

**COURT OF APPEAL DISAGREES WITH MANY HMRC ARGUMENTS**

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**Overleaf:**

Court of Appeal discussion points.

**The HMRC Application of Kittel Has Been Too Wide**

The Court of Appeal heard the joined cases of Mobilx, Calltell and Blue Sphere Global between 15 and 19 February 2010. The Judgement may be handed down as early as the middle of March 2010 and significant benefits are likely to be felt by many traders.

We would add caution to this statement, as the comments made by the Judges throughout the hearing may not all appear in the actual Judgement. What will happen, though, is that the Court of Appeal will consider all previous European and UK case law and provide detailed guidance to the Tribunal who, so far, have simply agreed with nearly every approach adopted by HMRC. The resulting legal precedent will be central to all current and future appeals.

Anyone who was present during the 5-day hearing would have felt a shift in favour of traders, but how far the court swings towards traders is difficult to predict.

In very general terms the following arguments were heard:

**1. Does Kittel allow HMRC to target those who have not purchased directly from a fraudster?**

We believe that only if you have purchased from a fraudster can the question of knowledge, or means of knowledge, be asked. If you are an exporter who purchased from a legitimate supplier, you have a good chance of success, if what was heard in court is to be believed.

**2. Will the Tribunal simply now say that your supplier is a fraudster to overcome this hurdle?**

This is an important issue in every case. If the Tribunal can simply say, "fine, we will just find everyone to be a fraudster", traders will be in no better position. There are, however, some reasons why the Tribunal's hands may be tied, see below. It may also be that the court rules that only if you purchase directly from the missing trader at the start of the supply chain, can you lose and, therefore, the courts interpretation of Kittel is extremely important.

## Next Edition:

Reaction to Court of Appeal Judgement.

### 3. **Can a Tribunal find a trader to be a fraudster if it is not inserted into the Commissioners' Statement of Case?**

The simple answer is no, as this has been dealt with in Dempster (2007) and Mobilx (2009) in the High Court and, importantly, in the Tribunal decision in POWA (Jersey) Limited (December 2009). We do not believe the court will find against the current case law. We believe that HMRC will have significant difficulties in winning many cases if they rely on a Tribunal finding that a company is a fraudster, when it has not been pleaded in the Statement of Case. HMRC appear to have forgotten the importance of such a document, as was seen in the above cases, and the Tribunal has only now seen the strength in this argument.

### 4. **Can a Tribunal find a trader, who is not in court to defend itself, a fraudster, or knowing participant?**

This is extremely interesting when you consider that you will, in all probability, need to be purchasing directly from the fraudster to lose. The court appeared uncomfortable with the proposition that a Tribunal could find a contra trader, or supplier, or anyone for that matter, to be a fraudster when they are not there to defend themselves. If the court rules that this cannot happen, then this will cause HMRC problems.

### 5. **Should the traders be able to rely on legal certainty, i.e. do you need to fully understand the law, its implications and be able to foresee events?**

Most traders were aware that Joint and Several Liability was the tool that HMRC had to combat fraud and this would mean that all companies in the supply chain would be liable and tax losses could be recovered from all companies in the supply chain. A Court of Appeal Judge stated that it was "grossly unfair" to target just the exporter. It is possible that the court will find that Joint & Several Liability should have been used in all current appeals.

### 6. **Is it more than just unfair that HMRC target only exporters, or is it also disproportionate and discriminatory?**

Counsel for the Commissioners stated that it is irrelevant whether it is unfair or not, because the law states that if you knew, or should have known, of a fraud connected with your transactions then you automatically lose your right to reclaim the VAT, whether action is

taken against others, or not. How sympathetic the court was to this issue was difficult to gauge, but they showed concern to say the least.

**7. Why was criminal action not taken in view of the serious allegations of conspiracy?**

The court appeared to believe that HMRC had overstepped the mark with this civil action and that most of the allegations amounted to a criminal act that should (or at least could) result in criminal prosecutions in a Crown Court, not civil action in a Tribunal. The court specifically pointed at contra trading cases and appeared sure that these are conspiracy allegations that should be dealt with criminally.

**8. If, through knowledge of a connection to a fraud, a trader automatically loses its right to reclaim VAT, why have the suppliers and other buffers not automatically lost their right to reclaim VAT on *their* purchases?**

This was an important point that was raised by the court and which HMRC could not reasonably explain. The court seemed surprised that HMRC identified fraud at the beginning of the supply chain, no fraud in the middle and then fraud again at the end by the alleged knowing exporter.

**9. What is it exactly that someone is supposed to know?**

The court challenged the whole concept of knowledge. Traders stand accused of having actual knowledge of the fraud, yet counsel for the Commissioners suffered extreme embarrassment when asked what it is that someone is supposed to know. Counsel for the Commissioners had to be helped by HMRC policy and a short break was requested during some aggressive questioning by the Judges on this and other related matters. The position was no better after the break, which significantly weakened their case.

So far, the Tribunal's have taken the view that they can say a trader knew of a fraud, simply because of the way it traded, without the trader knowing anything of the fraud itself. The Commissioners, fearful that they can only win if a trader has purchased directly from a fraudster, attempted to bring that fraud to the exporter's doorstep. The Commissioners case was a moveable feast and they stated at one point that the fraud does not necessarily have to be a large scale fraud

involving the stock purchased by the exporter, but that it could simply be any fraud perpetrated by the freight forwarder, or inspection, company or bank. The suggestion that a trader can lose millions of pounds simply because a freight forwarder does not pay the VAT charged on its invoices, is nonsense. An argument, we hope we can safely put in the “desperate” category.

### **Key Points in Court and Discussion Points:**

1. Kittel is very likely to only apply to those purchasing directly from a fraudster and companies who have lost in Tribunal only because they should have known, such as Mobilx and Olympia should ultimately succeed. It is unclear whether those already found to be actual participants in the fraud will also succeed in appeal, such as Calltell.
2. It means that it doesn't matter how much you have been told of fraud specifically in your supply chain, unless you purchased directly from a fraudster and had actual knowledge of the fraud, you will succeed. However, until more is known about the Judgement it is difficult to say if this will be a sweeping success for most. We do not think that there will be an automatic victory for all traders per se, and it depends how much freedom the Court of Appeal will give the Tribunal. What is for sure is that the Court of Appeal did not like how HMRC had approached this issue at all.
3. The court reiterate what the Chancellor of the High Court in Blue Sphere Global said in May 2009, namely that it is not good enough to know that there *might* be a fraud connected to your transactions; you have to know that it is fraud. The Court of Appeal explained the magnitude of HMRC's task by adding that it is not even good enough for a trader to be almost certain that its transactions would be connected with fraud, they had to know without doubt. The court had difficulty in understanding how HMRC can prove someone had such knowledge without direct evidence. This causes HMRC real difficulties and Blue Sphere should be referred to in every Tribunal appeal in this manner.

Having sat through the Court of Appeal hearing, we can provide further information, thoughts and explanations if will assist your current position.

If you have any questions at all, please contact us at any time, whether you wish to use our services, or not. It is important that all traders have the right advice at this time.