[2009] UKFTT 242 (TC)

TC00191

Appeal number LON/2007/1765

VAT – MTIC fraud – input tax – whether the purchases by the Appellant in the identified 8 deals were "connected with fraudulent evasion of VAT" as per Axel Kittel at para. [61] – held yes – whether the Appellant was a taxable person who knew or should have known that by its purchase it was participating in a transaction "connected with fraudulent evasion of VAT" – held yes, as to both means of knowledge (should have known) and actual knowledge (knew) – whether there was any need for a reference to the ECJ on a possible application of the Community law principle of equality – held no – Appeal dismissed – Costs awarded to HMRC

FIRST-TIER TRIBUNAL
TAX CHAMBER

4 DISTRIBUTION LIMITED **Appellant**

- and -

THE COMMISSIONERS FOR HER MAJESTY'S REVENUE AND CUSTOMS (*Value Added Tax*) **Respondents**

TRIBUNAL: JOHN WALTERS QC
SANDI O'NEILL

Sitting in public (as the VAT and Duties Tribunal) in London on 10-13, 16-20 and 25-27 March 2009

The Appellant did not appear and was not represented

Philip Singer QC, Rory Dunlop and Peter Mant, Counsel, instructed by the General Counsel and Solicitor to HM Revenue and Customs for the Respondents

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DECISION

Introductory – direction to hear the appeal in the absence of the appellant pursuant to rule 26(2) of the VAT Tribunals Rules 1986

1. This Tribunal made a Decision on a preliminary issue in this appeal (our "Preliminary Issue Decision"), which was released on 20 January 2009. As recorded in the first paragraph of our Preliminary Issue Decision, there had been a Directions hearing in this appeal, held on 17 October 2008. Directions made at that hearing and released on 21 October 2008 included directions fixing the hearing of the substantive appeal to begin on 9 March 2009 and to end on 27 March 2009 (15 hearing days). At the request of the parties the first hearing day (9 March 2009) was taken by the Tribunal as a reading day. The Tribunal assembled at the hearing venue to hear the substantive appeal for the first time on the morning of 10 March 2009.

2. Before the appeal was called on for hearing on that day, at the request of both of them, we received Mr. Andrew Young, Counsel for 4 Distribution Limited ("the Appellant"), and Mr. Philip Singer QC, Leading Counsel for the Respondent Commissioners ("HMRC") in our retiring room. Mr. Young stated that the Appellant was unable to finance legal representation at the hearing, and that his junior counsel had recently withdrawn from the case because of non-payment of his fees. He also said that the Appellant was exploring the possibility of HMRC releasing sufficient of the reclaimed input tax withheld – the subject matter of the appeal – to fund the Appellant's representation in the appeal.

3. Mr. Singer said that this matter had already been raised with HMRC and a request for such a release had been refused. He commented that the difficulty had been raised at a very late stage increasing the inconvenience.

4. The Chairman of the Tribunal noted what had been said and stated that the Tribunal was in no position to concern itself with HMRC's decision on the Appellant's request. He went on to point out that it was open to the Tribunal to hear the appeal in the absence of the Appellant under rule 26(2) of the VAT Tribunals Rules 1986 ("the Rules") – which applied at the time of the hearing.

5. Subsequently we received both counsel again, and, this time, the instructing solicitors also. Mr. John Ioannou of Messrs. Devereaux, Solicitors for the Appellant (and no relative of Mr. Vladimir Ioannou ("VI") a director of the Appellant) stated that his firm was unable to accept the commitment to fund the appeal hearing without payment from the Appellant or HMRC and requested us to adjourn the hearing of the appeal pending legal proceedings for judicial review of HMRC's refusal to release sufficient of the reclaimed input tax withheld to fund the Appellant's representation in the appeal.

6. We indicated that we were minded not to adjourn or postpone the appeal.

7. At a third meeting, we again received both counsel and instructing solicitors. We were informed by Mr. John Ioannou that Mr. Young and his firm would withdraw from the appeal if no adjournment was granted. He also said that the Appellant would make an emergency judicial review application and informed the Tribunal that the Appellant (which we understood to mean effectively VI, and also Iveta Nemcova ("IN") a director of and the sole shareholder in the Appellant) would not appear because the appeal was too complex a matter for lay representation. (It transpired that VI and IN also did not make themselves available for cross-examination.)

8. The matter was then adjourned into open court, where Mr. Young, on behalf of the Appellant formally made an application to adjourn the appeal. Mr. Singer opposed the application – reluctantly, because he recognised that it was highly unfortunate that the Appellant should be unrepresented at the hearing of the appeal – because of the lateness of the application and the remote likelihood of the Appellant being successful in the contemplated judicial review application.

9. The Tribunal ruled (and later directed) that the application for an adjournment was refused and the Tribunal would, in the circumstances, proceed to hear the appeal in the absence of the Appellant pursuant to rule 26(2) of the Rules.

10. In reaching its conclusion on the application the Tribunal had weighed the general desirability of granting an adjournment (as a means of possibly eventually having the benefit of legal representation of the Appellant at the hearing of the appeal) against the certain inconvenience to the Tribunal and to HMRC (including wasted costs) of adjourning a 3-week fixture indefinitely at the last moment. The Tribunal had regard to its own view (concurred in by Mr. Singer) that the contemplated judicial review application was most unlikely to be successful and, particularly, to the safeguard provided by rule 26(3) of the Rules under which a party has the opportunity to apply to the tribunal for it to consider setting aside a decision or direction given in that party's absence on such terms as the tribunal thinks just.

The appeal

11. The Appellant, by VI, as director, appealed to the Tribunal against the decision of HMRC, contained in a letter dated 5 October 2007 sent on behalf of HMRC MTIC Central Enquiry Hub by Mrs. B Thakker, the case officer, to the Appellant, denying the Appellant's right to deduct the input tax claimed of £731,867.50 for period 05/06 and £523,600.00 for period 06/06.

The input tax claimed

12. The input tax in issue for period 05/06 relates to 6 deals carried out by the Appellant and the input tax in issue for period 06/06 relates to 2 deals carried out by the Appellant. The details are as follows:

05/06 (May 2006)

Deals 1 and 2 re: purchases by the Appellant from Owl Ltd. ("Owl") of 800 Nokia 9300i phones and 1,000 Nokia 91 phones respectively. The input tax claimed in respect of these deals by the Appellant was £110,180.

Deals 3 and 4 re: two purchases by the Appellant from Owl of 2,000 Nokia 8800 phones respectively. The input tax claimed in respect of these deals by the Appellant was £270,900.

Deals 5 and 6 re: purchases by the Appellant from Owl of 4,500 Nokia 8800 phones and 1,000 Nokia 9300i phones respectively. The input tax claimed in respect of these deals by the Appellant was £350,787.

06/06 (June 2006)

Deal 1A re: purchase by the Appellant from Owl of 4,000 Nokia 8800 phones; and

Deal 1B re: purchase by the Appellant from Grovner Trading Ltd. ("Grovner Trading") of 4,000 Nokia 8800 phones.

The input tax claimed in respect of deals 1A and 1B (taken together) by the Appellant was £523,600.

13. The phones purchased in deals 1, 2, 3 and 4 (of May 2006) were onsold by the Appellant to Dantec Enterprises SL ("Dantec") (a Spanish entity). The phones purchased in deals 5 and 6 (of May 2006) were onsold by the Appellant to Evolution SARL ("Evolution") (a French entity). The phones purchased in deals 1A and 1B (of June 2006) were onsold by the Appellant to Dantec.

14. We mention at this point that HMRC in argument stated that (although their case was that on the face of the papers there were transactions which would give rise to a right to deduct input tax, subject to the *Kittel* point – see: below) it was consistent with their case, and possible, that these deals were fictitious in the sense that no phones were in reality bought or sold. However, having regard to the evidence before the Tribunal, we indicated that we proposed to deal with the case on the basis that the transactions were real transactions (and we so find), and Mr. Dunlop, for HMRC, said in response that HMRC would not object to that.

The *Kittel* point

15. We explained the *Kittel* point in our Preliminary Issue Decision, when setting out the context in which the preliminary issue arose. We repeat here the relevant passage from our Preliminary Issue Decision:

> 4. The appeal is against HMRC's refusal to make payment(s) of the amount(s) of the credit for input tax which the Appellant claims is allowable under section 26 Value Added Tax Act 1994 ("VATA") for the

monthly VAT accounting periods 05 and 06 of 2006. The Appellant claims to be entitled to such payment(s) under section 25 VATA.

5. HMRC's refusal to make the payment(s) claimed is based on their interpretation of the single judgment of the ECJ in the joined cases of *Axel Kittel v État Belge* (C-439/04) and *État Belge v Recolta Recycling SPRL* (Case C-440/04) – hereinafter "*Kittel*" – at paragraph 61, which is as follows:

> "… where it is ascertained, having regard to objective factors, that the supply [in relation to which credit for input tax is claimed] 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."

6. HMRC's case is that the Appellant knew or should have known that, by its 8 identified transactions for the purchase of Nokia mobile telephones in May and June 2006, almost all from a purchaser called Owl, but also from a purchaser called Grovner Trading, it (the Appellant) was participating in transactions connected with fraudulent evasion of VAT. We refer in this Decision to the state of fact where a taxable person, who receives a supply by purchasing goods, knew or should have known that, by his purchase, he was participating in a transaction connected with the fraudulent evasion of VAT, as that taxable person's "objective knowledge" of his participation in the fraud. Obviously, we intend the term "objective knowledge", so used, to include actual or subjective knowledge.

7. This case is a type of MTIC fraud case – that is, a type of "Missing Trader Intra-Community fraud" case. HMRC have investigated the chains of transactions of sale and purchase of the mobile telephones which include the Appellant's purchases, and their investigations have shown that all the relevant chains of transactions include intra-Community imports into the UK of the mobile telephones and onward domestic supplies of them by entities which have defaulted on their obligations to account to HMRC for the output VAT due on those onward domestic supplies ("Defaulters"). (These Defaulters are "missing traders" involved in intra-Community trade and, clearly, have fraudulently evaded VAT.)

