators to the Appellant that the nature of much of its trade in EUAs was fraudulent. It is therefore relevant to the Appellant's means of knowledge. For the avoidance of doubt, as set out above, the Tribunal is not satisfied that CFE knew that its transactions were connected with such fraud nor that it was a co-conspirator.

1371. The Tribunal has examined the wider context of CFE's transactions in VAT periods 03/09, 06/09 and 09/09, as set out below, and concluded that many of them were the product of orchestration by fraudsters as part of an overall scheme to defraud, as opposed to transactions that occurred in an ordinary commercial market.

1372. The impugned transactions were part of an overall MTIC fraud scheme involving a web of companies and "transactions" the sole aim of which was to defraud the Revenue. The transactions were orchestrated and contrived for such a purpose and had no ordinary commerciality to them. The carbon credit transactions were part of a wider circularity of carbon credits designed to facilitate MTIC fraud. The same entities participated on numerous occasions.

A majority of transactions tracing back to fraudulent tax losses

1373. The majority of CFE's carbon credits over a period of 9 months trace to fraudulent tax losses. That is impossible to understand outside of the operation of an overall scheme to defraud the Revenue. The percentage breakdown of CFE's trades connected to a fraudulent tax loss according to quarterly VAT periods in 2009 is as follows:

i. 03/09 – 72.91% (non-tax loss deals were made up of 3.8% non-UK purchases, 2.8% UK non-bank purchases and 20.5% UK bank purchases);
ii. 06/09 – 93.45% (non-tax loss deals were made up of 2.8% non-UK purchases, 0.1% UK non-bank purchases and 3.6% UK bank purchases); and
iii. 09/09 – 54.63% (non-tax loss deals were made up of 36.5% non-UK purchases and 8.8% UK bank purchases).

The sheer scale of the fraudulent tax losses

1374. Europol estimated that at its peak in 2009 VAT carousel fraud had cost EU Member State treasuries around £5 billion and that up to 90% of all carbon trading in some European countries was as a result of fraudulent activities. The Danish Registry in particular was used to perpetrate the frauds because of its lax account opening requirements which led to an increase in entities registering on it, most of whom had no association with carbon trading.

1375. HMRC has estimated UK VAT losses from carbon credit trading as between £250-300 million.

1376. BlueNext was assessed for VAT due of €355 million arising from a tax audit for the period between January 2006 – May 2009. This was ultimately settled for $42 million.

1377. A report by the Danish National Audit Office from March 2012 stated:

"72. The European VAT authorities first became aware of the fact that VAT carousel fraud was being committed in relation to CO2 allowances in May 2009. VAT carousel fraud was particularly pronounced in France and the UK during the summer and both countries therefore chose in different ways to abolish VAT on allowance trading without prior approval by the EU. 73. On 30 August 2009 SKAT recommended to the Minister for Taxation that Denmark requested the EU to approve an amendment of the Danish VAT rules to eliminate the risk of VAT carousel fraud in Denmark."

1378. The French Court of Audit stated in its 2012 Annual Report:

"4 VAT fraud in carbon trading
Extremely large scale fraud 93 *Between the third quarter of 2008 and June 2009, VAT fraud in the carbon trading market developed in France, undoubtedly involving the highest amounts ever detected by tax authorities. The Cour des Comptes estimates the tax loss to the state from this fraud as €1.6 billion. The scam was halted only after the administration issued a tax instruction on 11 June 2009 exempting carbon quotas from VAT."*

1379. The descriptions and quantum above cannot be understood absent the existence of a systematic overall scheme to defraud the Revenue.

Commonalities between the parties in CFE's supply chains

1380. HMRC's Summary of Parties in Supply Chains – provided to the Tribunal - shows the commonalities between the parties involved in the supply chains that CFE traded in. There are common addresses, company officers, accountants, and offshore banks. The companies had largely been recently formed or taken over, had little financial worth, had neither experience nor repute in the trading of carbon credits and had directors living outside the UK, with a focus on France, the Czech Republic and Israel.

1381. These commonalities are far beyond the realms of coincidence; they would only be seen in an orchestrated scheme to defraud the Revenue. Many of the traders had only one or two customers, which is a further indicator of contrivance. Mr Ayres' account given in August 2009 (above, at paragraph 790) regarding the meeting in Warwick on 10 June 2009 as to being directed with whom to trade, including CFE, cannot be explained other than by the existence of an overall scheme to defraud the Revenue.

Offshore payments including UK VAT

1382. Payments were used in several of the transaction chains to divert monies including UK VAT abroad, to accounts in Hong Kong and at the same bank in Cyprus (Marfin), and beyond the UK authorities' immediate grasp. This is indicative of an overall scheme to defraud the Revenue.

The relevance of the overall scheme to defraud to CFE's knowledge or means of knowledge

1383. HMRC submitted that whether CFE's transactions on which it has been denied the right to deduct, and those that it undertook previously in 2009 were part of an overall scheme to defraud the Revenue is probative of CFE's knowledge or means of knowledge as to the connection between its transactions and the fraudulent evasion of VAT.

1384. The Tribunal is satisfied it is relevant to its decision as to the role played by CFE in the impugned transactions to understand, firstly, whether they were part of an orchestrated scheme, and if so, how it operated, in order to assess whether CFE should have known after 15 June 2009 of the connection to fraud.

1385. It is unnecessary to demonstrate by direct evidence that CFE knew of individual elements of the fraud if the Tribunal is satisfied that the nature and operation of the fraud itself is sufficient to infer that CFE should have known.

1386. In order to prove means of knowledge, HMRC do not need to point to any single piece of evidence that provides the conclusion that CFE should have known that the transactions were connected with the fraudulent evasion of VAT, but HMRC can rather rely upon the inferences that can be drawn from the circumstantial evidence as a whole in relation to CFE's transactions for that conclusion.

1387. Pollock CB's famous dictum in *R v Exall* (1866) 4 F & F 922 in relation to the comparison between circumstantial evidence and a rope comprised of several cords is particularly applicable to cases such as this. The Tribunal is invited by authorities such as *Mobilx* to look at the cumulative circumstances of CFE's transactions when deciding whether CFE knew, or should have known, of the relevant connection:

"One strand of the cord might be insufficient to sustain the weight, but three stranded together may be quite of sufficient strength. Thus it may be in circumstantial evidence - there may be a combination of circumstances, no one of which would raise a reasonable conviction, or more than a mere suspicion: but the whole taken together, may create a strong conclusion of guilt, that is, with as much certainty as human affairs can require or admit of."

1388. As the Tribunal has concluded that the "surrounding circumstances" of the impugned and previous transactions include that they took place as part of an orchestrated and efficient fraud then, following *Mobilx,* it should take this into account in determining whether CFE should have known that its transactions were connected with the fraudulent evasion of VAT.

1389. CFE was in a pivotal position in the overall scheme to defraud the Revenue. In its transaction chains it was the first established and regulated trader to receive the carbon credits. On review of the initial assessments, HMRC accepted that CFE had effectively been duped into undertaking the transactions that traced to fraudulent tax losses prior to 8 June 2009 (Stratex aside) as part of this massive scheme to defraud the Revenue.

1390. The Tribunal finds that CFE was 'duped' throughout by fraudulent suppliers and counterparties in the sense that it participated in fraudulent chains of transactions without actively knowing it was doing so. Nonetheless, had it applied more reasonable and proportionate standards of due diligence from early June 2009 it would not have been. It should have known the transactions were connected to the fraudulent evasion of VAT from 15 June 2009.

1391. Duping CFE relied on (a) CFE's initial lack of interest in or even awareness of the risks posed to the carbon credits market by widespread VAT fraud, and (b) thereafter, CFE's KYC, AML and CDD checks being basic or standard, lacking enhanced due diligence and so lacking in analysis that CFE was prepared (at times almost recklessly) to trade with companies it should not have done.

1392. In this case, as soon as it became clear from the closure of BlueNext on 8 June 2009 and other information that there was something seriously wrong in the carbon credits market, CFE should have dug deeper to see the reality of what was taking place, which was orchestrated VAT fraud on a large scale.

1393. By 15 June 2009, given the failure of the counterparties to pass the Glove Test and the categorisation of the trade as high risk, it should have effected enhanced due diligence on its counterparties and ceased trading in response to negative indicators. Once armed with the awareness of the substantial risk that VAT fraud was afoot in the market in which it was trading, and having undertaken even a reasonable examination of the background (or rather lack it) of the great majority of its suppliers, it should have been obvious, at the very least, to those at CFE that their trade was directly connected to VAT fraud.

1394. CFE was not some one-man band that could have been ignorant of or have mistaken the apparent indicators of fraud. Its desk was led by a man, Mr Emanuel, who held himself out as an authority on the market. Its traders were experienced. It had huge resources in terms of market knowledge and experience, legal, tax, compliance and financial expertise. As an entity CFE was a sophisticated enterprise.

1395. That those engaged in VAT fraud on such a scale should have been attracted to CFE, with so many different suppliers for such a period of time engaged in the fraud, provides a

supporting inference that CFE, at the very least, should have known what was happening in the market from 15 June 2009.

1396. The fact that even as at 10 June 2009 Mr Ayres was being told by those at the behest of the orchestrators of the fraud to open an account with CFE (see paragraph 790 above) suggests that it was known that CFE was a good company to trade with from the fraudsters' viewpoint.

1397. The level of orchestration in the scheme of which CFE's transactions formed a part is relevant because it made the existence of the scheme obvious by 15 June 2009.

1398. If authority were needed for the proposition that the level of orchestration in a scheme is a factor relevant to the CFE's means of knowledge, it can be found in *Edgeskill Ltd v HMRC* [2014] UKUT 38 (TCC) where at [55] Hildyard, J. said:

"Issue (4): was there (a) an overall scheme to defraud (b) to which the Appellant was knowingly party?

55. The two parts of the fourth, final and most important question are inter-related; but they were, quite correctly, dealt with in turn by the FTT in its Decision, since the question whether the Appellant participated in an overall scheme to defraud informs, but does not answer, the question whether the Appellant knew or should have known that it was participating in such a scheme."

1399. Given the Tribunal has concluded that the impugned transactions formed part of an overall scheme to defraud the Revenue, that raises inferences about the Appellant's means of knowledge as to the transactions.

1400. In an overall scheme to defraud the Revenue, the transactions are contrived solely with that purpose in mind. Those orchestrating such a scheme do not tend to leave matters to chance, nor do they tend to abandon the rewards by involving parties who do not know what they are doing. To do so is to run the risk of exposure to the authorities by a party who uncovers the purpose of a transaction, and to run the risk of the scheme not going as planned. There remains, however, always the possibility of the innocent dupe.

1401. In respect of the counterparties other than Stratex that CFE dealt with prior to 8 June 2009, HMRC submitted: *"...it's accepted by the Revenue that the appellant neither knew nor should have known that the transactions were connected with fraud."*

1402. That duping relied upon a lack of knowledge of the risk of fraud in the carbon credits market and financial institutions such as CFE carrying out such limited checks on their counterparties that it was almost prepared to trade with anyone who had a certificate of incorporation and passed the most basic KYC and AML checks. That the Appellant was an innocent dupe does not mean that the transactions that took place prior to 15 June 2009 are irrelevant.

1403. The Tribunal has found that by 15 June 2009 CFE had accumulated substantial knowledge of the risk of fraud in the market in which it was trading.

1404. It should have been obvious to CFE that its transactions with those unregulated counterparties had been part of a carousel fraud when: it looked back at the transactions which it had undertaken from March 2009, which it demonstrably did and should have done; in the later knowledge of the risk of the VAT fraud; having made the link between VAT irregularities in the invoices provided by its counterparties and that risk of fraud; and having determined that its unregulated counterparties had numerous links between them, had little or no capital, had

little or no experience in the carbon credit market and had been trading unfeasible levels of carbon credits.

1405. When it decided to trade on with AHMD and Westis from 15 June 2009 CFE should have known that the transactions were connected with the fraudulent evasion of VAT.

1406. The scheme of which the impugned transactions formed a part, relied on carbon credits being circulated time and time again through fraudulent defaulting traders with VAT monies being removed on each spin of the carousel.

1407. If a party in receipt of such credits decided not to sell them but to retain them all, for example, because they believed that the market may rise at a certain point in the future, that would imperil the operation of the scheme. The existence of an overall scheme to defraud the Revenue is therefore suggestive of the means of knowledge of those whose transactions form part of it.

1408. The features of that scheme are likewise probative e.g. if circularity of carbon credits is present, the Tribunal is entitled to ask – how was this circularity achieved? Can it have occurred by accident or is it a product of contrived trade? If the trade was contrived then how could a sophisticated entity such as CFE/CO2e miss it?

1409. For example, those fraudsters who traded with CFE ran the risk, if CFE did not know the purpose of the transactions, of their being reported to the Serious Organised Crime Agency ('SOCA' – as then responsible) via a suspicious activity report. This scheme relied upon a sophisticated financial institution such as CFE, not making such a report to SOCA as it would stop the fraud at a stroke because consent would be required for trading to continue.

1410. In this case such a report was drafted in respect of two fraudulent traders but no such report was ever submitted without the reasons why being recorded. In the context of an overall scheme to defraud the Revenue the Tribunal is entitled to ask – why is that when the scheme relied on such reports not being made? This kind of behaviour suggests either a willing or 'Nelsonian blindness' or an almost reckless indifference to the propriety of the transactions entered into.

1411. As the Tribunal has concluded that all of the Appellant's transactions that are subject to this appeal were part of such an overall scheme to defraud the Revenue, the Tribunal is also entitled to ask – why is it that the orchestrators of this scheme chose CFE to be involved? Why were so many different suppliers who were engaged in the fraud attracted to CFE?

1412. One answer is: because CFE knew the purpose of the transactions. However, the Tribunal has not been satisfied of this.

1413. The Tribunal finds the more likely answer to be: the fraudsters knew that CFE would trade with anyone with a certificate of incorporation, not investigate or conduct effective enhanced due diligence into transactions that appeared extraordinary, make insufficient enquiries if any of the companies they were using to facilitate the fraud and would be unlikely to report any suspicions to the authorities.

1414. Again, the existence of an overall scheme is of relevance to whether the Appellant should have known that the transactions were connected with fraud. These were not one-off deals or small sums of money being dealt with.

1415. Another way of looking at it is this: if the existence of the overall scheme to defraud the Revenue was obvious from its cumulative features by 15 June 2009, how and why is it that CFE failed to understand what it was part of? Again, the existence and features of an overall scheme to defraud the Revenue go to the question of whether the Appellant should have known that the transactions were connected with the fraudulent evasion of VAT.

1416. The Tribunal therefore does not agree with the Appellant's approach, which is that once the connection with fraud is established then all evidence relevant to those limbs is irrelevant. The Tribunal is persuaded that the existence of an overall scheme is relevant to CFE's means of knowledge.

1417. But for the exclusion of hindsight properly understood (which is not the same as reliance on fact established after the event), the Tribunal does not confine itself in answering the means of knowledge question in *Kittel* to facts only demonstrably known to the Appellant at the time of the transactions. To do so would ignore the binding authorities such as *Mobilx*.

1418. Moses. LJ. endorsed the approach of Christopher Clarke, J. in *Red 12* in *Mobilx* at [83]:

"83. The questions posed in BSG (quoted here at § 72) by the Tribunal were important questions which may often need to be asked in relation to the issue of the trader's state of knowledge. I can do no better than repeat the words of Christopher Clarke J in Red12 v HMRC [2009] EWHC 2563:- [109]-[111]
….
[111] Further in determining what it was that the taxpayer knew or ought to have known the tribunal is entitled to look at the totality of the deals effected by the taxpayer (and their characteristics), and at what the taxpayer did or omitted to do, and what it could have done, together with the surrounding circumstances in respect of all of them."

1419. Discerning that a transaction was part of a fraudulent scheme was therefore an approach explicitly endorsed by the Court of Appeal. The Tribunal does not ignore inferences to be drawn from the existence of such a scheme in this case.

Circularity

1420. HMRC argued that the Tribunal should place significant weight on the circularity of the trade in the carbon credits when assessing CFE's knowledge or means of knowledge.

1421. The scheme relied upon multi-national financial services companies such as CFE, Barclays Capital and Citibank providing the liquidity in the form of the input VAT and ex-VAT purchase price paid by them. The fraudsters operated with such ease that they rarely needed to have recourse to buffer traders.

1422. In MTIC frauds there can sometimes be a long chain of "buffer" traders between the fraudulent defaulter and the "broker" trader reclaiming input tax. The "buffers" distance the broker from the defaulter and generally increase in status the further up the chain one goes, from the companies of no substance at the defaulter end to more established customers at the "broker" end.

1423. In this scheme those orchestrating the fraud saw little need for buffers because large and reputable financial services companies would trade with small and unknown companies such as CFE's suppliers without enhanced due diligence. Those companies were asked insufficient questions because OTC trading of these carbon credits was highly profitable, and there were good bonuses to be had for the traders involved.

1424. The scheme relied upon the swift circulation of carbon credits through a network of fraudulent defaulting traders to defraud the Revenue of the output VAT charged by those traders on each revolution of the carousel. Each carbon credit has a unique number which is recorded in the relevant registry when the credit is transferred. The carbon credits traded in the scheme were traded in blocks where the first and last credit had their number recorded.

1425. As set out in HMRC's Circularity Analysis, CFE traded on many occasions the same blocks of carbon credits which had been circulated through fraudulent defaulting traders. For example, the second set of entries in the analysis shows that between 5 May – 5 June 2009 CFE traded the same 4,000 unit block five times, which had passed through the fraudulent traders Adduco, Westis, BMC (twice) and Duntai.

1426. The same pattern occurs a number of times in the circularity analysis. BMC in particular repeatedly traded the same blocks of carbon credits with CFE. There is no commercial explanation for this pattern of trade. The only explanation for it is widespread and well organised MTIC fraud.

1427. By 15 June 2009 the warnings of the risk of fraud in the carbon credits market were specifically of carousel fraud i.e. the same carbon credits circulating time and again with VAT defrauded on each circuit.

1428. The Appellant asserted during the course of cross-examining Officer Ball that it did not retain the individual certificate numbers for carbon credits. The Tribunal accepts that it did not retain the individual certificate numbers but it could have done so.

1429. Officer Stone's unchallenged evidence is that account holders within the registries had access to historic information about their own transactions including volumes and certificate numbers. Indeed, Commission Regulation (EC) No 2216/2004 Annex XV [13-14] stipulated:

"13. Each registry administrator shall display and update the information in paragraph 14 in respect of its registry on the secure area of that registry's web site, in accordance with the specified timing.

14. The following elements for each account, by unit identification code comprising the elements set out in Annex VI, shall be displayed on the account holder's request to that account holder only:

(a) current holdings of allowances or Kyoto units;

(b) list of proposed transactions initiated by that account holder, **detailing for each proposed transaction the elements in paragraph 12(a) to (f)**, the date and time at which the transaction was proposed (in Greenwich Mean Time), the current status of that proposed transaction and any response codes returned consequent to the checks made pursuant to Annex IX;

(c) list of allowances or Kyoto units acquired by that account as a result of completed transactions, detailing for each transaction the elements in paragraph 12(a) to (g);

(d) list of allowances or Kyoto units transferred out of that account as a result of completed transactions, detailing for each transaction the elements in paragraph 12(a) to (g)." (emphasis added)

1430. Paragraph 12(a) to (g) sets out the following elements:

"(a) account identification code of the transferring account: the code assigned to the account comprising the elements set out in Annex VI;

(b) account identification code of the acquiring account: the code assigned to the account comprising the elements set out in Annex VI;

(c) account holder name of the transferring account: the holder of the account (person, operator, Commission, Member State);

(d) account holder name of the acquiring account: the holder of the account (person, operator, Commission, Member State);

(e) allowances or Kyoto units involved in the transaction by unit identification code comprising the elements set out in Annex VI;

(f) transaction identification code: the code assigned to the transaction comprising the elements set out in Annex VI;

(g) date and time at which the transaction was completed (in Greenwich Mean Time);

(h) process type: the categorisation of a process comprising the elements set out in Annex VII." (emphasis added)

1431. Accordingly, CFE could have had access to the unique carbon credit numbers that it traded. Had it examined the records available it would have been possible to determine that large amounts of the carbon credits traded by it had been re-circulated in a carousel, often within a very short space of time, since it was repeatedly dealing in the same blocks of credits.

1432. Had CFE looked at the information available to it showing the re-circulation of carbon credits, in the light of what it knew of its counterparties and the risk of carousel fraud, it would have supported a conclusion that its earlier transactions were part of the very carousel fraud it was warned about the risk of.

1433. Had CFE looked at the information available to it, CFE should have concluded that previous trading with the unregulated counterparties was part of a carousel fraud. It should also have concluded that future trades with those same counterparties, as in the transactions that are subject to this appeal, would also be part of a fraud. The circularity in the transactions prior to 15 June 2009 included CFE's purchases from: Westis, AHMD, GWD and Ayres i.e. the suppliers in the transactions that were in dispute after 8 June 2009.

1434. The Tribunal is satisfied that CFE did not keep records of these unique numbers and did not have sufficient reason to review unique numbers until the risk was obvious by 15 June 2009.

1435. The Tribunal is not satisfied it was reasonable or proportionate for CFE to have checked the unique numbers of the carbon credits that it was trading before it knew of the real risk of carousel fraud in the market by 15 June 2009.

1436. Thereafter CFE had easy access to the records and should reasonably have kept records and known of any instances from 15 June 2009 when it was trading the same units on repeated occasions. At this point, if a retrospective analysis had been conducted it would have become apparent that the same credits were being traded time and time again, for which there was no commercial explanation.

1437. However, the Tribunal finds it would have been difficult to discover that the trades with AHMD between 15-18 June 2009 and Westis between 28-29 July 2009 consisted of recycled

credits without having access to records of the unique numbers throughout May 2009 and up to 8 June 2009, a time period during which it would not have been reasonable to expect CFE to keep records. Further, not every transaction it entered has been proved, with hindsight, to be a circular trade.

1438. In those circumstances while the facts proving the circularity of some of the Appellant's trade is an indicator of the fraud which was taking place, the Tribunal is not satisfied it supports a finding the Appellant knew or should have known of the fraud taking place within the impugned transactions.

1439. Therefore, the Tribunal does not rely on the circularity of trades when assessing the Appellant's means of knowledge.

(3) A commercially inexplicable increase in carbon credit trading

1440. CFE's trade in carbon credits rocketed through May and June 2009 as set out above. It transacted over 12 million units in May 2009 and 8 million in June 2009.

1441. After July 2009 the DG Environment data of carbon credits transferred to CFE shows that CFE's business continued to fall off. No carbon credits were purchased in August 2009, 503,067 in September, 458,436 in October, 13,751 in November and, none in December.

1442. The increase in CFE's carbon credit trading between May – June 2009 cannot be explained by ordinary commercial factors.

1443. On 3 June 2009 Bloomberg circulated a press release from the London Energy Brokers Association announcing that emissions trading handled by brokers had increased 82% in the first 5 months of 2009, with trade in EUAs (the type of carbon credit traded by CFE in the majority of its transactions) increasing 75% for the period January – May 2009 compared to the same period in 2008.

1444. CFE had shortly beforehand, on 22 May 2009, issued a press release claiming that its volumes and revenues were up 500% on that same five-month period a year earlier saying *"Since we refocused our business on core brokerage, our volumes and liquidity have soared"*. Mr Rose claimed that CFE's increase in trading from January to May 2009 was *"in line with …market commentary"*. As the Tribunal has already found, the material relied upon by Mr Rose does not support such a broad statement.

1445. CFE's figures meant that it had been outperforming the market increase by a very large factor which might have led it to ask questions about how this was coming about. Despite this, Mr Rose claimed in his witness statement: *"…it provided further confirmation to me that the increase in trading volumes experienced by the EU Carbon Desk was consistent with the wider market."*

1446. Mr Rose stood by this explanation in his evidence. The Appellant suggested in opening that the fact of the spike in carbon credits trading was in some way applying hindsight; it is not. As at 3 June 2009, the date of the first blog, CFE knew that it was outperforming the rest of the EUA market increase by a factor of more than five. That alone was obviously too good to be true. The very next day, on 4 June 2009 Mr Rose messaged Mr Craib saying: *"Spot euas is a great business...easy and huge mkt"*.

1447. In his evidence Mr Rose claimed that he could not recall why he had described the spot EUAs thus. The implication is obvious. CFE's view was that this was easy profit for little effort. This was a long way from the *"survival of the fittest"* and intense competition envisaged by Mr Emanuel in his 2008 plan for the business.

1448. CFE's profit and success has to be measured not only against the rest of the market, but also against the fact that it had been loss making until it started to trade with Adduco in 2009.

1449. Mr Rose confirmed in his evidence that until 2009 the CO2e international division was not making money and was losing money and that in the first six months of 2009, brokerage of carbon credits became the most important source of revenue generation for the international division. Mr Rose confirmed that during this time the focus was on the carbon trading desk and he said that the international division was wound up in 2010 because Cantor had not received a return on its investment.

1450. Mr Emanuel's 2008 plan for the carbon desk was to capture *"regular compliance driven business from companies with no other visible route to market…"* which Mr Rose understood to mean that the counterparties would themselves be emitters. Absent that plan working, the carbon trading desk could not continue its business. The plan did not prevent CO2e suffering a loss in 2008 of over $2 million.

1451. However, CO2e turned around its fortunes in 2009 to make a profit of nearly $900,000 based on the increased trade in carbon credits.

1452. CFE's purported turnaround, from a loss-making to profitable enterprise in the space of just 3 months from March to June 2009, was a rapid and easy reversal of fortune.

1453. In the words of Moses, LJ. in *Mobilx* at [84], CFE chose "…to ignore the obvious explanation as to why [it] was presented with the opportunity to reap a large and predictable reward over a short space of time."

1454. CFE proffered various explanations for this increase in trade, all of which appear to stem from the claims of Mr Emanuel and none of which have a reliable, documented or independent evidential foundation.

1455. Mr Emanuel's first claim to explain CFE's rocketing increase in trade was that its counterparties were local consultants working for local emitters.

1456. Mr Rose said in his witness statement that Mr Emanuel had said:

"…that the counterparties were businesses set up as environmental consultants acting for small and medium sized emitters in various different European Countries. The consultants would give advice to the emitters on matter such as their carbon footprint projections, use of green energy and compliance requirements. The consultants may have been paid by the emitter in EUAs. The consultants would also provide a liquidity service selling excess allowances on behalf of these small and medium sized emitters who would otherwise not have necessarily been able to access the market easily…Mr Emanuel's suggestion that there were a huge number of EUAs in the market which the counterparties were aggregating seemed credible to me."

1457. Mr Buchan echoes this saying: "The counterparties were understood to be akin to brokers and aggregators who sold excess allowances provided as payment for consultancy services or on trust by emitters who would not have otherwise been able to access the market directly."

1458. The explanation about a group of local consultants who were aggregating carbon credits from smaller polluters is without evidential foundation and contradicted by the country references of the carbon credits traded by CFE, each of which recorded the country of issue. As an example, the carbon credits purchased by CFE were issued all over Europe and Scandinavia yet the companies that it purchased from were all in the UK and where they had foreign residents as directors those directors lived in Israel, France or the Czech Republic.

1459. There was no group of local consultants aggregating carbon credits, being paid in carbon credits (and apparently paid an astonishing amount), or being allowed to sell carbon credits "on trust". It is an inaccurate picture recounted by Mr Emanuel which in the absence of any reliable or independent evidence to the contrary as to its justification, the Tribunal is satisfied was relayed without regard to its reliability.

1460. The transaction chains do not trace to an original holder of carbon credits, instead the transactions trace repeatedly to fraudulent defaulting traders. This suggests that the chains were established for the purposes of a fraud on the Revenue.

1461. It was submitted on behalf of the Appellant that the evidence would show that what the Appellant believed at the time of the transactions was that its counterparties were environmental consultants, acting on behalf of small and medium-sized emitters in various member states. It was understood that these consultants were either paid for their services in carbon credits, or that they offered liquidity service to emitters wishing to sell excess credits who otherwise had no route to market themselves.

1462. The evidence shows no basis for that belief.

1463. It was submitted that the Appellant would not necessarily have expected its counterparties to have an established track record in trading carbon credits, or to be significantly capitalised in order to carry out that activity. It was submitted that the Revenue did not challenge the credibility of that explanation. It was submitted to be a perfectly reasonable explanation as to who the Appellant believed its counterparties to be. The Appellant submits there is no evidence to support HMRC's allegations that the Appellant had no basis for believing that or that Mr Emanuel simply invented it in order to deceive others at the bank.

1464. The Tribunal does not accept the credibility of Mr Emanuel's explanation as it had no reliable, independently documented basis. It cannot be equated to a reasonable one yet insufficient attempts were made to test or require evidence in support of the explanation relied upon.

1465. It was a theme of Mr Rose's evidence that on crucial matters he simply relied on what Mr Emanuel or others told him. Mr Rose could not identify any utilities companies or emitters that CO2e was trading with in the Spring of 2009 but believed that CO2e was trading with such companies because Mr Emanuel and Mr Von Butler told him so. His view was that he had reasonable explanations from Mr Emanuel and others that gave him comfort as to with whom CO2e was dealing.

1466. Mr Rose said that Mr Emanuel told him that the counterparties were largely local consultants who were sourcing carbon credits from local emitters. Mr Rose did not know the source of Mr Emanuel's information and did not specifically recall asking Mr Emanuel what the source was. Mr Rose could not recall which of the counterparties traded with between March and June 2009 were environmental consultants. Mr Rose could not recall whether

anything was ever provided to him in writing to the effect that the counterparties were consultants. Mr Rose could not recall whether Mr Emanuel had said that he had prior knowledge of any of the counterparties or had worked with them or their directors prior to the commencement of trading with CO2e.

1467. There is little if any documentation of good provenance that supports Mr Emanuel's account. To this the Tribunal can add the inference from his absence as a witness to conclude that this account was given with reckless indifference to the truth. The same applies to the other explanations proffered below.

1468. A further explanation provided to Mr Rose was that the counterparties were consultants who were providing a service and being paid in carbon credits or were simply offering an avenue to liquidity for those credits for their clients.

1469. This is yet another unreliable explanation. If these "consultants" were being paid in carbon credits then they were being paid tens of millions of Euros. That explanation should have been dismissed as commercially unlikely or at least investigated once the other features of the trade had made it apparent to CFE that there was a real risk of fraud in the market.

1470. Further, CFE's original plan was to be dealing with just those emitters who are now said to be these middlemen. There is no commercial reason why these emitters would not have come directly to CFE, who Mr Rose said put forward its credentials as a *"leading global provider of financial services to the world's environmental and energy markets"*. There was no commercial reason why these minnow counterparties should have been able to obtain credits at a lower price that CFE, an apparent giant of the sector.

1471. It is clear that Mr Rose's understanding of the market was limited and he relied heavily on others for explanations as to the trading.

1472. Mr Rose did not view it as his job to know the detail of where the carbon credits were coming from or where the directors of CFE's counterparties were located. He did not know what checks would be carried out to open a registry account. He did not know how the transactions were actually effected. He was not aware of who the people were who were opening new accounts with CFE.

1473. He relied on other people in the firm that had the knowledge to be able to do what was right. He relied on the London team to provide a rigorous control framework in place to guard against the operational risks created by matched principal trading. He relied on the brokers and the firm's functions to advise whether they were comfortable trading with the relevant counterparties. He trusted Mr Emanuel that he knew where the business was coming from and that the rest of the firm's support areas were doing their job to make sure that the business was operating correctly in line. Mr Rose said that from his point of view there were always explanations for why the transactions could be legitimate.

1474. Mr Rose did not know enough about how the business worked to say whether emitters could just as easily have approached CO2e directly as have used consultants. Mr Rose accepted that CO2e's counterparties did not need a UK presence in order to trade with it.

1475. It is plain that Mr Rose can do little more in terms of providing a reasonable explanation for the transactions than repeat what Mr Emanuel, and others, told him.

1476. The same applied to Mr Buchan. Mr Buchan did not accept that a carbon credit was something in bearer form. Mr Buchan initially refused to accept the obvious, that the new business plan for CO2e was that it would provide the access to the market for emitters. Mr Buchan initially accepted that the bid-ask spread was where CO2e was to make its profit on the business plan yet struggled to accept that the basic premise of the plan was to buy at a lower price and sell at a higher price.

1477. Despite accepting that the risk department should not have been taking as gospel what the traders told it, Mr Buchan could provide no reasonable explanation for his belief that the relevant counterparties were agents or environmental consultants. The effect of his evidence was that the belief was based on nothing more than the fact that the counterparties had actually sold CFE some carbon credits.

1478. What is more, Mr Emanuel and the traders appear to have kept parts of the truth of what was happening from Mr Rose and others.

1479. Mr Rose did not know whether ADE, Westis and Duntai were in fact independently run, as Mr Cooper had told HMRC on 25 June 2009. Mr Rose recalled that an explanation given to him by Mr Emanuel for similarities in invoices was that there was a common administrative services provider but Mr Rose did not recall Mr Emanuel providing any specific evidence to back up this explanation.

1480. Mr Rose did not recall whether Mr Emanuel made him aware of the exchange with ADE that followed ADE's provision of invoices for Westis trades. Mr Rose did not recall Mr Emanuel making him aware that it appeared to him that Westis and ADE were one and the same, despite his obvious disbelief of ADE's account that it had nothing to do with Westis. Mr Rose could not account for Mr Emanuel's willingness to overlook his concerns about ADE and offer them free brokerage to continue trading. The risk department was apparently not informed of the truth of the position about Westis and ADE either.