8. The Appellant does not deny that its purchases feature in chains of transactions which included intra-Community imports into the UK by Defaulters. Its case on the substantive *Kittel* issue is that it neither knew nor should have known that, by its purchases, it was participating in transactions connected with fraudulent evasion of VAT. That is, the Appellant denies objective knowledge of the fraud.

The issues for the Tribunal's determination

16. The issues for the Tribunal's determination in the appeal, all of which were addressed by HMRC at the hearing, are:

1. Were the purchases by the Appellant in the identified 8 deals "connected with fraudulent evasion of VAT" in the sense of that phrase as it was used by the ECJ in *Kittel* at [61]?

2. If and to the extent that they were, was the Appellant "a taxable person who knew or should have known that, by [its] purchase, [it] was participating in a transaction connected with fraudulent evasion of VAT" in the sense of that phrase as it was used by the ECJ in *Kittel* at [61]?

3. If and to the extent that it was, is there any need for a reference to the ECJ? (This third issue picks up a point which we left open at paragraphs [68] and [69] of our Preliminary Issue Decision.)

The evidence

17. The Tribunal had before it at the start of the hearing of the appeal witness statements (with numerous exhibits) from the following witnesses on behalf of HMRC: Roderick Stone, John Fletcher, Bhavna Thakker (the case officer), Russell Hall, Timothy Reardon, Paul Fisher, Susan Okolo, Malcolm Orr, John McPartlin, David Maud, Kyle Martin, Robert Ross and Terence Mendes. All these witnesses attended to give oral evidence. There was a witness statement from Jill Evans. She did not attend to give oral evidence and the Tribunal did not read her statement. In addition, we heard evidence on behalf of HMRC from George Moses-Ogbona.

18. The Tribunal had before it at the start of the hearing of the appeal witness statements (with exhibits) from the following witnesses on behalf of the Appellant: Iveta Nemcova (IN), Vladimir Ioannou (VI), Martinos Martoudes, Costas Papathanasiou and Ian Masih. These included a witness statement termed a "Reply Statement to John Fletcher" made by VI and dated 3 March 2009.

19. A second witness statement made by IN, dated 11 March 2009 and a further witness statement by VI dated 11 March 2009 termed "Second Witness Statement of Vladimir Ioannou" (with exhibits) were sent to the Tribunal after the hearing of the appeal in the absence of any representation of the Appellant had started. In fact these documents were delivered to our clerk just before the conclusion of the proceedings on the third day of the hearing (12 March 2009). After consideration, Counsel for HMRC did not object to our receiving this late evidence and we decided to do so.

The first issue

20. The first issue is: were the purchases by the Appellant in the identified 8 deals "connected with fraudulent evasion of VAT" in the sense of that phrase as it was used by the ECJ in *Kittel* at [61]?

21. We did not understand the Appellant to contend that its purchases in the identified 8 deals were *not* connected with fraudulent evasion of VAT in the relevant sense.

22. As indicated in paragraph 8 of our Preliminary Issue Decision (reproduced above), at the hearing of the preliminary issue in early November 2008 the Appellant (then represented by Counsel) did not deny that its purchases featured in chains of transactions which included intra-Community acquisitions into the UK by entities (Defaulters) which have defaulted on their obligations to account to HMRC for the output VAT due on onward domestic supplies of phones made by them.

23. Nevertheless, HMRC adduced evidence of the chains of transactions in which the purchases in issue featured. Each one of them included a Defaulter whose non-payment of the output VAT due from it constituted a tax loss suffered by the UK revenue and, we find, a fraudulent evasion of VAT. On this issue the burden of proof is on HMRC and we find that they have discharged it. The standard of proof which we have required is the normal civil standard of the balance of probabilities. We were referred by HMRC to *In re B (Children) (Care Proceedings: Standard of Proof) (CAFCASS intervening)* [2009] 1 AC 11 on the issue of the burden and standard of proof and we have endeavoured to apply the guidance given in the speeches in that case.

24. In that case at [15] Lord Hoffmann said:

> "There is only one rule of law, namely that the occurrence of the fact in issue must be proved to have been more probable than not. Common sense, not law, requires that in deciding this question, regard should be had, to whatever extent appropriate, to inherent probabilities. If a child alleges sexual abuse by a parent, it is common sense to start with the assumption that most parents do not abuse their children. But this assumption may be swiftly dispelled by other compelling evidence of the relationship between parent and child or parent and other children. It would be absurd to suggest that the tribunal must in all cases assume that serious conduct is unlikely to have occurred. In many cases, the other evidence will show that it was all too likely."

25. In judging whether HMRC have discharged the burden upon them to the standard required we have taken the view, on the basis of Officer Stone's evidence in particular – to which we make more detailed reference below – that in the context of "back to back" transactions in the wholesale trade in mobile phones in the "grey" market in the year 2006, chains of transactions linked to, or connected with, fraudulent evasion of VAT were inherently probable.

26. Our findings in relation to the details of the relevant Defaulters are as follows:

05/06 (May 2006)

Deal 1: (800 Nokia 9300i phones) – these were acquired into the UK in part (as to 500 units) by an entity called Tressle, from an entity called Macdelta, established in Cyprus, and in part (as to 300 units) by an entity called Causeway Initiatives from an unidentified source.

There is an unpaid VAT assessment issued against Tressle in the amount of £9,915,425.66 in respect of an unidentified period. However the assessment is dated 5 June 2006 and Tressle was the subject of a direction by HMRC dated

16 May 2005 under regulation 25(1)(c) of the VAT Regulations 1995, changing the end of its VAT period commencing on 1 March 2006 from 31 May 2006 to 16 May 2006 and changing the due date for payment of VAT from 30 June 2006 to 17 May 2006. It is therefore clear, and we so find, that the assessment is for the period from 1 March 2006 to 16 May 2006. The assessment has not been appealed.

Tressle's VAT registration was cancelled with effect from 17 May 2006 because HMRC were satisfied that it had been a willing participant in trade in relation to which it had no intention of accounting for the VAT charged on invoices. Included in the working papers supporting the figure of £9,915,425.66 VAT due is a purchase order from Park Supplies Ltd. ("Park Supplies"), which we accept relates to phones in the deal 1 chain.

The evidence of Officer Susan Okolo, which we accept, is that Tressle sold phones without payment having been received from customers.

Although HMRC did not exhibit transaction paperwork for Tressle, one of the sources of phones in deal 1, there was in evidence a payment instruction relating to the sale by Tressle's customer, Park Supplies, to Performance Specifications Ltd. ("PS") for PS to pay £701,750 to Macdelta and £2,663 to Park Supplies. We find that such payments were made by PS bypassing Tressle, and that therefore Tressle did not receive any or any significant payments in relation to its sales in the deal 1 chain.

Causeway Initiatives also did not receive payment for its supply of phones in the deal 1 chain. The evidence of Officer Russell Hall as to his examination and analysis of data obtained by HMRC from the Netherlands relating to the First Curacao International Bank ("FCIB"), with which the Appellant and many other entities featuring in this appeal had sterling accounts, satisfied us that substantially all of the payment was diverted by Fonedealers, a buffer in the chain, to Intertech Sarl, an entity not in the deal 1 chain of supply of goods, and from Intertech Sarl to Dantec Enterprises (the Appellant's customer).

Causeway Initiatives is, according to the evidence of Officer Paul Fisher, which we accept, a missing trader against which VAT assessments for undeclared sales eventually totalling £22,900,000 have been made. The assessments have neither been paid nor appealed.

We accept the evidence of Mrs. Thakker, the case officer, that she had traced 300 of the units supplied to the Appellant by Owl in deal 1 back to a supply by Causeway Initiatives to Realtech Distribution, the first buffer in the chain leading from Causeway Initiatives to the Appellant, *via* entities called Fonedealers, Worldwide Export and Mana Enterprises (and Owl). We also accept her evidence that she had traced the remaining 500 units back (*via* PS and an entity called High Speed Business (and Owl) to the supply by Tressle to Park Supplies referred to above.

On the basis of this evidence we find that the purchase by the Appellant of 800 Nokia 9300i phones from Owl in deal 1 was "connected with fraudulent evasion of VAT" in the sense of that phrase as it was used by the ECJ in *Kittel* at [61]. The relevant fraudulent evasion was committed by the two Defaulters, Tressle and Causeway Initiatives.

Deal 2: (1,000 Nokia N91 phones) – these were acquired into the UK by Causeway Initiatives. As in relation to deal 1, Causeway Initiatives did not receive payment for its supply of phones in the deal 2 chain. Again, the evidence of Officer Russell Hall as to his examination and analysis of the FCIB data satisfied us that substantially all of the payment was diverted by Fonedealers, a buffer in this chain also, to Intertech Sarl, and from Intertech Sarl to Dantec Enterprises.

As noted above, Causeway Initiatives is a missing trader.

We accept the evidence of Mrs. Thakker, the case officer, that she had traced the 1,000 units supplied to the Appellant by Owl in deal 2 back to a supply by Causeway Initiatives also, like its supply in the deal 1 chain, to Realtech Distribution, but this time *via* the entities called Fonedealers, Kingfisher Traders and Mana Enterprises.

On the basis of this evidence we find that the purchase by the Appellant of 1,000 Nokia N91 phones from Owl in deal 2 was also "connected with fraudulent evasion of VAT" in the sense of that phrase as it was used by the ECJ in *Kittel* at [61]. The relevant fraudulent evasion was committed by Causeway Initiatives.

Deal 3: (2,000 Nokia 8800 phones) – these were acquired into the UK by Causeway Initiatives from an entity called PZP Ena, established in Slovenia. As in relation to deals 1 and 2, Causeway Initiatives did not receive payment for its supply of phones in the deal 3 chain. Again, the evidence of Officer Russell Hall as to his examination and analysis of the FCIB data satisfied us that substantially all of the payment was diverted by Fonedealers, a buffer in this chain also, to Intertech Sarl, and from Intertech Sarl to Dantec Enterprises.

As noted above, Causeway Initiatives is a missing trader.

We accept the evidence of Mrs. Thakker, the case officer, that she had traced the 2,000 units supplied to the Appellant by Owl in deal 3 back to a supply by Causeway Initiatives also to Realtech Distribution and this time *via* Fonedealers, Kingfisher Traders and Mana Enterprises.

On the basis of this evidence we find that the purchase by the Appellant of 2,000 Nokia 8800 phones from Owl in deal 3 was also "connected with fraudulent evasion of VAT" in the sense of that phrase as it was used by the ECJ in *Kittel* at [61]. The relevant fraudulent evasion was committed by Causeway Initiatives.

Deal 4: (2,000 Nokia 8800 phones) – these also were acquired into the UK by Causeway Initiatives from PZP Ena. As in relation to deals 1, 2 and 3, Causeway Initiatives did not receive payment for its supply of phones in the deal 4 chain. Again, the evidence of Officer Russell Hall as to his examination and analysis of the FCIB data satisfied us that substantially all of the payment was diverted by Fonedealers, a buffer in this chain also, to Intertech Sarl, and from Intertech Sarl to Dantec Enterprises.

As noted above, Causeway Initiatives is a missing trader.

We accept the evidence of Mrs. Thakker, the case officer, that she had traced the 2,000 units supplied to the Appellant by Owl in deal 4 back to a supply by Causeway Initiatives also to Realtech Distribution, this time *via* Fonedealers, Worldwide Export and Mana Enterprises.

On the basis of this evidence we find that the purchase by the Appellant of 2,000 Nokia 8800 phones from Owl in deal 4 was also "connected with fraudulent evasion of VAT" in the sense of that phrase as it was used by the ECJ in *Kittel* at [61]. The relevant fraudulent evasion was committed by Causeway Initiatives.

Deal 5: (4,500 Nokia 8800 phones) – these were acquired into the UK by an entity apparently called Teknik from an entity called Premisten, established in Estonia. We accept the evidence of Officer Malcolm Orr that the particulars of the genuine trading entity called Teknik Ltd. had been hi-jacked or cloned (fraudulently misappropriated and used) in connection with an acquisition of around 14,800 phones from Premisten sometime before 5 June 2006. The VAT registration was cancelled with effect from that date. Assessments of undeclared tax amounting to well over £5 million were raised against the hijacked registration. These assessments have not been paid.

Neither Teknik, nor any entity purporting to be Teknik by means of a hijacked registration received any payment for the supply of phones in the deal 5 chain which was purportedly made by Teknik. Again, the evidence of Officer Russell Hall as to his examination and analysis of the FCIB data satisfied us that substantially all of the payment was diverted by Fonedealers, a buffer in this chain also, to Intertech Sarl.

We accept the evidence of Mrs. Thakker, the case officer, that she had traced the 4,500 phones supplied to the Appellant by Owl in deal 5 back to a supply by the entity using the hijacked Teknik registration to Info Tel Communications *via* Fonedealers, Worldwide Export and Kingfisher Traders, and Mana Enterprises.

On the basis of this evidence we find that the purchase by the Appellant of 4,500 Nokia 8800 phones from Owl in deal 5 was also "connected with fraudulent evasion of VAT" in the sense of that phrase as it was used by the

ECJ in *Kittel* at [61]. The relevant fraudulent evasion was committed by the entity using the hijacked Teknik VAT registration.

Deal 6: (1,000 Nokia 9300i phones) – these were acquired into the UK by an entity called Udeil Solutions from Macdelta. We accept the evidence of Officer John McPartlin that Udeil Solutions became a missing trader for these purposes, that it was deregistered for VAT with effect from 8 June 2006 and an assessment for over £6 million VAT has been made against it, which has gone unpaid.

Udeil Solutions did not receive any payment for the supply of phones in the deal 6 chain. Again, the evidence of Officer Russell Hall as to his examination and analysis of the FCIB data satisfied us that substantially all of the payment was diverted by Performance Specifications, a buffer in this chain, to Macdelta, the supplier to Udeil Solutions. That consideration, or almost all of it, found its way to Dantec Enterprises.

We accept the evidence of Mrs. Thakker, the case officer, that she had traced the 1,000 Nokia 9300i phones supplied to the Appellant by Owl in deal 6 back to a supply by Udeil Solutions to an entity called Novafone (UK) *via* PS and an entity called Xcel Solutions .

On the basis of this evidence we find that the purchase by the Appellant of 1,000 Nokia 9300i phones from Owl in deal 6 was also "connected with fraudulent evasion of VAT" in the sense of that phrase as it was used by the ECJ in *Kittel* at [61]. The relevant fraudulent evasion was committed by Udeil Solutions.

06/06 (June 2006)

Deal 1A: (4,000 Nokia 8800 phones) – these were acquired into the UK by an entity apparently called J.D. Telecom UK from an entity called Amex FHU, established in Poland (which was likely also to have been a hijacked registration). We accept the evidence of Officer David Maud that the particulars of the genuine trading entity called J.D. Telecom UK had been hi-jacked or cloned (fraudulently misappropriated and used). The VAT registration was cancelled with effect from 3 July 2006. Assessments of undeclared tax amounting to almost £7 million were raised against the hijacked registration. These assessments have not been paid, nor have they been appealed.

Neither J.D. Telecom UK, nor any entity purporting to be J.D. Telecom UK by means of a hijacked registration received any payment for the supply of phones in the deal 1A chain which was purportedly made by J.D. Telecom UK. Again, the evidence of Officer Russell Hall as to his examination and analysis of the FCIB data satisfied us that substantially all of the payment was diverted by an entity called AW Associates, a buffer in this chain also, to Amex FHU (or an entity purporting to be Amex FHU), the supplier to the

entity purporting to be J.D. Telecom UK. That consideration, or almost all of it, found its way to Dantec Enterprises, which had supplied the phones to Amex FHU (or the hijacker using Amex FHU's registration)..

We accept the evidence of Mrs. Thakker, the case officer, that she had traced the 4,000 Nokia 8800 phones supplied to the Appellant by Owl in deal 1A back to a supply by the entity using the hijacked J.D. Telecom UK registration to Atlantic Catering, *via* AW Associates, Xcel Solutions (and Owl).

On the basis of this evidence we find that the purchase by the Appellant of 4,000 Nokia 8800 phones from Owl in deal 1A was also "connected with fraudulent evasion of VAT" in the sense of that phrase as it was used by the ECJ in *Kittel* at [61]. The relevant fraudulent evasion was committed by the entity using the hijacked J.D. Telecom UK VAT registration.

Deal 1B: (4,000 Nokia 8800 phones) – these were also acquired into the UK by the entity apparently called J.D. Telecom UK from Amex FHU (which, as stated above, was likely also to have been a hijacked registration). Also as stated above, we accept the evidence of Officer David Maud that the particulars of the genuine trading entity called J.D. Telecom UK had been hijacked or cloned, the VAT registration cancelled and unpaid and unappealed assessments of undeclared tax amounting to almost £7 million raised against the hijacked registration.

Neither J.D. Telecom UK, nor any entity purporting to be J.D. Telecom UK by means of a hijacked registration received any payment for the supply of phones in the deal 1B chain (as in the deal 1A chain) which was purportedly made by J.D. Telecom UK. Again, the evidence of Officer Russell Hall as to his examination and analysis of the FCIB data satisfied us that substantially all of the payment was diverted by AW Associates, a buffer in this chain also, to Amex FHU (or an entity purporting to be Amex FHU), the supplier to the entity purporting to be J.D. Telecom UK. That consideration, or almost all of it, also found its way to Dantec Enterprises, the supplier to Amex FHU (or the entity which hijacked Amex FHU's registration).

We accept the evidence of Mrs. Thakker, the case officer, that she had traced the 4,000 Nokia 8800 phones supplied to the Appellant by Grovner Trading in deal 1B back to a supply by the entity using the hijacked J.D. Telecom UK registration to an entity called Novafone (UK), *via* AW Associates, High Speed Business, Owl (and Grovner Trading).

On the basis of this evidence we find that the purchase by the Appellant of 4,000 Nokia 8800 phones from Grovner Trading in deal 1B was also "connected with fraudulent evasion of VAT" in the sense of that phrase as it was used by the ECJ in *Kittel* at [61]. The relevant fraudulent evasion was committed by the entity using the hijacked J.D. Telecom UK VAT registration.

The second issue

27. Given that we have found that the purchases of phones by the Appellant in the deals under consideration were all "connected with fraudulent evasion of VAT" in the sense of that phrase as it was used by the ECJ in *Kittel* at [61], was the Appellant "a taxable person who knew or should have known that, by [its] purchase, [it] was participating in a transaction connected with fraudulent evasion of VAT" in that sense?

28. This we regard as the main issue in contention. The Appellant's case originally set out in its Notice of Appeal was that its transactions did not form part of an overall scheme to defraud the Revenue (as alleged by HMRC) and that even if it traded in a manner which led or might have led to this result, the circumstances were such that it did not have the means of knowledge that it was "implicating itself in a fraudulent transaction" (see: paragraph 10 of the Appellant's grounds of appeal). HMRC, on the other hand, submitted that we should find on the evidence that the Appellant had actual knowledge that its purchases in issue were connected with fraud and/or that we should find on the evidence that it had the means of knowledge that those purchases were connected with fraud.

The legal test

29. The test is set out in *Kittel* at [59] as follows:

> "… 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'."