1481. Mr Buchan's recollection of the *"understanding"* that these counterparties were selling millions of carbon credits *"on trust"* is also without reasonable foundation. CFE was unwilling to sell these credits *"on trust"* due to the risk involved in doing so.

1482. Mr Buchan made it a general requirement that CO2e received delivery of the carbon credits before making payment because of the risk of doing otherwise. He accepted that the financial status of the customer was relevant to the structure of the transaction when the terms of payment involved something other than simultaneous payment and receipt.

1483. Mr Buchan accepted that CFE was not willing to release carbon credits on trust and that it would not be prudent to do so. Mr Buchan's attempts to explain why another participant in the market would release these credits on trust were unreasonable. Mr Buchan would not accept the obvious, that it would be bad sense to transfer £5 million of carbon credits to an insolvent company. Mr Buchan could not provide a convincing explanation of the basis for his belief that CFE's counterparties were being paid in carbon credits for consultancy.

1484. If therefore follows that there was no reason for another commercially rational player in the market to do otherwise. What is more, it would have been commercially dangerous for someone with millions of carbon credits, in bearer form, to have transferred them to these minnow traders on credit when they had next to no financial standing. CFE viewed its own

strong balance sheet as providing comfort to counterparties – the same logic therefore applies to its counterparties.

1485. Mr Cooper provided a new apparent explanation, not in his witness statement, for the trading by the relevant counterparties when he gave oral evidence:

"It was a common school of thought at the time that what was probably going on here was a bunch of traders coming out of banks, things like that, who have set up their own trading operation…Or wherever they had come, from financial institutions, that were trying to make a go of things on their own, day traders, things like that."

1486. There was no evidence before CFE that these traders had come out of banks or other financial institutions. It must have been obvious to those dealing with these counterparties that they had not come out of a financial institution. They always wanted to sell whatever the market was doing and regardless of price. Furthermore, they did not display any of the commercial acuity that one might associate with ex-professional traders.

1487. There is no other apparently reasonable explanation advanced for CFE's sudden increase in carbon credits trading fuelled by these minnow counterparties. The only reasonable explanation was fraud and this should have been apparent by 15 June 2009.

1488. That is so without even examining the finer details of those counterparties and their commonalities. The explanation advanced by CFE as to local aggregators aggregating carbon credits from local emitters and either doing so on trust or as a form of remuneration for their services is not reasonable because it was a fiction.

1489. The main author of the explanations relied on by CFE, Mr Emanuel, has not been called by the Appellant to provide any evidence in support of it. The inference is that this was an attempt to explain away the inexplicable or an explanation given without reasonable care and relied upon without reasonable care. The only reasonable explanation for CFE's trade with the relevant counterparties was fraud. This is obvious with hindsight in relation to the all the trade but should have been apparent to the Appellant from 15 June 2009 in light of all the other information available to it.

1490. Once CFE was aware of the high risks of VAT fraud in the market by 15 June 2009 it should have been obvious to those at the company that its rapid increase in trade with these small counterparties was too good to be true. Despite this CFE carried on trading with counterparties involved in that rapid increase in trading. That CFE did so is probative of CFE's means of knowledge that the transactions from 15 June 2009 were connected with the fraudulent evasion of VAT. Had CFE retained and then looked at the information available to it from the variety of sources set out above it should have been obvious that the explosion of trade with the unregulated counterparties was attributable to carousel fraud.

(4) CFE's failure to follow its own procedures, in particular to implement enhanced due diligence

1491. Ms Mills was produced by the Appellant as a witness who could offer her opinion on what checks had been carried out by CFE on its counterparties by references to the JMLSG Guidance and her subsequent experience at CFE. Ms Mills was not at CFE at the time of the transactions and only joined the company in 2011. Ms Mills accepted that the business as a

whole had to consider its potential exposure to fraud. Ms Mills accepted that there were money laundering aspects to be considered in relation to tax fraud.

1492. Ms Mills was a witness manifestly trying to do her best to assist the Tribunal and gave evidence honestly. However, her evidence was predicated on a false assumption, that CFE had categorised trading with the relevant counterparties as low risk.

1493. The Money Laundering Reporting Officer's report for 2007 gave a risk rating of 3 out of 5 for trading with unregulated clients, which is medium to high. The report recommended that enhanced monitoring was undertaken on the business with unregulated counterparties. Ms Mills accepted that enhanced monitoring was for high risk accounts. There is no evidence that this recommendation was downgraded prior to the transactions that are subject to this appeal.

1494. Ms Mills then tried to suggest that this explained why documents over and above the basic requirement in the JMLSG guidelines were obtained. Ms Mills went from a position that this was all low risk trade which required basic CDD, to the position that this was higher risk trade which is why more than basic CDD had been done. This position is difficult to maintain.

1495. Ms Mills refused to accept what was before her, namely that CFE's own assessment prior to the relevant transactions was that the unregulated counterparties should have been subject to enhanced monitoring because they were higher risk, and that this was, at best, an assessment of medium risk. In consequence, she would not accept that her assumption that this was low risk trade must be wrong.

1496. Her attachment to this mistaken assumption in her witness statement does not assist the Appellant's case. Through no fault of her own, and despite genuinely wishing to assist the Tribunal, Ms Mills was not sufficiently informed and independent for the Tribunal to place much weight on her opinion evidence as to the quality of CFE's AML procedures in 2009.

1497. Ms Mills could not point to any documents when asked where the evidence of enhanced monitoring was. Ms Mills' statement that the desk head (Mr Emanuel) should have been reviewing trades at the end of every day and week and figuratively signing them off was made without knowledge that no evidence of any such sign-off in documentary form has been produced by CFE in these proceedings.

1498. Ms Mills accepted that the reasons for CFE reclassifying the OTC trade in carbon credits with unregulated entities as high risk; namely, the nature of the carbon credit business, the type of client base and the fact that the credits were in bearer form, were all known to CFE before the issue of VAT fraud came to light. CFE also knew from the outset of its trading that carbon credits were subject to VAT.

1499. Ms Mills accepted that whether a company was working out of a serviced office is a factor that could be taken into account in the customer identification process as raising a concern. The JMLSG guidance notes required CFE *"…to know who their customers are, what they do and whether or not they are likely to be engaged in criminal activity."* Ms Mills accepted that this was correct.

1500. Mr Sharratt says in his witness statement:

"I had several conversations with CantorCO2e during the following weeks and my primary contacts were Steve Treanor and Mark Cooper, the General Counsel for Europe and Asia. My

recollection of these conversations is that the business was aware that they were dealing with new entrants to the EUA market. However, they were unable to tell whether the anomalies on VAT invoices which they had discovered had arisen from a lack of business sophistication and back office functions or whether their counterparties might be in fact involved in VAT fraud. The suppliers were saying that their main concern and driver for their threats of legal action was the effect on their cash flow - if CFE withheld the VAT they would be unable to pay their own suppliers and would be placed in financial difficulty, for which they would blame CFE. Until there was clearer evidence of fraud, there was no assumption that CantorCO2e's supply chains might be tainted by VAT fraud. As a result, the principal focus of my advice was on the requirement to obtain a valid VAT invoice in order for CantorCO2e to recover its input VAT and, subsequently, on the question of whether HMRC might exercise their discretion in favour of CantorCO2e's claim for recovery if the suppliers were unable to rectify their invoices."

1501. Mr Cooper said in relation to the counterparties: "…our thinking at the time was that we did not know whether we were dealing with fraudsters or people who were simply badly organised, had poor administration, which is very typical in a lot of small traders."

1502. Mr Cooper accepted that CFE's view was that Mr Emanuel should have done a lot better in knowing his clients and that there were things that Mr Emanuel could have done to know those whom he was dealing with but in which he had failed.

1503. If CFE was unable to tell whether it was trading with fraudsters or not it should not have traded on with the counterparties.

1504. CFE's failure to follow its own recommended procedure of enhanced monitoring of unregulated counterparties goes to its means of knowledge as to the impugned transactions. It was submitted on behalf of the Appellant regarding CFE's procedures that it did undertake appropriate due diligence. It was submitted that it undertook due diligence which it considered to be appropriate to its money laundering obligations and while the Revenue take issue with that, there is no doubt that that is what CFE was trying to do at the time - there were no other due diligence warnings out there. It was submitted that the Appellant's evidence on due diligence demonstrated that it did take reasonable care in respect of its due diligence of clients and took steps which were proportionate to the risks perceived at the relevant time.

1505. The Tribunal cannot accept this in the light of the fact that enhanced monitoring, as recommended, was never undertaken on the relevant counterparties and that most of the factors that were stated as leading to the trade being categorised as high risk all existed at the outset of CFE's trading in carbon credits.

1506. Mr Rose said that carbon credits were described to him as very similar to bearer bonds and that Mr Emanuel had suggested to him that there was no reason to do a counterparty assessment risk due to the nature of the credits. Mr Rose also said that that Mr Emanuel suggested that the financial health of CO2e's counterparties was not relevant.

1507. The Tribunal is entitled to ask why Mr Emanuel was not only defying the MLRO's guidance, but was also seeking to persuade Mr Rose that it was right to do so.

1508. Mr Emanuel's own business plan contained a risk table setting out that there should be KYC and AML checks and financial disclosure. The financial disclosure that was anticipated was the provision of accounts. Mr Rose's recollection was that Mr Emanuel had told him that

these functions were being outsourced to CFE and he did not have specific knowledge of whether they were undertaken.

1509. CFE's Financial Year End 2007 accounts set out CFE's procedures to mitigate risk in matched principal trading: obtaining the latest set of audited financial statements, taking feeds from several credit rating agencies and reviewing the press. Mr Rose said that credit was not his area of expertise.

1510. There are, then, three sources that recorded what CFE was supposed to be doing in relation to these unregulated counterparties: the MLRO's report for 2007, Mr Emanuel's own business plan, and CFE's notes to its financial statements in relation to mitigating the risk from matched principal trading. None of these procedures were followed. By way of example, in relation to Adduco, Mr Rose did not know how that counterparty got through the checks if no accounts were provided by it.

1511. Mr Buchan accepted that when CFE became aware of a risk of fraud that would then be taken into account by the risk team and would change how it assessed risk. Mr Buchan accepted that once CFE knew of the risk of fraud it wanted to satisfy itself that the counterparty could have legitimately obtained what it was providing. Mr Buchan initially refused to accept that a check on whether a counterparty could have paid for what it was selling was an obvious way of satisfying CFE that its counterparty could have legitimately obtained what it was selling. This was an example of a refusal to make reasonable concessions where to do so would damage CFE's case.

1512. Mr Buchan belatedly accepted that the financial status of the relevant counterparties was relevant to him once he knew of the risk of fraud in the market. It should have been apparent to CFE that none of its counterparties had paid up front for such large volumes of carbon credits. It should have also been inferred that no reasonable trader would have granted these counterparties credit without much greater investigation.

1513. Mr Buchan was constrained to suggest that the counterparties were agents, which would have meant that they did not require credit. He could not provide a cogent basis for any belief that the counterparties were acting on an agency basis. The invoices show that the counterparties were all acting as principals.

1514. Mr Buchan stated that the transactions with Adduco made *"absolute sense"* to him. Yet it was a previously dormant company which had, in 20 days in March 2009, provided CFE with more than €5.3 million carbon credits at a cheaper price than CFE, with all its experience in the market, could obtain. It is difficult to accept this claim as reasonable. The same applies to Stratex and GWD.

1515. None of the checks carried out by CFE could have assured it that the relevant counterparties had legitimately acquired these enormous volumes of carbon credits. There is nothing to suggest that CFE's own later checks involved anything more than looking at websites.

1516. The Tribunal does not agree with Mr Buchan's evidence that a reasonable person would not stop trading with companies without having made any enquiries despite the risk of fraud and that it was not too late to carry out a risk assessment after the trading had already happened. Mr Buchan would not even accept that once CFE knew of the risk of fraud and was not satisfied

as to even the rationale for a counterparty trading carbon credits, then it should have stopped trading.

1517. Mr Buchan's suggestion that the brokers go out to the counterparties and proactively obtain financials such as accounting statements and profit and loss was not acted upon. Mr Buchan could not properly explain why, putting it down to the brokers forgetting to do so.

1518. Mr Buchan initially denied speaking to Mr Emanuel at all about Westis. His initial evidence was incorrect.

1519. Mr Emanuel's encouragement of a regime where no checks were undertaken on CFE's counterparties suggests that Mr Emanuel was reckless as to whether they would have passed the enhanced monitoring checks. That would have been the end of the business.

1520. That CFE failed to follow its own recommendations and procedures is indicative of means of knowledge that the transactions were connected with fraud. This failure suggests that some at CFE may even have been prepared not to know everything about the counterparties it was trading with, for fear that it would be affixed with knowledge of facts about them that would have put a stop to the lucrative trade upon which it had embarked. Such a conclusion is supported by paragraphs of the draft Suspicious Event Report to which the Tribunal will return below.

1521. The issues raised at the meeting of the risk committee on 22 June 2009 *viz.* analysing all parts of the trade to be comfortable that it made sense, are what CFE should have focused on and from a much earlier stage. As Mr Buchan said in his evidence, analysing trades is a normal part of what CFE does. Had any thought been given earlier to whether the trades with the relevant counterparties made sense, the reasonable answer would have been a "no". As Mr Buchan accepted, the "second line of defence" was to check on the first. That did not happen early enough or in any meaningful or reasonable sense.

1522. The overwhelming impression from CFE's evidence is that no one had proper oversight of CFE's response to the emerging risk of fraud; Mr Rose relied on the other functions of CFE, and those other functions, such as the risk department, disclaimed responsibility. The proper checks were not made. The risk team expected to see the enhanced due diligence documents, but when those were documents were not provided e.g. in relation to Westis, no-one in that team was sufficiently concerned. Mr Buchan claimed that he did not even know why an existing customer was asked to fill out a new document when that was the very purpose of one of the new checks.

1523. Mr Buchan further stated that when he was e-mailed by Mr Emanuel on 28 July 2009 asking for authorisation to carry on trading with Westis despite the new procedures not being carried out, that he did not recall advising against it and it was not his function to do so.

1524. No one in CFE superior to Mr Emanuel was properly apprised of what the traders and Mr Emanuel knew about their counterparties. The risk committee was not apparently even aware that the decision had been taken to carry on trading with counterparties whom CFE suspected in order to offset VAT possibly paid out wrongly by CFE. That state of affairs was not the conduct of a company taking reasonable care.

1525. Despite his evidence to the contrary, Mr Buchan, as with Mr Rose and all those below including Mr Emanuel in CFE, failed to maintain effective, adequate or reasonable oversight.

(5) The decision to carry on trading with counterparties

1526. Mr Rose accepted that CFE had resolved to continue selling to those companies who had not provided valid VAT invoices to reduce CFE's liability for VAT previously paid over and that the traders were instructed to try to get counterparties who had caused a VAT exposure to continue trading. Mr Cooper accepted that there was a tension or a contradiction in this.

1527. The Appellant's strategy was, as put to Officer Ball, purportedly to avoid the risk of VAT loss. That strategy failed because CFE failed to carry out the checks that it said that it would. It in fact led to tax losses as is made plain by CFE's acceptance that each of the transactions subject to this appeal was connected with the fraudulent evasion of VAT.

1528. The suggestion that HMRC somehow tacitly approved this at the meeting of 25 June 2009, in the absence of CFE disclosing to it in full what CFE collectively knew about the traders, is not reasonable. CFE's strategy put off the inevitable: it paid VAT to traders it suspected of involvement in fraud. It had not carried out proper checks into those traders despite knowing of the real risk of fraud in the market. It was focused only upon receiving valid VAT invoices that it could present to HMRC to claim input tax thereon.

1529. Mr Rose did not recall who was going to, or who did, give explicit instructions to continue trading after 11 June 2009. Mr Rose said that he was made to feel comfortable that continuing to trade with CFE's customers without evidence and certainty that they were involved in fraud was acceptable. This is a disappointing statement from the man with overall or ultimate responsibility for CFE's AML function at the time, and who should have known that if CFE had a reasonable suspicion of money laundering, CFE would not have been able to trade with the affected counterparties.

(6) The contents of the draft Suspicious Event Report and decision not to submit a SAR

1530. Mr Rose's evidence was that he was neither familiar with nor involved in matters relating to SOCA, was not invited to the relevant meetings, and was not consulted on the decision whether to make a SAR. Mr Rose said that he did not know whose decision it would have been to make a SAR and was not privy to any discussion about whether a report should be made. Mr Cooper's evidence was: *"Laurence would have no input into a decision to submit a SAR at all."*

1531. On 12 June 2009 Mr Taylor the Money Laundering Reporting Officer ("MLRO") in CFE's compliance department completed "*Draft 1*" of the Suspicious Event Report which recited Mr Emanuel's reading of the blog, the previous checks by CFE into its counterparties, the basic mechanism of MTIC VAT fraud and the need "*to consider whether CFE has been the victim of a VAT fraud and if so what other implications follow including SOCA reporting obligations."*

1532. The Tribunal has dealt with the draft report at length in its fact finding. However, given its significance it is necessary to return to consider its contents.

1533. The draft report noted:

"If a SAR is made no further action should be taken on the account including the receiving of additional credits without informed consent. This would extend to accepting further credits for the affected accounts as we may be caught by s329 of POCA."

1534. This would have conflicted with CFE's plan to continue to trade with the counterparties until it held sufficient monies on account to meet the potential VAT liability.

1535. The draft report noted:

*"**Findings***
All the UK accounts have only recently been opened with CFE. Most of companies comprising one individual who is the shareholder of the company and in many cases the individuals are resident in France. Westis Ltd, Stratex Alliance Ltd and Aristo Partners Ltd are operating from the same premises. Separately Adduco Consulting Ltd, Business Management Consulting Ltd and Northumberland Consultants Ltd also operate out of the same premises.

Several clients have bank accounts in Marfin Popular Bank Co Ltd, a listed registered bank in Cyprus (Westis and Adduco). Volumes traded are on context albeit at the upper end. These firms are often set up by sole traders and therefore the trading activity being undertaken which of itself is not suspicious."

1536. The draft report noted in relation to Adduco:

"Invalid VAT Number Supplied. Became invalid around time of trading was dormant company.
….
Sole director and beneficial owner is a French national, Mr Eric Agnard…The company is registered to the same address as Axle Ltd and Northumberland Consultants Ltd.
…
Company filed dormant accounts: 31/10/2007…"

1537. The draft report noted in relation to Westis:

"…
Sole director and beneficial owner was a French national, Mr Franck Stork. Westis. The company is registered to the same address as Stratex Alliance Ltd and Aristo Partners Ltd. We received invoices including the VAT consideration but without any VAT number. On speaking to the client he stated that he had a valid VAT number and come back with the details. We investigated the details and HMRC confirmed it was valid but not against Westis Ltd. We consulted the client who stated that it was the number of his parent company Epicure Solutions Limited which had bout Westis Ltd on the 9 May 2009. Client submitted Tax certificate of Epicure Solutions and resubmitted the invoices in that name…
JE is uneasy about this client."

1538. The draft report noted in relation to Stratex:

"…Registered to the same address as Aristo Partners Ltd and Westis Ltd. Owner of the company is Frank Stork resident in France. We have paid VAT to the amount of €6,376,039 but the client is not VAT registered. We called the client on 10 June asking for his VAT number and the client said he would call back which he didn't. We again called the client and he stated that the VAT application was currently with HMRC. Client seemed nervous when discussing his VAT status. We phoned the client again to discuss business and the client volunteered a discussion on his VAT status reminding himself that he still owed us a

document. Client stated that he was in the process of concluding several deals in Romania implying that there would be a number of credits for us to sell on his behalf."

1539. The draft report noted in relation to Axle:

"...Registered to the same office as Adduco Consulting Ltd and Northumberland Consultants Ltd. Company owner Maxime Arlani, a French national…Company has only being trading with us since 3 June.
…
As the first day of trading was also the day we received the blog the invoices were scrutinised in more detail and it appeared that the invoices contained no VAT number despite including the VAT consideration.
The client stated that he was registered but subsequently came back to the broking desk and confirmed that he had made a mistake and that the VAT application had been made. However we had already paid the invoices.
…"

1540. The draft report noted in relation to Aristo:

"*…Registered to the same address as Stratex Alliance Ltd and Westis Ltd. Owner of the company is Anthoiny Muthot resident in France….Business consider client incompetent. The invoices received contained no VAT number and we became more conscious of the VAT situation once the blog was issued on 3 June 2009. The client indicated that they had a VAT number and would look into I which they did stating that a VAT application had been made…"*

1541. The draft report noted in relation to NCL:

"…The company is registered to the same address as Adduco Consulting Ltd and Business Management Consulting Ltd. Owner is a French national Yamina Berrehill. We have paid a total VAT consideration €3,431,994. Client has a valid VAT number but we are unable to confirm whether it belongs to the client. Legal advice has stated that the VAT invoices don't strictly contain the correct information (for example should show a currency conversion where relevant in order that the VAT consideration is show in sterling.

We have not chosen to determine whether the VAT number is valid to Northumberland Consulting Ltd as the concern is that if it isn't then we are on notice and would have to account to the HMRC for the over payment.

WHAT IF ANYTHING ARE WE DOING WITH GW DEALS LTD AH MARKETING.?"

1542. In relation to the record by Mr Taylor that CFE had chosen not to determine whether NCL's VRN was properly valid Mr Cooper accepted that this should not have even entered a compliance officer's head and that it was not what somebody in his position should be saying.

1543. The draft report concluded:

*"**Proposal***
[Based on the information gathered and taking into account the reporting obligations, I believe that there is sufficient foundation to submit a suspicious activity report in respect of [ ]. Informed consent will be requested to continue to accept credits for trading and in the case of [ ] also to release the net surplus funds.]
Recommendations
Enhanced Customer Due Diligence is recommended for the business on the basis that carbon emissions credits are subject to VAT and the fact that credits are in bearer form. Further given the nature on many of these clients involve one trading companies it would be appropriate to apply the same requirements imposed on applicants from individuals. It is also recommended that the client take on process be formalised for the CO2e business.

Changes to the confirmation and disclaimer language have been made to provide clarity on the roles of CFE and CO2e. New rules around permissioned trading of Spot credits have been introduced to ensure that we are either always flat or have a net VAT surplus from the matched principal activity."

1544. As the Tribunal has already dealt with, Mr Cooper exhibited to his second witness statements two partially completed SOCA Disclosure Reports in relation to Adduco and Westis, which are undated and which identify the offences suspected as MTIC fraud.

1545. On 15 June 2009 at 13:10 Mr Taylor e-mailed several of those in CFE confirming that the carbon credits trading business had been re-classified as high risk for AML purposes.

1546. At 14:43 Mr Taylor e-mailed Mr Rose stating:

"I have spoken tonight with MC to bring him up to speed with my thoughts on whether we have to report anything to SOCA. He told me there were further updates from the work you have been doing today which may well alter the situation for me. Please can we catch up tomorrow?"

1547. The Tribunal has addressed this email at length above in its fact finding and drawn conclusions (see paragraphs 947-954). The natural interpretation of "altering of the situation", since no SAR was ever submitted to SOCA, is that Mr Taylor was going to submit a SAR but that his conversation with Mr Rose "altered" that view. Mr Rose's witness statement was silent on the issue.

1548. After this email was brought to Mr Rose's attention in giving evidence, he was not able to recollect the details of what was discussed between him and Mr Taylor although he denied trying to persuade Mr Taylor out of a making a disclosure. The lack of complete overview over the taking of such an important decision is an unsatisfactory position for the man with ultimate responsibility for AML compliance in CFE to adopt.

1549. Mr Cooper's written evidence is that he had several conversations with Mr Taylor, the details of which are omitted. Mr Cooper's evidence is no substitute for that of Mr Taylor, who wrote the draft. Having completed a 6.5-page report detailing where he had come to, it is unlikely that the matter was simply left, with no definite and recorded decision taken as to whether a SAR should be submitted.

1550. The JMLSG Guidance states that:

"If the nominated officer decides not to make a report to SOCA, the reasons for not doing so should be clearly documented or recorded electronically and retained with the internal suspicion report."

and that:

"In order to provide a defence against future prosecution for failing to report, the reasons for any conscious decision not to report should be documented or recorded electronically."

1551. No reasonable explanation has been provided as to why Mr Taylor failed to document and why he did not make a report. The idea, posited by Mr Cooper, that Mr Taylor prepared a draft report, and draft SARs, in case they became relevant is not reasonable. The contemporaneous emails suggest Mr Taylor was preparing the draft report so as to make a decision on whether to take action. The lack of recorded decision whether to make a SAR report or not is an awkward question for CFE for which it has no good explanation.

1552. At [1.29] the JMLSG Guidance requires that the overall relationship between the MLRO and the director or senior manager allocated overall responsibility for the establishment and maintenance of the firm's AML systems is clearly documented so that each knows the extent of his and the other's role and day-to-day responsibilities. There is no evidence that this relationship was documented.

(7) The contents of CFE's own money laundering report which accepted it suspected it was the victim of VAT fraud

1553. In the CFE Money Laundering Reporting Officer's annual report in 2010 Mr Taylor wrote:

"In June 2009 following press commentary on carousel fraud in the spot emissions market CFE suspected it had been the victim of VAT fraud."

1554. Mr Cooper's best attempt to explain this, in the context of no SAR being submitted, was: *"I think that's a careless form of words…"*. If CFE suspected that it had been the victim of VAT fraud in June 2009 it was obliged to make such a report. No explanation has been provided for Mr Taylor's failure to submit such a report.

1555. The acceptance that it actively suspected VAT fraud at the time in June 2009 evidences the subjective state of mind of many in CFE, as the Tribunal has found, but it also supports the Tribunal's conclusion that, objectively, CFE had the material available to it upon which it should have known its transactions were connected to VAT fraud.

1556. In cross-examining Officer Ball, the Appellant sought to disaggregate the individual factors known to CFE at the time the initial draft report was compiled. That is an inaccurate basis upon which to assess reasonable suspicion.

1557. A compelling inference is to be drawn from the following:

i. the e-mail above;
ii. the partially completed disclosure reports;

iii. the absence of any SAR being submitted;
iv. CFE's failure to call Mr Taylor to give evidence;
v. the proposal in the draft report being an effective bar to CFE's agreed strategy of continuing to trade with the relevant counterparties until it held enough monies to cover the potential VAT liability;
vi. the submission of a SAR effectively being an end of CFE's trade in carbon credits;
vii. the absence of disclosure of detailed records of conversations around the issue; and
viii. the fact that later Mr Taylor committed to writing that CFE suspected that it was the victim of a VAT fraud.

1558. As set out above in the Tribunal's fact-finding, the conclusion is that Mr Taylor was persuaded by his conversations with others in CFE, including Mr Rose and Mr Cooper, not to submit a SAR.

1559. As is also set out above, it is likely that there was no direct instruction made to Mr Taylor but he felt aggregated pressure against his better instincts not to submit a report. The lack of explanation for the decision not to submit the SAR strongly implies that Mr Taylor has no innocent explanation for his change of mind ie. that it was reasonably based on the objective indicators. Rather the Tribunal infers that the true explanation for his change of mind would not reflect well upon Mr Taylor or those in CFE.

1560. CFE did not engage with the authorities to explain their concerns for two weeks after Mr Emanuel read the blog on 5 June 2009 until 19 June 2009 when it arranged the meeting with HMRC for 25 June 2009.

1561. Instead, the senior management at CFE sought to protect its bottom line and to avoid the conclusion that should have been manifest, namely that the majority of its trade in EUAs was undermined by the fraud of others. The lack of action over the SAR illustrates this effectively.

(8) The nature of the contact and trades with the specific counterparties in particular, AHMD and Westis

1562. The Tribunal has examined the timeline leading to CFE's transactions that occurred from 15-18 June and 28-29 July 2009 with AHMD and Westis. In the chronology summarised above the Tribunal has addressed the reasons that support its conclusion that CFE possessed means of knowledge of the fraudulent connections to these transactions through its dealing with the specific counterparties and others, its awareness of VAT fraud in the market and inadequate response to the risks of which it was aware.

(9) Adverse Inferences

1563. The Tribunal has drawn specific inferences adverse to the Appellant as is set out in the fact-finding section. This primarily relates to the Appellant's failure to provide witness statements or call witnesses who were working within CFE conducting the relevant transactions or with responsibility for their oversight or compliance who might have explained documents they created or saw or other conversations they have may have had with counterparties or within CFE.

1564. The Tribunal considers that there is no reason why adverse inferences ought not to be drawn in this case. It has followed Morgan, J.'s order of questions set out in *British Airways* (*supra*) which provides a convenient summary:

"- is there some evidence, however weak, to support the suggested inference or finding on the matter in issue?
- has the Defendant given a reason for the witness's absence from the hearing?
- if a reason for the absence is given but it is not wholly satisfactory, is that reason "some credible explanation" so that the potentially detrimental effect of the absence of the witness is reduced or nullified?
- am I willing to draw an adverse inference in relation to the absent witness?
- what inference should I draw?"

1565. The most notable absent witnesses are Mr Emanuel and his team of traders Mr Bush, Mr Lynch, Mr Von Butler and Mr Weldon, and the MLRO / compliance officer Mr Taylor. It was submitted on behalf of the Appellant that it was not open to the Tribunal to draw adverse inferences where *"none of the individuals whose non-attendance is criticised in this appeal are parties to the appeal, nor indeed are they employees of the appellant. All of them ceased to be employed by the Appellant at 2011 at the latest."*

1566. There are difficulties with the Appellant's submission. In many circumstances it may be perfectly reasonable that a party to litigation is not able to call witnesses who are no longer employed by it in relation to events that took place many years before. It is little surprise that few of the relevant employees who conducted the transactions continued to be employed by the Appellant by the time of the hearing some nine years later. However, these innocent explanations cannot properly be relied upon by the Appellant in this case.

1567. Many of the witnesses who did give evidence on behalf of the Appellant are also no longer employees of CFE, albeit Mr Cooper and Mr Rose left Cantor after 2016, years after 2013 when HMRC raised the assessments and the Appellant appealed to the Tribunal.

1568. More importantly, there was no positive explanation, and in particular no evidence, as to the reason for these witnesess' absence. They had very relevant evidence to give. The Tribunal was not provided with any good reason why the individuals were no longer available to CFE to be called as witnesses. There was no evidence put forward that the witnesses were uncontactable or unwilling to give evidence or there were any enforceable legal agreements that would prevent them giving evidence.

1569. An adverse inference that can be drawn from this is that either the witnesses were unwilling to support CFE's case or they would have given evidence unhelpful to CFE's appeal or damaging as to their own conduct.

1570. No reasonable explanation or evidence has been put forward by CFE as to why it has not called the witnesses in respect of whom the Tribunal makes adverse inferences (ie. Mr Emanuel and his team of traders and Mr Taylor). CFE has located all but one of them. CFE plainly has no difficulty *per se* in calling ex-employees to give evidence since its two main witnesses, Messrs. Rose and Cooper, left Cantor's employment in May and August 2016 (albeit they made witness statements while still employees).

1571. The identified individuals who could have given evidence made or received phone calls with counterparties or within CFE and made or received various important documents such as emails or the Suspicious Event Report. They also may have been able to explain the gaps in evidence where there were no longer documents available. They had relevant evidence they might have been able to give which might have provided an alternative or innocent explanation which may have assisted the Tribunal in interpreting the natural wording of documents.

1572. Neither is the Appellant correct to distinguish a difference between not calling a witness and not calling a party. The issue here is not whether the party gives evidence, it is whether the party calls a relevant witness. The authorities canvassed in *Wisniewski* make this clear.

1573. Another way of rebutting the Appellant's assertion that it is only failure by a "party" to give evidence that allows an adverse inference to be drawn, is to look at the authorities, in which there are only two parties, but a judge is able to draw an adverse inference from the failure by the parties to call relevant witnesses (e.g. *Richardson-Ruhan v Ruhan* [2017] EWHC 2739 (Fam)) at [17-19]).

1574. Further, in this case the "party" in this case is a body corporate. It can only give evidence through human agency. The absent witnesses are effectively "the party."

1575. If Mr Emanuel were, for example, to have given evidence in which he admitted that he knew that the relevant transactions were connected with the fraudulent evasion of VAT then his state of knowledge would be attributed to the Appellant. The Appellant cannot avoid that attribution through pointing out that he is an ex-employee.

1576. The Appellant suggested that it was open to HMRC to call the relevant witnesses and there was no reason why they could not. This is unrealistic because it is a basic principle that a party cannot call a witness simply to impugn his evidence. Therefore, it would not have been open to HMRC to seek to call these witnesses, for them to give evidence that they did not know that the transactions were connected with fraud and then accuse them of lying, or accuse them of concocting explanations.

1577. The Tribunal approaches the issue of adverse inferences at two levels in this case, at the level specific to witnesses and in relation to the wider picture.

1578. On the more specific level there are further adverse inferences to be drawn from the absence of certain witnesses. None of this amounts to *"open-ended speculation."*

1579. There are numerous individual facts that the Tribunal has found provided a *prima facie* case against Mr Emanuel. He plainly disbelieved ADE's account that it had no relationship with Westis yet then offered them free brokerage to continue trading. He made no enquiries of Westis about the episode and continued trading with the company in late July 2009.

1580. There is a *prima facie* case that Mr Emanuel invented an account about ADE volunteering that they were in the same offices as Westis and shared office infrastructure in a similar way to trading houses. His correspondence with ADE shows that this was, *prima facie*, inaccurate.