30. The emphasis in that paragraph, particularly on "objective factors" to which regard must be had in ascertaining knowledge or means of knowledge, but also on "objective criteria" which form the basis of the relevant legal concepts, suggests to this tribunal that the test is a composite one, whether the taxable person objectively "knew or should have known" the stated circumstances.

31. This approach is supported by Burton J's "loose description" at [29] of *R (on the application of Just Fabulous (UK) Ltd.) v HMRC* [2008] STC 2123 of the relevant "*mens rea* – 'knew or should have known'", with a reference to *Kittel* at [56]. Burton J did not, in the passage referred to, subdivide the requirement into constituent limbs of "knew" or "should have known".

32. This tribunal recognises however that the requirement has generally been interpreted as having two limbs, and, as stated, the parties to this appeal have both made submissions on the separate issues of knowledge and means of knowledge.

33. On that basis, in order to succeed, HMRC must show the connection between the Appellant's purchases in the deal chains in issue and fraudulent evasions of the VAT by the respective defaulters. If that is established (as we have found that it has been), the burden is on the Appellant to show that it did not know and could not have known about the fraud (see: Lewison J's expressed formulation in *HMRC v Brayfal* CH/2008/APP0082 at ¶ 1 [50]). The Appellant must show, having regard to objective factors, that it did not know and could not have reasonably been expected to know that there was (or was likely to be) a missing trader somewhere in each chain (compare Lewison J at [91] of *HMRC v Livewire Telecom Limited* and *HMRC v Olympia Technology Limited* CH/2008/APP/0116 and CH/2008/APP 0252 (hereinafter "*Livewire*")).

34. HMRC, while preferring the formulation of the burden of proof set out in the previous paragraph, referred us also to the formulation adopted by a VAT Tribunal in *Calltel Telecom v HMRC* [2007] UKVAT V20266, where it said that it was incumbent on HMRC to raise a case, not necessarily amounting to proof but sufficient to demand an answer, that there were facts or circumstances which support, or at least are consistent with, the conclusion that the appellant knew, or should have known, of fraud in the chain.

35. The High Court (Sir Andrew Morritt) in *Blue Sphere Global Ltd. v HMRC* [2009] EWHC 1150 (Ch) has recently (22 May 2009) indicated a third possible formulation of the appropriate burden of proof, namely that HMRC must show on the balance of probabilities, and having regard to objective factors, that the Appellant knew or should have known of the connection of its transactions with fraud. We will consider the second issue arising in the appeal with reference to all three formulations of the burden of proof.

36. In considering whether the burden of proof is discharged on this issue (as on the first issue) we have in mind the guidance given by the House of Lords in *In re B (Children) (Care proceedings: Standard of Proof) (CAFCASS intervening)* from which we have made a citation at paragraph 24 above.

37. Officer Roderick Stone, who has and has had since before 2004, senior responsibility within HMRC for combating MTIC fraud, gave evidence at the hearing of the appeal, as he had done at the hearing of the preliminary issue. We found Mr. Stone an honest witness and we accept his evidence as summarised below.

38. Mr. Stone said that in cases of MTIC fraud of the type with which this appeal is concerned it is usual to see (as we do with all the deals in this appeal) a transaction chain consisting of a minimum of five businesses. The first business will be the missing trader (Defaulter), the second will be a first-line buffer, whose purpose is to distance the Defaulter from the second-line buffer (the third business). The second-line buffer is used to make a third-party payment offshore. This will ensure that the sale price of the goods is not passed down the chain to the Defaulter and that funds representing the VAT for which the Defaulter has failed to account to HMRC are sent offshore. The fourth business is the third-line

buffer whose purpose is to distance the second-line buffer from the Broker. The fifth business is the Broker, who supplies the goods out of the UK to an entity in another member state and claims the input tax repayment.

39. Mr. Stone went on to say that the goods once supplied out of the UK by the Defaulter may pass through "conduit traders", which are traders in other EU countries, or outside the EU, whose sole function is to be seen to be buying and selling the goods without incurring a VAT liability. Eventually the goods may return to the UK for the repeated perpetration of the fraud. In such a case the fraud is termed a 'carousel fraud'.

40. Mr. Stone's evidence was that he thought the chains as he described them required overall orchestration and contrivance by all participants in them, in order that the parties who lay out funds at the beginning recover those funds plus the repaid input tax which they are stealing from the Treasury. His view was that traders who perform a buffer or broker role in an MTIC fraud chain can participate in those chains without knowing the identities of other participants beyond their own immediate customer and supplier, but the transactions in an MTIC fraud chain normally had objective features which were not characteristic of transactions unaffected by fraud, such as third party payment requests, the use of freight forwarders to store goods, unusual pricing structures, lack of commercial risk and the use of offshore banking facilities with sterling denominated accounts.

41. Mr. Stone's evidence was that the incidence of MTIC fraud had increased after the decision of the ECJ in the joined cases of *Optigen Ltd., Fulcrum Electronics Ltd., and Bond House Systems Ltd. v Commissioners of Customs and Excise* [2006] STC 419, from £1.12bn to £1.9bn in 2004-05 to £2.5bn to £4.5bn in 2005-06. However he told us, and we accept, that the amount of fraud has now declined because of the effect of HMRC's denial of input tax repayment claims where HMRC allege that the traders concerned knew or should have known that their transactions were connected with fraudulent tax loss and also of the introduction of the reverse charge on the supply of mobile phones and computer chips which was widely expected to be introduced on 1 October 2006 but whose introduction was delayed until 1 June 2007. Exports and dispatches of mobile phones reduced in amount from £21 billion in the first half of 2006 to £2 billion in the second half of 2006 and only about 0.1 per cent of the 179,000 traders registered for VAT in the mobile phone and computer trade classifications have registered for the reverse charge since 1 June 2007. The transactions in this appeal, of course, relate to the first half of 2006.

42. In judging whether HMRC have discharged the burden upon them to the standard required we have (as we have said in paragraph 25 above), in accordance with the guidance in *In re B* taken the view that it was inherently probable that trades in mobile phones in the "grey" market in the year 2006, having the objective features referred to by Mr. Stone, formed part of chains of transactions linked to, or connected with, fraudulent evasion of VAT.

43. As to the matter of what knowledge can be attributed to the Appellant, following Lewison J in *Livewire* at [125], we consider that knowledge to be what was known by the Appellant's directors and its senior employees. On the facts of this case, we expand that class of persons to include the Appellant's officers and others engaged by the Appellant to manage its trade.

44. With reference specifically to the alternative tests stated in paragraphs 34 and 35 above, we approach the matter of what, objectively, the Appellant should have known, by considering whether the evidence shows that, objectively, the Appellant ought to have known that VAT would go unpaid (compare the Advocate-General in *C&E Commrs. v Federation of Technological Industries* [2006] STC 1483 (hereinafter "*FTI*")).

45. In the context of deciding what, objectively, the Appellant ought to have known, we consider the knowledge which, objectively, a reasonable person in the position of managing the Appellant company and its trade would have had.

46. Also, we consider that a reasonable person in the position of managing the Appellant company and its trade must be taken to be one who has regard to the objective of preventing evasion of VAT which is encouraged by the VAT Directives (compare *Kittel* at [54]). This objective imposes responsibilities on taxable persons as such, as well as on the competent authorities of the member states. The responsibilities imposed on taxable persons are of course different to those imposed on the competent authorities.

47. Taxable persons as such (and it is to be remembered that the Appellant's claim to be repaid its input tax is grounded in its status as a taxable person) have a responsibility to take every step which could reasonably be required of them to satisfy themselves that the transactions they are effecting do not result in their participation in VAT evasion (see: *Teleos* [65] where *FTI* [33] and *Kittel* [51] - which refers to 'all reasonable precautions' - are cited).

48. We consider specifically whether the evidence shows that the Appellant traded on a commercial basis. If it does not, then we regard the fact that it did not as an objective factor which may indicate that the Appellant knew or should have known that by its purchases it was participating in transactions connected with fraudulent evasion of VAT.

49. We also consider specifically whether the evidence shows that the Appellant had proper and adequate regard to its responsibility as a taxable person to prevent evasion of VAT. If it does not, then we regard the fact that it did not as an objective factor which may indicate that it failed to take every step which could reasonably be required of it to satisfy itself that the transactions it was effecting did not result in its participation in VAT evasion.

50. With this background in mind, we examine, first, the evidence relating to what (if anything) the Appellant ought to have known of the connection between its purchases in the deal chains in issue and fraudulent evasions of the VAT by the

respective defaulters. We then give our decision on that issue. We go on, separately, to consider what (if anything) the Appellant knew of that connection.

The facts relevant to what (if anything) the Appellant ought to have known, or knew

Whose knowledge or means of knowledge should be attributed to the Appellant?

51. We deal first with the point of whose knowledge or means of knowledge should be attributed to the Appellant. This point is relevant both to the evidence of what the Appellant ought to have known and the evidence of what the Appellant knew.

52. The director and sole shareholder of the Appellant in May and June 2006 was IN. IN was well aware of the prevalence of MTIC fraud in mobile phone trading at this time. She said in her witness statement of 29 August 2009 (paragraph 30): "I accept that because of HMRC's warnings I recognised that there could be risks associated with trading." She went on to say that at the time (May and June 2006) she thought that in the light of due diligence carried out by the Appellant the deals in issue bore no risk. IN's knowledge can therefore be attributed to the Appellant. IN is, we find, a person having some understanding and knowledge of business generally, as she trained as a fashion designer and had a fashion design business for 3½ years in Slovenia before starting a fashion business (Ashleigh Rose International Ltd.) in the UK, to manufacture lingerie, swimwear and outerwear.

53. VI was at that time and subsequently living with IN as "common law partners" (VI's language in his witness statement) and we find that VI and IN were managing the Appellant company and its trade from their residential address.