1581. There is a *prima facie* case that Mr Emanuel similarly relayed without proper foundation the account about local consultants for local emitters providing the source for the carbon credits traded by CFE. There is no independent evidence produced to support that account. There is a *prima facie* case that Mr Emanuel gave his account that these consultants were either being paid in the carbon credits that they sold or were selling them on trust without proper investigation. CFE itself would not have sold carbon credits on trust and the sums were far too large to represent payments for consultancy. Mr Emanuel knew that Adduco was not validly VAT registered yet allowed a trader below him, Mr Bush, to seek to continue trading with Adduco. Mr Cooper's evidence was that CFE had formed the view that Mr Emanuel had done a very poor job.

1582. The inference to be drawn is that the Appellant did not call Mr Emanuel, or he was unwilling to attend, for fear that he would give evidence that damaged both CFE's case (and perhaps even his personal reputation). Not only has the Appellant not sought to call Mr Emanuel, it actively instructed him not to meet with HMRC in 2010. Mr Cooper's explanation for this was:

"I would have thought at the time, the feeling was that given the events that we were dealing with, it would be unhelpful for an employee with whom we were about to sever relations to be muddying the waters."

1583. Not only is there an adverse inference to be drawn from Mr Emanuel's absence as a witness, but that inference is strengthened by the Appellant effectively requiring Mr Emanuel not to speak to HMRC as part of the negotiations over his severance.

1584. The Appellant has chosen not to produce any document, evidence or open form of explanation in relation to Mr Emanuel's absence. Despite the understandable sensitivities over former employees with whom relations may be strained, there was no submission that, as a former desk head, he had entered into a non-disclosure agreement which would prevent him from testifying (not that any agreement should prevent a witness from testifying). The Tribunal is satisfied that if CFE had wanted to rely on Mr Emanuel's evidence there would have been no reason for the Appellant either not to call him to give evidence or provide evidence as to why he was not being called.

1585. In Mr Taylor's case, there is a *prima facie* case that he had suspected that CFE was a victim of a VAT fraud, as set out in his draft Supsicious Event Report of 12 June 2009 and Money Laundering report from 2010 but failed both to report it to SOCA and failed to record his reasons for so doing as required by the Money Laundering Regulations 2007. The Appellant could not have carried on trading its way out of VAT liabilities absent SOCA's consent if such a report had been made. The inference is that the Appellant was unwilling to call Mr Taylor because he would give damaging evidence such as that he was persuaded not to make the report or chose not to make it without good reason.

1586. The individual traders could have given relevant evidence of the transactions themselves. The absence of any witness who conducted the impugned transactions, coupled with the lack of evidence to explain their absence, is striking. Each trader sought to trade with entities with which they knew there were irregularities as revealed by the emails.

1587. A reasonable inference to draw from the traders' absence is, again, that the Appellant is unwilling to call them because they might expose facts that support CFE's full means of knowledge as to the connection between the transactions and the fraudulent evasion of VAT.

1588. The Tribunal does not draw any adverse inferences in relation to the absence of Mr Ross Tanton, who carried out the KYC checks in CFE's compliance department. CFE had decided, prior to the transactions in issue, that there should be enhanced monitoring of the types of counterparties with whom CFE carried out the impugned transactions, yet no such monitoring was carried out. HMRC seeks an inference to be drawn that the Appellant fears calling Mr Tanton for fear that he will give evidence that he was told not to carry out the enhanced monitoring. There is little prima facie evidence to support such an allegation and there is little additional evidence that Mr Tanton might reasonably have given beyond that given by Mr Taylor.

1589. As for the wider picture, because the Tribunal is satisfied that there is a *prima facie* case that CFE should have known that its transactions were connected with fraud then the Tribunal can, since no proper reason has been given for the absence of key witnesses, draw the inference that if they gave evidence they would have exposed facts unfavourable to the Appellant and support HMRC's case that it should have known that the transactions were connected with fraud. That inference is heightened in the case of Mr Emanuel, whose absence is particularly striking given the number of documents that implicate him in holding suspicion, having means of knowledge and not sharing information with CFE's management.

1590. As set out elsewhere, in 2010, after the events in question, Mr Emanuel sought an appointment to meet the Revenue but was prevented from going to that meeting on the instruction of CFE. Even if this may have been governed by the terms of his departure from the company, it suggests that CFE was not going out of its away to allow its current and former employees to cooperate with HMRC.

1591. Regrettably, the Tribunal finds this to be consistent with the attitude of the witnesses who did give evidence in robust defence of CFE but were not prepared to make reasonable concessions where appropriate. This approach lacked reasonableness. It suggests an uncooperative attitude towards HMRC that may not have been confined to the witnesses but reflected at a corporate level.

1592. The Appellant's failure to call any of the witness who carried out the impugned transactions, actually dealt with any of the counterparties in the impugned transactions or the initial checks into them, or the individual who drafted three documents concerning a suspicious activity report, is striking. It not only provides a general adverse inference in relation to the Appellant's case but it also means that large parts of the Appellant's case are uncorroborated – much of it relies on hearsay upon which less weight should be attached.

1593. The lack of corroboration cannot be made up for by the hearsay evidence of the claims made by Mr Emanuel. In *Wetton v Ahmed* [2011] EWCA Civ 610, the Court of Appeal stated that the trial judge was entitled to assess the credibility of a witness's oral evidence by reference not only to contemporaneous documents but also by reference to the *absence* of those documents. Arden, LJ. said at [14]:

''In my judgment, contemporaneous written documentation is of the very greatest importance when assessing credibility. Moreover, it can be significant not only where it is present and the oral evidence can be checked against it. It can also be significant if the written documentation is absent. For instance, if the judge is satisfied that certain contemporaneous documentation is likely to have existed were the oral evidence correct, and the party adducing oral evidence is responsible for its non-production, then the documentation may be conspicuous by its absence and the judge may be able to draw inferences by its absence''.

1594. The observations of Leggatt, J. in *Gestmin SGPS SA v Credit Suisse (UK) Ltd* [2013] EWHC 3560 (Comm) at [15-22] are also applicable, in particular the conclusion at [22]:

"In the light of these considerations, the best approach for a judge to adopt in the trial of a commercial case is, in my view, to place little if any reliance at all on witnesses' recollections of what was said in meetings and conversations, and to base factual findings on inferences drawn from the documentary evidence and known or probable facts. This does not mean that oral testimony serves no useful purpose – though its utility is often disproportionate to its length. But its value lies largely, as I see it, in the opportunity which cross-examination

affords to subject the documentary record to critical scrutiny and to gauge the personality, motivations and working practices of a witness, rather than in testimony of what the witness recalls of particular conversations and events. Above all, it is important to avoid the fallacy of supposing that, because a witness has confidence in his or her recollection and is honest, evidence based on that recollection provides any reliable guide to the truth."

1595. The lack of corroboration extends to how the vast majority of the transactions were carried out since the Appellant destroyed the telephone call records in 2013 despite a policy to archive them for a period of 7 years. HMRC contended that the Appellant's disclosure of telephone calls was lacking. The Appellant's case in opening was that this destruction was the fault of HMRC.

1596. The point was raised in Officer David Ball's second witness statement, and it is responded to within Mark Snelling's witness statement.

1597. A letter of 31 May 2016 from Pinsent Masons sets out the extent of the disclosure, and the reasons why CFE's calls were overwritten in 2013 as a result of a group-wide implementation of a policy change concerning record retention periods. Mr Snelling confirmed the truth of that explanation in his witness statement and confirmed in oral evidence that the destruction was across the board for all the departments looked after by the voice recording department and not specifically in respect of records held by CO2e and Cantor Fitzgerald.

1598. Mr Snelling accepted that an assurance had been given to HMRC that the material would be archived for 7 years and then destroyed despite that assurance. Mr Snelling said that a litigation hold should have been deployed over the records but for reasons unknown the hold was not applied. Mr Snelling said that the incident was *"...hugely embarrassing and I would much prefer that it had not taken place. But the reality is unfortunately it did."*

1599. HMRC were fully aware of the existence of the records prior to their deletion and were empowered to obtain them. Officer Ball was not sure why he did not request copies of the phone records at that time; but accepts that he could have.

1600. Despite the unfortunate manner in which material came to be destroyed, the Tribunal, having heard the evidence and HMRC not pursuing the allegation, accepts that this was not a deliberate act on the part of the Appellant. It was caused by mistake or a failure to take reasonable care. There was no sinister motive or deliberate spoliation of documents or phone records, but the destruction of records leaves large parts of the Appellant's case uncorroborated.

Conclusion on the Third Issue

1601. In conclusion on this issue, the Tribunal upholds HMRC's denial of input tax on CFE's six transactions with AHMD between 15-18 June 2009 and four transactions with Westis between 28-29 July 2009 on the basis that it should have known they were connected to the fraudulent evasion of VAT.

1602. The Tribunal allows the appeal against the denial of input tax in respect of the three transactions between 8 and 10 June 2009 with AHMD, GWD and Mettec on the basis that the Appellant neither knew nor should have known they were connected to the fraudulent evasion of VAT.

1603. The Tribunal would have allowed the appeal against the denial of input tax in respect of the transactions with Stratex between 18 May and 3 June 2009. However, while it finds the Appellant did not have knowledge or means of knowledge of the connection to VAT fraud in relation to the Stratex transactions, it has upheld the denial of input tax on the basis of the invalid invoices submitted (the First and Second Issues).

1604. The result of the first three issues decided is that HMRC's denial of input tax is upheld in the sum of £6,162,121.24 for the period 06/09.

1605. This is made up of £5,605,119.74 denied on 17 VAT invoices from Stratex on the basis they were invalid and £557,001.50 denied on 6 invoices from AHMD between 15 and 18 June 2009 on the basis of means of knowledge of the connection to VAT fraud pursuant to *Kittel*. The appeal is allowed in respect of input tax claimed in the sum of £245,890.94 on three invoices from GWD, AHMD and Mettec between 8 and 10 June 2009.

1606. HMRC's denial of input tax is upheld in the sum of £1,322,800.16 for the period 09/09. This is made up input tax claimed on four invoices from Westis between 28 and 29 July 2009 which is denied on the basis of means of knowledge pursuant to *Kittel*.

1607. The denial of input tax for the two periods forms the basis of the assessments that HMRC then raised which are now considered.

The Fourth Issue

The validity of an assessment for period 06/09

1608. The Appellant submits that no assessment or no valid assessment was issued by HMRC in respect of VAT period 06/09. This argument was not raised in the Appellant's grounds of appeal but was pursued, without sustained objection, in the course of evidence and in written and oral submissions before and during the hearing.

1609. It is a mixed question of fact and law.

The Law on the Fourth Issue

1610. Section 73(2) VATA provides as follows:

> 73(2) In any case where, for any prescribed accounting period, there has been paid or credited to any person—
> (a) as being a repayment or refund of VAT, or
> (b) as being due to him as a VAT credit,
> an amount which ought not to have been so paid or credited, or which would not have been so paid or credited had the facts been known or been as they later turn out to be, the Commissioners may assess that amount as being VAT due from him for that period and notify it to him accordingly.

1611. There is no prescribed form in law for either making or notifying an assessment to VAT, which are two different procedures. The FTT reviewed the relevant binding authorities on the topic in *Aria Technology Ltd v Revenue and Customs* [2016] UKFTT 98 (TC) (*"Aria"*).

1612. At paragraphs [30]-[38] of her decision in *Aria*, Tribunal Judge Jennifer Dean considered Mr Puzey's submissions on the same issue in light of existing authorities:

"30. Mr Puzey highlighted the wording of section 83(1)(p) which provides for a right of appeal to the Tribunal against "an assessment…or the amount of an assessment." He contended that the FTT has repeatedly determined as part of that jurisdiction the question of whether an assessment is in existence. The main issue in *Courts Plc* was the question as to what constitutes an assessment for the purposes of VATA 1994. Similarly in *House t/a P & J Autos v CEC* [1996] STC 154, *CEC v Bassimeh* [1997] STC 33 and *Cheesman v CEC* [2002] STC 1119 all concerned the question as to whether an assessment was validly made and in each instance the Tribunal determined that issue. It was submitted that the distinction that the Appellant seeks to draw between whether an assessment exists or whether it has been validly made is without merit; either a valid and enforceable assessment exists or it does not.

……………………………………..

32. The starting point, HMRC submitted is section 73(1) and (2) of the 1994 Act ………

33. Mr Puzey submitted that it is clear from the legislation that there is no set procedure for making and notifying of an assessment, which are two different processes.

34. Mr Puzey cited *House* in which Sir John Balcombe giving the judgment of the Court of Appeal said:

"We have been referred to two cases before the value added tax tribunal, one of some antiquity—the case of *Bell v Customs and Excise Comrs [1979] VATTR 115*, a decision of the London tribunal, with Mr D A Shirley as chairman. In the report there appears this passage (at 120):

> 'In our judgment, the Notice of Assessment should define precisely the period of time to which it relates. It is the formal document by which the Commissioners notify the amount of tax due from the person whose returns are said to be wrong or incomplete. We do not consider that the schedules sent (in this case but by no means invariably) with the Notice of Assessment are themselves a Notice of Assessment so much as working papers of the Commissioners leading up to the assessment contained in the Notice of Assessment. The schedules, moreover, contain references to two different periods, and want that certainty to which the Manchester Tribunal alluded in [*Scott v Customs and Excise Comrs* (1978) *VAT Decision 517*]. We see no reason why a taxpayer should have to read through a number of schedules in order to detect the precise claim against him or attempt to reconcile a formal document (form VAT 191) which is or may be inconsistent with schedules sent therewith or at a later date.'

Now, I think there are several problems which that particular passage throws up. First, it gives to the document entitled notice of assessment, whether it be in form VAT 191, which was the form used in the *Rififi* case, or in form VAT 655, which was the form used in this case, an importance which it cannot properly bear. As I have said, neither form is prescribed either by the 1983 Act or regulations. All that the 1983 Act provides is that the taxpayer should be notified, and, for the reasons I have already given, it seems to me that that was what had happened in this case. Whether, on the facts of the *Bell* case, there was adequate notification, I need not here consider. Also, it seems to me that that passage indicates a mistake, or mistaken view, which, at the time, was understandable, where it is said that the assessment is contained in the notice of assessment. As I attempted to explain in my judgment in the *Rififi* case (at 106–107) by reference to *Grunwick Processing Laboratories Ltd v Customs and Excise Comrs [1986] STC 441 at 442* and *Don Pasquale (a firm) v Customs and Excise Comrs [1990] STC 556 at 562*, the assessment of the amount of tax considered to be due and the notification to the taxpayer are separate operations. That in itself is sufficient to indicate that the judgment in *Bell* was made under a misapprehension as to the proper effect of the law."

35. In *Bassimeh* the Court of Appeal reiterated the distinction between an assessment and notification of the assessment made stating:

“Thirdly, the same and other authorities have considered what may be involved in defining and distinguishing between 'assessment' and, on the other hand, 'notification' of the assessment made. It has come to be accepted that this is a three-stage process; the decision to assess, followed by the assessment, then by the notice given (see in particular *Don Pasquale (a firm) v Customs and Excise Comrs* [1990] STC 556 at 562 per Dillon LJ, and the decision of His Honour Stephen Oliver QC the value added tax tribunal chairman in *Georgalakis Partnership v Customs and Excise Comrs* (1993) VAT Decision 10083). The position is complicated by the fact that where there is no evidence of the internal processes of VAT offices or of the assessment in fact carried out, the terms of the notice must be relied upon to indicate what the assessment was. This has led to the suggestion that the assessment is contained in the notice of assessment, but that analysis is wrong (see Sir John Balcombe in *House (trading as P & J Autos) v Customs and Excise Comrs* [1996] STC 154 at 162, where he said that 'the assessment of the amount of tax considered to be due and the notification to the taxpayer are separate operations').”

36. In *Courts* Jonathan Parker LJ stated (at [107]) on the issue of existence of an assessment:

“Mr Parker submits that the issue in the instant case is not so much as to the precise point in time at which an assessment is made (i.e. is complete); rather, it is as to the existence or otherwise of an assessment in December 1999. In one sense, this is a distinction without a difference since an assessment only 'exists' when it is made, and the point in time at which an assessment is made is the relevant point in time for the purposes of the s 73(6) time limits. On the other hand, I agree with Mr Parker that the issue in the instant case falls to be resolved on the basis of the particular facts of the case. In my judgment, given that the making of an assessment is an internal matter for the commissioners, in respect of which there is no prescribed statutory procedure, it is simply not possible to arrive at a formula which will determine in every case whether or not an assessment has been made. The commissioners may, for example, decide to treat certain cases as special or exceptional cases, to which their normal internal processes should not apply. Indeed, the instant case is an example of that (I return to this below). Accordingly, I am unable to go as far as the judge when (in para 57 of his judgment) he advanced the seemingly absolute proposition that 'an assessment is made when [the VAT 641] has been completed and signed off'. In the majority of cases, that may well be so; but there can in my judgment be no absolute rule to that effect. In my judgment the position in this respect is correctly reflected in the internal guidance issued in October 1997 (quoted in para 13 above).”

37. Mr Puzey highlighted the judgment of Arden LJ in *HMRC v BUPA Purchasing Ltd & Others* [2007] EWCA Civ 542 at [37]:

“There is no statutory definition of 'assessment'. It is in general a legal act on the part of the Commissioners constituting their determination of the amount of VAT, interest, penalty or surcharge that is due (see generally, *Courts plc v Customs and Excise Comrs* [2004] EWCA Civ 1527, [2005] STC 27).”

38. HMRC also relied on *Queenspice v HMRC* [2011] UKUT 111 in which the Upper Tribunal (referring to *House*) said at [23]:

“May J dealt with this submission where he said ([1994] STC 211 at 226):

'Although the commissioners choose to use printed forms headed “Notice of Assessment”, there is in my judgment no magic about such forms. They are not required by statute or regulation which prescribe no particular formality at all. All that is required is that the commissioners should make an assessment to the best of their judgment and notify it to the taxpayer. There is perhaps an understandable tendency to merge the assessment with the notification and to look only or mainly at a single document if it is called notice of assessment. But there appears to be no reason why notification should not be given by letter, nor any reason why in this case the letter dated 24 May 1990 should not be seen as, or part of, due notification. That letter states the amount of the assessment and refers to the schedules for the details of the build up of the amount. I do not see why a notification cannot be contained in more than one document provided that it is clear which document or documents are intended to contain the notification

and that that document or those documents contain in unambiguous and reasonably clear terms the substantial minimum requirements to which Mr Cordara has referred."''

1613. As Tribunal Judge Dean accepted in *Aria*, a combination of letters denying the right to deduct input tax and consequent letters notifying adjustments to the relevant VAT returns may function as an assessment for the purposes of VATA. There is no requirement to even use the word "assessment" so long as it is clear that a decision has been made that tax is due and that there is a calculation of that tax. At paragraphs [44] to [46] of the decision the Judge concluded:

"44. We found the remainder of the authorities supported the following propositions:

- The "making" of an assessment refers to the determination that an amount is due;
- There is no set formula by which an assessment must be made;
- The processes of assessing and notification of that assessment are separate;
- The assessment process involves a decision that tax is due and a calculation of that amount;
- Notification can take any form so long as the terms are clear to the taxpayer.

45. We agreed with the comments of Jonathan Parker LJ in *Courts* which we concluded are applicable in this case (emphasis added):

"Mr Parker submits that the issue in the instant case is not so much as to the precise point in time at which an assessment is made (ie is complete); rather, it is as to the existence or otherwise of an assessment in December 1999. In one sense, this is a distinction without a difference since an assessment only 'exists' when it is made, and the point in time at which an assessment is made is the relevant point in time for the purposes of the s 73(6) time limits.

46. Accordingly, we concluded from the authorities that this tribunal has jurisdiction to decide whether an assessment exists."

1614. The decision was upheld on an appeal by the Upper Tribunal in *Aria Technology v HMRC* [2018] UKUT 363 (TCC). The Upper Tribunal agreed that the making of an assessment involved a decision that tax was due and a calculation of the amount owed. It held that no set formula was required, following *Customs and Excise Commissioners v Bassimeh* [1997] S.T.C. 33 and applying *House (t/a P&J Autos) v Customs and Excise Commissioners [1994]* S.T.C. 211.

1615. The Upper Tribunal held that HMRC's letters refusing the claim for input tax and stating an amended amount communicated an "assessment" to the appellant since they conveyed, clearly and succinctly, HMRC's conclusion as to the amount owed (see paragraphs 177-182 of the decision).

The Facts on the Fourth Issue

Facts as communicated to the Appellant

1616. In a letter dated 6 December 2012, HMRC Officer David Ball notified the Appellant of a decision to deny input tax in respect of periods 03/09, 06/09 & 09/09. The calculation of the sum due is evidenced in the letter at [17], whereby Officer Ball informed the Appellant that the total amount of input tax to be denied for the period 06/09 was £34,317,697.80. The calculation

of the sum was set out in a schedule of transactions and amounts set out in Annex A to that letter.

1617. The denial was said to be on based on two reasons: a) for those transactions where the Appellant did not hold a valid VAT invoice; and b) that the Appellant knew or should have known that its transactions were connected to the fraudulent evasion of VAT (the *Kittel* principle).

1618. At [17] Officer Ball further stated that the total amount of input tax to be denied under both the invalid invoice and *Kittel* grounds for all VAT periods, 03/09, 06/09 and 09/09 was £36,330,792.25. The amount was broken down by each period: 03/09- £690,294.29; 06/09 - £34,317,697.80; and 09/09 - £1,322,800.16. At [18] Officer Ball stated:

"A formal notice of assessment for these amounts, plus interest due, will be forwarded to you shortly, together, with instructions for payment. If there is any associated interest payments these will also be included in the assessment".

1619. It is also worth noting that earlier in that letter at [10], when dealing with the denial on the grounds of invalid invoices, HMRC Officer Ball additionally referred to an 'assessment' in the following terms:

"Details of the transaction on which input tax has been denied due to CO2e having an invalid invoice are outlined in Annex A. The amount assessed in the following periods is as follows…..VAT period 06/09 - £16,698,317.64."

1620. In a letter dated 3 January 2013 Officer Ball notified the Appellant that as a result of the decision of 6 December 2012 denying input tax of £34,317,697.80 for the period ending June 2009, the Appellant's VAT return for VAT period 06/09 was amended from a repayment claim of £4,742,232.30 to net tax due of £29,575,465.50 (the amended amount).

1621. Officer Ball's letter of 3 January 2013, known as a V1-35 return adjustment letter, evidenced that the denied sum was set against the repayment claim on the 06/09 return.

1622. There was therefore a decision made by HMRC that VAT was due from the Appellant for a specific VAT period, 06/09, the calculation of the VAT due (£29,575,465.50) and a notification of that sum being due. Furthermore, a reason was given for the amended amount of net tax due by reference to the letter of 6 December 2012.

1623. By a form VAT 655 ('titled Valued Added Tax Notice of Assessments(s) and/or overdeclaration(s)') stamped 18 January 2013, HMRC notified the Appellant of assessments to tax for the periods 03/09 and 09/09, but not 06/09. The date of calculation was 6 December 2012 and the net amount of tax due to Revenue & Customs was said to be £2,013,094. The second page of the assessment was headed 'Details of Assessment(s) and/or overdeclaration(s)'. It contained calculations for underdeclared tax of £690,294 for period 03/09 and £1,322,800 for period 09/09.

1624. HMRC's decision of 6 December 2012 denying input tax and making an amendment to the Appellant's VAT return of 3 January 2013 was further amended subsequently.

1625. First it was amended by HMRC's Review Decision of 12 April 2013, by which the input tax denied for the period 06/09 was reduced by the Review Officer Peter Birchfield. In relation to the denial of input tax on the grounds of knowledge or means of knowledge (*Kittel* Principle),

Officer Birchfield reduced the sum denied from £34,317,697.80 to £5,804,009.98 for the period 06/09.

1626. It is also worth noting that Officer Birchfield used the word ‘assessment’ in his letter in that part referring to the denial of input tax for 06/09. Officer Birchfield stated the original decision to deny input tax on the grounds that the invoices were invalid was £16,698,317.64 for the period 06/09 before reducing this sum. As far as his review on this topic he stated:

“Officer Ball has correctly denied the input tax in relation to the Stratex Alliance invoices and has correctly exercised his discretion to refuse deduction based on alternative evidence. This element of the invalid invoice assessment will be upheld. The input tax denied is: Period 06/09 £5,005,117.74”.

[Emphasis Added]

1627. The decisions of 6 December 2012 and 3 January 2013 in relation to period 06/09 were further varied by a letter to the Appellant from Officer Birchfield of HMRC dated 25 June 2013. It was headed ‘Review of appealable decision….Supplementary Assessment Notification’. In this letter HMRC notified the Appellant of a supplementary VAT recovery assessment in the sum of £604,002.20 and corrected two figures in the Review Decision (“the Supplementary Assessment”).

1628. This Supplementary Assessment was also a second notification of adjustments to the 06/09 VAT return because officer Birchfield admitted he had discovered two errors in the calculations he had made. He made a correction to the input VAT in relation to the *Stratex* invoices being £5,605,119.74, not £5,005,117.74 and decided 8 June 2009 was the relevant date from which to deny the input tax for other supplies in the sum of £802,892.44. He stated:

“This makes the total VAT disallowed in period 06/09 £6,408,012.18 (not £5,804,009.98 as notified)……The supplementary assessment is therefore: Period 06/09 £604,002.20 The basis of the denial of the assessed tax and the evidence to support it is unchanged.”

1629. In a letter dated 29 July 2013 HMRC Officer Ball wrote to the Appellant in relation to the denial of input tax for the period ending June 2009. He stated that the letter dated 3 January 2013 requiring adjustments was further amended so that the Appellant’s June 2009 VAT return should be adjusted again. This was set out in a table containing three columns: the original return, HMRC’s amendments dated 3 January 2013, and the further amendments following HMRC’s review. The first and third columns are set out below:

	Original Amount	Amended as per letter 3 January 2013	Amended Amount after review
Box 3 - Total Output tax	£40,007,243.35	……	£40,007,243.35
Box 4 - Input Tax	£44,749,475.65	……	£38,341,463.47
Box 5 - Net Tax	CR£4,742,232.30	……	£1,665,779.88

1630. The final row of the table (Box 5) set out the net tax position for 06/09: as set out in the return (original amount) - a repayment claim of CR£4,742,232.30; after the denial of input tax (amended as per letter 3/1/13) - an amount due of £29,575,465.50; and after review, an amount due of £1,665,779.88

1631. The effect of the table was that the net tax now stated to be due from the Appellant as a result of the adjustment to the return for the period was £1,665,779.88 (reduced from £29,575,465.50).

1632. The letter stated it took into account Peter Birchfield's review which was dated 12 April 2013.

1633. Although not stated in the letter, it must also have taken into account Officer Birchfield's correction of 25 June 2013 that the total input tax disallowed for 06/09 should be £6,408,012.18.

1634. This is apparent from the final table set out in the letter for the adjusted return for 06/09 as against the original return (where there is a difference of £6,408,012.18 between the input tax as claimed in the original amount (£44,749,475.65) and the amended amount after review (£38,341,463.47). The same difference is apparent from the repayment claim of £4,742,232.30 and payment due of £1,665,779.88.

Officer Ball's evidence of HMRC's internal workings

1635. Officer Ball produced a third witness statement with exhibits addressing the topic of the internal workings of HMRC in making, calculating and notifying its decisions to the Appellant. He was cross examined by Ms Shaw QC on this statement. The evidence elicited in cross examination is accurately relayed in Ms Shaw QC's submissions as set out below. The Tribunal accepts the evidence of Officer Ball on this issue as being established on the balance of probabilities.

1636. In his third witness statement dated 20 February 2018, Officer Ball explained the process by which the above sequence of events had occurred following his decision letter denying input tax dated 6 December 2012.

1637. He stated on 10 December 2012 he completed a VAT 641 form used for making assessments under section 73 of VATA, in respect of the Appellant for periods 03/09, 06/09 and 09/09. He saved the form onto HMRC's Electronic Folder.

1638. He then sent a copy of the V641 form to his Senior Officer for approval and in the normal course it would have been considered and approved based on the denial letter. He knew this to have happened as the Senior Officer approved the form and sent it to the VAT Services team who rejected it. They did so on the basis that the 06/09 return was not in order because there was a query over that period. HMRC was conducting pre-credibility checks for this period. This means HMRC wanted to complete checks with the Appellant before paying the amount it was reclaiming. Hence enquiries were ongoing at that time.

1639. On 4 January 2013 Officer Ball competed a form confirming his decision that the 06/09 return needed adjusting. He copied these details into the secure notes on the electronic folder. For the part of the notes that stated 'Give details of any adjustments to queried or suspended

periods (link V1-35 Letter(s) to the UCRE)' he stated "See letter 03/01/2013 £34,317,697.80 i/tax denied….".

1640. The letter he referred to dated 3 January 2013 is that set out above – the V1-35 letter informing the Appellant of the adjustment of the 06/09 return from being a repayment return to a payment return.

1641. Following the issuing of the V1-35 letter dated 3 January 2013, on 10 January 2013 Officer Peter Davies authorised the adjustment. The secure electronic notes reflect that on 11 January 2013 Officer Sarah Deex recorded that the 06/09 return was adjusted as per the V1-35 letter resulting in the Appellant's £4,742,232.30 repayment claim becoming a £29,575,465.50 payment to HMRC.

1642. For the period 06/09 HMRC did not release the funds claimed in the Appellant's return. Officer Ball stated in his statement that hence no assessment was required for the sum claimed as a repayment (£4,742,232.30). Instead, the VAT return was adjusted internally and the Appellant was notified by the V1-35 letter.

1643. Following Peter Birchfield's review conclusion dated 12 April 2013, further adjustment to the 06/09 return period was required. On 29 July 2013, Officer Ball issued the further V1-35 letter to the Appellant as set out above showing the original amounts claimed, the amendments as per the letter dated 3 January 2013 and then further amended amounts that took into account Peter Birchfield's review.

1644. The internal process to amend the 06/09 return again was the same as before. In the secure electronic folder he did not record his decision to issue a V1-35 letter for the further adjustment of 29 July 2013. He did not recall why this occurred.

1645. On 1 August 2013 Officer Outram recorded in the secure notes that he had "..reviewed David's letter and the figures which resulted in this and I give SO Authority for this Amendment".

1646. On the same date Officer Steve Sharrock recorded in the secure notes that further adjustments were required to the 06/09 return following the review. These showed that the return was adjusted from a payment of £29,575,465.50 to a payment of £1,665,779.88. Following this on 5 August 2013 Officer Deex noted on the system "V100 input. 484 0609". Officer Ball understood this was confirmation that the adjustment was made on HMRC's system.

1647. The effect of the various internal steps and notifications of HMRC is set out at paragraph 27 of Officer Ball's witness statement as a summary:

a) he had calculated a sum of input tax to be denied and notified this in the Decision of 6 December 2012;

b) In consequence of that decision the repayment claimed by the Appellant for period 06/09 of £4,742,232.30 was not paid and never has been. There was no need to issue an assessment for this sum;

c) The balance of the sum denied for period 06/09 namely £29,575,465.50 was calculated and notified to the Appellant as due and owing on 3 January 2013;

d) The sum in (c) above was adjusted as a result of Officer Birchfield's review. Officer Ball undertook the necessary recalculations which resulted eventually in the notification of the sum now due and owing of £1,665,779.88 in respect of the 06/09 period (in the letter of 29 July 2013). This sum had been determined as being due and owing to HMRC and is recorded as such on their internal systems.

Appellant's submission on the Fourth Issue

1648. Ms Shaw QC, on behalf of the Appellant, submitted that it can reasonably be inferred from the form VAT 655, stamped on 18 January 2013, that Officer Ball made assessments only for the periods 03/09 and 09/09. Similarly, it can reasonably be inferred from the absence of any VAT 655 for the period 06/09 that no such assessment was made in respect of the period 06/09.

1649. She submitted that the use of a VAT 655 is in line with the usual means by which an assessment is made, namely by completion of a VAT 641 form: see *Courts plc v CCE* [2004] STC 690, at [13]; completion of that form then automatically generates the VAT 655: ibid, at [11].

1650. She drew attention to the requirements in law for the making of an assessment set out in paragraph 37 of the decision in the First-tier decision in *Aria* citing *BUPA Purchasing*:

"It is in general a legal act on the part of the Commissioners constituting their determination of the amount of VAT, interest, penalty or surcharge that is due."

1651. So she submitted that this meant that simply determining the amount of VAT due is not sufficient. There must also be the legal act of assessment. What this requires, as the Upper Tribunal points out in their decision in *Benridge Care Homes Ltd v HMRC* [2012] UKUT 132, cited in paragraph 24 of the First-tier decision in *Aria*, is that HMRC cannot do it by accident. She relied upon the passage in *Benridge Care Homes* where the Upper Tribunal stated:

"In the present case the letters did not purport to be assessments and Mr Chapman did not seek to establish the respondent's case on the basis that they were. We do not think that they were assessments. They reflect a conclusion that no assessment is required or should be made because no net amount of VAT is sought. Even allowing for Lady Justice Arden's comments in BUPA as an administrative act, we consider that the Commissioners of the assessing body must believe that they are making an assessment. We do not think that they can assess, so to speak, by accident."

1652. Ms Shaw QC submitted this demonstrates that at the very least HMRC must be cognisant of the fact that they are making an assessment. So again, simply determining that an amount of tax is due is not sufficient.

1653. Then finally, paragraph 25 of that decision is an extract from *Courts Plc v CEC* [2004] EWCA Civ 1527 in which the Court of Appeal ask the question:

'When is an assessment made?

[106] "An assessment is made when you have finished calculating the amount upon which the assessment is to be based and a final decision to assess that amount has been taken."'

1654. Thus, she submitted, simply calculating the amount of tax that is due is not sufficient. HMRC have to make a decision to assess.

1655. In the present case, she argued that Officer Ball did not make an assessment for the 06/09 period for five reasons.

1656. First, that was not what Officer Ball understood himself to be doing. At no point in his third witness statement or in his oral evidence did he say that he made an assessment for the period 06/09. So, Ms Shaw QC submitted if one must be cognisant of the fact that one is making an assessment, it's apparent that Officer Ball was not so cognisant.

1657. She submitted that all Officer Ball did and all he understood himself to be doing for the period 06/09 was to issue an error correction notification in the form of the letters above which he described as V1-35 letters (dated 3 January 2013 and 29 July 2013).

1658. Second, she submitted that the effect of those letters is simply to show what the Appellant's VAT return should have looked like. It shows the numbers that should have been contained in that return. Plainly what those error corrections showed was that an amount of tax was due to HMRC. But that, she submitted, is not sufficient. What was required was for Officer Ball to then go on to make an assessment of the amount shown as due, and that is apparent from the Revenue's own internal guidance, VAEC8320 which says:

"If a repayment return reverts to a payment return [precisely what has happened here], we disallow the credit under section 25 and make an assessment."

1659. She submitted that the two letters (of 3 January and 29 July 2013) make no mention of rights of review or appeal or indeed a requirement to make a payment. While these are not essential ingredients of an assessment, they are evidence of what HMRC thought it was doing and the absence of those features sheds light on what Officer Ball thought he was doing. He confirmed in his cross-examination that an assessment is an appealable decision and that an appealable decision should state the rights of review and appeal of a taxpayer.

1660. So Ms Shaw QC submitted that the absence of these features confirms the status of these letters as a different and prior administrative act to the making of an assessment. The absence of these references is entirely explicable by reason of the nature of the letters that were sent. They are something other than assessments. She submitted that they were error correction notifications.

1661. Third, Ms Shaw QC submitted, as Officer Ball confirmed in cross-examination, he took no other steps or actions in respect of the period 06/09 after issuing the letters. What he was required to go on to do after issuing those letters and after Officer Davies authorised the error correction was to then go on to make the assessment for the amount shown as due. The Tribunal should make an inference from the evidence as to whether a decision was made and what Officer Ball thought he was doing.

1662. Fourth, Ms Shaw QC submitted that the actions in respect of the period 06/09 can be contrasted with Officer Ball's actions in respect of the periods 03/09 and 09/09 where Officer Ball followed to the letter the four-step assessment process that he set out in his third witness statement.

1663. Fifth, she submitted that on any view the denial letter of 6 December 2012 cannot properly be construed as an assessment for the period 06/09 because it does not calculate the amount of tax due for that period. All that it calculates is the amount of input tax deniable for

that period. Those are different amounts. So, on any view that letter could not constitute the assessment, and indeed Officer Ball himself accepted that in cross-examination.

1664. In supplementary submissions Ms Shaw QC drew the Tribunal's attention to [181] of the Upper Tribunal's decision in *Aria Technology.*

1665. In contrast to the facts of *Aria*, she submitted that:

(1) Officer Ball undertook a different exercise in respect of the 06/09 period from that which he undertook in respect of the 03/09 and 09/09 periods.

(2) This is evident from the different processes he adopted in respect of the periods. In particular, he completed a VAT 641 and VAT 655 for the periods 03/09 and 09/09 but not 06/09; and the omission of the 06/09 period from these two documents was deliberate on the part of Officer Ball.

(3) It is also material to note that Officer Ball notified the Appellant of its right of appeal against the assessment when he sent the VAT 655 to the Appellant in respect of the periods 03/09 and 09/09 on 18 January 2013 but that he omitted such a notification from his letter of 3 January 2013 in respect of the 06/09 period (cf the letters in *Aria*, which both included information about appeal rights: see [167] and [168] of *Aria*).

(4) Furthermore, and also in contrast to the position as regards 03/09 and 09/09, there is nothing in the evidence which shows that Officer Ball either (1) made a determination that an amount was due from the Appellant to HMRC in respect of 06/09, or (2) notified the Appellant that an amount was due from it to HMRC for that period. It is important to note in this regard that in the present case there was no equivalent to the letter referred to in [167] of *Aria* which stated that the amount notified in the 'further letter' was 'now due' to HMRC in respect of the relevant period.

1666. Thus, for these reasons she submitted on behalf of the Appellant that there was no assessment for the period 06/09:

(1) Whilst Officer Ball made an assessment in respect of the periods 03/09 and 09/09, he did not do so in respect of the period 06/09 – indeed he deliberately took a different course of action in respect of that period. In particular he did not make a 'decision to assess'; he did not make a decision that a calculated amount of tax was due from the Appellant for 06/09.

(2) Further or alternatively, unlike the officer in *Aria*, he did not notify the Appellant of any decision or determination that a calculated amount of tax was now due from the Appellant to HMRC in respect of 06/09.

(3) It follows that, as regards the 06/09 period in the present appeal, there was no decision to assess, no assessment and no notification.

Discussion and Decision on the Fourth Issue

1667. The Tribunal rejects the arguments of the Appellant on this issue for the reasons set out below which are largely, but not exclusively, for the reasons that HMRC submitted.

1668. Section 73(1) and (2) VATA provide for HMRC to make and notify assessments. There is no statutory procedure for making and notifying an assessment.

1669. An assessment is, in general, a legal act on the part of HMRC constituting their determination of an amount of VAT due (Arden, LJ. in *HMRC v BUPA Purchasing Ltd & Others* [2007] EWCA Civ 542 at [37]). There is a three-stage process, the decision to assess, followed by the assessment, then by the notice given (*The Commissioners of Customs and Excise v Bassimeh* [1997] S.T.C. 33 (*"Bassimeh"*).

1670. An assessment is not required to be issued in a particular form. Making an assessment is an internal matter for HMRC. There is no formula that will determine whether an assessment has been made in any given case. HMRC may decide to treat certain cases as special or exceptional cases, to which their normal internal processes should not apply. Notification can take any form so long as the terms are clear to the taxpayer (*Courts Plc v Customs and Excise* [2004] EWCA Civ 1527 at [97, 107 & 119]).

1671. As cited above, in *Queenspice v HMRC* [2011] UKUT 111 the Upper Tribunal stated as follows at [23]:

Although the commissioners choose to use printed forms headed "Notice of Assessment", there is in my judgment no magic about such forms. They are not required by statute or regulation which prescribe no particular formality at all. All that is required is that the commissioners should make an assessment to the best of their judgment and notify it to the taxpayer. There is perhaps an understandable tendency to merge the assessment with the notification and to look only or mainly at a single document if it is called notice of assessment. But there appears to be no reason why notification should not be given by letter, nor any reason why in this case the letter dated 24 May 1990 should not be seen as, or part of, due notification. That letter states the amount of the assessment and refers to the schedules for the details of the build up of the amount. I do not see why a notification cannot be contained in more than one document provided that it is clear which document or documents are intended to contain the notification and that that document or those documents contain in unambiguous and reasonably clear terms the substantial minimum requirements to which Mr Cordara has referred.

1672. All an assessment must contain is: the name of the taxpayer, the amount of tax due, the reason for the assessment and the period of time to which it relates (*House (trading as P & J Autos) v Customs and Excise Commissioners* [1994] STC 211, at p 223h-j and p 226g-h *per* May, J. (as he then was).) There is no requirement for the assessment to state when a sum due must be paid.

1673. Perhaps more surprisingly, there is no need for it to state the appeal rights for it to be an assessment. The absence of a right of appeal being stated on an assessment does not invalidate it (*The Commissioners for Her Majesty's Revenue & Customs v NT ADA Ltd* [2018] UKUT 0059 (TCC) at [48]).

1674. The process of assessing and notification of that assessment are separate (*The Commissioners of Customs and Excise v Bassimeh* [1997] S.T.C. 33 (*"Bassimeh"*) Evans, L.J.).

1675. A summary of the law on making VAT assessments is set out at [181] of the Upper Tribunal's decision in *Aria Technology Ltd v HMRC* [2018] UKUT 0363 (TCC) ("*Aria*"):

181.In the light of these and other authorities, we are satisfied that the FTT correctly summarised the law at [44] of the Judgment as follows: "The "making" of an assessment refers to the determination that an amount is due; There is no set formula by which an assessment must be made; The processes of assessing and notification of that assessment are separate; The assessment process involves a decision

that tax is due and a calculation of that amount; Notification can take any form so long as the terms are clear to the taxpayer.

1676. On 3 January 2013 HMRC notified the Appellant that as a result of the Decision on 6 December 2012, its VAT return for VAT period 06/09 was adjusted from a repayment claim of £4,742,232.30 to a payment due to HMRC of £29,575,465.50. The calculation of the sum due is evidenced by the letter of 6 December 2012, whereby £34,317,697.80 was denied for period 06/09, and the letter of 3 January 2013 whereby that denied sum is set against the repayment claim on the 06/09 return.

1677. The remaining sum for 06/09 was initially assessed by reason of the Decision of 6 December 2012 and evidenced in the first notification of adjustments of the 06/09 VAT return on 3 January 2013. It was amended subsequently by a combination of the Review Decision of 12 April 2013, Supplementary Assessment of 25 June 2013 and second notification of adjustments to the 06/09 VAT return on 29 July 2013 as per *Queenspice* and *Aria*.

1678. The Appellant's assertion (made for the first time in its opening skeleton argument dated 12 February 2018) that no valid assessment has been made for 06/09 is rejected.

1679. It is apparent that in this case HMRC's basis for the denial of input tax for 06/09 and intention to raise a consequential assessment sum for period 06/09 can have been undertaken no later than the original decision of 6 December 2012. The calculation of the sum of tax due for 06/09 and notification of that sum were first contained in the letter of 3 January 2013. There was further evidence of HMRC making a decision to assess the Appellant for the sum notified as being due in the internal workings from 10 December 2012.

1680. The revised calculation of the assessed sum for 06/09 was made in the correction and supplementary assessment on 25 June 2013 with notification of the revised total assessment made in the letter on 29 July 2013.

1681. Therefore, while Officer Ball did not explicitly state in his third statement or in oral evidence that he made an assessment for 06/09 and there was no formal V655 (notice of assessment) issued to the Appellant, in contrast to 03/09 & 09/09, this is not determinative of the issue for the reasons set out above.

1682. Further, the Upper Tribunal in *Aria* decided at [184]-[186] that as a matter of law the officer making the assessment does not have to be aware that he is making an assessment because the Officer's state of knowledge is not determinative:

"184. We do not consider that the Upper Tribunal's decision in Benridge Care Homes Ltd establishes that the subjective views of a particular HMRC officer on the legal question whether he or she has made an assessment are determinative. In Benridge, the taxpayer made a claim for repayment of VAT. HMRC decided that the repayment was not due as the taxpayer had overstated input tax claims and understated output tax due and they decided to refuse the claim for repayment. Therefore, the Upper Tribunal's conclusion in the passage quoted was that the "administrative act" which HMRC thought that they were performing, and which they were performing, was a straightforward refusal to pay the taxpayer the sum claimed. That was clearly very different from an "assessment" which involved a decision that the taxpayer was liable to pay HMRC a sum of money.

185.Mr Firth also referred us to Pill LJ's statement in Courts plc v Customs & Excise Commissioners [2005] STC 27 at [119]:

What this case has highlighted is the importance of officers of the respondents being clear in their own minds what they are doing at each stage; whether they are making an assessment or a decision to assess or some other exercise."

In that passage, Pill LJ was not saying that the subjective beliefs of a particular officer can determine whether or not an assessment was made. Rather, he was saying that, because the question of whether, and when, an assessment is made will depend in large part on HMRC's internal actions, there is a public interest in HMRC officers understanding what they are doing at each stage.

186.Therefore, despite Mr Bailey's acceptance that he did not think he was making an assessment in law, we consider the FTT was correct to conclude that the letter of 7 October 2018 constituted an assessment."

1683. The Tribunal is satisfied that this undermines the point made on behalf of the Appellant that the assessing officer must be cognisant of the fact he is making an assessment. What is required is a decision that tax is due and that is what the letters of 6 December 2012 (providing the basis for the assessment) and 3 January 2013 (providing the calculation and notification of tax due) evidence in this case.

1684. While it would have been preferable for HMRC to have issued a document explicitly stating that it was an assessment for tax due – such as a V655 notice of assessment - and to inform the Appellant of a payment date and right of appeal in respect of 06/09, this is not required in law. Any prejudice to the Appellant is diminished by the fact it was able to appeal against the assessment for 06/09, as it has done for 03/09 and 09/09.

1685. The Tribunal has accepted the sequence of internal decisions and calculations made by HMRC as set out in their internal notes, which cumulatively amount to a decision to seek payment of £1,665,779.88 in respect of the period 06/09 and notification of these decisions to the Appellant in the set of correspondence.

1686. While none of the following is necessary evidence to support its conclusion, the Tribunal has also noted that in his letter of 6 December 2012 Officer Ball stated he was making an assessment in addition to denying input tax in respect of invalid invoices and that an assessment would be issued to the Appellant. On 10 December 2012 he filled out the VAT 641 to instruct HMRC to issue a V655 and internal notes record a decision that appellant should pay a sum of money with the calculation thereof and later notification on 3 January 2013.

1687. Officer Birchfield also states in his review of April 2013 that there had been an assessment in respect of the denial of input tax on the grounds of invalid invoices. Further, in his letter dated 25 June 2013 he explicitly issued a supplementary assessment for 06/09 in the sum of £604,002.20, which is reasonably inferred to be in the knowledge or belief that there was already an assessment made and notified in respect of 06/09.

1688. The "Revenue Manual" produced by the Appellant in cross-examination of Officer Ball is in no way binding. It deals with voluntary declarations of errors by taxpayers by way of an error correction notification (VAT652: Correction of Errors in VAT Returns). Such notifications claiming repayment of VAT under-claimed, or overpaid in error are made pursuant to section 80 VATA and are subject to a 4-year cap.

1689. The situation in relation to the Appellant's 06/09 period does not concern errors notified by the Appellant, it concerns errors found by HMRC where repayment of the return amount

had already been suspended pending pre-credibility checks. The correct part of the manual (VAEC8320) was that dealt with in re-examination of Officer Ball.

1690. As set out above therefore, the fact that the notification of an adjustment to the Appellant's 06/09 VAT return did not contain the word "assessment" is irrelevant. The fact that it did not state any appeal rights does not invalidate an assessment (*The Commissioners for Her Majesty's Revenue & Customs v NT ADA Ltd* [2018] UKUT 0059 (TCC) at [48]). Whether HMRC made an assessment for the VAT due from the Appellant to HMRC for VAT period 06/09 is not a matter upon which Officer Ball can give determinative evidence, as it is as much a matter of law as one of fact.

1691. In this case, there was therefore demonstrably:

a) a reason given for an assessment in relation to period 06/09 by reference to the decision letter denying input tax dated 6 December 2012 (as amended by the review decision of 12 April 2013 and supplementary assessment letter of 25 June 2013);

b) a decision made by HMRC that VAT was due from the Appellant for a specific VAT period 06/09;

c) a calculation by HMRC of the VAT due from the Appellant (£29,575,465.50, later revised to £1,665,779.88); and a notification by HMRC to the Appellant of that sum due in a letter dated 3 January 2013 (as amended by letter dated 29 July 2013).

Conclusion on the Fourth Issue

1692. All the ingredients for an assessment are present as a matter of both fact and law.

1693. There was an assessment made by HMRC against the Appellant in respect of period 06/09, ultimately in the sum of £1,665,779.88 (of which £604,002.20 was contained in a supplementary assessment).

1694. That assessment, if issued in time, would be reduced as a result of the Tribunal's conclusion on the Third Issue allowing the appeal against £245,890.94 of input tax denied in respect of transactions carried out by CFE between 8 and 10 June 2009. Therefore, the sum in question capable of assessment for 06/09 would be £1,419,888.94.

1695. Whether the assessment for 06/09 was made within the statutory deadline forms part of the Fifth Issue to be decided.

The Fifth Issue

1696. The Fifth Issue is whether HMRC's assessments for 06/09 and 09/09 were made in time or were time barred by virtue of sections 73(6)(b) and 77 of the Value Added Tax Act 1994 (the time bar issue).

1697. The Tribunal has decided by virtue of the fourth issue that an assessment by HMRC was made in respect of 06/09 on the basis of the denial of input tax decision of 6 December 2012, which was calculated and notified by 3 January 2013. The assessment was reduced by virtue of the review on 12 April 2013, supplemented on 25 June 2013 and notified on 29 July 2013.

1698. There is no dispute that the assessment in respect of period 09/09 was made and notified in a formal notice of assessment dated 18 January 2013 in the sum of £1,322,800 (this remained unchanged throughout).

1699. Therefore, the assessments were made within the longstop time limit of four years provided by section 77 VATA.

1700. Nonetheless the Appellant submits that any assessments made by HMRC in 2013 (whether by January, April or June) in respect of 06/09 and 09/09, were made outside of the statutory time limit provide by section 73(6)(b) VATA.

1701. The Appellant submitted that the assessments were made more than one year after evidence of facts, sufficient in the opinion of the Commissioners to justify the making of the assessment, came to their knowledge for the purposes of section 73(6)(b) VATA. The Appellant submits that evidence of facts sufficient in the opinion of HMRC Officer Ball to justify making the assessments made came to his knowledge by December 2011 at the latest and that even if he did not hold such an opinion, it was unreasonable or perverse for him not to do so by this time.

1702. In reply, HMRC submit that the assessments were made within one year of the Pinsent Masons report dated 21 September 2012 provided by the Appellant which contained further information in relation to both VAT periods. HMRC submitted that it was only on receipt of this report that evidence of facts sufficient in the opinion of Officer David Ball to make the assessments which he (and later Officer Birchfield) made came to his knowledge and that this was a reasonable opinion to reach.

1703. The primary questions for the Tribunal to decide are:

a) when was Officer Ball of the opinion that evidence of facts sufficient to justify the assessments he raised for each of 06/09 and 09/09 had come to his knowledge? Each time period and opinion must be considered separately. If evidence of facts sufficient in his opinion to justify the assessments came to his knowledge by 6 December 2011 then the assessments were out of time, taking place over one year after. If evidence of facts, sufficient in his opinion to justify raising the assessments only came to his knowledge by September 2012 on receipt of the Pinsent Masons report, then the assessments made in January 2013 would be made in time, subject to b).

b) If evidence of facts sufficient in Officer Ball's opinion to justify the assessments only came to his knowledge in September 2012, was it unreasonable or perverse only to have reached this opinion at such a late time and not by December 2011?

Law on the Fifth Issue

1704. Section 73(2) VATA provides as follows:

"(2) In any case where, for any prescribed accounting period, there has been paid or credited to any person—
(a) as being a repayment or refund of VAT, or
(b) as being due to him as a VAT credit,
an amount which ought not to have been so paid or credited, or which would not have been so paid or credited had the facts been known or been as they later turn out to be, the Commissioners may assess that amount as being VAT due from him for that period and notify it to him accordingly".

1705. There is no legal prescribed form for either making or notifying an assessment to VAT, which are two different procedures. The FTT reviewed the relevant binding authorities on the topic in *Aria Technology v HMRC* [2018] UKUT 363 (TCC) (*"Aria"*). As accepted in *Aria*, a combination of letters denying the right to deduct input tax and consequent letters notifying adjustments to the relevant VAT returns functions perfectly well as an assessment for the purposes of VATA. There is no requirement to even use the word "assessment" so long as it is clear that a decision has been made that tax is due and that there is a calculation of that tax.

1706. Section 77 VATA provides, in as far as is relevant:

"(1) Subject to the following provisions of this section, an assessment under section 73, 75 or 76, shall not be made–

(a) more than 4 years after the end of the prescribed accounting period or importation or acquisition concerned,…"

1707. Section 73(6) VATA provides as follows:

73(6) An assessment under sub-section (1), (2) or 3) above of an amount of VAT due for any prescribed accounting period must be made within the time limits provided for in Section 77 and shall not be made after the later of the following –

(a) 2 years after the end of the prescribed accounting period; or

(b) one year after evidence of facts, sufficient in the opinion of the Commissioners to justify the making of the assessment, comes to their knowledge,

but (subject to that section) where further such evidence comes to the Commissioners' knowledge after the making of an assessment under sub-section (1), (2) or (3) above, another assessment may be made under that sub-section, in addition to any earlier assessment.

1708. The leading authority on the application of section 73(6)(b) remains the case of *Pegasus Birds Ltd. v Commissioners of Customs and Excise* [1999] STC 95 in which Dyson, J. (as he then was) set out the legal principles to be applied at p.101:

"1. The Commissioners' opinion referred to in Section 73(6)(b) is an opinion as to whether they have evidence of facts sufficient to justify making the assessment. Evidence is the means by which the facts are proved.
2. The evidence in question must be sufficient to justify the making of the assessment in question. C & E Commissioners –v- Post Office [1995] STC 749, 754G.
3. The knowledge referred to in Section 73(6)(b) is actual, and not constructive knowledge: C & E Commissioners –v- Post Office at p.755D. In this context, I understand constructive knowledge to mean knowledge of evidence which the Commissioners do not in fact have, but which they could and would have if they had taken the necessary steps to acquire it.
4. The correct approach for a Tribunal to adopt is (i) to decide what were the facts which, in the opinion of the officer making the assessment on behalf of the Commissioners, justified the making of the assessment, and (ii) to determine when the last piece of evidence of these facts of sufficient weight to justify making the assessment was communicated to the Commissioners. The period of one year runs from the date in (ii): Heyfordian Travel Ltd. –v- C & E Commissioners [1979] VATTR 139, 151: and Classicmoor Ltd. –v- C & E Commissioners [1995] V & DR 1, 10.1.27.
5. An officer's decision that the evidence of which he has knowledge is insufficient to justify making an assessment, and accordingly, his failure to make an earlier assessment, can only be challenged on

Wednesbury principles, or principles analogous to Wednesbury: Classicmoor paras. 27 to 29; and more generally John Dee Ltd. –v- C & E Commissioners [1995] STC 941, 952D-H.
6. The burden is on the taxpayer to show that the assessment was made outside the time limit specified in Section 73(6)(b) of VATA."

1709. Dyson, J. confirmed that the taxpayer has to show that the decision of the Commissioners (as to whether they have evidence of facts sufficient to justify making the assessment) was perverse or wholly unreasonable. Dyson, J. set out an example of a wholly unreasonable delay in making an assessment as follows:

…In some cases, the position will be clear. Suppose that evidence of all the facts which in the opinion of the Commissioners justified the making of the assessment was known to the Commissioners at the beginning of year 1, and the assessment was not made until the beginning of year 3. Suppose further that the reason for the 2 year delay is that the file was lost, or there was a change of staff with the result that the officer who had acquired the evidence did not pass it on to his successor. In those circumstances, the delay in making the assessment would be wholly unreasonable, and an appeal would succeed on the time limits point.

1710. That test was approved by the Court of Appeal, where Aldous, LJ. stated ([2000] STC 91 at [11-15]):

Subsection (6) is to protect the taxpayer from tardy assessment, not to penalise the commissioners for failing to spot some fact which, for example, may have become available to them in a document obtained during a raid.
…
An opinion as to what evidence justifies an assessment requires judgment and in that sense is subjective; but the existence of the opinion is a fact. From that it is possible to ascertain what was the evidence of facts which was thought to justify the making of the assessment. Once that evidence has been ascertained, then the date when the last piece of the puzzle fell into place can be ascertained. In most cases, the date will have been known to the taxpayer, as he will be the person who supplied the information.

1711. In relation to whose opinion as to the sufficiency of evidence was relevant, Dyson, J. said:

Nor is there any problem about identifying the person whose opinion is to be determined. The person whose opinion is imputed to the Commissioners is the person who decided to make the assessment. It does not matter that he or she may not be the person who first acquired knowledge of the evidence of the facts which are considered to be sufficient to justify making the assessment. The knowledge of all officers who are authorised to receive information which is relevant to the decision to make an assessment is imputed to the Commissioners.

1712. In *Carbondesk Group PLC v Revenue & Customs* [2015] UKFTT 367 (TC) Judge Herrington said at [19-21]:

19. Although, as Mr Kinnear submitted, and as demonstrated in the authority he relied on for this submission, Subhan & Others v CCE (2001) VTD 17110, a decision to ask for further information before making an assessment can be justified if the officer believes that in the absence of that information the assessment would not be to best judgment, the preliminary issue in this case is to be determined by asking whether the officer's decision to make the assessment she actually made only after receiving the further material was unreasonable in the Wednesbury sense, with the result that her decision not to make an earlier assessment will have been shown to be perverse and wholly unreasonable…

20. … As Mr Mantle also submitted, the test is not based on the question of the reasonableness of the decision to request the further information but is one based on the sufficiency of the evidence that was obtained as a result of the request. The assessing officer therefore takes the risk, if a request is made for further information, that the information received is not of sufficient weight and therefore, with hindsight, the decision not to make an earlier assessment without it is to be regarded as perverse or wholly unreasonable.
21. I therefore reject Mr Kinnear's submission that whether the further material when received changes the preliminary view of the officer is not material. Pegasus Birds makes it clear that the tribunal must determine when the assessing officer received the last piece of evidence which in the officer's opinion was of sufficient weight to justify the making of the assessment. Therefore, if the further investigations produce nothing of material significance the result must be that the last such piece of evidence was received before the officer asked for the further information.

1713. In *Rasul v Revenue and* Customs [2017] UKUT 357 the Upper Tribunal noted:

16. The threshold for making a "best judgment" assessment is therefore comparatively low. But that is not the same as saying that the twelve month time limit in s 73(6)(b) starts to run as soon as there is sufficient evidence before HMRC to enable an officer to reach the view that he is entitled to issue a "best judgment" assessment. If the officer decides that further enquiries need to be made and/or further information obtained before making an assessment, the time limit will not start to run against him unless that decision is perverse or wholly unreasonable.
...
70. Mr Woolf's submissions fail to appreciate that the test in s 73 (6) (b) focuses on the sufficiency of evidence of the facts that would justify an assessment. In our view, in considering the sufficiency of evidence the Officer is entitled to consider what weight he can attach to the evidence that he has been given. The principles laid down by Dyson J in Pegasus Birds set out at [9] above make it clear that the statutory provision focuses on the evidence of the facts that need to be proved and that the task of the tribunal is to determine when the last piece of evidence of these facts "of sufficient weight" to justify making the assessment was communicated to HMRC: see the first and fourth principles.
…
72. In our view, it was open to the FTT to conclude, as it clearly did, that the various statements that Mr Spranklen made in his evidence to the effect that it would be unreasonable to make an earlier assessment and that he did not wish to act hastily were all directed to the question as to whether the evidence he had was of sufficient weight to justify the assessment. We accept Mr Millington's submission that Mr Spranklen's concerns regarding unfairness or unreasonableness were inextricably linked to his concerns that the evidence was of insufficient weight, as the FTT clearly found by the manner in which it expressed its findings at [51] of the Decision.
…
83. Furthermore, we agree with Judge Raghavan's assessment to the effect that were it the case that Mr Rasul did not attend the meeting at which he would have been given the opportunity of providing further evidence in relation to the phonecards and top-up takings could give rise to the inference that Mr Rasul had nothing more to say on the subject. It is therefore a new piece of evidence which is clearly relevant to the sufficiency of the evidence which had previously been obtained.
…
88…As the FTT correctly said, the fact that the evidence might reasonably be regarded as of sufficient weight so as to found the basis for a valid best judgment assessment does not mean a decision not to regard the evidence as being of sufficient weight is one which is necessarily wholly unreasonable or perverse. If that were the case, it would effectively impose a requirement on HMRC to issue assessments on a "hair trigger" basis. It is therefore clear that insofar as the FTT fell into error that error did not in any way influence its assessment that Mr Spranklen's opinion that he did not have evidence of sufficient weight to justify an assessment until after the meeting on 20 April 2010 was wholly unreasonable or perverse.
89. Similarly, although in certain passages from Mr Spranklen's evidence that we have quoted above, the Officer refers to it being "wholly unreasonable" to have made an assessment without Mr Rasul being

given the opportunity to attend a further meeting and that following the meeting he could proceed to a best judgment assessment we cannot see how that in itself makes his opinion that he did not have sufficient evidence to justify an assessment before that time wholly unreasonable or perverse. The fact that he might, as a matter of law, have been able to proceed to an assessment on the basis of the material he already had is a separate matter to the question as to whether he was of the opinion that the evidence he had was of sufficient weight and whether such opinion was wholly unreasonable or perverse.
90. In any event, as Mr Millington submitted, had Mr Spranklen proceeded to make an assessment in circumstances where his belief was that the evidence that he had was not of sufficient weight to justify the assessment and that he would be acting wholly unreasonably and taking advantage of the taxpayer in so doing, that would call into question whether the assessment was made honestly and in good faith.
91. Therefore, we can see no basis on which we should interfere with the FTT's finding that it was not wholly unreasonable or perverse of Mr Spranklen to have formed the opinion that he did not have evidence of sufficient weight to make the assessment until after the meeting on 20 April 2010. Since s 76 (6) (b) VATA 1994 focuses on whether the evidence obtained is of sufficient weight, the fact that no new material emerged from the meeting of 20 April 2010 is of no concern. It was the context of the meeting of 4 September 2009 that in the opinion of Mr Spranklen did not give the evidence he obtained sufficient weight to make an assessment, but the fact that it was repeated in a more formal setting in his opinion gave that same information sufficient weight on which he could base his assessment.
92. We can see nothing wholly unreasonable or perverse in that opinion. Indeed, Mr Spranklen is to be commended for following an approach which was designed to be scrupulously fair to Mr Rasul. It is obviously highly desirable that HMRC's Officers should be seen to be scrupulously fair in the way that they approach the question of best judgment assessments and it would be highly undesirable if the law was to be interpreted in such a way that it operated as an encouragement to make an assessment in circumstances where there is any doubt as to whether the taxpayer has been treated fairly.

1714. The approach in *Rasul* is also reflected in *The Royal Bank of Scotland Group PLC v Revenue and Custo*ms [2017] UKFTT 223 (TC). Judge Mosedale said at [14-15]:

14. However, it seems to me that there is one relevant point worth mentioning about evidence of facts. On a number of occasions, the assessing officer (Officer Williams) stated that even though the information was already known to HMRC from one source, although he had not known it at the time, he would have wanted confirmation of it from RBS rather than rely on the other source. The appellant's view was that obtaining confirmation of the fact from RBS was irrelevant: HMRC had evidence of the fact once they had it from any source.
15. But a fact is a fact: evidence is what tends to prove (or disprove) the alleged facts. S 73 does not refer to 'facts' but to 'evidence of fact', reflecting that whether or not something actually is a fact can only be ascertained by evidence and some evidence is stronger than other evidence. HMRC might think in some cases that a particular fact is only evidenced to the degree necessary to justify an assessment if it is confirmed from more than one source: whether that is a reasonable view will depend on the circumstances. But having evidence of a fact from one source is not necessarily sufficient evidence of that fact to justify an assessment. It must depend on the exact circumstances and in particular the reliability of the source.

The Facts on the Fifth Issue

The timing of the assessments

1715. The Tribunal has already decided the following as above:

a) in respect of period 09/09 the assessment was notified to the Appellant on 18 January 2013, having been made by that or an earlier time – such as the decision letter of 6 December 2012;

b)in respect of period 06/09 the basis for the assessment was made in the denial decision of 6 December 2012, it was calculated and notified to the Appellant on 3 January 2013. Thereafter the assessment was reduced as of the review decision of 12 April 2013, supplemented on 25 June 2013 and the amendment notified to the Appellant on 29 July 2013.

1716. In order to decide what evidence of facts were before the HMRC decision makers at what point in time, it is necessary to examine the course of HMRC's enquiries from August 2009 until July 2013.

1717. Consideration begins with Officer Ball's explanation for the timing of the assessments in his witness statement.

1718. Officer Ball states at paragraph 7 of his first witness statement on this issue:

'Since August 2009 I have requested information and documentation from CFE on numerous occasions to enable me to come to a decision as to whether the relevant input VAT should be denied and if so on what bases. In particular on 30th January 2012 I sent an email to CFE asking various questions which followed up on a series of previous requests to which I had no had answer…I raised further enquiries with CFE in a letter dated 24th May 2012….I was told by CFE that my questions which had been outstanding for some period of time, would be answered in a report to be produced by CFE's representatives Pinsent Masons. As the officer carrying out the extended verification I was of the opinion that until I had received the answers to those questions I did not have evidence of facts sufficient to make assessments against CFE, since the questions concerned not only the alternative evidence provided by CFE in ration to the invalid invoices from Stratex but also evidence about what CFE knew or should have known in relation to the transactions….I received a copy of the report on 21 September 2012….'

HMRC Information Gathering

1719. The course of HMRC's enquiry or extended verification was as follows.

1720. On 28 August 2009, Mr Treanor of CFE, sent Officer Edgson of HMRC a copy of the retail blotter for all trades carried out by the EUA Desk for the 06/09 VAT period. This showed the names of the counterparties to each trade, the amount of the payments made to the sellers and the output VAT and input VAT in respect of each trade.