54. VI was closely involved with the Appellant company from its inception and at all stages thereafter. VI is clearly an intelligent person with a good understanding of business generally. He is now a qualified accountant. He had (before any involvement with the Appellant company) worked as a consultant for a company called Kinetic Distribution Ltd., which dealt in mobile phones, and, as he told Officers Gaston and Ross when they visited the Appellant on 18 January 2005, he was familiar with the due diligence aspects of the mobile phone trade. One of his companies, VI Corporate Limited ("VI Corporate") was the Appellant's company secretary. Another of his companies, International Corporate Restructuring & Insolvency Ltd ("ICRI") was the Appellant's accountant. According to the invoices issued by the Appellant company to ICRI, it appears that the Appellant company delegated much of the day to day running of its trade to ICRI, including the performance of due diligence.

55. Apart from the visit on 18 January 2005, HMRC officers visited on 20 October 2004, 25 July 2005, 21 October 2005 and 20 January 2006. All of these visits were before the relevant deals were transacted. The note of the visit on 20 October 2004 made by Officer Nicholas and exhibited by Mrs. Thakker states that VI and a director named Mr. Nicolas, as well as VI, described as "the accountant", were present and that VI "did all the speaking when I was there". Officer Ross stated that VI "did most of the talking" at the visit on 18 January 2005. Officer

Ross spoke to VI at visit on 25 July 2005, which had been arranged at the Appellant's request. At the visit on 21 October 2005, Officers Gaston and Lamb saw VI. It is plain that the meeting ended with VI on bad terms with the officers. At the visit on 20 January 2006, Officers Gaston and Ross did not see VI (they saw IN, Mr. Ian Masih, the sales director, and Mr. Shah, an accountant). Officer Gaston's report states "it is clear Mr. Masih is the force behind this business and [IN] is out of her depth". Officer Ross's evidence was that VI stayed in another room during this visit and would not join the meeting. We accept this evidence and despite VI's statements that his agreement with IN was that she would have sole control of the Appellant and be responsible for any decision making, and that the fact that he owned no shares in the Appellant meant that he could not exercise any influence on the Appellant's decisions, we find that VI's involvement with the Appellant company's trade was sufficiently close that it would be right to attribute VI's means of knowledge, and actual knowledge, to the Appellant for the purposes of applying the *Kittel* test.

The Appellant's due diligence – verification of the bona fides of customers and suppliers

56. The Appellant's case is that the due diligence carried out by it (through VI directly or *via* ICRI) showed that VI "did everything in my power and knowledge to ensure that [the Appellant's] activities were legal" (VI's first witness statement at paragraph 21) and, in particular, included all the checks suggested in HMRC's Notice 726 ("Joint and several liability in the supply of specified goods") (*ibid.* paragraph 6). He states (*ibid.* at paragraph 21) that the evidence of due diligence supporting the claim for repayment of input tax in VAT period 01/06 was agreed by Officer Gaston to be "in order" and states that the due diligence procedures followed then were not only followed at all times since (including the periods relevant to this appeal) but also were improved. He asks rhetorically "How did [the due diligence procedures followed] suddenly become inadequate?"

57. We now consider the evidence relating to the due diligence carried out by the Appellant in relation to its customers, its suppliers, inspections of goods it supplied (including recording IMEI numbers) and insurance of goods it supplied.

58. There were two customers, Dantec and Evolution. Dantec sent the Appellant a very short, undated letter of introduction apparently enclosing a copy certificate of incorporation, copy VAT registration certificate and bank account details. Dantec had been trading for about a year before it entered into its transactions with the Appellant which are relevant to the appeal. Evolution sent the Appellant a letter dated 4 April 2006 and provided copy certificates of incorporation and VAT registration. These showed that Evolution had been incorporated on 12 May 2005 and started to trade on 1 June 2005, from which date the VAT registration had been effective. The certificate of incorporation also showed that one of the two directors of Evolution on 26 March 2006 (the date of the extract from the appropriate Register) was a UK national, Mr. Alfred Warner, with an address in Coventry.

59. There is no evidence that VI or IN (or anyone else on behalf of the Appellant) visited the premises of either customer, or took any trade references for either of them, or any commercial checks on either of them, or had any substantive discussions with either of them before the supplies were made.

60. Both Dantec and Evolution signed customer declarations provided by the Appellant, which stated that they had checked into the background of their own customers (among other declarations).

61. The Appellant obtained validation from HMRC of the VAT numbers of its customers (and suppliers) for each deal. In deals 1 to 4 of May 2006, the Appellant did not receive confirmation that Dantec's registration was valid until 22 May 2006, which was the date on which the Appellant released the phones to Dantec, but the timings on the relevant faxes suggest that the release instructions were not sent to the freight forwarders until after the relevant confirmations had been received from HMRC. Although the VAT registration numbers in all the other deals were confirmed by HMRC after the respective invoice dates, HMRC's confirmations were received before the Appellant sent instructions to the freight forwarders to release the phones to its customers.

62. Although the Appellant did not instruct the UK freight forwarders to release the goods to its customers until payment had been received, and took no credit risk as such, phones were physically moved to a warehouse in France, so that the Appellant did incur some commercial risk.

63. With regard to due diligence on the Appellant's suppliers, we note that in all the deals bar one the exclusive supplier was Owl. In the exceptional deal (deal; 1B of 06/06), the suppliers were Owl and Grovner Trading, only because Owl was unable to supply all 8,000 phones required (it could only supply 4,000 phones directly to the Appellant – deal 1A) and recommended that the Appellant approach Grovner Trading. (We are satisfied on HMRC's evidence of the chains of transactions, as indicated above, that in this exceptional case Owl was in fact Grovner Trading's supplier of the 4,000 phones in question, which it supplied to the Appellant in deal 1B.)

64. VI knew of Owl and its director, Mr. Sharma, because he, as a director of ICRI, had been asked to assist Owl's sister company, Owl Import & Export Limited, to apply to vary its VAT accounting periods from quarterly periods to monthly periods in September 2005. Owl supplied the Appellant with a standard (pro-forma) short introductory letter bearing a fax transmission date of 13 September 2005 and copies of certificates of incorporation on change of name (in 2001) and VAT registration. The name of the company incorporated under the name of Owl Ltd before the change of name was1st HRC Ltd. That company was incorporated in 1998 and a copy of the relevant certificate of incorporation was supplied. The certificate of registration for VAT in the name of Owl showed an effective registration date of 5 July 1999. Owl also supplied the Appellant with its banking details. The Appellant did not provide any other information about Owl. HMRC exhibited an Experian "silver" credit report on Owl dated 24 July 2006.

This showed that Owl had capital employed of £80,600 and a recommended credit limit of £15,000.

65. Owl signed supplier declarations for each of the deals confirming to the Appellant that it (Owl) had carried out due diligence on its own supplier and that it had title to the goods. Grovner Trading sent an introductory letter to the Appellant dated 30 May 2006, and, although they are not referred to in the letter, there are copies of Grovner Trading's certificate of incorporation (in 2002), certificate of VAT registration (effective date 1 May 2003) and bank details in evidence.

66. Grovner Trading also signed the supplier's declaration provided by the Appellant.

67. There is no evidence that VI or IN (or anyone else on behalf of the Appellant) visited or carried out any commercial or credit checks on Grovner Trading. The Appellant apparently relied on the introduction from Owl.

68. There is no evidence that the Appellant tried to source phones from other suppliers or obtain other comparative price quotations. (The due diligence on pricing in the Appellant's evidence was limited to undated print-offs from consumer website(s) of the retail prices of the relevant Nokia handsets.)

Inspection of goods

69. As to inspections of goods, IN's evidence was that the Appellant had had all goods it supplied inspected since the start of trading in January 2006 either by an inspection company or by her (IN), or by her and VI, except on one occasion when the shipments had already been dispatched by the shippers before an inspection could be made.

70. The evidence on inspection is as follows. The Appellant's due diligence documentation checklist has boxes for both the instruction of an inspection report and the provision of one. For deals 1 to 4 (May 2006), neither of these boxes was ticked. There is however an inspection note apparently signed by IN recording an inspection by her on 19 May 2006. It noted an inspection of 3 consignments of phones being respectively 800 Nokia 9300i pieces, 1000 Nokia N91 pieces and 4000 Nokia 8800 pieces. These correspond to the supplies under deals 1, 2 and 3 and 4 respectively. The condition of the boxes is noted as "brand new" and the pieces are noted as being supplied with both 2 and 3 pin chargers. This inspection note was not in the Appellant's due diligence packs for deals 1 to 4 and was supplied to HMRC for the first time in 2009. IN put in evidence third party inspection reports for a number of small transactions carried out in 2006 but before the transactions with which this appeal is concerned. The Appellant has given no explanation as to why it did not seek independent inspections of the larger transactions carried out in deals 1 to 4 in May 2006.

71. There are three inspection reports in relation to deal 5, which was a supply of 4,500 Nokia 8800 phones. There is in evidence an instruction by the Appellant

(signed by IN) dated 30 May 2006 to Aberdale Inspections Ltd. ("Aberdale") to inspect "the stock of 4500 Nokia 8800". The letter gives no indication of where the stock was. There is also in evidence two inspection reports dated 30 May 2006 by Aberdale. One of these is apparently incomplete – we have page 1 of 2 but not the second page. It shows an inspection of 3500 Nokia 8800 phones at Interken Freighters (UK) Ltd (at Southall, Middlesex). These are stated to have 2 and 3 pin chargers. The second report from Aberdale is of 1000 Nokia 8800 phones with 2 and 3 pin chargers, also at Interken Freighters (UK) Ltd. Both these inspection reports give the company name as "Owl Ltd" rather than the Appellant. There is also an inspection report of the same date with the Appellant's name on it, issued by Secure Freight (at Harmondsworth, Middlesex). This shows an inspection of 1000 Nokia 8800 phones with 2 pin chargers and other details, which differ from those on the Aberdale reports. Other exhibits show that the 1000 units which were part of deal 5 were warehoused by Secure Freight. We find that there were two inspection reports for the same 1000 phones (at two different warehouses). The Appellant has offered no evidence that it queried either of these reports, though it is unclear when the Appellant first saw the reports from Aberdale.

72. For deal 6 there is another inspection note stating that IN and VI had inspected 1000 Nokia 9300i phones at Interken Freighters on 31 May 2006 at 9.30 a.m. these phones are also noted as having had both 2- and 3-pin chargers. This note also was not disclosed to HMRC until 2009.

73. For deals 1A and 1B of June 2006, IN's evidence is that the Appellant instructed A1 Inspections to make an inspection of the goods supplied but before the inspectors could get to the Pauls Freight premises the goods had left the warehouse. There was therefore no inspection of these goods.

Insurance of goods

74. Turning now to insurance of the goods supplied by the Appellant, the goods supplied in deals 1 to 4 are apparently covered for the full sale value by a certificate of insurance issued by Interken Logistics FZCO in the name of the Appellant and dated 21 May 2006. IN's evidence is that the phones supplied in deal 5 were also insured, although no certificates were in evidence either for the 3,500 phones warehoused by Interken or the 1,000 phones warehoused by Secure Freight. The phones supplied under deal 6 were the subject of a second certificate of insurance issued by Interken Logistics FZCO in the name of the Appellant and dated 31 May 2006.

75. Two invoices issued by Interken Logistics FZCO were in evidence apparently providing insurance cover for the phone supplied under deals 1A and 1B of June 2006. However IN's evidence was that these invoices were unpaid due to lack of funds. No certificate of insurance was issued.

76. The certificates that were issued state that the premium amount is "as agreed by or on behalf of the insured". There is no evidence of any insurance premiums having been paid. Further, there is no evidence that the Appellant took out its

own insurance cover for any excess of loss, or risk that the goods would not be covered by the freight forwarders' own insurance policies for any reason.

The mark-ups achieved

77. We accept the evidence produced on behalf of HMRC as to the margins or mark-ups achieved not only by the Appellant but also by other entities featuring in the relevant chains of supply, including Owl.

78. That evidence is summarised in the following table:

Deal no.	Defaulter unit price	Average mark-up of buffers exc. Owl /*(%)*	Owl mark-up/*(%)*	4DL sale price to customer	4DL mark-up/*(%)*	No. & type of phones sold by 4DL	4DL invoice date
1Causeway	£301.36	41p *(1.36)*	£5.00 *(1.66)*	£314.75	£7.75 *(2.52)*	800* N9300i	18.5.06
1Tressle	£299.40	53p *(1.78)*	£6.00 *(1.99)*				
2	£379.40	40p *(0.11)*	£3.00 *(0.79)*	£393.50	£9.50 *(2.47)*	1000*N91	18.5.06
3	£381.31	41p *(0.11)*	£5.00 *(1.31)*	£396.75	£9.75 *(2.52)*	2000*N8800	18.5.06
4	£381.36	41p *(0.11)*	£5.00 *(1.31)*	£396.75	£9.75 *(2.52)*	2000*N8800	18.5.06
5	£348.40	40p *(0.11)*	£31.00 *(8.86)*	£411.50	£30.50 *(8.00)*	4500*N8800	30.5.06
6	£277.65	53p *(0.19)*	£10.75 *(3.85)*	£313.00	£23.00 *(7.93)*	1000*N9300i	31.5.06
June 1A	£367.40	53p *(0.14)*	£5.00 *(1.34)*	£404.00	£30.00 *(8.02)*	8000*N8800	29.6.06
June 1B	£366.90	53p *(0.14)*	£5.00 *(1.36)* *to*				
			Grovner				
			50 p *(0.13)*				

79. It is to be noted that the mark-ups received by entities in the chain (buffers) before Owl were generally very modest. Owl's mark-ups were significant, but (except for deal 5) less than the mark-ups achieved by the Appellant. In the June deals (1A and 1B) Owl's mark-up to both its customers (the Appellant and Grovner Trading) was £5 per phone. Grovner Trading sold the phones it supplied to the Appellant (deal 1B) at a mark up of (an additional) 50p per phone. But the Appellant bought from both Owl and Grovner Trading at the same price per phone – the difference of 50p per phone in the deal 1B chain is reflected, not as one would have expected, in the sale price obtained by Grovner Trading from the Appellant, but in the prices paid by the defaulter, JD Telecom to its supplier Amex FHU (or the entity which hijacked the Amex FHU VAT registration). Although JD Telecom bought from a single supplier, that supplier charged two different prices 50p apart which reflected the split between the supplies from Owl and

Grovner Trading to the Appellant. On the basis of this evidence, we find that the chain of supplies relating to deal 1B was manipulated by persons unknown.

80. Commenting on the Appellant's mark-ups, Mr. Fletcher said (in evidence which we accept) that he did not believe they could be explained by rational or profitable arbitrage. The "grey" market in which the Appellant dealt was a highly competitive area and profit margins are often low. Further, it is extraordinary and not capable of commercially justifiable explanation, that the profit margins in the chain of supply do not progressively diminish as one goes down the chain of supply, but instead the Appellant was able to achieve a much greater mark-up. The amount of the Appellant's mark-up cannot be justified by its costs of insurance, transport, warehousing and handling, and there is no other value added to the supply by the Appellant.

Details on the purchase orders and invoices

81. Details on the purchase orders and sales invoices issued by the Appellant for all the transactions comprised only the model of Nokia handset and the quantity and price per phone. We accept Mr. Fletcher's evidence that that level of detail was wholly inadequate and commercially unsatisfactory. Details of the phones supplied which were available from the third-party inspection reports provided by the Appellants and were *not* included in the Appellant's purchase orders and invoices included the colour of the phones, the country of manufacture, the manual language, the region covered by warranty, and the type of charger. These details, we find, would have been present if the transactions had taken place in a commercial market. The cost of putting right a mismatch of expectations between a buyer and seller on these items could be as much as £5 per unit to adapt a handset or source a correct manual, and if this was not done a buyer could be expected to reject the stock. We do not accept VI's contention in reply to Mr. Fletcher's statement that customers wanted to purchase a particular model and would accept any colour, for example.

The timing of relevant transactions

82. The deals were generally "back-to-back" with same day invoice dates and participants' accounts with FCIB credited and debited often on a single day. However, anomalies were identified by HMRC in the timing of the transactions in the chains in which each of the deals featured.

83. The evidence showed that the phones supplied in deal 1 were released to the customer, Dantec, by AFI Logistique, to whom they had been shipped "on hold" by Interken, on 22 May 2006. However although the Appellant instructed Interken to ship the phones "on hold" on 21 May 2006, it did not fax a request to release the phones to the customer until 25 May 2006. Further, Owl, the Appellant's supplier, did not instruct the freight forwarders to release the phones to the Appellant until 30 May 2006.

84. Similar anomalies were shown in connection with the supplies in deals 2, 3 and 4.

85. In deal 5, Evolution paid the Appellant on 2 June 2006 and the instructions to release the goods to Evolution were faxed by the Appellant to the freight forwarders on that day. However, further up the chain the phones were released on 30 May 2006, although payment was not made until 1 June 2006. It is anomalous to see release of goods before payment is made in these types of transaction. A similar anomaly was shown in connection with deal 6.

86. In deal 1A of June 2006, the evidence was that Owl (the Appellant's supplier) released the phones to the Appellant on 3 July 2006. However Owl did not pay its supplier, Xcel, until 5 July 2006. If the transactions were effective, therefore, Xcel must have released title to the phones before being paid (no release instruction by Xcel was in evidence).

87. In deal 1B of June 2006, the Appellant released the phones to Dantec on 3 July 2006, but Owl (Grovner Trading's supplier) did not release the phones to Grovner Trading (the Appellant's supplier) until 4 July 2006.

Consideration of the commerciality of the Appellant's trading

88. Expert evidence on the "grey" market for mobile phone handsets during 2006 was given by Mr. Fletcher, who is a Principal Adviser with KPMG and was instructed by HMRC. VI asserted that Mr. Fletcher did not have relevant experience in the "grey" market and was not independent, but we reject those criticisms. We accept Mr. Fletcher's evidence.

89. Mr. Fletcher described the "grey" market as the market for legal wholesale distribution of mobile phone handsets other than those sold (in the "white" market) by original equipment manufacturers, who only sell directly to mobile network operators, large specialist multiple retailers and authorised distributors. It is common ground that the Appellant trades in the "grey" market and not in the "white" market.

90. Mr. Fletcher identified four categories of trade in the "grey" market. They were: arbitrage, dumping, volume shortages and handset unlocking (also known as box-breaking).

91. Arbitrage occurs when an original equipment manufacturer adopts a different pricing policy in different territories. Mr. Fletcher said that Nokia (the original equipment manufacturer of all the phones traded by the Appellant) does not have a differential pricing policy within Europe.

92. Mr. Fletcher also addressed the issue of whether there would be sufficient fluctuations in the exchange rate between the euro and sterling to make arbitrage possible in May and June 2006. He concluded there would not.

93. Mr. Fletcher's evidence was that where arbitrage was possible, the characteristics of an arbitrage trade were slim margins and short chains between supplier and customer. Neither of these was exhibited on the facts of this appeal.

94. Dumping operations occur when sellers desire to dispose of surplus, usually dated, stock. It is not initiated by buyers. IN's evidence was that she "only transacted business on a back to back basis and purchased what needed to be sourced to satisfy my customers' demands". In other words, the Appellant's evidence is that its trade was initiated by its customers, not by sellers. Further, two of the three types of handset traded by the Appellant had been relatively recently launched and would not be likely to be the subject of dumping operations for that reason.

95. Volume shortages occur in the opposite circumstances from dumping, when an original equipment manufacturer has underestimated a demand for a particular product or is otherwise unable to meet the demands of its customers. Mr. Fletcher's evidence was that volume shortages can and do occur globally but would tend to be for brief periods of up to two weeks and would not account for large volumes in relation to total sales of the handset. He did not believe that the Appellant's transactions were meeting any volume shortage in the market as its sales were not to authorised distributors or specialist multiples or retailers owned by mobile network operators.