1721. Between 28 August 2009 and 1 September 2009 further correspondence took place between Mr Cooper of CFE and Officer Edgson.

1722. On 1 September 2009, Officer Ball emailed Mr Treanor, asking about whether Stratex had a VAT registration number, as he was unable to find it. Stratex had been mentioned at the meeting with HMRC on 25 June 2009 in the context of entities who had not provided a VAT number on their invoice but appeared to have carried out genuine transactions. Mr Cooper also believes that he sent invoices in relation to Stratex to Officer Edgson in early July 2009.

1723. Mr Treanor replied to Officer Ball on 2 September 2009. He confirmed that CFE had not been presented with the VAT number for Stratex. Mr Treanor noted, however, given the size of the transactions, it was clear that Stratex was a taxable person with an obligation to be registered for VAT.

1724. There was further email correspondence between Mr Treanor and Officer Edgson on 4 September 2009. Officer Edgson stated that, in relation to Stratex, the advice he had received from his policy colleagues was that HMRC would restrict any input tax deductions on purchases from suppliers who were not VAT registered. As such, it was likely that input VAT in respect of trades with Stratex would be disallowed.

1725. Mr Treanor replied to Officer Edgson that he found his response alarming. He commented that the Appellant believed that it had already provided sufficient information to deal with any reasonable enquiry, much of which had been available to HMRC since the meeting on 25 June 2009. Mr Treanor also requested Officer Edgson to consider the deduction of input tax in relation to the trades with Stratex in the light of HMRC's own published guidance and Business Brief 01/06.

1726. Meanwhile, on 9 September 2009 HMRC made an unannounced visit to the principal place of business of Stratex. Officer Ball accepted in evidence that, by that date, he knew that:

(1) CFE had bought carbon credits from Stratex in respect of which they paid VAT;

(2) CFE had sold those credits on;

(3) the Stratex invoices were invalid because they did not contain a VRN; and

(4) Stratex was not in fact VAT registered.

1727. Officer Ball also accepted that by that date he had all the evidence of the facts to conclude that the Stratex trades were connected with VAT fraud.

1728. Mr Treanor emailed Bob Page of HMRC and Officer Edgson on 1 October 2009. This was sent in response to an email from Officer Page on 15 September 2009 regarding Stratex. Mr Treanor again confirmed that the Appellant did not have a VAT registration number for Stratex and again set out the basis on which HMRC's discretion should be exercised in favour of the Appellant in respect of an input VAT deduction on the trades with Stratex. Mr Treanor argued that the criteria for the application of HMRC's discretion to allow a deduction of input VAT in respect of Stratex were clearly satisfied. Officer Edgson replied on 1 October 2009 to confirm he had passed the email on to Officer Ball for his response.

1729. On 6 November 2009, Mr Treanor sent an email to Officer Edgson, attaching his responses to a questionnaire provided by HMRC.

1730. On 27 November 2009 a meeting was held between Mr Treanor and Mr Cooper and Officers Ball, Stone, Edgson, Drakes, Smallbone and Davidson of HMRC. HMRC asked the Appellant for details of records and information on a number of topics.

1731. On 12 January 2010, Officer Rod Stone of HMRC sent Mr Treanor a letter setting out a list of the information which Mr Stone said was requested at the 27 November 2009 meeting. The requests comprised:

(1) Structure and organisation of emissions trading;
(2) Names of traders involved in emissions trading;
(3) Risk and Marketing analysis reports in relation to emissions trading;
(4) Details of risk management processes;

(5) Details of levels of authorisation for the trading desk;
(6) Daily Value and Risk details;
(7) Transaction monitoring processes under FSA and Money Laundering requirements;
(8) KYC documents in relation to emissions counterparties;
(9) Business relationships, contracts and third party agreements;
(10) Any Suspect Activity Reports [sic] made;
(11) Any reports made to the FSA;
(12) Any concerns that may have been raised with head office;
(13) Deal documentation including EUA certificate numbers, purchase and sales invoices, settlement details in relation to purchases and sales of EUAs;
(14) Details of incentives/bonuses for traders dealing in emissions trading.

1732. On 27 January 2010 Mr Cooper wrote to Officer Ball about Mr Emanuel and a forthcoming appointment Mr Cooper understood Mr Emanuel to have with HMRC. Mr Cooper informed Officer Ball that Mr Emanuel had been made redundant and did not have authority to represent CO2e and that he had therefore been instructed that it was not appropriate for him to attend the meeting. The letter stated:

'You should be aware that following a reduction in the volume of business undertaken by the Company, a number of roles were recently identified as being redundant – including that of Mr Emanuel. The terms upon which Mr Emanuel's employment will cease are currently being discussed with him.

Mr Emanuel is not authorised to represent the Company and we have therefore instructed Mr Emanuel that it is not appropriate for him to attend the appointment with the HMRC'.

1733. Officer Ball confirmed in oral evidence that he did not reply to this letter and or take any steps to contact Mr Emanuel.

1734. Officer Ball did accept that HMRC were entitled to approach Mr Emanuel, or indeed any of Mr Von Butler, Mr Weldon, Mr Lynch, Mr Bush, Mr Treanor, Mr Tanton and Mr Taylor. He also agreed that it was normal practice for HMRC themselves not to ask officers who are no longer employed by the department to give witness statements.

1735. Officer Stone chased for an update on 8 February 2010 as to how the exercise of collating the information requested was going.

1736. An email from Officer Edgson to Officer Smallbone and others dated 25 March 2010 shows that Officer Edgson spoke to Mr Treanor on that day and that Mr Treanor had said that it had taken longer than anticipated to get the information. Officer Stone told Officer Edgson that he was *"content to allow them an extension but want*[ed] *all the information requested no later than end of April"*.

1737. On 3 June 2010 Officer Stone served a notice on Mr Treanor under Schedule 36 to the Finance Act 2008 for the Appellant to produce documents and provide information.

1738. Mr Ben Khan (the successor of Mr Treanor as Head of Tax in the London office of Cantor Fitzgerald) responded by letter dated 30 June 2010. Item 8 of this letter stated that all KYC documents for counterparties had already been provided to Officer Ball, and item 13 stated that all invoices had been provided to Officer Ball.

1739. On 1 September 2010 HMRC Officers Edgson and Smallbone spoke on the telephone. Officer Smallbone said that the Appellant's reply did not provide the information requested, and that HMRC would therefore have to make a decision on the basis of the information they already had. He also said that the EU had recently provided transaction data. An internal HMRC note of their telephone conversation states '*The Transaction chain data is still being trawled through by the MTIC case team and that process needs to be finalised in order to quantify tax losses involving Cantor*'.

1740. On 13 October 2010 Officer Ball sent a document entitled *"Due Diligence received from Cantor regarding Carbon Credit trades"* to Officer Smallbone, containing the details of CO2e's due diligence on its counterparties, including the 5 disputed counterparties. This document would go on to form part of the basis of Officer Ball's draft submission to HMRC's VAT Fraud Team. In the *"Overview"* section at the end, it is evident that Officer Ball drew some overall conclusions from the material he had assembled and reviewed.

1741. On 2 November 2010 Officer Ball emailed Mr Khan requesting specific invoices for Aristo, Axle, Roxel and Sky Formations Limited. He also requested specific KYC documentation for Carbondesk Limited and SVS Securities Plc. Mr Khan provided this information to Officer Ball by letter dated 18 November 2010.

Officer Ball's Submission to the VAT Fraud Team

1742. On 19 November 2010 Officer Ball sent a draft witness statement to Ms Flora Ebechidi to review. This was the draft form of Officer Ball's submission to the VAT Fraud Team. It contained details of the amounts of input tax in issue for each period and tax loss details showing the extent of the connection with VAT fraud in respect of various counterparties, including those in dispute, and a draft conclusion that the overall scheme was carried out to defraud the VAT system.

1743. On 17 January 2011 Officer Ball sent a knowledge case document (a submission on whether the Appellant had knowledge or means of knowledge) to Officer Douglas Armstrong to provide a higher officer review. This review was completed on 1 February 2011. Officer Armstrong had concerns but he ultimately agreed with Officer Ball's draft submission that the Appellant had knowledge such that input tax should be denied for period 06/09 in the sum of £41,054,429.58.

1744. On 2 February 2011 Officer Lisa Orr conducted a technical consultant review of Officer Ball's submission. She concluded her review as follows:

"I do believe that potentially the litigation of this case may be difficult and that the case would be benefitted with further questions being asked and challenges made of the company in terms of its activities and conduct; but we have what we have and I do believe there is sufficient evidence to demonstrate on the balance of probabilities that Towerbridge knew at the time of entering into the transactions they were connected to fraud – certainly in the 06/09 deals".

1745. On 3 February 2011 Officer Orr reiterated in an email to Officers Ball, Smallbone and Armstrong *"I think that currently we have sufficient (esp for 06/09) to allow Policy to support David's actions"*. The *"actions"* were said by Officer Ball in oral evidence to mean a decision to deny the input tax for 03/09 and 06/09.

1746. On 11 March 2011 Officer Gill provided the VAT Fraud Team's comments to Officer Ball, stating '*You're on the right lines but I feel there's more we can do before we reach the decision stage*'. He indicated a number of areas of further work to be done, and that further information may be required from Cantor. Officer Gill included the following comment about Westis:

"I'm concerned about the defaulter Westis which hadn't registered for VAT during the period under review and was using the VRN of Epicure Business Solutions, What was Cantor told when it attempted to verify its VRN? Westis was registered following the intervention of LBS [Large Business Service] *but what did Cantor say to LBS? Somebody within HMRC told Cantor it couldn't foresee any problems with paying VAT to Westis, but who said this? You'll agree this set of circumstances is irregular so we'll need a full audit trail of who did what, why and when."*

1747. On 14 March 2011 Officer Ball sent Officer Armstrong a contribution from Officer Stone to the "means of knowledge" submissions, which comprised general information on the carbon credit market, including details of the circulation of information on VAT fraud within the market. It is worth noting that the contribution included the following under the heading "Market Trend" at paragraph 12:

"It is accepted that the world wide recession that existed in 2009 led to a significant drop in the price of EUAs and the recession also offered by certain emissions traders as an explanation for the creation and significant increase in volume on the secondary market (OTC).... Consequently, to maximise a profit, a business should have bought OTC from the cheapest source and sold on a futures contact. The cheapest source would have been direct from an operator or from an exchange. However to trade futures requires long term investment. The only firm that chose to buy OTC and sell on as a futures contract was Standard Bank who were not at the relevant time a member of the Bluenext exchange."

1748. On 22 March 2011 Officer Ball made some initial responses to Officer Gill's points in his email of 11 March 2011. It is notable that Officer Ball did not suggest that there was any further information that he considered he needed to make an assessment but nor had he completed all the answers to the points and did not suggest he had all the information he considered he needed to make the assessment.

1749. On or before 5 July 2011 Officer Ball received data from DG Environment showing the block numbers of the credits traded by CFE. Officer Ball appears to have started analysing the material at that time.

1750. On 17 August 2011 Officer Ball sent his revised draft and incomplete witness statement and means of knowledge submission to Officer Armstrong for review. The draft statement says at page 11 'At this point in time a decision has not been made with respect to Cantor's input tax claims for 03/2009 and 06/2009.'

1751. On 30 August 2011 Officer Ball emailed others in HMRC to note that he had discovered Cantor purchased an additional 216,000 units from Westis in July and he would contact Cantor and ask for the purchase invoices.

1752. On 1 September 2011 he emailed Officer Bob Ross and stated: 'The information from DG Environment showed that Cantor had purchased an additional 216,000 units from Westis in July 2009 which I had no knowledge of. However on receiving the breakdown of Cantor's

09/09 return I have found they purchased 773,000 units. Could you please assess Westis £1,322,800.17 as detailed on Cantor's spreadsheet'.

1753. That day Officer Ball sent an email to Kanaklata Vaja of BGC asking for purchase invoices from either Kaplan or Westis and all due diligence carried out on Kaplan.

Officer Ball's 5 September 2011 means of knowledge submission

1754. By 5 September 2011 Officer Ball completed his means of knowledge submission for HMRC's policy department titled 'Template for submission to the VAT fraud team for input tax refused under the *Kittel* principle (Knowledge test)'. It was 151 pages long including the line manager and technical team endorsements from Officer Armstrong dated 30 August 2011 and Officer Orr dated 5 September 2011.

1755. The submission set out the basis for the conclusion of Officer Ball that the Appellant should be denied input tax on a *Kittel* basis for the periods 03/09 and 06/09. The first hundred pages or so of the document rehearsed and analysed the evidence compiled over two years as to the connection of the Appellant's transactions to fraud and at least thirty pages of which dealt with means of knowledge. It included all the transactions of the Appellant which were later denied on 6 December 2012 and assessed by HMRC for this period.

1756. The document set out the input tax sums to be denied as £695,598.13 for 03/09 and £41,054,429.58 for 06/09 and sums to be assessed as £695,598.13 for 03/09 and £36,312,197.18 for 06/09. These sums are larger than the sums eventually denied and assessed in the letter of 3 January 2013 for 06/09 (denied £34,317,697.80 and assessed £29,575,465.50) and letter of 18 January 2013 for 03/09 (denied and assessed £690,294).

1757. Officer Ball virtually accepted in oral evidence on a couple of occasions that he was of the opinion he had sufficient evidence to deny input tax on a *Kittel* basis (which equates to the same basis for raising the assessments) for the periods 03/09 and 06/09 based on this report of 5 September 2011:

'Q. We get that at the very end of this 151-page report.

JUDGE RUPERT JONES: Sorry, 5 September of which year?

MS SHAW: 2011.

A. Yes.

Q. Now, the purpose of this submission is to set out the basis for your conclusion that the input tax incurred by the appellant in the first two periods 03/09 and 06/09 should be disallowed under the Kittel principle, isn't it?

A. That is correct.

Q. So you were of the opinion by this stage that you had evidence of facts sufficient to deny the input tax on a Kittel basis --

A. I think what occurred, I was requested to do this form and put it in place with my findings as at that time.

Q. Yes. But the purpose of it as you've just confirmed is to set out the basis for your conclusion that the input tax for those periods --

A. Yes.

Q. -- should be denied under the Kittel principle?

A. Yes.

Q. So with the exception of the July Westis transactions, all of the facts referred to in the December 2012 letter and the May 2012 letter that we've been looking at are referred to in this submission, aren't they?

A. They should have been.

Q. And indeed much of your first witness statement is cut and pasted from this submission, isn't it?

A. I wouldn't be 100 per cent sure on that but it would form a basis.'

and:

'Q.………So by 5 September [2011] you were plainly of the opinion that you had evidence of the facts sufficient to justify denying the input tax for 03/09 and 06/09, weren't you?

A. This was purely -- this is documents that was put to the relevant area asking for my findings as at that time and that's what I did. All the --

Q. Yes, it's your submission setting out the basis for your conclusion --

A. Yes, that is correct.

Q. -- that input tax should be denied –

A. That is correct.

Q. -- for those periods under the Kittel principle, isn't it?

A. That is correct.

Q. Now this submission doesn't deal with the Westis July transactions. If we go to page 14477 in this volume. You say here:

"I am awaiting information from Cantor on carbon credits purchased in July 2009 that I only found out about from DG Environment information. However, witness statement and means of knowledge would not change to any extent, only the increase in possible denial and further background."

So what you are saying here is that you had already decided that the July transactions would be denied on a Kittel basis; all that was going to change is the size of the denial by including the July transactions within your decision.

A. That would be -- appear what it says.

Q. Now this opinion, that you were going to deny input tax under the Kittel principle, was not something which had formed overnight, was it? It had been forming over many months beforehand; that's right, isn't it?

A. I don't think you can form it overnight as I -- you have to form it over a period of time.'

1758. It is material to note that:

(1) much of what appears in the submission appears in Officer Ball's first witness statement;
(2) as regards each of the transactions in dispute, Officer Ball answered "no" to the question *"Is there any evidence to indicate that your trader did not receive or make the supplies in question"*; and
(3) within the section entitled *"Payments and Loans",* next to the question 4.33 *"Has the customer paid your trader and/or has your trader paid its supplier?"* Officer Ball wrote "*I would anticipated* [sic] *that all receipts and payments of money regarding Cantor's transactions are in order*". Officer Ball confirmed in evidence that he was accepting that CFE had paid for the supplies in question.

1759. It is also material to note that the reasoning Officer Ball deployed to support his submission on knowledge and means of knowledge (section 4 running from pages 117 to 148) was similar to that which was found in the final decision letter issued on 6 December 2012.

1760. Indeed, Officer Ball accepted in cross examination that, with the exception of the July Westis transactions, all of the facts referred to in the pre-assessment letter (dated 24 May 2012 and the final decision letter (dated 6 December 2012) should have been referred to in this submission.

1761. Officer Armstrong completed his higher officer review of Officer Ball's revised submission on 30 August 2011. Officer Armstrong noted, inter alia, the following:

"Cantor are a long established brokerage and a lot of the normal indicators of contrivance simply do not apply as they are considered the norm in this trade
Back to back
No added value
No losses
No insurance
Financing
The main evidence of contrivance comes from 2 sources,
The first being the data registry information which has found the following
• Circularity of block numbers of EUAs purchased
• Price dropping in chains
These two items have been discussed with the strategy team and in their view they are significant
The similarities found with the defaulting traders
• *Same PPOB* [principal place of business] *in a couple of case* [sic]
• Marfin popular bank in Cyprus used for several defaulters
• False TOGCs to get a vat registration
• Recent changes in Director
• Foreign national directors
• Common accountant"

1762. It is to be noted that: (1) The Tribunal has accepted that, either CFE or CO2e, and the group generally, did not know about the block numbers of the EUAs purchased at the time of the relevant transactions; (2) It has not been shown that either CFE or CO2e, or the group generally know of *"price dropping in the chains"*, but in any event, it is not relied on by HMRC

as being a factor; and (3) The similarities between traders noted by Officer Armstrong are not common to GW Deals, AH Marketing or Mettec.

1763. Officer Armstrong concluded that:

"The officer's submission is to deny both 03/09 and 06/09 and there is certainly some evidence to support the denial of the earlier period. If not deemed sufficient, I think there is certainly enough to deny from early June 2009."

Officer Ball's September 2011 Information Request

1764. On 1 September 2011 Officer Ball requested information from the Appellant (through Kanaklata Vaja of BGC Partners on behalf of the Cantor Group) in respect of, inter alia, purchases from Westis and Kaplan in July 2009, having received information on them from DG Environment. This was the information he was waiting for at that time. The only other queries in the email were regarding Adduco Consulting (amount of input tax in March 2009), Green & Blue (invoices & due diligence) and NLT Consulting (invoices & due diligence) but these queries were either not significant or became irrelevant to the assessment raised for 06/09.

1765. On 5 September 2011 Officer Ball emailed various of his HMRC colleagues involved in the investigation stating that he was *"awaiting information from Cantor"* in respect of carbon credits purchased in July 2009 that he only found out about from DG Environment information (i.e. hence his request of 1 September 2011), but that "*…witness statement and means of knowledge would not change to any extent only the increase in possible denial and any further background"* .

1766. As has been outlined above, in cross examination Officer Ball accepted that he had by this stage already decided that the disputed transactions for 03/09 and 06/09 would be denied on a *Kittel* basis; all that was going to change to any extent is the size of the denial by including the July transactions and any further background.

1767. On 5 September 2011 Officer Orr had completed her technical review of Officer Ball's revised submission and supported it.

1768. On 12 September 2011 Officer Ball emailed various of his HMRC colleagues involved in the investigation stating that he had *"completed the MOK* [Means of Knowledge] *(last I heard with Lisa) except for July transactions and possible change regarding Green and Blue (company by similar name misser in UK). Your thoughts on how I should proceed would be appreciated.*"

1769. Officer Ball chased his 1 September 2011 request of Kanaklata Vaja of BGC Partners on 23 September 2011.

VAT Fraud Policy's Review of Officer Ball's Submission

1770. On 11 October 2011 Officer Gill completed his review of Officer Ball's revised submission. His conclusion was that he agreed that Cantor should have known that its transactions were connected with the fraudulent evasion of VAT, but Officer Gill went on to say that *"Despite this I believe we should hold off from issuing the decision letter as I do not think the evidence within your submission will be enough to defend your decision in the VAT Tribunal should Cantor appeal"*.

1771. Indeed, Officer Gill had doubts about the evidential foundation of the case Officer Ball wished to present (which was similar to the case on which he based his final decision). In particular:

(1) Officer Gill did not believe that input tax on the supplies from Westis could be denied by HMRC given the steps taken by the Appellant in relation to that counterparty, including verifying the position with HMRC. Officer Gill's view was that *"Cantor's behaviour regarding Westis is consistent with that of a diligent trader…"*.
(2) He also did not, contrary to Officer Ball's belief, consider that there was anything in Officer Ball's submission which he considered was sufficient to show actual knowledge on the part of Cantor.
(3) By contrast to the markets for computer chips and mobile phones, the market in carbon credits was *"not contrived, and the parameters between legitimate and fraudulent supplies are ill defined, or possibly not defined at all"*.
(4) There were very few factors to be relied on to show that Cantor should have been put on notice of VAT fraud.
(5) As to circularity, Officer Gill considered that this would only amount to circumstantial evidence unless it could be shown that Cantor had the means to know about this at the time and, if it were even feasible to obtain and cross-check the data, whether it was reasonable to expect that to have been done.
(6) As to a possible "price drop" in one of the chains, which was a factor Officer Armstrong had referred to, Officer Gill considered that it was *"nowhere near enough to show that Cantor should have known of the connection with fraud"*.
(7) Officer Gill went on to say:
*"Although the Court of Appeal [*in Mobilx*] warned against placing an undue emphasis on due diligence, it did not rule out its relevancy, rather, instead, that there was a danger in making it the main focus of the Kittel principle. As things stand, despite the promising nature of ongoing work, due diligence remains the central pillar of your case. The other key area of your case, the concerns that Cantor expressed to LBS, is intimately related to due diligence. Whilst when combined, they point to "should have known", frustratingly, I do not believe this evidence will be sufficient to successfully litigate your case in an appeal"*.

1772. On 17 October 2011 Officer Ball sent a draft of his submission to Officer Stone stating 'As requested. I am still awaiting information from Cantor'. This draft submission was 149 pages long but without the line manager or technical teams' endorsement.

1773. Officer Ball chased his 1 September 2011 request of Ms Vaja of BGC partners on 20 October 2011.

Preparation to Assess

1774. On 1 November 2011 Officer Ball emailed Officers Gill, Orr and Armstrong to ask "is there any further work you require me to carry out on Cantor? I am still awaiting information from Cantor regarding July 2009 purchases that I need to add or complete new MOK".

1775. Officer Ball needed information about the July 2009 trades to complete the submission in respect of the 09/09 period. This was the information which had originally been requested by Officer Ball in September 2011.

1776. Officer Orr replied that Officer Eileen Patching (a member of HMRC's VAT policy unit) said that she would review personally as "[Officer Patching] *was aware that Policy hadn't yet*

approved the decision and that you [*ie.* Officer Ball] *felt there was sufficient evidence. In view of this I would suggest you don't do anything on it at the moment and wait to hear from Eileen"*.

1777. On 5 to 6 December 2011 there was an exchange between Officers Ball, Stone and Smallbone. Officer Ball asked whether he could use information received from the FSA. Officer Stone denied that request but stated that after Officer Ball had made a decision 'we can make an approach to the FSA for a statement'. Officer Smallbone commented that Officer Ball could use the information to inform further questions of Cantor, but should not mention the FSA as the *"FSA do not want Cantor to know they have provided us with the information"*.

1778. 6 December 2011 is the date by which the Appellant submits that Officer Ball had evidence of facts in his opinion sufficient to justify the making of the assessments for 06/09 and 09/09. In reality the Appellant submits that Officer Ball was of the opinion he had evidence of facts sufficient to justify the assessment by 5 September 2011 when he completed the means of knowledge submission in support of denying input tax for the periods 03/09 and 06/09.

1779. The Tribunal is satisfied that Officer Ball did hold such an opinion in relation to period 06/09 as of 6 December 2011, indeed he held the opinion as of 5 September 2011. Further, even if he did not hold such an opinion, it was unreasonable not to hold such an opinion by 6 December 2011.

1780. The Tribunal will return to this topic and give further reasons within the discussion and decision section below. In summary, the Tribunal finds Officer Ball was of the opinion by 5 September 2011 he had evidence of facts sufficient to deny the Appellant input tax for period 06/09. The Tribunal finds that he held the same opinion by 5 September 2011 that he had evidence of facts sufficient to raise an assessment for period 06/09 which he went on to make on 6 December 2012 (as calculated and notified on 3 January 2013). He held this opinion by 5 September 2011 – and therefore by 6 December 2011 - even though there was further material upon which he relied on to base the assessment which derived from the Pinsent Masons report which was received on 21 September 2012 – see below.

1781. Subsequent to 6 December 2011, Officer Ball conducted further investigations and further queries relevant to period 06/09 and held off making the assessment following guidance from other officers in HMRC who disagreed he had sufficient evidence to raise an assessment. This is set out in the paragraphs below. Thus, Officer Ball waited till after the Pinsent Masons report of 21 September 2012, by which time he did have extra and relevant evidence on which to base his assessment for the period. However, that is not to say Officer Ball was not of opinion far earlier that he had sufficient evidence to raise an assessment in relation to period 06/09. Officer Ball virtually accepted this in cross-examination and it is implied by several contemporaneous emails in 2011 and 2012. To the extent that Tribunal has erred in finding this fact and Officer Ball did not hold the opinion by 5 September 2011 or by 6 December 2011, it was unreasonable for him not to do so. While Officer Ball later received further evidence in the Pinsent Masons report of 21 September 2012, none of this was so significant that it could reasonably have been determinative and changed his opinion from believing he had insufficient evidence into believing he had sufficient evidence.

1782. The Tribunal makes a different finding in relation to period 09/09 – the July 2009 Westis trades on which input tax has been denied and an assessment raised on 18 January 2013. Officer Ball only received information as to the existence of these trades in August 2011. Thereafter he made enquiries regarding them, for example to see purchase invoices in his email

of 1 September 2011, and repeated these requests thereafter. He only received the requisite evidence in answers on 13 July 2012. This was highly relevant evidence because it was evidence confirming the existence of the transactions and the VAT paid. The Tribunal is satisfied that it was only by 21 September 2012 that Officer Ball was of the opinion he had sufficient evidence to raise an assessment in relation to period 09/09. He was consistent in the contemporary emails and in cross examination that by 6 December 2011 he had insufficient material regarding the July 2009 Westis trades to raise the assessment that he later raised. Further, this was a reasonable opinion to hold until at least 13 July 2012. There was no means of knowledge submission completed for period 09/09, in contrast to that completed on 5 September 2011 for period 06/09. It was reasonable for Officer Ball to hold the opinion that he had insufficient evidence of fact to raise an assessment for this period before 6 December 2011 and he needed to investigate these transactions further and obtain the purchase invoices.

1783. On 6 December 2011 Officer Ball emailed Officer Drakes that he was *"putting together I hope the last list of questions for Cantor"* and asked for her help. On 14 and 15 December 2011 Officer Drakes provided Officer Ball with further background information on CO2e.

1784. In late December 2011 and January 2012 Officer Ball and Officer Patching discussed a list of queries that would be provided to the Appellant.

1785. On 18 January 2012 Officer Smallbone informed Officer Ball that he may use documents from the FSA.

30 January 2012 request

1786. On 30 January 2012 Officer Ball sent the Appellant (through Ms Vaja of BGC Partners) by email the list of questions that he had prepared with the assistance of Officer Drakes. The email was titled '*Questions regarding Cantor EUA purchase and sales*' and began '*Previous questions on which I have not received a reply to date*'. The areas of questioning were:

(1) The July 2009 purchases in respect of which Officer Ball had already made requests in September 2011.
(2) The sterling amount of the input tax claimed for each purchase with Adduco in March 2009.
(3) Sales to Green and Blue;
(4) Sales to NLT Consulting.
(5) CFE's purchases from traders that were not registered for VAT.
(6) Why CO2e verified various companies' VRNs between 4 and 16 June 2009.
(7) The purpose of Cantor's monitoring processes, when Cantor started to trade in EUAs in London, whether it identified the significant increase in purchases, and if so what actions it took in response.
(8) Voice recordings and correspondence retained by CO2e.
(9) Whether CO2e's individual traders were still employed by a Cantor entity.

1787. The tenor of the evidence, both documentary and from Officer Ball in re-examination, pointed both ways - that Officer Ball was partly interested in the answers to these questions but was partly doing this to satisfy Officer Gill. For his own part, Officer Ball was mostly focused on the information he had sought back in September 2011 regarding the Westis trades in July 2009:

‘Q…………..A series of questions asked by you on 30 January 2012 to BGC Partners. Do you see that?

A. Yes, I do.

Q. Who drafted this email, Mr Ball?

A. I did, partly with the assistance of ... the name has gone, sorry. The name has gone. But the majority of that was from myself.

Q. Right.

A. The wording or the essence of it was from myself. It was just a couple of comments that had been put in.

Q. Were these questions asked by you to satisfy Mr Gill or were these matters you were genuinely interested in having the answers to?

A. I think both, really. I mean, Mr Gill was asking for more answers. I thought also -- and I had requested back in September. The July trades to me were very important. I mean, I couldn't -- I must admit at the time when I saw them, I was -- well, quite shocked really that for one, we hadn't been told about these trades, whereas there was three occasions that we could have been told about these trades. The first time was after the August 2009 meeting, the second time was when the purchase invoices were supplied to me in January, I think January of 2010, and then in 2011 when Susi Luard asked me for all the copies of the invoices, purchase invoices.

Q. Okay. Did you agree or disagree with the advice of Mr Gill that further information should be sought?

A. I was -- I am always open to advice, really. If somebody believes there is extra information due, then I am open to it, unless that is not available. I mean, if someone is asking for the impossible, I would tell them.

Q. Did you consider that this was asking for the impossible, Mr Ball?

A. No, I don't really, no. I knew that partly Rod Stone, I understood, had the information.

Q. What information?

A. Some of the things that Mr Gill was requesting, further information regarding the market, et cetera.

Q. But the information contained in this email?

A. Yes.

Q. Did you have this beforehand?

A. Before Mr Gill's --

Q. Before you wrote this email, was this stuff you already had?

A. Yes, I had that information, yes.

Q. Which information?

A. Well, I had the information regarding the Westis trades in from the DG Environment. That was --

Q. You knew they had come in, but you were asking for an explanation in this email?

A. Yes, yes.

Q. Did you already have that explanation from Cantor or not?

A. No, sorry. No, not at all. I think there were probably about two or three emails going from -- between myself and the lady at -- I can't pronounce her name again -- at Cantor, but at no point in time was I ever advised the answer.

Q. Had you received Cantor's explanation for its business in March to June 2009 by this stage, Mr Ball?

A. Yes. I think we sent out general questions to them, and within meetings they did tell us that, you know, mainly this was spot trading.

Q. Yes.

A. And exactly what Cantor did, which we was able to anyway glean from the web, et cetera, and --

Q. You knew in general what they did?

A. I knew.

Q. Did you know about the details of their transactions?

A. No, no. Not at all, no.

Q. Let's look at what you were asking for. You asked for responses to your requests of 1 September and 20 October, yes?

A. Yes.

1788. On 10 February 2012 Officer Ball received information on Green & Blue which had been received from the French authorities.

1789. On 15 February 2012 Officer Ball sent a letter to Cantor with a proposed third party information notice which Officer Ball proposed to send to the FSA requesting information on Cantor. The request was for records relating to purchase and sale of EUAs and Due diligence, emails and any other information undertaken by Tower Bridge GP Limited relating to purchase and sales of EUAs.

1790. On 7 March 2012 Officer Ball emailed various of his HMRC colleagues involved in the verification exercise stating that *"At the end of this month, it is three years since the first return including input tax that we could deny and raise an assessment. Cantor has still not advised me the € / £ rate they used. As I am awaiting information I guess the four year rule applies"*. Thus, by this time, the information requested by Officer Ball on 30 January 2012, was still outstanding.

1791. The Officer's evidence was to the effect that the request regarding the Euro/sterling exchange rate that CFE had used was additional to the other information requested - it related to CFE's trades with Adduco in March 2009 (transactions not in dispute). In fact, as noted below, Officer Ball in fact already had the ability to discover that information because the exchange rates were embedded but hidden in the VAT returns.

1792. On 30 March 2012 McGrigors LLP, the firm then acting for the Appellant, and which later became part of Pinsent Masons LLP, wrote to Officer Ball to update him on the process of replying to his various enquiries stating that they had nearly completed the work and anticipated being able to send a final response shortly after Easter.

HMRC's Internal Discussions about Assessment Time Limits

1793. By 2 April 2012 Officer Stone suggested that perhaps a pre-assessment letter would prompt Cantor to respond more quickly to the request of 30 January 2012 given that *"we have assessment time limits to be concerned about"*. Officer Ball replied that he was *"more than happy to issue an assessment letter. Would we start with March 09 period to see reaction? Also what about penalties?"* Officer Stone asked Officer Ball to call him. There is no record of whether Officer Stone called Officer Ball or, if he did, what was discussed.

1794. Officer Ball came close to accepting in evidence that the reason why he was more than happy to issue an assessment letter on 2 April 2012 was because he was already of the opinion that he had sufficient evidence to disallow the input tax.

'Q. If we go back to a page to 151, we see in the middle of the page, 2 April 2012, in response to Mr Stone's email to you about issuing a pre-assessment letter, you say: "Rod, I am more than happy to issue an assessment letter. Would we start with March 09 period to see reaction? Also what about penalties?"