96. Mr. Fletcher's evidence included an estimation of the Appellant's sales in May and June 2006 as a percentage of the total sales of the models traded. His source for this comparison was electronic point of sale information from GfK Retail and Technology relaxing to sales of Nokia phones in Europe and the UAE. His conclusion was that the Appellant's sales of the Nokia 8800 had amounted to 49% of the distributor market in May 2006 (as distinct from the mobile network operator's share of the market) and the corresponding figure for June 2006 was 54%. The corresponding figures for May 2006 sale of the 9300i and N91models were 32% and 8%. VI disputed these figures, but by reference to Nokia's accounts using figures which included revenues from products other than mobile phones and related to sales worldwide. Mr. Fletcher's evidence was that the phones supplied by the Appellant were unlikely to have gone outside Europe because they were of European specification with warranties which would have been invalid outside Europe. GfK's information also showed that the models traded in by the Appellant were some of the smaller sellers among Nokia's product range available in Europe and the UAE, and not, as VI apparently believed, large sellers in those markets. Although the presentation of GfK's point of sale information made it difficult for us to be entirely satisfied that Mr. Fletcher's estimates of the Appellant's market share were precisely accurate, nevertheless we accept that he has demonstrated that the volumes of phones traded by the Appellant would be much too large to be accounted for by trading in the volume shortages category of the "grey" market.

97. Handset unlocking or box breaking is a very resource-intensive trade where a trader takes advantage of the difference of the price in handsets where a mobile phone is bought by a consumer with a pre-pay or term contract and the same phone is bought without such a ties, SIM-free. SIM-free mobile phones are more valuable. The unlocking trade consists of the purchase of mobile phones loaded with software encoded by the mobile network operator, the electronic removal of

the software and the reconfiguration of the phone to anonymise it (remove any connection with the mobile network operator), followed by repackaging it for sale. It is common ground that neither the Appellant nor its suppliers or customers traded in this market.

5 *The Evolution payments*

98. Officer Hall analysed the movements on the Appellant's account with FCIB using material made available to HMRC by the Dutch authorities. Officer Reardon analysed the payments passing from the Appellant to its principal supplier, Owl, noting that there was a gap in trading between these two companies from 18 to 30 May 2006. At 18 May 2006 Owl invoiced the Appellant a total of £2,558,680 including VAT. By 22 May 2006 the Appellant had paid £2,150,000 of this debt, leaving an amount unpaid at that time of £408,680, when the credit balance on the Appellant's FCIB account was £82,568. The funds to discharge the outstanding amount due to Owl of £408,680 came from Evolution in the form of a payment of £450,000 credited to the Appellant on 30 May 2006. Evolution had received this money from Dantec immediately beforehand. Trading between the Appellant and Owl then resumed and by the end of May 2006 the Appellant was indebted to Owl for a net amount of £2,355,287.50. At the close of business on 1 June 2006, the Appellant's account at FCIB had a credit balance of £46,781. On 2 June 2006 the Appellant's account was credited with a total of £2,164,750 being payments due from Evolution for deals 5 and 6. At this stage the Appellant was still short of funds to discharge its indebtedness to Owl, but another payment of £200,000 was received by the Appellant from Evolution, which enabled it to make the required payment to Owl of £2,355,287.50, also on 2 June 2006.

99. The Appellant's ledger entries for the payments of £450,000 and £200,000 from Evolution described the amounts as "payments on account". Officer Reardon explained that the aggregate amount of £650,000 was reversed as a wrong entry on 2 June 2006 but was not repaid. On the face of it, therefore, Evolution had made gratuitous payments to the Appellant totalling £650,000.

100. The Appellant offered no explanation for these payments until IN exhibited two supplementary documents in the late submission of evidence made on 11 March 2009 (after the appeal hearing had started), to which we have referred above. In particular, VI did not refer to these payments in any of the evidence submitted by him.

101. The first of these supplementary documents was a purported purchase order from Evolution dated 25 May 2006 for various Nokia handsets with a total invoice purchase price of £4,327,550. At the bottom of this document is the statement "as per agreement 15% of non-refundable deposit will be arranged between the parties". This deposit would represent a payment of £649,132 – close to £650,000.

102. The second supplementary document is purportedly an undated letter to Evolution from the Appellant and signed by IN which reads: "Further to our telephone conversation of today, we write to put on records [*sic*] that we expect

you to honour the balance of your proforma purchase. If you are not able to complete as you have indicated, I am afraid we will not refund the deposit in accordance with your commitment. Failure to from your site [*sic*] to complete will result in forfeiture of your deposit."

Were any of the phones traded in the deals in question the subject of a 'carousel'?

103. We have noted (at paragraph 39 above) Officer Stone's concern that the supplies affected by MTIC fraud are so devoid of commercial substance that the same goods dispatched by a broker are acquired by a defaulter and are therefore the subject of a fraudulent 'carousel'.

104. We accept that, on the balance of probabilities, at least 2000 of the 4000 Nokia 8800 phones which were the subject of deals 3 and 4 were the subject of a 'carousel'. The Appellant's customer in these deals was Dantec and Dantec had supplied them to Intertech SARL, which in turn supplied them to PZP Ena, which supplied them to Causeway Initiatives, the defaulter in deals 3 and 4. The evidence on which we base this finding consisted, first, of release notes both dated 18 May 2006, whereby Intertech SARL instructed the release to PZP Ena of 2000 Nokia 8800 phones, which it had received from Dantec, and PZP Ena instructed the release to Causeway Initiatives, also of 2000 Nokia 8800 phones. Secondly, the Appellant invoiced Dantec for the 4000 Nokia 8800 phones supplied in deals 3 and 4, also on 18 May 2006.

105. We also accept that, on the balance of probabilities, at least some of the 8000 Nokia 8800 phones which were supplied by the Appellant in deals 1A and 1B in June 2006 were the subject of a 'carousel'. Again, the Appellant's customer was Dantec and the Appellant's invoices to Dantec were dated 29 June 2006 and the stock releases by the Appellant to Dantec were dated 3 July 2006.

106. Documentation from the freight forwarder Pauls Freight showed that Pauls Freight had received 4000 Nokia 8800 phones on behalf of Dantec from the AFI Logistique warehouse in France on a number of vehicles identified on CMRs on 30 June 2006, and a further 4000 Nokia 8800 phones also on behalf of Dantec on 30 June and 1 July 2006. The Pauls Freight documentation exhibited by the case officer, Mrs. Thakkar, showed the serial releases of stock by each participant in each of the deal chains 1A and 1B through to the Appellant's supplies to Dantec. CMRs together with ferry crossing documentation showed that Pauls Freight shipped phones to AFI Logistique on behalf of the Appellant on 1 July 2006.

Our decision on whether the Appellant ought to have known of the connection between its purchases in the deal chains in issue and fraudulent evasions of the VAT by the respective defaulters.

107. We have concluded that, having regard to objective factors, the Appellant should have known that, by the purchases in issue, it was participating in transactions connected with fraudulent evasion of VAT. We reach this conclusion both on the basis that the Appellant has failed to discharge the burden

of proof on it to show that it had no such means of knowledge; and also on the (first) alternative basis that HMRC has shown a *prima* facie case that the Appellant had such means of knowledge, and the Appellant has failed to rebut the case successfully raised by HMRC. Further, we have concluded on the (second) alternative basis that HMRC has shown on the balance of probabilities that the Appellant had such means of knowledge.

108. Although the Appellant through IN and VI cannot be taken to have had the means of knowing (as opposed to suspecting) that third party payment requests featured in the chains of transactions in which they were participating by the purchases in issue, on their own evidence they did know that the trade in which they were operating was affected by widespread fraudulent evasion of VAT. They also knew that, in the deals they were doing, freight forwarders were used to store goods, there were unusual pricing structures enabling the Appellant from a standing start to make very large margins in deals which were made available to it without much effort on its part, there was a lack of real and significant commercial risk, and offshore banking facilities with sterling denominated accounts were routinely used. These were objective features which were characteristic of transactions in chains of transactions linked to, or connected with, fraudulent evasion of VAT in the wholesale trade in mobile phones in the "grey" market in the year 2006. The presence of these objective features in all the deals in issue is objective evidence which we are satisfied showed means of knowledge, on the part of the Appellant, that, by the purchases in issue, it was participating in transactions connected with fraudulent evasion of VAT.

109. We accept the submissions of HMRC that too much emphasis can be placed on due diligence, as to its probative effect in demonstrating the Appellant's lack of means of knowledge. Nevertheless the undertaking by a trader of due diligence which is adequate in the circumstances of its trading activities, would be an objective factor showing that the trader undertook its trade on a commercial basis.

110. In fact, in our view, the Appellant's due diligence was, taken as a whole, unsatisfactory and inadequate in the circumstances of its wholesale trade in mobile phones in the "grey" market in the year 2006. There are numerous examples of inadequacy. They include the fact that the letters of introduction received from its two customers, Dantec and Evolution, provided so little information that the Tribunal cannot accept that they could reasonably have formed the basis for a multi-million pound business. There was no evidence of steps taken to verify the *bona fides* of the Appellant's customers, or indeed of its suppliers, Owl and Grovner Trading, which we would have regarded as appropriate investigation of their reliability as persons to do honest business with, particularly bearing in mind the magnitude of the business and the fact that it commenced so suddenly and without any obvious preparation in terms of sourcing.