So the reason why you were more than happy to issue an assessment letter on 2 April 2012 is because you were already of the opinion that you had sufficient evidence to disallow the input tax and you had held that opinion since September 2011, hadn't you?

A. That's -- that appears to be the wording there.'

1795. The Tribunal has considered this answer carefully. If read in the context of all the other correspondence, both before and after, it cannot be inferred that Officer Ball accepted in cross examination he was of the opinion since September 2011 or after that he had sufficient evidence to disallow the input tax in relation to period 09/09.

1796. He had been investigating the Westis transactions of July 2009 since he first became aware of them in August 2011 and had been chasing information regarding them since September 2011 which he still had not received. He had not filled in any means of knowledge submissions with any completed conclusion as to denying input tax for July 2009 (09/09) or the amount in question.

1797. In relation to period 06/09, Officer Ball's answer in cross examination is more revealing. Officer Ball did not expressly but impliedly agreed with the suggestion that he was of the opinion he had sufficient evidence to raise an assessment at this time. The Tribunal is satisfied he was agreeing that this is what the wording of the email implies without answering whether or not he was of that opinion at that time. This answer has to be read in the context of the completed means of knowledge submission for period 03/09 and 06/09 which Officer Ball had prepared by 5 September 2011. While he may genuinely have been interested in the answers to the further questions sent on 30 January 2012 they did not affect whether Officer Ball had already formed the opinion he had sufficient evidence to raise an assessment in relation to period 06/09.

1798. The Tribunal is satisfied Officer Ball was of such an opinion in relation to period 06/09 by 2 April 2012 (when he still had no answers to his questions of 30 January 2012) and had

been since 5 September 2011. Further, Officer Orr's email of 1 November 2011 is consistent with such a finding as are Officer Ball's answers in cross examination.

1799. On 3 April 2012 Officer Armstrong asked a number of his HMRC colleagues, including Officer Ball, for a case update on their carbon credit cases and whether another meeting would be beneficial. Officer Ball replied on the same day that he had nearly finalised a pre-assessment letter, which did not include the July 2009 purchases from Westis. Officer Ball also stated that he had *"no problem with a meeting* [i.e. a meeting between Officer Ball and his other colleagues working on other carbon credit cases] *as any new information is important".*

The Pre-Assessment Letter of 24 May 2012

1800. An undated draft of Officer Ball's pre-assessment letter, eventually sent on 24 May 2012, was disclosed. On 23 April 2012 Officer Stone informed Officer Ball that he was *"in the process of assisting"* Officer Ball with the drafting of the letter. He asked for certain invoices, which Officer Ball sent on. Officer Ball also mentioned that he was still awaiting information from Cantor in respect of the July 2009 trades with Westis. Officer Ball also included an Epicure invoice that was obtained from the FSA.

1801. Officer Stone returned a significant redraft of Officer Ball's letter on 1 May 2012. His redraft was thorough, with many sections that were entirely new.

1802. On 9 May 2012 Officer Nick Chambers of the VAT Fraud Team also reviewed the pre-assessment letter. His comments on the document were fairly minor.

1803. On 24 May 2012 Officer Ball issued his pre-assessment letter in relation to all the VAT periods from January to July 2009 (03/09, 06/09 & 09/09). The letter gave CFE one month to respond. The conclusion at paragraph 151 of the letter sets out a bullet point list of the indicators to suggest that the integrity of many of the transactions was compromised.

1804. Paragraph 152 of the letter addressed these factors and concluded the Appellant had knowledge or means of knowledge that the transactions were connected with fraud. Officer Ball stated: '*Further, given that all this information was available to CFE and its officials, I believe that there are sufficient grounds to believe that responsible officials in the company knew or should have known of that fact. However, before concluding the matter I invite you to provide another explanation'*. This appears to be some evidence the Officer already believed he had sufficient evidence to deny input tax but was waiting for the Appellant to give an explanation before 'concluding the matter' ie. denying input tax / raising an assessment.

1805. While it is advisable to seek to give the Appellant an opportunity to provide contrary evidence or provide an alternative explanation before raising an assessment (such that it might change the officer's mind and avoid the raising of an assessment), it does not absolve an HMRC officer of complying with legal time limits for raising assessments. The law on time limits requires the officer to raise an assessment within one year of evidence of facts, sufficient in his opinion to justify an assessment, coming to his knowledge.

1806. The Tribunal is satisfied that many of the conclusions drawn in this letter of 24 May 2012 have as their source the matters set out by Officer Ball in the means of knowledge submission prepared by 5 September 2011. The conclusions in the letter were based on material that was available to Officer Ball as at 30 August 2011, even if the evidence before Officer Ball was not identical by this point.

1807. On 1 June 2012 Pinsent Masons wrote to Officer Ball to ask for an extension of time to 21 September 2012 to respond to his letter dated 24 May 2012.

1808. The request was considered by HMRC. Officer Patching said that she had no objection *"subject to time limits for assessment"* and *"Regarding time limits - is the September date more than 6 weeks before any assessment must be raised? Don't agree to a timetable that you cannot them meet or make it clear that you may have to raise a protective assessment"*.

1809. Officer Stone told Officer Ball on 12 June 2012 that he could agree to an extension to 19 August 2012 and that Officer Ball needed *"to be able to issue a protective assessment by end of August"*.

1810. Pinsent Masons considered that, given the nature of the allegations made by Officer Ball, they would not be able to meet a deadline of 19 August and so made a renewed request for time beyond that date. Officer Stone appeared to be inclined to refuse the request and in an email of 14 June 2012 said that *"The answer must still be the same. Consequently we need to prepare a protective assessment and a list of documents for a potential Tribunal case"*.

1811. It appears that on 15 June 2012 Officer Ball sent Officer Stone a draft assessment letter to review (referred to in Officer Ball's email as 'Please find assessment').

1812. A meeting took place on 9 July 2012 between Pinsent Masons, representatives of Cantor and HMRC. The meeting note made by Officer Ball (as amended by Officer Stone) records Office Stone as saying that no decision had been made regarding denial of input tax and that HMRC were aiming to decide by August 2012 but there was no deadline for the assessment as *"new information was coming in from DG Environment and 12 month rule / 4 year rule had not gone. However would seek advice to assess and protect HMRC's position. HMRC policy would attend to time limits"*.

1813. On 13 July 2012 Pinsent Masons provided certain invoices, but only those for the Westis trades on 28 July 2009 related to counterparties to the transactions in dispute, and KYC documents for NLT Consulting and Green & Blue in advance of providing a fuller response to HMRC's information requests of 30 January and 24 May 2012.

Further Discussions about Time Limits

1814. In late July 2012 there were discussions between Officers Ball, Stone and Patching about assessment time limits, which were being considered in light of Pinsent Masons' request for further time to respond to Officer Ball's May letter. On 24 July 2012 Officer Stone noted that they needed to assure themselves that HMRC would still be in time to assess if they granted an extension. Officer Stone said that, in his view there were 'five key dates for applying the 12 month rule':

"When did we complete the analysis of the EU data sufficiently to support a decision to assess?
What date did we lodge a submission with VAT policy?
What date did we receive a recommendation followed [sic] *the submission to policy?*
What date did we issue the pre-assessment letter?
When did we finalise the tax loss?"

1815. Officer Stone believed that the time limit had not expired, stating 'I firmly believe we are still within the 12 month rule if we were to extend the date to reply'.

1816. Later the same day, Officer Patching added her view as follows:

"The clock starts to tick when you have received the last piece of evidence that enables you to make the assessment, which you are now making to best judgment.
*On 7 March 2012 David [*Ball*] stated that he did not have yet have the information from Cantor on the echange rate they used* [sic]. *If that information goes directly to the calculation of any assessment then the clock was not ticking on that day. If it was not required and if the other evidence is sufficient to make an assessment in best judgment then the clock will be ticking.*
As the prospective assessing officer only David can say if he has sufficient information or not."

1817. Officer Ball emailed Officer Stone on the next day, 25 July 2012, asking if they could meet to "discuss the assessment" and stating that he believed that "we have sufficient to assess Towerbridge now and the only thing to decide is reduction in deliberate if any (prompted 70% max down to 35%)", the latter statement being a reference to the separate matter of penalties. This appears to be a further admission that Office Ball was of the opinion that he believed he had sufficient evidence to assess at this time which was prior to the receipt of the Pinsent Masons report.

1818. On 25 July 2012 Officer Ball emailed Officer Gavin Stock in relation to Adduco stating: *"I had requested the sterling figures from Cantor however they have still not been received. Rod Stone advised me they were hidden in the details of the 06/09 return. I have know* [sic] *been able to find the sterling values and it shows we over assessed Adduco".* Officer Ball therefore asked Officer Stock to reduce the assessment on Adduco. This email shows two things:

(1) The information concerning the Euro/sterling exchange rate that Officer Ball thought he was waiting for related only to CFE's trades with Adduco (as Officer Ball confirmed in oral evidence); and
(2) HMRC in fact already had that information, or at least the means of working out that information from the invoices (as Officer Ball confirmed in oral evidence).

1819. On 26 July 2012 Pinsent Masons again chased for a response to their request for further time. Officer Ball emailed Officer Stone a few minutes after receiving Pinsent Masons' email, stating "*If we issue an assessment the timing of coming back to us does not matter on the basis we agree to extend from the normal 30 days when they request*". Officer Stone then asked for Officer Ball's phone number which he provided, but there is no note of any call, if one took place.

The Penalty Decisions and Actions Checklist

1820. On 6 August 2012 Officer Ball emailed Officer Stone informing him that he would like to complete the *"PDAC and letters to be sent to Towerbridge as soon as possible"*. A PDAC ("Penalty Decisions and Actions Checklist") is an HMRC document which must be completed and authorised whenever a new penalty is to be considered (see HMRC's Compliance Handbook 407100 (as from 7 October 2012), available at:

http://webarchive.nationalarchives.gov.uk/20121007192707/http://www.hmrc.gov.uk/manuals/chmanual/CH407100.htm).

1821. HMRC guidance from around the time stated that *"Best practice is to create the PDAC as soon as an inaccuracy, failure or wrongdoing has been identified and to continue to complete it as the compliance check progresses"* (ibid). Assuming that Officer Ball followed HMRC's internal guidelines, it is to be inferred that he had by that date concluded that there was "*inaccuracy, failure or wrongdoing"* on the part of the Appellant.

1822. On 3 September 2012 Officer Ball emailed Officer Stone stating *"Ian* [Edgson] *just phoned and asked when we expect to assess. I said closer to date when Cantor should reply to our letter".* The implication, is that Officer Ball was, as he had already stated on 25 July 2012, of the opinion that he had sufficient information to assess the Appellant but was holding off from doing so. It is perhaps notable that Officer Ball said that he would assess *"closer to the date when Cantor should reply"* not *"after Cantor have replied"* or words to like effect. It was Officer Stone, who of course is not the assessing officer, who said in response to Officer Ball's email *"let's wait for their reply and see if it alters anything".* Officer Ball simply replied *"Thanks".*

1823. On 5 September 2012 Officer Ball emailed Officer Stone to ask if there was anyone in particular allocated to deal with PDACs for carbon credit cases or whether Officer Ball had to go through "normal channels". Officer Ball's position, as stated in his email, was that his PDAC *"is ready to go through the process and I would like to put it in place as soon as possible".*

1824. Officer Stone, however, considered that Officer Ball should *"wait until the assessment is agreed and they have replied. If we start the process before hand, it looks as if we have already taken the decision without giving consideration to the full facts. That will open us to criticism. When we do start the process follow the normal process but copy in myself, Ian and Eileen Patching….I have no doubt LBS will want you to justify your conclusion".*

1825. Officer Ball replied later that day, *"No problem I just thought Eileen wanted it done at same time* [sic]. *I agree with your thoughts".*

1826. Officer Ball accepted in evidence he was not waiting for the Pinsent Masons report for information in relation to the question of whether the transactions in issue were connected to VAT fraud but that was not the same as the issue of knowledge or means of knowledge.

The Pinsent Masons Report ("PM Report") of 21 September 2012

1827. On 21 September 2012 Pinsent Masons provided their report to HMRC titled 'Tower Bridge GP Limited, Report in response to HMRC letter dated 24 May 2012'. It was 49 pages long with a further 34 pages of appendices.

1828. It began 'Following the receipt of HMRC's letter of 24 May 2012 to Tower Bridge GP Ltd…, Pinsent Masons LLP have been instructed by Tower Bridge GP Ltd …. (together "cantor") to carry out a full investigation into the matters raised in the HMRC Letter. Prior to the HMRC Letter, Cantor received a request for information from HMRC by way of email on 30 January 2012. A response from Cantor was imminent when the HMRC Letter was received.

This response was delayed by the receipt of the HMRC letter, as a full investigation was then required. Responses to the questions raised in this email are set out in schedule 2 to this report.'

1829. The PM Report was based upon interviews with existing employees and set out: the Background to CFE's EU trading desk, Background to the market, Chronology of Key Events – June 2008 to 8 March 2009, 9 March 2009 to 3 June 2009 & 3 June 2009 to August 2009.

1830. At paragraph 5.39 the PM Report it stated: 'it was believed that the counterparties were largely local consultants who were sourcing EUAs from local emitters.' Part 2 was a response to specific points in HMRC's letter of 24 May 2012 including a background on case law and issues considered by HMRC, Key individuals, HM Treasury, Financial Services Authority, Blue Next Exchange, Verification of VRNs, Counterparties, Recycling of EUAs.

1831. The PM Report responded to the conclusion at paragraph 151 of HMRC's letter of 24 May 2012 regarding the red flags with 'Cantor submissions' as to why the *Kittel* test was not satisfied at the time the transactions were entered into. It stated that there were explanations for the circumstances of the transactions other than an actual connection with fraud (such as market forces) and concluded that CFE and its officials did not know and should not have known that the only reasonable explanation for the transactions was that they were connected with VAT fraud.

The Drafting of Officer Ball's Decision Letter denying input tax

1832. On 12 October 2012 Officer Ball circulated his first draft of the decision letter. It made no mention of the PM Report.

1833. Officer Edgson commented on Officer Ball's draft on 15 October 2012 and said that it *"looks very blunt to me. I understand that the customer replied to your letter of 24 May. You have made no reference to that letter, or its contents, in this letter. You need to at least acknowledge it"*.

1834. On 16 October 2012 Officer Ball forwarded his draft letter to Officer Stone again, and also made some comments on the Pinsent Masons ("PM") Report in his covering email. It is material to note that Officer Ball noted: *"Schedule 8.1 Schedule 2 states Cantor did not routinely monitor telephone conversations. They have not said what happened after June 2009 and if not why not. I would have expected some statement that they have checked but found no problems. They do state they are archived for 7 years"*.

1835. On the subject of the phone records, he accepted in evidence he did not request them and that he should have done.

1836. On 17 October 2012 Officer Patching emailed Officer Ball to say that *"it would be useful to...have your analysis of the impact of the information* [i.e. the PM Report] *on your decision"*. Officer Ball replied to say that *"Their reply has little impact on my decision"*.

1837. Officer Ball stated in evidence that this was a *"bit of a poorly worded email"* on his part, and that the majority of the information had been received but the PM Report *"really joined together my ideas"*. He also stated that there were a number of pieces of new information contained in the PM Report which he had not known before such as the full story about Westis.

1838. However, the Tribunal is satisfied Officer Ball had already reached the view that he had sufficient evidence of fact to justify making an assessment for the 03/09 and 06/09 periods by this time.

1839. Officer Stone also replied to Office Patching to inform her that he was *"assisting* [Officer Ball] *to redraft parts of his decision letter. It will take me all next week"*.

1840. Officer Stone emailed again later on the same day, explaining that he had taken the opportunity to re-read the PM Report. He clearly considered that Officer Ball's draft required considerable further work to respond adequately to it. He went on to say *"To articulate this reasoning, and how we evidence it, will be in the detail. We do not have put* [sic] *ourselves under pressure by rushing the decision. Rather we need to produce a quality document that demonstrates the flaws in their conclusions"*.

1841. It goes without saying that Officer Stone was not the assessing officer. The Tribunal is satisfied that Officer Ball had already decided that he had sufficient information to assess the Appellant in respect of periods 03/09 and 06/09 by this time. HMRC could, therefore, take their time in preparing their response to the PM Report but they could not extend the time for assessment by doing so.

1842. On 18 October 2012 Officer Kristian Jarvis, part of HMRC's VAT Fraud Team, offered his initial views, including the view that there was *"no immediate rush"* to issue the decision letter.

1843. On 26 October 2012 Officer Jarvis emailed Officer Ball, copying in Officers Patching and Stone, to advise that, in his view, HMRC should only deny input tax on invoices from 3 June 2009 onwards, being the date on which members of the CFE trading desk knew about the anonymous blog.

1844. Officer Jarvis was of the view that the only evidence relied on by Officer Ball to support his decision as regards transactions before 3 June 2009, including Officer Ball's reliance on the group's due diligence and the sudden increase in volumes traded, was not sufficient to support denial on the basis of *Kittel*.

1845. Officer Stone commented that he *"personally would not rush to this conclusion. Whilst I do not disagree with you, I would like another week or so to work my way through our evidence and not relying upon the opinion of Pensent [sic] before coming to any conclusion"*.

1846. Officer Stone on 2 November 2012 provided to Officer Ball his submission to the VAT Fraud Team. Officer Stone concluded that CFE knew or should have known that they were participants in a VAT fraud from 18 May 2009 and that they knew with effect from 2nd June. It includes some comments in track changes by "DN" (presumably Dave Nickolls in HMRC's VAT Fraud Team), one of which was *"Surely we wouldn't plead this!"* in respect of the allegation that Cantor knew that they were participants in VAT fraud.

1847. Officer Ball responded later that day to say that, besides some minor comments, he was *"more than happy"* with Officer Stone's submission.

1848. On 5 November 2012 Officer Stone informed Officer Ball that he had received some more data from the EU Commission and that he would have to update a number of spreadsheets. Officer Ball simply replied *"OK"*.

1849. On 8 November 2012, after the decision had been made to seek advice from HMRC Solicitor's Office and counsel, Officer Stone emailed Officer Ball to say *"you have a done a great job in getting it this far but our hands are tied by any decision policy and counsel make…What concerns me is that only you, and to a certain extent me, know the full extent of evidence and consequently policy cannot make an informed decision"*.

1850. On the following day, 9 November 2012, Officer Stone told Officer Ball that the VAT Fraud Team wanted to *"use the invalid invoice measure in respect of Stratex and Knowledge with effect from 2nd June"*, i.e. they wanted to deny the input tax in respect of the Stratex trades on the basis that the invoices held by the Appellant were not valid VAT invoices. Officer Stone continued *"I told them that I didn't think that was a winner given that the commodity existed, payment had been made and Stratex had a liability to be registered"*. Officer Ball confirmed in evidence that its trading made Stratex liable to be registered and that HMRC could have compulsorily registered it.

1851. Accordingly, HMRC not only had the means of establishing that the substantive requirements for input tax deduction in respect of the Stratex transactions had been met but had in fact concluded that to be the case in advance of Officer Ball's decision letter being issued on 6 December 2012.

1852. On 27 November 2012 Officer Jarvis updated Officers Ball and Stone following a conference that was held a day earlier. Officer Jarvis reported that the policy advice was to deny input tax in respect of the Stratex trades on the basis that the invoices were invalid (and Officer Jarvis also stated that *"we will not be applying discretion"*) and to deny input tax in respect of all relevant counterparties on the *Kittel* basis from 18 May 2009.

1853. On 28 November 2012 Officer Stone instructed Officer Ball to draft a decision letter '*for denial for 33m with effect from 18th May 2009*' which includes *"reference to our previously* [sic] *letter and the Pinsent report"*. Officer Stone continued *"Given the fact that we have summarised most of the facts in our previous letters it shouldn't need to be detailed"*. Officer Ball's response, sent 9 minutes later, was essentially *"OK"*.

1854. There is no indication whatsoever from these exchanges that Officer Ball considered that he was waiting for the PM Report before he could assess, or that he considered that the report was the last piece of the jigsaw in that regard.

1855. On 29 November 2012 Officer Ball circulated a second draft of his decision letter. The substantive parts of it spanned four pages and it contained six comments in response to the PM Report. Officer Ball stated that an assessment for the periods 06/09 and 09/09 would follow, and the reasons for that appeared to be those set out in the 24 May 2012 letter.

1856. In relation to invalid invoices Officer Ball stated 'When reviewing the transactions carried out by BCG Group it has been decided that transactions will be assessed from the 18th May 2009 the date when the first trade with Stratex Alliance Limited took place. As you are aware this company had not registered for VAT and the invoices received by BCG Group did not include a VAT registration number. The invoice was therefore an invalid invoice for VAT purposes.'

1857. Officer Stone substantially amended Officer Ball's draft (the new letter was six pages long and included only a handful of paragraphs from Officer Ball's letter) and sent it to Mr Nickolls in the VAT fraud policy unit on 30 November 2012, copying in Officer Ball.

1858. On 4 December 2012 Officer Jarvis sent a version of the decision letter to Officer Dave Nickolls. The draft itself has not been provided, although a version including comments from Officer Nickolls has been, and Officer Jarvis himself noted in his email *"Bar the last page this is all my work!"*.

1859. While the draft was with Officer Nickolls, Officer Jarvis emailed Officers Stone, Ball and Nickolls on 4 December 2012 regarding the case. As regards the invalid invoices point, Officer Jarvis said:

"As you know under Reg 14(1) – it is up to the trader to hold a valid VAT invoice. This trader doesn't for these transactions and therefore its right to deduct is lost. Therefore we must consider discretion.
Given the low level of commercial checks, particular in light of what FSA, FATF & JMLSG guidelines recommend, undertaken by this trader we have decided to deny Cantor its input tax on these supplies on the basis that it does not have a valid VAT invoice, the transactions are connected with VAT fraud and the trader has not carried a reasonable level of due diligence and therefore we would decline to apply our discretion to allow the input tax.
This approach is in accordance with our intranet (& internet) guidance."

1860. It is apparent from the foregoing that the first person who raised the exercise of HMRC's regulation 29(2) discretion as appears in the 6 December 2012 decision to deny input tax was Officer Jarvis, not Officer Ball. Officer Ball disagreed with a suggestion put to him in cross examination and stated that he did exercise a discretion prior to Officer Jarvis in his oral evidence, but there is no record or evidence to support this.

1861. The contemporary written documents are clear and the Tribunal accepts the Appellant's submission Officer Ball did exercise a discretion in relation to denying input tax based upon the invalidity of the Stratex invoices but only did so after following from Officer Jarvis' lead. There is no evidence of any prior exercise of discretion by Officer Ball or anyone else prior to Officer Jarvis raising it.

1862. Officer Ball was therefore driven to accept that he agreed with each of the factors relied upon by Officer Jarvis in order to exercise his discretion to deny input tax on the invalid Stratex invoices set out in Officer Jarvis' draft of the letter dated 5 December 2012, namely that:

(1) the Appellant did not have a valid VAT invoice;
(2) Stratex was not registered for VAT at the time of the transactions;
(3) the transactions were connected with VAT fraud; and
(4) CO2e did not carry out a reasonable level of due diligence.

1863. On 5 December 2012, having received suggestions from Officer Nickolls, Officer Jarvis circulated a thirteen-page version of the decision letter which was essentially written afresh, as Officer Jarvis had alluded to in his email of 4 December 2012. Officer Jarvis asked for people to comment but expressed a preference for people not to make "*wholesale changes…unless absolutely necessary*".

1864. It is material to note in the light of HMRC's contention that Officer Ball had seen no evidence of payment to Stratex, that paragraph 5 of the draft letter, and indeed the final letter, stated in respect of an 18 May 2009 invoice from Stratex that: *"Stratex Ltd charged CO2e VAT, which CO2e paid to Stratex on or about 19th May 2009"*.

Officer Ball's Final Decision Letter of 6 December 2012

1865. The decision letter denying input tax for periods 03/09, 06/09 and 09/09 was finally issued by Officer Ball on 6 December 2012. It was thirteen pages long and largely in accordance with Officer Jarvis' draft.

1866. Officer Ball anticipated issuing assessments after this letter had been sent. The decision letter contained the following references to the PM Report:

(1) In paragraph 14, which said that the PM Report had been examined in considerable detail and taken into account.
(2) In the first complete paragraph on, which referred to the increase in revenue and trading experienced by CO2e/CFE. Officer Ball accepted in evidence that in general terms, although not in the precise terms set out in the letter, he was already aware prior to the PM Report that there had been an increase in trading and an increase in revenues during the period in issue;
(3) In paragraph 15(iii), which referred to the 3 June 2009 anonymous blog. Officer Ball accepted in evidence he was aware of the rumours of VAT fraud in the market prior to the PM Report but stated he had not seen the blog before.
(4) In the first paragraph under the heading "Imputation of Knowledge", which referred to case law on the attribution of knowledge of an employee of a company. This is not evidence of fact.

1867. Ultimately, the question is not whether the PM report provided some new evidence which Officer Ball relied on in making his assessment. It did provide some evidence which he did rely on. That does not answer the question whether he was of the opinion he had sufficient evidence before receipt of the report to make the assessment he did. Officer Ball in evidence and emails set out above came close to accepting he did.

1868. The Tribunal finds he did hold such an opinion as from 5 September 2011 in relation to period 06/09. The further enquires from 30 January 2012 and 24 May 2012 were of a limited nature into this time period and the extra evidence relied upon derived from the report was icing on the cake rather than material that went to his opinion he had sufficient evidence.

1869. Even to the extent that the Tribunal is wrong and Officer Ball was not of the opinion as of 5 September 2011 that he had sufficient evidence to make the assessment for 06/09, he would have been acting unreasonably in not holding that opinion.

1870. It would be unreasonable to rely on the four points set out above as justifying the difference between holding the opinion of sufficiency of evidence only after 21 September 2012. Points (1) and (4) were not new evidence and points (2) and (3) were additional evidence for points Officer Ball already had other evidence as of 5 September 2011 on which he could rely as grounds in support of denial. These grounds in support of denial of input tax were the same grounds relied upon to make the assessments such that there is no difference between the evidence considered in relation to denial of input tax and that for making of an assessment. Indeed paragraph 18 of the decision letter states that a notice of assessment would follow shortly thereafter.

1871. The letter also set out a number of items on which HMRC relied as "indicators to support a conclusion that CO2e knew or should have known that its transactions were connected to fraud":

(1) Firstly, the nature of the suppliers to CFE: Officer Ball accepted in evidence that he knew of the nature of the suppliers with which CFE thought it had been dealing prior to the receipt of the PM Report.
(2) Secondly, the due diligence checks carried out – Officer Ball accepted in evidence that he had all the information concerning those in 2009.
(3) Thirdly, the increase in the level of trade experienced by CO2e/CFE – Officer Ball accepted in evidence that he had that information by the time he wrote his 24 May 2012 letter and that he in fact had this by 5 September 2011 (being the date of Officer Orr's review of his 17 August 2011 submission).
(4) Fourthly, the VAT invoice anomalies – Officer Ball accepted in evidence that he had that information by the time he wrote his 24 May 2012 letter. In fact, he had this by 5 September 2011.
(5) Fifthly, the recirculation of carbon credits – Officer Ball accepted in evidence that he had that information by the time he wrote his 24 May 2012 letter.
(6) Sixthly, the March 2008 FSA publication – Officer Ball had this by 5 September 2011.
(7) Seventhly, the BlueNext exchange report regarding the dramatic increase in units traded and drop in price – Officer Ball accepted in evidence that he was already aware of the suspension of the exchange on 8 June 2009.
(8) Eighthly, the further investigatory work carried out by CO2e (effectively checking the VRNs) – Officer Ball accepted in evidence that he had that information by the time he wrote his 24 May 2012 letter and that he in fact had this by 5 September 2011.
(9) Ninthly, an 8 June 2009 Reuters report concerning the BlueNext exchange – Officer Ball had this by 5 September 2011.

1872. Officer Ball stated in oral evidence that proof of payment formed no part of his decision in relation to invalid Stratex invoices. Officer Ball did not dispute that the transactions took place, or that the input tax was incurred; he also accepted that CFE paid the money.

1873. The factors on which Officer Ball appears to have relied to exercise his discretion to refuse to accept alternative evidence and deny input tax on the invalid Stratex invoices was an alleged lack of VRN, poor due diligence by CFE and a connection to fraud. Officer Ball accepted that the only difference between the invalid invoices issued by ADE (which were allowed) and those issued by Stratex (which were not) was that the former was VAT registered while the latter was not.

3 January 2013 return adjustment letter

1874. On 3 January 2013 Officer Ball sent a letter (described by HMRC as a V1-35 letter) to the Appellant advising it of amendments he considered should be made to its VAT return for 06/09. The amendment changed the return from a repayment return to a payment return as set out above. The Tribunal has found this to be evidence that an assessment of tax due had been calculated and notified on 3 January 2013, following the decision on 6 December 2012 that the assessment should be made on the basis of the denial of input tax.

1875. The Tribunal has already considered the evidence below when determining the Fourth Issue.

1876. Officer Ball agreed in oral evidence that the letter of 3 January 2013 was intended to notify the Appellant of the error correction to its VAT return. It is accepted that the letter makes no mention of any rights of review or appeal (not that this is required in law for the purposes of making or notifying an assessment). Officer Ball accepted that an assessment was

an appealable decision and that when an appealable decision is made then the decision-maker must notify the taxpayer of his rights of review and appeal. He also accepted that the reason why the 3 January 2013 letter made no mention of such rights was because it was an error correction notification and not an appealable decision. However**,** these are matters of law upon which Officer Ball cannot give relevant or determinative evidence.

1877. Officer Ball did not fill in a VAT 641, or indeed take any actions, in respect of the £29.5m shown as due to HMRC in the 3 January 2013 letter. On 4 January 2013 Officer Ball sent a VAT 641 for the periods 03/09 and 09/09 to the Appellant. This was approved by Officer Ball's line manager. The reason why this VAT 641 excluded the 06/09 period was that it had not by that time been authorised. This was subsequently authorised on 10 January 2013, but Officer Ball did not complete a further VAT 641 in respect of the 06/09 period.

1878. On 18 January 2013 Officer Ball sent the Appellant a VAT 655 notice of assessment for periods 03/09 and 09/09. The letter drew the Appellant's attention to its right to appeal against the assessment or to have it reviewed. There is no dispute that this was a valid assessment, the only question was whether it was made in time or not.

1879. On 1 February 2013 the Appellant requested a review of the 6 December 2012 decision.

Officer Birchfield's Review of 12 April 2013

1880. On 4 February 2013 Officer Birchfield was sent two documents apparently relating to the case by email by Officer Smallbone. On 5 February 2013 Officer Peter Birchfield commenced his review. His initial notes were disclosed. He noted concerns about the position HMRC had adopted in denying the input tax based principally around the facts that the Appellant had approached HMRC about its concerns (leading to the 25 June 2009 meeting) and that CO2e even withheld some the suppliers' VAT in case it was going to be part of a tax loss.

1881. On 6 February 2013 Officer Birchfield met Officer Ball and the notes of that meeting were disclosed. On the issue of the discretion to accept alternative evidence for invalid invoices, Officer Birchfield commented *"Letter issued confirms considered alternative evidence (N.B none has been substantiated) but probably wasn't asked for it by D.B. Ask Pinsent Mason* [sic] *to provide evidence to substantiate their points"*.

1882. On 10 April 2013 Officer Birchfield circulated his draft review decision letter internally for review and comment. His email and the first draft of his letter were disclosed.

1883. On the discretion to deny input tax on the invalid VAT invoices, Officer Birchfield considered that:

(a) (i) the supplies as shown in the invoices took place; (ii) the carbon credits as detailed on the invoices is what was supplied; (iii) the Appellant can show that they paid for those supplies; (iv) the supplies were used for the purposes of making an onward taxable supply; (v) the value of the supplies made the suppliers taxable persons (even if they were not in fact registered for VAT); (vi) the sample evidence Officer Birchfield had seen showed that CFE paid its suppliers (not any third parties) to the bank accounts held in the Cantor accounting system as belonging to those suppliers.

(b) The foregoing would be sufficient in trading not connected to fraud to allow deduction based on alternative evidence. Officer Birchfield confirmed in oral evidence that there was adequate alternative evidence of the charge to VAT.
(c) Officer Birchfield stated that Officer Ball had decided not to allow deduction because of the indicators available to the Appellant of connection to fraud and the fact that the invoices were connected to a fraud. The Tribunal does not accept this was a proper characterisation of the reasons why Officer Ball exercised his discretion not to accept alternative evidence for invalid Stratex invoices. The evidence of Officer Ball, which the Tribunal has accepted, is that he refused to exercise his discretion because Stratex were not VAT registered, the transactions were connected to fraud and CFE had performed inadequate due diligence.
(d) Denial of input tax cannot be based on the technical deficiencies of an invoice when it is connected to fraud if alternative evidence would otherwise support deduction.

1884. On the *Kittel* issue Officer Birchfield considered that the input tax on the Stratex transactions should be denied on the basis of *Kittel*, but that as regards the other relevant counterparties the date from which the Appellant knew or should have known that the only reasonable explanation for the trading was connected to a fraud was 8 June 2009.

1885. On the time bar issue for the assessments, Officer Birchfield considered that HMRC were out of time in respect of the Stratex transactions because no new evidence had been obtained after the beginning of 2010 and '*when viewed this way the decision in relation to the Stratex Alliance invoices is out of time*'.