111. There was no evidence that the Appellant tried to source phones from other suppliers or obtain comparative price quotations. We accept the evidence of

Mr. Fletcher that there is no apparent commercial logic behind the Appellant's decision not to attempt to source such large volumes of handsets from an authorised distributor. He said (and we accept) that the commercial benefits of working with an authorised distributor are so compelling (reasonable expectation that the phones had come to the authorised distributor from the original equipment manufacturer – Nokia – and not from a fraudulent or otherwise unreliable source) and the risk of working from personal contacts so high as to make the Appellant's choice inconsistent with the rational profit-maximising behaviour Mr Fletcher would expect from someone working in such a competitive low-margin industry.

112. We accept HMRC's submission that there was no evidence of any insurance premiums actually having been paid by the Appellant. In a trade involving such a large quantity of valuable stock, this is compelling evidence of the uncommerciality of the Appellant's business.

113. The mark-ups achieved were not explicable by commercial trading in the legitimate "grey market" (i.e. that part of it unaffected by fraudulent evasion of VAT), in which competition is keen and profit margins are low. We would expect the mark-ups on transactions achieved by someone in the Appellant's position at the end of a chain of supplies to be low to take account of the fact that traders higher up the chain would be expected to be able to obtain for themselves the greater amount of any profit that was available to the chain transactions taken as a whole. The amount of the Appellant's mark-up cannot be justified by its costs of insurance (none), transport, warehousing and handling, and there is no other value added to the supply by the Appellant. All the deals were in our view wholly uncommercially profitable to the Appellant.

114. The details on the purchase orders and invoices, the information on the notes of stock inspection carried out by the Appellant and the anomalies identified by HMRC in the timing of the relevant transactions were not consistent with commercial trading.

115. We accept Mr. Fletcher's evidence that the Appellant's trade does not fit in to any of the categories of commercial trading in the legitimate "grey" market.

116. The fact, which we have found, that at least some of the phones which were the subject of deals 3 and 4 and 1A and 1B were the subject of a 'carousel', having been dispatched out of the UK to another Member State and brought back to the UK again preparatory to a further dispatch is a further objective factor indicating uncommercial trading.

117. The receipt of the Evolution payments demonstrates a lack of commerciality in the Appellant's trading arrangements. In agreement with HMRC's submissions, we do not accept as genuine the Appellant's explanation for these payments, presented by IN so late in the day. We can think of no satisfactory explanation of why, if IN's explanation for the Evolution payments had been true, it would not have been given at a much earlier stage in the

preparation for the appeal. Further, a non-refundable deposit (which the Appellant contends the Evolution payments were) is neither consistent with the Appellant's earlier trading policy nor is it commercially credible.

118. In his closing submissions, Mr. Dunlop gave 22 reasons for the Tribunal to reject IN's explanation. The following two are in our view particularly persuasive.

119. First, the timing and amounts of the two Evolution payments suggest that they were in reality made for the specific purpose of funding the transaction chains, by means of enabling the Appellant to discharge its obligations to Owl.

120. Secondly, Evolution purchased 4,500 Nokia 8800 phones from the Appellant on 30 May 2006 (deal 5) and 1,000 Nokia 9300i phones on 31 May 2006 (deal 6). The purchase order for deal 5 has the same number as the purchase order (purportedly dated 25 May 2006) submitted in late evidence for the purchase of phones to the value of £4.3m contended for by IN in her late evidence. The Tribunal does not believe that a genuine customer, albeit a new customer as Evolution was) would forego £650,000, 15% of the value of the purported unconfirmed order, and still go on to complete a purchase from the Appellant at full price of phones to the value of £2.165m.

121. Finally, we mention that HMRC submitted that further evidence of the uncommerciality of the Appellant's deals was its failure to record more than a small sample of the IMEI numbers for the phones which it traded. These are numbers which identify each individual telephone and the recording of them would obviously be a step that a commercial trader would take in order to protect itself from claims relating to the phones sold not meeting specification or otherwise being not fit for purpose. We agree that this is a further indication of the uncommerciality of the Appellant's deals.

122. We find for these reasons that the Appellant did not trade on a commercial basis. We regard this fact as an objective factor which indicates that the Appellant knew or should have known that by its purchases it was participating in transactions connected with fraudulent evasion of VAT.

123. We turn to consider specifically whether the evidence shows that the Appellant had proper and adequate regard to its responsibility as a taxable person to prevent evasion of VAT.

124. We find that the Appellant's failure to carry out adequate due diligence in the area of verifying the *bona fides* of its suppliers and customers, the shortcomings of the Appellants' systems of inspection of the goods in which it traded, the failure to record and analyse the IMEI numbers of the goods in which it traded to guard against 'carousel' trading, and its failure to insist on full details of goods on purchase orders and invoices received and issued show that it failed to have proper and adequate regard to its responsibility as a taxable person to prevent

evasion of VAT. The failures are cumulatively a failure to take 'all reasonable precautions' in terms of paragraph 51 of *Kittel*.

125. We bear in mind the guidance of Floyd J i*n Mobilx Limited (in administration) v HMRC* CH12008/APP/0649 at [7] that: "Paragraph 51 [of *Kittel*] needs to be understood in the sense that 'all reasonable precautions' may, in some cases, involve ceasing to trade in specified goods in a particular market, at least in the particular manner in which the trader undertakes that trade." Floyd J went on to say that "such a situation may conceivably arise where, from other indications available to the trader, the trader knew or should have known that it is more likely than not that, despite all due diligence checking, any further goods traded in the same way will be implicated in VAT fraud".

126. *Kittel*, particularly as interpreted by Floyd J in *Mobilx*, shows that the availability of an input tax credit for a transaction in what has been proved to be a fraudulent chain is not the subject of a "cat and mouse" game between the person claiming repayment of input tax and HMRC. The VAT system envisages and, for its proper working requires, honest cooperation between taxable persons and HMRC to facilitate freedom of legitimate trade and to prevent fraudulent evasion of VAT. A taxable person's right to a repayment of input tax must not be abused, and a taxable person is, by virtue of its status as such, is obliged to take all reasonable precautions to prevent its involvement in abusive transactions. In some cases, as Floyd J said, this may involve ceasing to trade in specified goods in a particular market, at least in the particular manner in which the trader undertakes the trade. In our judgment the Appellant's status as a taxable person obliged it, in order to prevent abuse, to cease to trade in the market in which it was trading in the deals in issue, at least in the manner in which it actually undertook that trade.

127. We conclude for these reasons that the evidence shows that the Appellant did not have proper and adequate regard to its responsibility as a taxable person to prevent evasion of VAT. The Appellant failed to take every step which could reasonably have been required of it, by virtue of such responsibility, to satisfy itself that the transactions it was effecting did not result in its participation in VAT evasion.

128. For these reasons we hold that the Appellant ought to have known of the connection between its purchases in the deal chains in issue and the fraudulent evasions of VAT by the respective Defaulters.

Our decision on whether the Appellant actually knew of the connection between its purchases in the deals chains in issue and fraudulent evasions of the VAT by the respective defaulters

129. We have further concluded, having regard to objective factors, that the Appellant actually knew that by the purchases in issue, it was participating in transactions connected with fraudulent evasion of VAT.

130. We regard our conclusion on the Evolution payments, and in particular our rejection of IN's lately submitted explanation of them, to be sufficient evidence to find that it is more probable than not that IN and VI, and through them, the Appellant, actually knew that it was participating in deals connected with MTIC fraud.

131. We agree that the operation of MTIC fraud chains of transactions requires orchestration and compliance with the requirements of the orchestrator(s) by each participant. There remains the possibility that a particular individual participant is an "innocent dupe" unaware that it is in fact complying with the requirements of one or more orchestrators of an MTIC fraud. In this case, having regard to all the evidence, and not only the evidence of the Evolution payments, we find that it is more probable than not that the Appellant, through VI and/or IN, was not such an "innocent dupe", and it knowingly participated in the frauds.

The third issue: is there any need for a reference to the ECJ?

132. At [68] of our Preliminary Issue Decision we said that if we found (as we have in this Decision) that the Appellant had "objective knowledge" of its participation in identified frauds and we also found that the requirement for equal treatment for domestic transactions and transactions carried out between member States by taxable persons had been breached, then a reference to the Court of Justice might be necessary.

133. We have concluded that such a reference is not necessary on the short ground that circumstances which demonstrate that the Appellant has abused its right to repayment of input tax also demonstrate that it has abused any right not to be discriminated against as a trader supplying to an entity in another Member State.

134. The ECJ said in *Kittel* at [54] that "Community law cannot be relied on for abusive or fraudulent ends" and cited *Kefalas and Others* (Case C-367/96) [1998] ECR I-2843 at [20], *Diamantis* (Case C-373/97) [2000] ECR I-1705 at [33] and *Fini H* (Case C-32/03) [2005] ECR I-1599 at [32] in support of that proposition.

135. In any event, we are not satisfied that the circumstances of this appeal do, or even could, give rise to any right in the Appellant's favour not to be discriminated against as a trader supplying to an entity in another Member State.

136. It seems to us that the Appellant's point that where a Tribunal has found objective knowledge sufficient to deny repayment of input tax as a matter of law, nevertheless that result can, as a matter of law, be reversed by reliance on another Community law principle (equal treatment) is clearly misconceived.

137. For these reasons we dismiss the appeal.

138. HMRC applied for costs under rule 29(1) of the VAT Tribunals Rules 1986. Although these rules have now been replaced by the Tribunal Procedure (First-tier Tribunal) (Tax Chamber) Rules 2009, we direct that the VAT Tribunals

Rules 1986 shall apply (see: para. 7(3)(a), Schedule 3, the Transfer of Tribunal Functions and Revenue and Customs Appeals Order 2009).

139. The appeal is one where HMRC had not precluded itself from applying for costs under its policy then in force, and we award HMRC its costs of and incidental to and consequent upon the appeal to be assessed by a Taxing Master of the Supreme Court pursuant to rule 29(1)(b) of the VAT Tribunals Rules 1986.

JOHN WALTERS QC

JUDGE OF THE FIRST-TIER TRIBUNAL
RELEASE DATE: 18 September 2009