1886. Officer Birchfield also noted in respect of the other denied transactions for 06/09 that *"David Ball certainly thought he had sufficient evidence to deny when he sent his submission to Doug Armstrong in January 2011 and Officer Armstrong endorsed Officer Ball's submission on the 2/02/2011"*. However, Officer Birchfield went on to consider that the formal advice from the Policy team issued to Officer Ball on 11 October 2011 which concluded that the author felt 'unable to agree to commit to a decision at this stage whilst there are still so many questions about how the market operates'.

1887. Officer Birchfield noted the advice suggested additional work for Officer Ball to conduct in relation to how the Carbon Credit Market worked, confirming circularity, evidencing the weaknesses in the due diligence done when compared with Tower Bridge's obligations in relation to FSA anti-money laundering requirements and identifying the company's internal accounting and invoice processing systems. Officer Birchfield noted a further e-mail from Officer Gill to Officer Ball regarding re-presenting the submission when the additional queries had been answered. Officer Birchfield noted the outstanding queries with Tower Bridge were not responded to by the trader until 13 July 2012 by Tom Cartwright of Pinsent Masons and upon the Pinsent Masons report on 21 September 2012.

1888. Officer Birchfield considered that the content of the report was relevant, and he had to consider the contents before he was able to make a decision. The pre-assessment letter of 24 May 2012 gave the trader an opportunity to offer an alternative explanation as to why they had no knowledge or means of knowledge before the decision to deny was made. The decision was issued within 12 months of the report of Pinsent Masons and within 12 months of the receipt of the documents supplied on 13 July 2012 in response to David Ball's email of 31 January 2012.

1889. Officer Birchfield therefore concluded that the remaining parts of the assessment in period 06/09 and 09/09 were made within time.

1890. On 10 April 2013 Officer Jarvis provided his initial comments on Officer Birchfield's draft. Officer Jarvis thanked Officer Birchfield for his review and said that there were many points on which he agreed. He went on *"However, as you may have anticipated, I have a few comments to make,* ***although it is important to remember that this is ultimately your review and not mine and you should reach your own conclusions****"* (original emphasis). The Tribunal does not accept the Appellant's submission that Officer Jarvis was improperly seeking to influence the conclusion of Officer Birchfield's review.

1891. On the discretion not to accept invalid invoices, Officer Jarvis suggested that Officer Birchfield had not adequately considered the lack of appropriate commercial checks. Officer Jarvis pointed to HMRC guidance and case law that he said showed that HMRC were allowed to take this into account when exercising their discretion, although he said that *"You may feel that our approach goes too far when examining the legal vires of Regulation 29(2)"*. He said to Officer Birchfield that if he considered that CFE had carried out *"normal commercial checks to establish the bona fides of the supply and supplier"* then he would be entitled to conclude that *"discretion should apply"*.

1892. On the time limits issue, Officer Jarvis said *"My understanding is that the key point here is whether* ***the assessment*** *is out of time and not whether individual transactions are out of time. In your review (section 5) you seem to be separating the decision to assess the Stratex transactions from the overall assessment? My understanding is that this approach is wrong in law (although is not my area of expertise). We have allowed Tower Bridge (through Pinsent Masons) a chance to respond to our case and I would have thought that the deadline is set by Pinsent Mason's* [sic] *detailed report on this issue which was sent 21 September 2012? Please correct me if this is wrong"* (original emphasis).

1893. On 11 April 2013 Officer Birchfield emailed and thanked Officer Jarvis for his comments and said that he would take them into account. As regards the issue concerning the invoices, Officer Birchfield stated *"I do accept the trader did appropriate due diligence on suppliers"* (i.e. he considered that the condition that Officer Jarvis had raised concerning *"normal commercial checks"* was met).

1894. On the time limits issue, Officer Birchfield said *"Rod* [Stone] *has told me that it is Policy where an MOK decision is being considered that we will not raise any assessment (even if were might have sufficient evidence to do so) until we have considered all the circumstances of the trading and that in this case we weren't in that position until we had received the Pinsent Mason [sic] Report"*, and asked Officer Jarvis to confirm.

1895. Officer Birchfield ended his email *"I have to conclude this by tomorrow and inform the trader of my decisions so this is urgent"*.

1896. Officer Jarvis responded later that day:

(1) On the assessment time limit issue, Officer Jarvis stated that, having spoken to Officer Nickolls, he confirmed his previous advice.
(2) On the invalid invoices issue, Officer Jarvis said: *"As discussed on the phone I think it would be beneficial to run both arguments against this trader – The primary argument would be that the trader had an invalid VAT invoice under 14(1)(d) - we would argue that discretion doesn't apply as the supplier was not VAT registered. The Alternative arguments (which also supports not applying our discretion under 14(1)(d)) is that the trader knew or should have known that these transactions were connected to VAT fraud (i.e. the Kittel principle). In this*

case the two technical case [sic] *(invalid invoice) and the Kittel principle compliment* [sic] *each other but are two distinct basis* [sic] *on which to deny the trader it's* [sic] *input tax".*

1897. Having given advice to Officer Birchfield as to his review decision, which the Tribunal does not accept to be improper because Officer Birchfield still made his own mind up, Officer Jarvis emailed Officer Stone to say that he was "off home now, but this is just to let you know that I am at least confident that we should be able to maintain the denial of the Stratex invoices….There's not a lot more I can add now!".

1898. Officer Stone also provided two sets of comments and advice to Officer Birchfield by emails dated 10 and 11 April 2013 respectively. Officer Stone was seeking to advise and give input into the review decision but this was not improper.

1899. Officer Birchfield demonstrated his independence in his decision making as he does not appear to have made any changes to his decision in respect of them.

1900. On 12 April 2013 Officer Birchfield emailed various of his HMRC colleagues, including Officers Stone, Jarvis and Ball, to say that he had *"taken on board everyone's representations"* and has *"made some changes to the review document and the amount I am supporting denial on. I do not propose to make any further changes or consider any more representations as this no reflects my final position"*. He said that he was now drafting a *"far briefer document"*.

1901. There are two near-final versions of the review decision.

1902. The first draft was nineteen pages and contained more detail (six pages) on the time limits issue. It recited the details of HMRC only receiving information from DG environment identifying the EUA units in 2012: "*During 2012 information exchanged by the European Fiscal authorities is received and put into a format by Rod Stone hereby it can be interpreted by HRMC Officers (such as Officer David Ball). This information goes to circularity of the carbon credits through Tower Bridge which is referred to in the decision letter of the 6/12/2012.*" It also accepted that 'David Ball certainly though he had sufficient evidence to deny when he sent his submission so Doug Armstrong in January 2011 and Officer Armstrong endorsed Officer Ball's submission on 2/02/2011'. It also records the form advice from the policy team issued to David Ball on 11 October 2011. "Having reviewed your submissions I agree that Cantor should have known that its' transactions were connected to a fraudulent evasion of VAT. Despite this I believe we should hold off from issuing the decision letter as I do not think the evidence with your submission will be enough to defend your decision in the VAT Tribunal should cantor appeal".

1903. This first version of the review decision concluded that until the two responses were received to the queries of 31 January 2012 on 13 July 2012 and Pinsent Masons report on 21 September 2012, the Officer was not in a position to know what relevance the reply might have and how it might influence any potential decision he might be considering. The questions asked were relevant following policy advice and this was the last information given to HMRC before the decision was notified. Therefore, the draft review concluded the denial and assessments were made in time.

1904. The second version of the review decision was thirteen pages long (without the detail on time limits) and contained further minor comments and amendments by someone else in HMRC.

1905. The review decision was then issued on 12 April 2013 in the thirteen-page format.

1906. As regards HMRC's discretion to accept alternative evidence on invalid invoices, Officer Birchfield identified two types of deficiency in the invoices in question, one being that the VAT amounts were expressed in Euros rather than sterling (the Adduco and ADE invoices); and the other being that there was no VAT registration number shown on the invoices (the Stratex invoices).

1907. In relation to the former, Officer Birchfield accepted that: (i) the supplies shown on the invoices took place; (ii) the Appellant could show that they paid for the supplies; (iii) the supplies were used for the purpose of making onward taxable supplies; and (iv) CFE paid its suppliers (not any third parties) to the bank accounts held in CFE's accounting system as belonging to those suppliers. Officer Birchfield decided that the Appellant had satisfactory alternative evidence to support deduction and so the invoices were allowed.

1908. In relation to the Stratex invoices, Officer Birchfield stated in the letter he declined to exercise his discretion to allow input tax deduction on the basis that Stratex was not VAT registered. However, Officer Birchfield accepted in evidence that all of the factors listed at (i) to (iv) above applied equally to the Stratex transactions. He accepted that the difference was that Stratex was not VAT registered and had it been, he might have been inclined to accept alternative evidence.

1909. Officer Birchfield earlier in evidence stated that he considered that it was *"entirely relevant that the transactions are connected to fraud"* and that HMRC thought the trader knew or should have known that was a relevant factor in the exercise of discretion. But that was not a factor he relied on at the time of his decision. The reason for relying on such a factor in respect of the discretion would appear to be an alternative to protect HMRC's position in the event that they could not discharge their burden in respect of the *Kittel* denial.

1910. Officer Birchfield also accepted in evidence that:

(a) Stratex was registrable for VAT;
(b) Stratex was a taxable person that made taxable supplies to the Appellant on which input tax was incurred by the Appellant;
(c) but for the fact that Stratex was not registered for VAT, Officer Birchfield would have exercised his discretion to allow the input tax deduction; and
(d) the fact that Stratex was not VAT registered in no way negated the fact that the Appellant incurred input tax on the transactions in dispute.

1911. As regards the assessment time limits, Officer Birchfield had changed his position from his original and first draft conclusion that the assessments regarding the Stratex invoices were out of time. The final version of his review decision decided that all the assessments were in time. However, Officer Birchfield accepted in oral evidence that there was no new evidence of fact as regards the Stratex transactions received by HMRC after the beginning of 2010. Officer Birchfield also accepted in evidence that it remained the case that Officer Ball certainly thought he had sufficient evidence to deny when he sent his submission to Officer Armstrong (in 2011).

The Appellant's submissions on the Fifth Issue

1912. Ms Shaw QC made the following submissions on behalf of the Appellant.

1913. Section 73(1), Value Added Tax 1994 ("VATA") allows HMRC to assess a taxpayer in respect of amounts of input tax which ought not to have been claimed and to notify the taxpayer accordingly.

1914. The power contained in s.73(1) is, however, subject to the time limits set out in ss.73(6) and 77, VATA, which require the assessment to be made within four years of the end of the prescribed accounting period (sections 73(6) and 77(1), VATA); and not later than either:

> (a) Two years after the end of the prescribed accounting period (s73(6)(a), VATA); or
>
> (b) One year after evidence of facts sufficient in the opinion of the Commissioners to justify the making of the assessment comes to their knowledge (s.73(6)(b), VATA).

1915. Insofar as assessments were made in this case, she submitted they were undoubtedly made outside the two-year time limit set out above; accordingly, the question is whether they were made within one year after evidence of facts sufficient in the opinion of HMRC to justify the assessment came to their knowledge.

1916. Ms Shaw QC submitted that the applicable legal principles in applying this time limit are set out in the Judgment of Dyson J in *Pegasus Birds Limited v CCE* [1999] STC 95 (*Pegasus Birds (HC)*), at 101g-102c (subsequently endorsed by the Court of Appeal [2000] STC 91 (*Pegasus Birds (CA)*)):

> "1. The commissioners' opinion referred to in s 73(6)(b) is an opinion as to whether they have evidence of facts sufficient to justify making the assessment. Evidence is the means by which the facts are proved.
>
> 2. The evidence in question must be sufficient to justify the making of the assessment in question (see Customs and Excise Comrs v Post Office [1995] STC 749 at 754 per Potts J).
>
> 3. The knowledge referred to in s 73(6)(b) is actual, and not constructive knowledge (see Customs and Excise Comrs v Post Office [1995] STC 749 at 755). In this context, I understand constructive knowledge to mean knowledge of evidence which the commissioners do not in fact have, but which they could and would have if they had taken the necessary steps to acquire it.
>
> 4. The correct approach for a tribunal to adopt is (i) to decide what were the facts which, in the opinion of the officer making the assessment on behalf of the commissioners, justified the making of the assessment, and (ii) to determine when the last piece of evidence of these facts of sufficient weight to justify making the assessment was communicated to the commissioners. The period of one year runs from the date in (ii) (see Heyfordian Travel Ltd v Customs and Excise Comrs [1979] VATTR 139 at 151, and Classicmoor Ltd v Customs and Excise Comrs [1995] V&DR 1 at 10).
>
> 5. An officer's decision that the evidence of which he has knowledge is insufficient to justify making an assessment, and accordingly, his failure to make an earlier assessment, can only be challenged on Wednesbury principles, or principles analogous to Wednesbury (see Associated Provincial Picture Houses Ltd v Wednesbury Corp [1948] 1 KB 223) (see Classicmoor Ltd v Customs and Excise

> Comrs [1995] V&DR 1 at 10–11, and more generally John Dee Ltd v Customs and Excise Comrs [1995] STC 941 at 952 per Neill LJ).
>
> 6. The burden is on the taxpayer to show that the assessment was made outside the time limit specified in s 73(6)(b) of the 1994 Act."

1917. Accordingly, in the present case, she submitted that the relevant opinion for the purposes of s.73(6)(b), VATA is the opinion of Officer Ball and the correct approach was to ask what facts did Officer Ball consider to be necessary to justify the making of the assessment and when did he have knowledge of those facts.[8]

1918. As to the first part of the exercise, namely ascertaining the facts which in the opinion of Officer Ball were sufficient to justify making the assessment, the Court of Appeal in *Pegasus Birds (CA)* explained, at [15]:

> *"An opinion as to what evidence justifies an assessment requires judgment and in that sense is subjective; but the existence of the opinion is a fact. From that it is possible to ascertain what was the evidence of facts which was thought to justify the making of the assessment. Once that evidence has been ascertained, then the date when the last piece of the puzzle fell into place can be ascertained."*

1919. Ms Shaw QC submitted it should also be noted that evidence of fact means evidence of basic fact rather than, for example, inferences of fact or calculations (per *Lazard Brothers & Co Ltd v CCE* VAT Decision 13476 (1995)). What is, and is not, evidence of basic fact is a question of law for the Tribunal to determine.

1920. Nor is legal analysis evidence of fact: see *Enron Europe Limited (In Administration) v HMRC* VATD 20436, at [24] and [30]).

1921. Finally, she submitted that the knowledge of all officers authorised to receive information relevant to the decision to assess is imputed to the assessing officer (*Pegasus Birds (HC)*, at 102f-g).

1922. Ms Shaw QC submitted that while Officer Ball contended that the last piece of evidence of the facts sufficient to justify the Decision was the Pinsent Masons Report of 21 September 2012, it was clear, however, from the terms of Officer Ball's letter of 24 May 2012 (in particular see paragraph 152) that he was already of the opinion that he had sufficient information to justify making assessments in respect of all the transactions in issue.

1923. Although Officer Ball, and HMRC, were perfectly entitled to continue to request information from the Appellant and receive a counter explanation, they ran the risk of it producing nothing of any material significance: see *Carbondesk Group plc v HMRC* [2015] UKFTT 367 (TC), at [20].

1924. In the circumstances, she submitted that it is apparent that the one-year time limit found in s.73(6)(b), VATA had expired by 6 December 2012 because there was no new evidence of basic facts sufficient in the opinion of Officer Ball to justify the making of the assessments after 6 December 2011.

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[8] Officer Birchfield's supplementary assessment does not appear to have been based on any evidence of basic fact that was not (1) available to Officer Ball at the time of his assessments, or purported assessments, and (2) relied on by Officer Ball. Accordingly, the focus can, for practical purposes, be on Officer Ball's position.

1925. Further or alternatively, she submitted that the assessment in respect of the Stratex transactions was made outside the one-year time limit. Officer Ball was already of the opinion that he had sufficient information to justify making assessments in respect of those transactions before 6 December 2011 (being one year before his letter of 6 December 2012).

1926. Ms Shaw QC submitted that HMRC cannot lawfully delay making an assessment in respect of an amount for which they have evidence of facts sufficient in their opinion to justify making an assessment simply by identifying some other amount due for that same period for which additional evidence of facts is still required.

1927. In that regard it should be noted that the Stratex transactions make up £5,605,119.77 of the amounts assessed for the period 06/09. The remaining disputed transactions (relating to AH Marketing, GW Deals and Ayres) account for £798,892.24. The Stratex transactions therefore constitute over 87.5% of the amounts assessed for that period (as varied following the Review).

1928. The obligation on HMRC is, therefore, to make an assessment in respect of any amount due for any prescribed accounting period within one year of evidence of the facts sufficient in their opinion to justify the assessment of *that* amount.

1929. Furthermore, she submitted that it was legitimate to treat the Stratex transactions separately from the other transactions in 06/09 when the amounts are separately assessed (insofar as they were assessed at all), or at least separately addressed, in the letter of 6 December 2012 and the factors justifying the denial of input tax separately identified.

1930. For all those reasons, the assessment of the amount of VAT due for the period 06/09 in respect of the Stratex transactions fell outside the one-year time limit.

1931. Further and alternatively, she submitted that Officer Ball's decision not to make earlier assessments was perverse. As was stated in *Pegasus Birds (HC)*, at 104d-e:

> 'The question for the tribunal on an appeal, therefore, is whether the commissioners' failure to make an earlier assessment was perverse or wholly unreasonable. In some cases, the position will be clear. Suppose that evidence of all the facts which in the opinion of the commissioners justified the making of the assessment was known to the commissioners at the beginning of year one, and the assessment was not made until the beginning of year three. Suppose further that the reason for the two-year delay is that the file was lost, or there was a change of staff with the result that the officer who had acquired the evidence did not pass it on to his successor. In those circumstances, the delay in making the assessment would be wholly unreasonable, and an appeal would succeed on the time-limits point.
>
> More difficult are cases where the commissioners delay making the assessment because they consider that they need more evidence…"

1932. Ms Shaw QC submitted that for the reasons already given, it was apparent that Officer Ball delayed making his assessments. Moreover, he did so with no reasonable basis. Once Officer Ball formed the opinion that he had sufficient evidence to justify the assessments, he was obliged to make them. It was not open to Officer Ball to seek to extend the time limit by requesting further information:

"The first conclusion is that the time limit…is stated to be fixed. It is not open to either party to extend it, nor is it extended by the fact of the Commissioners asking for further information,

subject always to the conditions as to the sufficiency of the evidence in the opinion of the Commissioners" (Lazard Brothers & Co Ltd v CCE (1995) VAT Decision 13476)

1933. Further, in assessing the reasonableness of Officer Ball's decision to delay making the assessments, notwithstanding the fact that he had formed the opinion that he had sufficient evidence to justify them, regard must be had to the nature of the exercise in raising an assessment:

> "The Tribunal considers that in forming their opinion of what is evidence of facts sufficient to justify the making of an assessment, the Commissioners are bound to have regard to the obligations upon them as defined by the judgment in the appeal of Van Boeckel. The obligation on the Commissioners is inter alia to make an honest and bona fide value judgment to come to a view as to the amount of tax due. They must fairly consider all material placed before them and as long as there is some material on which the Commissioners can reasonably act they are not required to carry out investigations which may or may not result in further material being placed before them. This means, in the view of the Tribunal, that in judging what evidence is sufficient, they may not neglect the consideration that they can assess without exhaustive enquiries and on the material which is before them. That does not mean that they cannot seek for further material if they desire, but it does mean that they are not free to conclude that it can only be sufficient in their opinion if it is exhaustive. In the present appeal it is conceded that the Commissioners could have assessed before they did, on the basis of the facts in their possession. They decided to seek further information from the appellant in the form of schedules including calculations, on which Mr Abel wished to seek agreement. That appears to the Tribunal to be a perfectly proper approach, for the reasons given by Mr Abel, but it would not suffice to displace the obligation on the Commissioners to act to their best judgment, nor to stop time from running. Requiring the taxpayer to prepare his own assessment is another thing. The obligations on the Commissioners to exercise the best of their judgment is not an obligation which the Commissioners can delegate to the taxpayer. Further it is relevant to the Commissioners' powers to assess to the best of their judgment that the desire to reach an agreement with the taxpayer though laudable, is not one which should of itself be taken to interrupt the running of the time limits imposed by statute." (*Lazard Brothers*, emphasis added)

1934. Ms Shaw QC submitted that Officer Ball was not, therefore, entitled to delay raising the assessments until the point at which HMRC's enquiries were exhausted or until they had acquired every last shred of evidence on which they intended to rely in support of the assessments.

1935. She submitted that Officer Ball was required to make an assessment within one year of evidence of facts *sufficient* in his opinion to justify the making of the assessments. The test, therefore, is as to whether Officer Ball had enough – not whether he had everything – to justify the assessments. As submitted above, Officer Ball had sufficient evidence before 6 December 2011 because no new evidence of basic facts sufficient in the opinion of Officer Ball to justify the making of the assessments came to light after that point.

1936. Further or alternatively, Ms Shaw QC submitted that the decision not to assess earlier in respect of the Stratex transactions was unreasonable. As noted above, Officer Ball had the evidence that he considered sufficient to justify making the assessment in respect of those transactions in advance of 6 December 2011.

1937. As far as the one-year time limit is concerned, HMRC asserted that the last piece of evidence of facts sufficient in the opinion of Officer Ball to justify the making of the assessments was the Pinsent Masons Report submitted on 21 September 2012. She submitted that whilst undoubtedly that report provided Officer Ball with additional facts, it is not apparent that it provided him with evidence of the facts sufficient in his opinion to justify the making of the assessments.

1938. She submitted that in their written opening submissions, HMRC criticised the Appellant for failing to address the UT's decision in *Rasul v HMRC* [2017] STC 2261. She submitted that the passages cited by HMRC in their submissions relate almost exclusively to the particular facts of that case as to when Mr Spranklen (the officer in that case) was of the opinion that he had evidence of facts sufficient to justify the assessments. Self-evidently, the question for the Tribunal in the present appeal turned on the particular facts of this case.

1939. For the avoidance of doubt, the Appellant accepted that the test is not as to whether there was *"sufficient evidence to enable an officer to reach the view that he is entitled to issue a "best judgment" assessment"*. The test is when was Officer Ball of the opinion that he had evidence of facts of sufficient weight to justify the making of the assessments.

1940. Nor is it disputed that Officer Ball requested further information. However, as the Tribunal noted in *Carbondesk*, at [20] (referred to in the Appellant's first skeleton argument and cited with approval in *Rasul*) if the additional evidence received pursuant to the request is not of sufficient weight to justify the making of the assessment then it cannot constitute the last piece of evidence for the purposes of s73(6)(b), VATA.

1941. Ms Shaw QC submitted that in their written opening submissions, HMRC contended that their submissions as to when Officer Ball had evidence of facts sufficient in his opinion to justify the making of the assessments apply equally to Officer Birchfield.

1942. However, she submitted it was unclear as to how they could apply equally. As the Appellant understands it, Officer Birchfield did not make a best judgment assessment under s.73, VATA; his Supplementary Assessment of 25 June 2013 was made pursuant to s77(6), VATA, to correct an arithmetical error (not to assess other amounts shown to be due upon the discovery of new evidence of facts). The validity of that Supplementary Assessment depends upon whether Officer Ball's assessment for the period 06/09 was in time. If Officer Ball's assessment in respect of the period 06/09 was out of time, then so too was Officer Birchfield's Supplementary Assessment.

1943. In summary Ms Shaw QC submitted as follows:

1944. The first sub-issue within the question of time limits is whether the Tribunal can look separately at the Stratex transactions within the 06/09 period. The relevant question here is when did Officer Ball hold the opinion that he had sufficient evidence of fact to justify the assessments. As regards the 06/09 assessment, if there was one, within that assessment is an amount of VAT in respect of the Stratex transactions. So the Stratex transactions represent an amount due for the prescribed accounting period 06/09. That does not detract from the fact that "the assessment" is the assessment that was made, it is just within that assessment are amounts which she submitted the Tribunal can properly compartmentalise.

1945. Ms Shaw QC submitted the relevant question is when was Officer Ball of the opinion that he had evidence of fact sufficient to justify the assessment which remains in issue. She

submitted that what that means is evidence of fact sufficient to justify either the 09/09 assessment or any of the transactions within the 06/09 period other than Stratex, AH Marketing, GW Deals and Mettec.

1946. She submitted that the correct approach, as the opening words of 73(6) VATA dictate, is to apply the time limit to any amount assessed within the assessment in issue. In regards to section 73(6), she submitted that it is further supported by the tailpiece to subsection (6), which expressly allows for situations where further such evidence comes to the knowledge of the Commissioners, they may make another assessment in respect of that same accounting period. So she submitted that once HMRC have enough evidence of fact to justify an assessment for an amount, they are required to make that assessment and nothing precludes them from subsequently gathering further facts in respect of other transactions or events in respect of that same accounting period in raising another assessment.

1947. Ms Shaw QC submitted that in the vast run of cases HMRC will have concluded their investigation and will simply raise their assessment in respect of all of the items within the year. But if in a situation like this, where there are a number of different transactions within the period, they are required to scrutinise at what point they have sufficient evidence in respect of certain transactions and to raise the assessment at that point.

1948. She submitted that in this case, as regards Stratex, Officer Ball accepted that he had everything he needed by September 2009. Ms Shaw QC submitted that once he had reached that point in respect of Stratex, Officer Ball was not entitled to hold off raising an assessment because there were other miscellaneous items within that period. Stratex was the lion's share of the input tax now in dispute for 06/09. She submitted that Officer Ball effectively deferred raising an assessment in respect of £5.6 million-odd of tax because he was waiting for £690,000 or so. So she submitted that this was not correct and it was not proportionate. He was perfectly entitled to make a separate assessment in respect of those other items further down the track if he wanted to.

1949. She submitted that this approach was exactly what Officer Birchfield concluded in his original independent review. He thought the Stratex amounts were out of time. That was because, as he said, Officer Ball did not receive any new evidence of fact. He thought he had enough to deny when he sent his submission through in 2011.

1950. In respect of Officer Birchfield's review, he referred to the outstanding queries between Officer Ball and Tower Bridge set out in the email of 30 January 2012 and said that although they did not specifically refer to Stratex, they did relate to how Tower Bridge operated in the market and the checks it had in place and that that was relevant to his decision. Officer Birchfield then said:

"It is in the response from the company, which comes eight months later as an annex to the Pinsent Masons report, that the logic behind claiming on the Stratex and Westis invoices is fully articulated."

1951. However, Ms Shaw QC submitted that if you look at the Pinsent Masons report in respect of the Stratex invoices it refers the reader to Mr Treanor's email, which is dated 1 October 2009. So she submitted that it is obvious that Officer Ball had everything he needed in respect of Stratex at that point.

1952. Ms Shaw QC submitted that Officer Ball accepted in cross-examination that he was prepared to accept the explanations provided in Mr Treanor's email of 1 October 2009. Indeed, when they looked at his submission to the VAT fraud policy team it was clear that he did accept the explanations. She submitted that it was plain that Officer Ball had evidence of all the facts sufficient to justify the denial of the Stratex input tax, and indeed that he had formed the opinion that he had enough back in 2011. That much flowed from the September 2011 email.

1953. She submitted that then left the remainder of the disputed transactions for 06/09, namely AH Marketing, GW Deals and Mettec. She submitted that the Tribunal needed to separate out the Stratex transactions from the other transactions within the assessment, but also needed to separate out the two different bases for the assessment for the Stratex transactions. However, in practical terms there was no distinction, because the reason why the Stratex invoices have been denied on a *Kittel* basis is that they have been shown to be connected with fraud and it was said from the absence of a VAT registration number on the invoice that the Appellant knew or should have known that.

1954. She submitted that the basis on which HMRC said the Appellant knew or should have known is the absence of the VRN on the Stratex invoices. So that was something known. There was no other factor. There were no rumours of fraud and so on by that point. All the due diligence was obtained by Officer Ball a long time before. He was not waiting for any information. He himself accepted that.

1955. Ms Shaw QC submitted that the basis on which the invalid invoices point arose were all, again, facts known to Officer Ball very early on. The due diligence was all provided back in 2009. The absence of a VAT registration number was apparent from 2009, as was that Stratex was not VAT registered, which was apparent from the visit conducted back in 2009. Likewise, the connection with tax loss was again established back in 2009 so all of those factors were known by Officer Ball.

1956. In respect of the GW Deals, Mettec and AH Marketing transactions she submitted that all of the facts on which those amounts were denied were again known to and all referred to in Officer Ball's 2011 submission to the VAT fraud policy team. The only items in respect of 06/09 that Officer Ball was awaiting, which is to be seen from his September 2011 email, concerned counterparties now not in dispute, such as Green and Blue.

1957. She submitted that on 1 September 2011 Officer Ball was waiting for information regarding the July 2009 Westis transactions. The question of the Adduco exchange rate for March 2009 had become irrelevant as had the invoices for Green and Blue and due diligence, and invoices for NLT and due diligence.

1958. Ms Shaw QC submitted that as far as the July 2009 Westis transactions were concerned, despite what Officer Ball said in his email of 1 September 2011, it was plain from the email of 5 September 2011 that he had made his mind up to deny the input tax. The only difference it was going to make was to increase the amount denied.

1959. She submitted that the email of 5 September 2011 was an important email to establish that Officer Ball had, in his opinion, as of 5 September 2011, evidence of facts sufficient to justify the making of the assessment that he then went on to make out of time. As for evidence of the specific assessment in relation to 09/09 that Officer Ball went on to make, she submitted that the only amounts included in the 09/09 assessments were the Westis trades.

1960. Ms Shaw QC submitted the computation of the 09/09 assessment was apparent from the spreadsheet provided to Officer Marian Drakes, so that if Officer Ball had those numbers, then he had the facts. The fact Officer Ball had not carried out the calculation was not evidence of fact. Knowing of carbon credits purchased in July 2009 that he only found out about from DG Environment information, and having prepared a witness statement on means of knowledge, would not have changed Officer Ball's position to any extent, only increase the possible denial and provide any further background.

1961. So she submitted that Officer Ball accepted that he had by this stage already decided that the disputed transactions would be denied on a *Kittel* basis. All that was going to change was the size of the denial by including the July transactions within his decision.

1962. She submitted the Tribunal had to view each period of 06/09 and 09/09 separately. There is no dispute that there can be different time limits for the assessments for the two different VAT periods.

1963. Ms Shaw QC submitted she was not suggesting that Officer Ball was required to assess on a hair trigger. She was suggesting that Officer Ball's opinion formed over a period of time, and the point at which it started to form was on 13 October 2010 when he sent through a document called "Due diligence received from Cantor regarding carbon credits trades" to Officer Smallbone. She submitted it was evident from that that Officer Ball had already started to draw overall conclusions from the materials he had assembled and reviewed.

1964. She submitted that on 17 August 2011, Officer Ball had sent his means of knowledge submission to the VAT fraud policy team. That was the document that was referred to as 'the 5 September 2011 submission' because Lisa Orr had dated it 5 September 2011 when she reviewed it, but it was actually produced by Officer Ball and sent to Officer Armstrong on 17 August 2011. Officer Ball had accepted that what this document did was to set out the basis for the conclusion that the Appellant should be denied input tax for the periods 03/09 and 06/09 on a *Kittel* basis, albeit that it did not address period 09/09.

1965. She submitted it was material to note that the reasoning Officer Ball deployed to support his submission of 5 September 2011 was essentially the same as that found in the final decision letter issued on 6 December 2012. He accepted in cross-examination that, with the exception of the July transactions, all of the facts referred to in the pre-assessment letter and the final decision letter were referred to in this 2011 submission. She also asked the Tribunal to consider Lisa Orr's email recording that Officer Ball felt there was sufficient evidence.

1966. Ms Shaw QC submitted that Officer Ball was not himself interested in the answers to the remainder of those questions of 30 January 2012, which were prepared with the assistance of Officer Marian Drakes, but was really doing so to satisfy Officer Gill. The email of 30 January 2012 references the July Westis transactions, as well as the sterling amount on Adduco and the Green and Blue and NLT, but these were queries from the 1 September 2011 email that were not of relevance. So she maintained that for his own part, Officer Ball was really only interested in the information that he had sought back in September 2011.

1967. She relied on Officer Ball's 7 March 2012 email where he talked about time limits and said that the information he was waiting for was the euro/sterling rate. So she submitted that notwithstanding the information request made on 30 January 2012, the only information that he considered was relevantly outstanding was that exchange rate. Again, she submitted that

this was confirmed in his evidence but in fact he already had that information because it was embedded in the VAT return.

1968. She also relied on Officer Stone's suggestion of 2 April 2012 that perhaps a pre-assessment letter might be appropriate, and Officer Ball's reply that he was more than happy to issue an assessment letter. His evidence was that the reason why he was more than happy to issue an assessment letter was because he was already of the opinion he had sufficient evidence to disallow the input tax.

1969. Having looked at the evidence, she submitted that Officer Ball was plainly of the opinion prior to receiving the PM Report and from September 2011 that he had sufficient evidence of the facts to justify denying the input tax and thus to make the assessments.

1970. In making that submission she was not suggesting that Officer Ball was lying, but the trial was taking place many years after the events and memories fade, so that Officer Ball's recollection was understandably a little hazy.

1971. Secondly, she submitted that Officer Ball appears to have confused a) when he formed his opinion that he had sufficient information to assess with b) his decision to agree to wait before he assessed. As to the former, she submitted the documents speak for themselves. So that is what the contemporaneous evidence shows, she submitted.

1972. So whilst Officer Ball did not concede the point explicitly, she submitted the sum total of his evidence in cross-examination is that he was of the view that he had enough to assess back in September 2011 at the latest.

1973. Ms Shaw QC submitted that HMRC had invited the Tribunal to look at the pre-assessment letter of 24 May 2012 and say that it's evident from that pre-assessment letter that no decision had been made regarding the assessment of any amounts. This was because the letter does not contain any numbers calculating the assessment and there is no date from which knowledge or means of knowledge is said to run. But she submitted that there can be no dispute that the facts upon which those items are based were known to Officer Ball long before.

1974. She submitted that the mere fact that Officer Ball had not carried out his calculations did not save HMRC, nor did the fact that the date from which knowledge or means of knowledge was said to run, namely the date of the first Stratex invoice, had been fixed upon. Those were conclusions reached from the underlying evidence of facts which had been in the possession of Officer Ball for considerable time, but certainly by September 2011 at the latest.

1975. The alternative way in which the Appellant put its case on this is that it was apparent that the Pinsents report was immaterial to the decision to deny input tax, and that is apparent from comparing the December 2012 decision letter, not only with the Pinsents report itself but with the pre-assessment, 24 May 2012, letter and also Officer Ball's submission back in 2011.

1976. She submitted that the Pinsents report was clearly not the last piece of evidence of fact sufficient, in Officer Ball's opinion, to justify making the assessments. It was plain from the evidence that Officer Ball had everything he needed to make the assessments. Officer Ball was neither required nor entitled to make exhaustive inquiries. So even if Officer Ball did not form the opinion back in September 2011, as she submitted he plainly had, he should reasonably have formed that opinion.

1977. She submitted that it was unreasonable to take the view that further evidence was required. That was the reasonableness challenge. She submitted it was unreasonable because it was absolutely clear that the additional information which Officer Ball requested was wholly immaterial to his decision to assess. So whilst he was free to ask, that did not prevent the time limit from running and that is precisely the point made by the FTT in *CarbonDesk*, that HMRC run the risk that additional requests will return nothing of any significance to the ultimate decision to be made.

1978. So for all those reasons she submitted that all the assessments are out of time and it followed that if the assessment for 06/09, if there was one, was out of time, then so too was Officer Birchfield's supplementary assessment.

HMRC's submissions on the Fifth Issue

1979. Mr Puzey submitted on behalf of HMRC that there can be no question of the denial of the input tax reclaim of £4,742,232.30 for VAT period 06/09 being out of time since there was no requirement to assess for that sum as due that could be out of time since the VAT remained in the hands of HMRC.

1980. He submitted that the remaining sum for 06/09 was assessed by reason of the decision of 6 December 2012 and calculated and evidenced in the first notification of adjustments of the 06/09 VAT return on 3 January 2013. It was amended subsequently by a combination of the Review Decision of April 2013, Supplementary Assessment of 25 June 2013 and second notification of adjustments to the 06/09 VAT return on 29 July 2013 in accordance with *Aria Technology*.

1981. Mr Puzey submitted that in this case the calculation of the assessed sum for 06/09 can have been undertaken no later than 6 December 2012, which is the date of the Decision.

1982. He accepted that: the decision of 6 December 2012 to deny input tax for 06/09 & 09/09; first VAT return adjustment for 06/09 (calculating and notifying the assessment for 06/09 on 3 January 2013); 18 January 2013 Assessment for 09/09; Review Decision of April 2013 for 06/09 and 09/09; correction and Supplementary Assessment for 06/09 of 25 June 2013; and second VAT return adjustment for 06/09, notifying the revised assessment for 09/09 on 29 July 2013, were all issued beyond the two-year time limit provided for by section 73(6)(a) VATA.

1983. However, Mr Puzey submitted that the adjustments and assessments were made within 4 years after the end of the relevant prescribed account periods for 06/09 and 09/09 (before 30 June and 30 September 2013) and within one year of evidence of facts sufficient in the opinion of the assessing officers (Officers Ball and Birchfield) to justify the making of the assessments coming to their knowledge. The assessments for 06/09 and 09/09 were therefore made within the one year limit provided for by Section 73(6)(b) VATA.

1984. The assessment in relation to VAT periods 03/09 and 09/09 was made on 18 January 2013. Only that part of the assessment concerning 09/09 remains in issue. Mr Puzey submitted that the Supplementary Assessment (25 June 2013) was in relation to VAT period 06/09. All documents constituting the required assessments and notifications were made within the 4-year period.

1985. Mr Puzey submitted that the last piece of evidence of fact sufficient in the opinion of Officer Ball to justify making the required assessments in respect of VAT periods 06/09 and

09/09 was the detailed report on the Appellant's transactions prepared by its representatives Pinsent Masons and sent to HMRC on or around 21 September 2012 ("the PM Report").

1986. The PM Report provided replies to questions asked by Officer Ball in the e-mail dated 30 January 2012 and also replied to issues and concerns raised in the pre-assessment letter from Officer Ball dated 24 May 2012.

1987. Mr Puzey relied on Officer Ball's evidence in his witness statement that until he had received the answers to the questions that he had raised on 30 January and 24 May 2012, he did not have evidence of fact sufficient to make assessments against CFE. This was because the questions related not only to alternative evidence provided in relation to the invalid invoices from Stratex but also evidence about what CFE knew or should have known in relation to the transactions that were being verified.

1988. Mr Puzey relied on Officer Ball's e-mail of 30 January 2012 which refers to requests for information that he had made of CFE on 1 September 2011 and 20 October 2011 to which he had not received a reply. The e-mail then asks a series of relevant questions about CFE's trading in general and the transactions undertaken.

1989. The stated purpose of Officer Ball's pre-assessment letter of 24 May 2012 was to inform CFE of the status of HMRC's extended verification of its carbon credit transactions. The letter noted at [2-3]:

"Before coming to any conclusion concerning culpability, it is important to ensure that HMRC properly understand the nature of both your business and the relevant transactions. Therefore I would invite you to consider the content of this letter and where necessary clarify HMRC understanding of your transactions and provide any additional information that you may believe to be pertinent.

HMRC will allow you one month from the date of this letter to provide any further information that assists in this matter and to answer any outstanding queries including those at paragraphs 10, 87 and 145 of this letter."

1990. In a letter dated 1 February 2013 (five months later) Pinsent Masons described the extensive PM Report in the following terms:

"2.1 Considerable time and cost was devoted to the Response Document (enclosed) so as to provide HMRC with the key facts in relation to this matter, together with our client's submissions in response to the 24 May letter."

1991. Mr Puzey submitted that having asserted that the PM Report provided HMRC with the key facts in relation to the matter, it is difficult for the Appellant to succeed with the argument that the Report did not in fact provide HMRC with any new facts; yet that is what the Appellant averred later in the same letter at 4.26 "*...no new evidence of facts have to come to HMRC's knowledge in the last year sufficient to justify making an assessment.*"

1992. Mr Puzey submitted that it was noteworthy also that prior to service of the PM Report and during 2012 Pinsent Masons repeatedly sought the agreement of Officer Ball to extensions of time in which to serve the same with the assurance that it would address the questions which he had asked of CFE.

1993. Mr Puzey submitted that Officer Ball's decision to rely on the PM Report cannot be shown to be even close to perverse or wholly unreasonable, which is the required hurdle for

CFE to meet. The PM Report contained the first substantive explanations both of CFE's trading in carbon credits in general and of the specific transactions that were being verified. These explanations and their credibility or otherwise were more than capable of rationally forming the last piece of evidence of fact sufficient in the mind of Officer Ball to raise the assessment.

1994. As per *Rasul* at [16]:

"16. The threshold for making a "best judgment" assessment is therefore comparatively low. But that is not the same as saying that the twelve month time limit in s 73(6)(b) starts to run as soon as there is sufficient evidence before HMRC to enable an officer to reach the view that he is entitled to issue a "best judgment" assessment. If the officer decides that further enquiries need to be made and/or further information obtained before making an assessment, the time limit will not start to run against him unless that decision is perverse or wholly unreasonable."

1995. Mr Puzey submitted that Officer Ball plainly did require further information, as he said in his pre-assessment letter:

"Before coming to any conclusion concerning culpability, it is important to ensure that HMRC properly understand the nature of both your business and the relevant transactions. Therefore I would invite you to consider the content of this letter and where necessary clarify HMRC understanding of your transactions and provide any additional information that you may believe to be pertinent."

1996. Mr Puzey submitted that Officer Ball's approach chimes with that of the Officer in *Rasul* who was guilty of nothing more than seeking to be scrupulously fair to the taxpayer prior to raising an assessment. As the Upper Tribunal said in *Rasul* at [92]:

"It is obviously highly desirable that HMRC's Officers should be seen to be scrupulously fair in the way that they approach the question of best judgment assessments and it would be highly undesirable if the law was to be interpreted in such a way that it operated as an encouragement to make an assessment in circumstances where there is any doubt as to whether the taxpayer has been treated fairly."

1997. Mr Puzey submitted that the dicta above apply equally to Officer Birchfield who made the Review Decision, caused the second VAT return adjustment to be made and made the Supplementary Assessment. All the above were raised within 1 year of the receipt of the Report.

1998. Mr Puzey submitted that it is critical for the Tribunal to bear in mind that the matter in issue concerns the assessment actually made, not a theoretical assessment that could have been made. What matters is whether Officer Ball held the opinion that he did not have evidence of fact sufficient to make the actual assessment made, and if he did, whether that opinion was perverse. The Appellant has neither challenged the truth of Officer Ball's evidence, nor has it suggested to him that if he did hold that opinion, it was perverse.

1999. Mr Puzey submitted that Officer Ball's evidence was that the Pinsent Masons report of 21 September 2012 contained new information, and important information. He submitted that Officer Ball gave his evidence in a perfectly straightforward and obviously honest fashion. His evidence was that he did not have sufficient evidence of fact until receipt of the Pinsent Masons report and that he did not consider that it would be fair, having said that HMRC would await the receipt of the report, for a decision to be made prior to that.

2000. Officer Ball said, for example, that he had not seen the blog of 3 June 2009 prior to the Pinsent Masons report. Whether Officer Ball was aware of rumours of fraud in the carbon

credits market cannot be equated to what he knew of CFE's knowledge of those rumours and CFE's reaction to them. Officer Ball said that he did not, prior to the receipt of the Pinsent Masons report, have full information about Westis. The decision letter made reference to information that was provided in the Pinsent Masons report.

2001. Mr Puzey submitted it should be no surprise to the Tribunal that an HMRC decision to assess a multi-national investment bank for tens of millions of pounds of VAT due is not made in a vacuum by the decision-making Officer. That he received advice and opinions from others within HMRC, often conflicting, is also no surprise. That Officer Ball received such advice and the opinions of others does not detract from the fact, as given by him in evidence, that the decision was his. It would be of no surprise that not each and every discussion of relevance to making the decision was committed to paper. Nor will it be of any surprise that draft submissions to the policy department and draft witness statements are created in support of those submissions.

2002. Mr Puzey submitted that notably, the same draft witness statement cross-examined upon made plain that no decision had yet been made in respect of the 03/09 and 06/09 periods. That there is such a process does not, and cannot, equate to a final decision having been made by Officer Ball.

2003. HMRC invited the Tribunal to dismiss the Appellant's appeal on the Fifth Issue on the basis that all the assessments were made in time.

Discussion and Decision on the Fifth Issue

2004. The Tribunal addresses the assessments for the two VAT periods 06/09 & 09/09 separately.

Period 06/09

2005. As above, the Tribunal has concluded that the assessment for this period was based on the decision to deny input tax on 6 December 2012 and calculated and notified in the return adjustment letter of 3 January 2013.

2006. The question is whether this assessment was made more than one year after HMRC's assessing Officer, David Ball, was of the opinion that evidence of facts sufficient to raise the assessment in question had come to his knowledge.

2007. The Tribunal is satisfied that the Appellant has discharged the burden of proving that Officer Ball was of the opinion he had sufficient evidence of facts to raise the assessment for period 06/09 by 5 September 2011. Therefore, the assessment raised, at the earliest on 6 December 2012, was made more than one year after this date and is out of time. Likewise, the supplementary assessment made on 25 June 2013, correcting arithmetical calculations, is out of time and statute barred under section 73(6)(b) VATA.

2008. Further, or alternatively, the Tribunal is satisfied that even if Officer Ball was not of the required opinion by 5 September 2011 it was unreasonable for him not to have come to this conclusion by this date (or 6 December 2011 at the latest).

2009. In coming to these two conclusions in respect of this VAT period the Tribunal largely adopts the submissions made on behalf of the Appellant set out above, which it does not repeat.

2010. The only major departure from the Appellant's argument is that the Tribunal does not accept the Appellant's submission on the sub-issue: that an assessment is divisible for the purpose of applying statutory time-limits. The Tribunal is not satisfied it should consider that part of HMRC's assessment for 06/09 flowing from the denial of input on the invalid Stratex invoices separately from that part of the assessment flowing from the denial of input based on the *Kittel* means of knowledge test. Likewise, it should not separately consider the assessment flowing from the *Kittel* decision on the Stratex transactions from that relating to the GWD, Mettec and AHMD.

2011. There is no authority for the proposition that an assessment is divisible and that each constituent part should be separately considered for the purpose of analysing time limits. The statutory language does not support such an argument – section 73(6)(b) VATA speaks of evidence of fact sufficient to justify the making of 'the assessment'.

2012. Indeed, the authorities direct the Tribunal to examine the timing of the evidence available to the Officer of HMRC to raise the specific assessment they go on to make. Not only is there no authority for such a proposition, it could cause enormous practical difficulties for HMRC if they had to consider different deadlines for the raising of different parts of an assessment for the same VAT period. Taken to its extreme, it might lead to HMRC being required to raise very many different assessments for the same VAT period, which make up a total assessment for any VAT period, with regard to each basis for assessment or sum of money. The alternative is that HMRC would be required to apply very many different time limits to the making of the one assessment.

2013. Other than on this point, the Tribunal agrees with the Appellant's submissions regarding period 06/09. The reasons for otherwise agreeing with the Appellant's submission as to period 06/09 can be summarised as follows.

2014. The first stage in the *Pegasus Birds* test is to consider what the facts which, in the opinion Officer Ball, justified the making of the assessment for VAT period 06/09. The second stage is to determine when the last piece of evidence of these facts of sufficient weight to justify making the assessment was communicated to HMRC.

2015. As is set out above in the fact-finding section, the Tribunal has found that by 5 September 2011 Officer Ball had completed and received the endorsement for a means of knowledge submission supporting the denial of input tax on a means of knowledge basis for periods 03/09 and 06/09.

2016. This was an extremely detailed document of 151 pages, the first hundred pages or so rehearsing and analysing the evidence compiled over two years (since August 2009) as to the connection of the Appellant's transactions to fraud and at least thirty pages of which dealt with means of knowledge. It set out the calculation of the sums to be denied and the sums to be assessed for each of periods 03/09 and 06/09.

2017. At this point it is worth noting that the sums to be assessed were calculated as flowing from the returns submitted by the Appellant adjusted by the sums proposed to be denied. When it comes to considering the evidence available for the assessment this is simply the evidence available for the denial of input tax considered together with the Appellant's VAT return.

2018. In his witness statement Officer Ball suggested that the further evidence he relied on which made him form the opinion he had sufficient evidence to raise the assessment of 6

December 2012 was that flowing from his requests of 30 January 2012 and 24 May 2012, namely the evidence contained in the Pinsent Masons report of 21 September 2012.

2019. While the Tribunal accepts that Officer Ball was honestly trying to assist the Tribunal in his evidence, the events in question (taking place between 2009 and 2012) occurred between six and nine years before the hearing (in 2018). On a couple of occasions in cross examination Officer Ball came very close to accepting that his means of knowledge submission 5 September 2011 was evidence of him having the opinion he had sufficient evidence to raise an assessment for period 06/09. That is what it appears to be on the face of the document and the endorsements from his senior officers.

2020. Officer Ball also accepted that with the exception of the July 2009 Westis transactions, all of the facts referred to in the pre-assessment letter (dated 24 May 2012) and the final decision letter (dated 6 December 2012) should have been referred to in the submission. Therefore, addressing the first question in *Pegasus Birds*, the evidence of facts that Officer Ball had assembled and recorded by 5 September 2011 established the basis for connection to fraud and means of knowledge in relation to all the impugned invoices in the period 06/09.

2021. The evidence of facts available to Officer Ball by 5 September 2011 was all that he later relied on to raise the assessment for 06/09 with the exception of the explanation for the Appellant's trading provided in the Pinsent Masons report of 21 September 2012. While he later relied upon this explanation for trading, it was not the evidence of fact which made Officer Ball form the opinion he had sufficient evidence to raise an assessment for period 06/09. He had already formed the opinion he had sufficient evidence to raise an assessment for 06/09 by 5 September 2011. Indeed, if anything Officer Ball rejected the Appellant's later explanation for trading set out in the Pinsent Masons report.

2022. The Tribunal has approached the oral and written evidence of Officer Ball as it has all the witnesses who gave evidence to the Tribunal at the hearing. It has been mindful of the effect of the passage of time on the memories of all witnesses when the hearing took place around nine years after the events in issue occurred. Therefore, the Tribunal has placed considerable weight on the contents of the contemporary documents and communications such as emails prepared between 2009 and 2012.

2023. Notwithstanding the primary reliance on contemporary documents, Officer Ball himself came close to admitting the suggestion in cross examination that by 5 September 2011 he was of the opinion that evidence of fact sufficient to deny input tax for 06/09 (hence raise an assessment) had come to his knowledge.

2024. As with all the witnesses, it is likely that Officer Ball's memory is not likely to be as reliable as the evidence from the contemporary documents. There were various emails in which it appears that Officer Ball or others state or imply he was of the opinion he had sufficient evidence to raise the assessment by 5 September 2011. For example, Officer Ball's emails of 5 and 12 September 2011 and Officer Orr's email of 1 November 2011 regarding Officer Ball having completed his submission except for the July 2009 transactions imply this to be the case (see also Officer Armstrong's endorsement of 30 August 2011).

2025. It is also evidenced by Officer Ball's offer to raise an assessment in his email of 2 April 2012 (before he received any further significant evidence after his September 2011 submission or 30 January 2012 questions and well before receipt of the Pinsent Masons report on which

he now relies) and further references to raising an assessment irrespective of receiving that report in emails on 25 July 2012 and on 17 October 2012.

2026. Further, the conclusion at paragraph 152 of his pre-assessment letter of 24 May 2012 was that he believed he had sufficient grounds to make a means of knowledge denial / assessment but was giving the Appellant an opportunity to provide an explanation in reply – rather than that he needed further evidence before he considered he had sufficient evidence. Again, this was his stated position well before receipt of the Pinsent Masons report.

2027. It appears that Officer Ball understandably received input from other officers in HMRC as to further queries to conduct and to hold off issuing his decision until these were completed (the only query Officer Ball himself initiated was in his email of 1 September 2011 regarding the purchase invoices).

2028. This input from others in HMRC began with Officer Gill's email of 11 October 2011. This is evidenced by Officer Ball having already drafted his 151 page means of knowledge submission containing detailed evidence collected over two years from (August 2009 to August 2011) which detailed the specific transactions, counterparties, dates and calculations for the 06/09 period of denial totalling about £42 million (and consequent assessment of £37 million).

2029. Officer Ball received no substantially fresh evidence in relation to period 06/09 after September 2011 and certainly none that would reasonably tip the balance from believing he had insufficient evidence to raise the assessment to then having sufficient evidence.

2030. The Pinsent Masons report was only mentioned four times in Officer Ball's denial decision of 6 December 2012. There were only two new matters of evidence referred to in the decision letter emanating from the report: – 1) the increase in trade which Officer Ball was already aware of in general terms; and 2) the 3 June 2009 anonymous blog (Officer Ball was already aware of general rumours of fraud). It was not suggested by Officer Ball that these were two pieces of evidence that tipped his state of mind from being one of having made no decision in September 2011 then to be able to make a decision he had sufficient evidence in December 2012.

2031. It is accepted by the Tribunal and the Appellant that the Pinsent Masons report did provide Officer Ball and HMRC with new evidence relevant to the denial/assessment decision for 06/09, particularly regarding the Appellant's belief as to who it was trading with (local consultants). It also provided explanations relevant to the July 2009 Westis transactions (the explanations regarding Epicure etc which are mainly relevant to period 09/09).

2032. However, ultimately, the question is not whether the PM report provided some new evidence of fact which Officer Ball relied on in making his assessment. It did indeed provide some further evidence of fact which he did rely on. That does not answer the question whether he was of the opinion he had sufficient evidence of fact before receipt of the report to make the assessment he did. Officer Ball in evidence and in the emails set out above came close to accepting he did.

2033. Further, the contents of the body of the report was not the evidence that had been requested in Officer Ball's questions of 30 January 2012. The answers to those questions were contained in schedule 2 to the Pinsent Masons report. There were nine questions – the first of which was not relevant to the 06/09 assessment. None of the answers to the remaining eight questions was relied upon in the 6 December 2012 decision and it was not suggested by Officer

Ball that it was the answers to these eight specific questions which changed him from being of the view he had insufficient evidence to having sufficient evidence to raise an assessment regarding period 06/09.

2034. As above, the evidence supports a finding on the balance of probabilities that he was already of that view by 5 September 2011 and before receiving the answers to the questions of 30 January 2012.

2035. The further enquiries Officer Ball made of the Appellant on 30 January 2012 and 24 May 2012 were of a limited nature into this time period and the extra evidence relied upon (the increase in trade, blog report and explanation for the Appellant's trade) derived from the PM report were icing on the cake rather than evidence of fact that converted him to the opinion he had sufficient evidence to raise an assessment.

2036. The Tribunal has found therefore, answering the second question in *Pegasus Birds*, that the last piece of evidence of fact sufficient to raise the means of knowledge denial / assessment for period 06/09 was that received by the end of August 2011 before the production of Officer Ball's 5 September 2011 completed means of knowledge submission.

2037. Officer Ball was entitled to ask for written explanations from CFE of their trading – further to the meeting in 2009 - this was a reasonable and sensible course to take. Moreover, CFE delayed unreasonably in providing answers to HMRC's questions of 30 January 2012 and pre-assessment letter of 24 May 2012 by providing information on 13 July 2012 and the report on 21 September 2012.

2038. However, Officer Ball took the risk that in waiting so long for the replies and not making a decision whether to assess by 5 September 2012 he might be out of time. He took a risk when it is apparent from his 151 page means of knowledge submission of 5 September 2011 he believed he had evidence of fact sufficient to raise the assessment for 06/09. It was fair and reasonable for HMRC to give CFE an opportunity to respond to questions and the pre-assessment letter by 24 May 2012 but Officer Ball should have proceeded to assess by 5 September 2012, within a year of forming the opinion he had sufficient evidence. Officer Ball did not do so until 6 December 2012 – the assessment for 06/09 was therefore out of time.

2039. Further or alternatively for the above reasons, and as the Appellant submits, even if Officer Ball was not of the opinion by 5 September 2011 that he had sufficient evidence to raise the 06/09 assessment which he raised on 6 December 2012, it would be unreasonable for him not to have arrived at this opinion by this time.

2040. Officer Ball's means of knowledge submission, the product of two years of investigation, contained and recorded detailed evidence of fact regarding the connection to fraud for the 06/09 transactions and the Appellant's means of knowledge. It would have been perverse for Officer Ball not to have formed the belief as to the sufficiency of evidence on the preparation of this submission but only upon receipt of the Pinsent Masons report of 21 September 2012.

2041. For the sake of completeness, the Tribunal has taken into account the fact that the denial of input tax and basis for assessment of 6 December 2012 relied on an additional ground to *Kittel* – that the Stratex invoices were invalid. While the means of knowledge submission of 5 September 2011 did not consider this ground separately, it was only focussed on *Kittel*, it is apparent from the facts found above that all the evidence of fact was before Officer Ball by this time upon which he could and should have formed the opinion he could assess on the invalid

invoice basis. His means of knowledge submission contained the details of the evidence of the invalid Stratex invoices, the lack of VRN on the invoices, Stratex's lack of VAT registration, the poor due diligence conducted by the Appellant and the connection of the transactions to fraud. This was all the material upon which Officer Ball relied, on 6 December 2012, when exercising his discretion to refuse to accept alternative evidence.

2042. The Tribunal did not receive any contemporary documents that implied or stated that Officer Ball was of the opinion by 5 September 2011 that he had sufficient evidence of fact to deny input tax / raise an assessment based on the invalidity of the Stratex invoices. It does not appear he gave thought to the invalid invoice ground for denial until he later received advice from other officers. However, the same evidence was available to Officer Ball for denial of input tax on the Stratex invoices on *Kittel* grounds and invalid invoices by 5 September 2011. It would therefore be unreasonable for the Officer not to have come to the opinion that he had sufficient evidence to deny and raise an assessment on the invalid invoice basis for period 06/09 by this time. This is particularly so, when Officer Ball had formed this opinion in relation to the Stratex invoices on the *Kittel* basis.

2043. Officer Birchfield was also of view, expressed both in written documents and in oral evidence, that Officer Ball believed he had sufficient evidence to deny /assess the input tax based on the invalid invoices of Stratex by 5 September 2011 and hence Officer Ball's assessment was out of time.

2044. Further the assessment raised for 06/09 was identical in sum whether input tax was denied on the Stratex invoices on *Kittel* or invalidity grounds. Therefore, to the extent that the denial of input tax for 06/09 and consequent assessment is based on two separate grounds, not only was the evidence available for both identical and sufficient but it would not have affected the opinion as to the sufficiency of the evidence of fact in raising the assessment for 06/09 which was actually raised. Therefore, raising an assessment based on the denial of invalid Stratex invoices in December 2012 was equally out of time.

2045. The Tribunal has concluded that the decision to deny input tax of 6 December 2012 which formed the basis of the assessment, and calculation and notification of the assessment for 06/09 by letter of 3 January 2013 were out of time. It therefore follows that the amendments (reduced after review on 12 April 2013) and supplementary assessment of 25 June 2013, correcting calculations, were also out of time.

2046. In passing, the notification of the final calculation of the amount of tax due for period 06/09 was only made on 29 July 2013. This was outside of the four-year time limit for period 06/09 (under section 77 VATA) but it has not been suggested that this *notification* was the date of the *making* of the final assessment for 06/09 which appears to have been accepted to have been made by 25 June 2013.

2047. The assessment for 06/09, as reduced on review and supplemented, is cancelled.

Period 09/09

2048. The Tribunal is not satisfied that the Appellant has discharged its burden of proof that the assessment for period 09/09 raised on 18 January 2013 was made out of time.

2049. The factual position for this VAT period is rather different. It accepts HMRC's submissions in so far as they relate to this period.

2050. Officer Ball did not complete any means of knowledge submission to deny input tax or raise an assessment for period 09/09 at the time of 5 September 2011 or subsequently.

2051. He did not receive information as to the existence of the Westis trades of July 2009 until August 2011 on receipt of the material from DG Environment. Only after they came to his attention did he then set out about investigating the transactions.

2052. Officer Ball was clear throughout the contemporaneous emails set out above (beginning on 5 September 2011) and his oral evidence that he believed he had insufficient evidence of fact to deny input tax / raise assessments in relation to the July 2009 Westis trades at this time or at all in 2011. The Tribunal accepts this evidence as being credible and reliable.

2053. Officer Ball began his enquiries by asking the Appellant for specific information and evidence regarding the transactions by asking for copies of the purchase invoices (from Westis) by email on 1 September 2011. He received no reply to this email and repeated the request on 30 January 2012 and in the letter of 24 May 2012. The Tribunal accepts Officer Ball's evidence that he was awaiting the evidence sought on 1 September 2011, which was then copied into his requests of 30 January 2012 and 24 May 2012.

2054. He did not receive this information and evidence, the invoices requested, until 13 July 2012 when the Appellant eventually replied to his request first made on 1 September 2011. Copies of the invoices were important evidence of fact regarding the transactions – they provided evidence of the fact of the trade taking place and confirmation of the amounts of VAT charged by the Appellant which could be denied / assessed. The Tribunal accepts that this evidence of fact was believed to be necessary to make an assessment and this belief was reasonable.

2055. Thus, the first time Officer Ball could reasonably have formed the opinion he had sufficient evidence to raise the assessment he later raised for period 09/09 would be 13 July 2012 and the one-year time limit would only begin to run from this date (ie up to July 2013). The assessment in respect of 09/09 was made six months later on 18 January 2013.

2056. The Tribunal further accepts Officer Ball's evidence that he did not hold the opinion he had sufficient evidence of fact to raise the assessment regarding period 09/09 (the Westis transactions of July 2009) until he received the Pinsent Masons report of 21 September 2012. Officer Ball stated he received further relevant information regarding the Westis trades of July 2009 in the Pinsent Masons report of 21 September 2012. The explanation relied on for the Westis, ADE and Epicure invoicing irregularities was evidence of fact he did not previously have and this constituted evidence of fact upon which he relied to support making an assessment as he suggested.

2057. The Tribunal finds as a matter of fact that Officer Ball was of the opinion that the sufficiency of evidence of fact to raise the 09/09 assessment only came to his knowledge on 21 September 2012. Further, the Tribunal finds that this was a reasonable opinion to hold (or reasonable at the very earliest from 13 July 2012). It would not have been reasonable to form the view that there was sufficient evidence of fact to raise an assessment before 13 July 2012. This is for the same reasons set out above.

2058. Thus the 09/09 assessment raised on 18 January 2013, and upheld as a result of the review decision on 12 April 2013, was raised within time. It was made and raised within the four-year

time limit required by section 77 VATA and within the one-year time limit running from 21 September 2012 (or at the earliest by 13 July 2012) as required by section 73(6)(b) VATA.

2059. The assessment for 09/09 is affirmed and upheld.

Conclusion on the Fifth Issue

2060. The Tribunal is satisfied that the Appellant has discharged the burden of demonstrating that the assessment for the period 06/09, based on the 6 December 2012 decision to deny input tax and calculated and notified on 3 January 2013, was made outside the statutory time limit provided under section 73(6)(b) VATA. Therefore, the assessment under appeal for period 06/09, (originally in the sum of £29,575,465.50, reduced by virtue of the review on 12 April 2013 and supplemented on 25 June 2013), in the sum of £1,665,779.88 is cancelled. Had this assessment been made in time it would have been reduced further by a sum of £245,890.94 following the Tribunal's conclusion on the denial of input tax in respect of *Kittel* for period 06/09.

2061. The Tribunal is satisfied that the assessment for period 09/09, made on 18 January 2013 and upheld on review on 12 April 2013, was made within the statutory time limits of section 77 and section 73(6)(b) VATA. This assessment in the sum of £1,322,800.16 for period 09/09 is upheld and affirmed.

Conclusion on all issues and disposal of the appeal

2062. The appeal is allowed in part.

2063. The Tribunal concludes as follows:

a) On the First Issue, HMRC's denial of £5,605,119.74 input tax claimed by CFE on seventeen invalid VAT invoices from Stratex conformed with the Principal VAT Directive. The invoices failed to satisfy the formal conditions under the Directive and Regulation 14 VATR which require a VAT Registration Number to be recorded on the invoices. On the facts of this case, there was no directly effective right under the Directive to recover input tax based only upon the Stratex transactions satisfying the substantive conditions for the charge of VAT;

b) On the Second Issue, HMRC acted reasonably in denying input tax on the invalid Stratex invoices when exercising the discretion to refuse to accept alternative evidence. HMRC's denial of £5,605,119.74 input tax for period 06/09 is upheld as a result of the determination on the First and Second issues;

c) On the Third Issue, although CFE (and hence the Appellant) did not know, it should have known from 15 June 2009 that its transactions between 15-18 June 2009 with AHMD and 28-29 July 2009 with Westis were connected to the fraudulent evasion of VAT. CFE / the Appellant did not know and should not have known that its transactions with Stratex between 18 May and 3 June 2009 and with GWDeals, Mettec/Ayres and AHMD between 8 and 10 June 2009 were connected with fraud. As a result of the determination on the Third Issue HMRC's denials of £557,001.50 input tax for period 06/09 and £1,322,800.16 for period 09/09 are upheld on the basis of the principle in *Kittel*.

d) As a result of determining the first three issues, the total denial of input tax upheld for period 06/09 is £6,162,121.24 and for 09/09 is £1,322,800.16 (a total of £7,484,921.40 input tax denied for both periods).

e) On the Fourth Issue, there was a valid assessment in law for period 06/09 made on the basis of HMRC's denial of input tax decision of 6 December 2012, which was calculated and notified by their VAT return adjustment letter dated 3 January 2013;

f) On the Fifth Issue, HMRC's assessment for period 06/09, as reduced and supplemented totalling £1,665,779.88, was made outside the statutory time limit provided under section 73(6)(b) VATA so is cancelled. The assessment for period 09/09 in the sum of £1,322,800.16 was made within the statutory time limits, is affirmed and upheld.

2064. This document contains full findings of fact and reasons for the decision. Any party dissatisfied with this decision has a right to apply for permission to appeal against it pursuant to Rule 39 of the Tribunal Procedure (First-tier Tribunal) (Tax Chamber) Rules 2009. The application must be received by this Tribunal not later than 56 days after this decision is sent to that party. The parties are referred to "Guidance to accompany a Decision from the First-tier Tribunal (Tax Chamber)" which accompanies and forms part of this decision notice.

TRIBUNAL JUDGE
RUPERT JONES

RELEASE DATE: 05 MARCH 2019