

20781

VAT – input tax – MTIC fraud – contra trading – whether Appellant knew or ought to have known about the fraud – no – underpayment of two invoices – claim on these allowed only to extent that payment in fact made constituted tax inclusive consideration (s.26A VATA 1994) - appeal allowed in part

MANCHESTER TRIBUNAL CENTRE

REF: MAN/

BRAYFAL LTD

Appellant

- and -

**THE COMMISSIONERS FOR
HER MAJESTY'S REVENUE AND CUSTOMS**

Respondents

**Tribunal: David Demack (Chairman)
Arthur Brown FCA CTA
Peter Whitehead**

Sitting in public in Manchester on 26-30 November 2007, 15-17, 21, 28-30 January, 7-10, 14-16 April and in London on 16 May 2008

Michael Patchett-Joyce of counsel instructed by The Khan Partnership, solicitors, London for the Appellant

John Black QC and Jonathan Cannan instructed by the Solicitor and General Counsel for HM Revenue and Customs for the Respondents

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DECISION

Introduction

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1. The appellant company, Brayfal Ltd (“Brayfal”), a dealer in mobile phones, made input tax claims of £910,977, £401,065 and £100,100 for accounting periods 03/06, 05/06 and 06/06 respectively. On receiving each one, the Commissioners for Revenue and Customs (“the Commissioners”) subjected it to extended verification.
10 The Commissioners assessed £26,223 of the 03/06 claim to tax, and Brayfal appealed the assessment. That appeal (MAN/06/913) is separate from the present one, so that we are not concerned with it. By voluntary disclosure made in January 2007, Brayfal withdrew two of the three claims made in its VAT return for period 05/06 totalling £200,165, and the single claim for period 06/06, saying that they were “voluntarily
15 cancelled”. Consequently, the amount at issue before us is £1,085,654.

2. Despite the amount at issue having been so determined in January 2007, by their decision letter of 20 April 2007 the Commissioners stated that they were rejecting Brayfal’s original claims for all three one monthly periods referred to above, and prepared the Statement of Case on the same basis. The Commissioners rejected the
20 claims because they considered the transactions upon which they were based formed part of an overall scheme to defraud the revenue, and that Brayfal, through its director, Mr David Robert Kibbler (“Mr Kibbler”), knew or should have known that to be the case. The fraudulent scheme alleged by the Commissioners was one of MTIC (Missing Trader Intra-Community) fraud, and in particular the complex
25 variation thereof known as contra-trading. The contra-trader allegedly involved was Future Communications (UK) Ltd (“Future”).

3. The concept of contra-trading will by now be familiar to most readers of these tribunals’ decisions. But to assist those unfamiliar with it, we include paragraphs 4 to 6 of the tribunal decision in *Livewire Telecom Ltd v. The Commissioners (2008)*
30 *Decision No. 20538*, where Dr Avery Jones, the learned chairman, provided the following most helpful introduction to and list of problems connected with contra-trading:

“4. In order to demonstrate where the loss of tax arises from MTIC fraud we start with a simple example of an import of goods by X who sells them to Y who
35 exports them. The tax on acquisition (import) by X is cancelled by input tax of the same amount, and the output tax charged on sale by X will be cancelled by input tax repaid to Y on the export, so that the United Kingdom exchequer receives no net tax. If both X and Y are fraudsters Y will have to finance the output tax charged by X, which is recovered by X not paying the output tax to
40 Customs. The only gain by the fraud is if Customs pay the input tax to Y when the exchequer is left with a loss of the amount of the input tax; the non-payment of output tax by X is merely the recovery of what Y put in. If the exporter is

innocent of that fraud he is entitled to repayment of the input tax that he has actually paid to X even though this represents tax never paid by A and the exchequer is left with the same loss of the amount of the input tax.

5 5. ..., this appeal is concerned with contra-trading. In contra-trading there are, in
its simplest theoretical form, two chains of transactions. First, the “dirty chain,”
in which there is a missing trader, defaulting trader, or trader using a hijacked
VAT number (“missing trader” for short), comprising A (the missing trader) who
is the importer of goods into the UK, who sells them to B, who sells them to C
who exports the goods, and is thus in a VAT reclaim position. (For simplicity we
10 shall use the expressions import and export for intra-Community trade,
acknowledging that these are not the proper labels.) Secondly, the “clean
chain,”¹ in which there are no missing traders, comprising C, who is this time the
importer, who sells to D, who sells to E, the exporter (the Appellant in this appeal
is in the position of E). The effect of the clean chain is that the net input tax
15 position of C in the dirty chain is cancelled by output VAT in the clean chain.
There is no benefit to C in this as C has paid the input tax to B, and therefore C
could be a trader who happens to carry out both import and export transactions
unconnected with any fraud, or C could be a trader who is controlled by a
“puppet master” to enter into the cancelling transactions to disguise A’s
20 involvement in a fraud. The effect of the contra-trades is that C does not excite
Customs’ attention as it is not applying for a repayment; the non-payment of tax
by A is less noticeable since without a return Customs do not know how much
tax A owes. The input tax reclaim that C had in the dirty chain has moved to E
who is at the end of a clean chain. The only way for Customs to refuse
25 repayment of E’s input tax is to show that E knew or ought to have known of A’s
fraud in a completely different chain, and possibly of C’s involvement. Since, as
we have demonstrated in our example in paragraph 4 above, the only gain from
A’s fraud is the recovery of input tax by E this must imply that E is a participant
in the fraud and, unless he is the puppet-master, is presumably sharing the tax
30 recovered with someone else. As Mr Scorey [counsel for Livewire] pointed out it
is difficult to see how a case of E having means of knowledge, rather than actual
knowledge, can arise.

35 6. The nature of contra-trading is easy to state in the above way but the problem
in real life is that there is no logical connection between the clean and dirty
chains. First, the VAT accounting periods for C and E will not coincide; E may
be on a monthly accounting period as it is a habitual exporter, but C may be on a
three-monthly period, and C need only arrange that the net tax is nil during that
three-monthly period by entering into transactions after E’s transactions.
Secondly, the goods dealt in may be different in the two chains. Thirdly, for a

¹ “We are using this expression to differentiate this chain from the undoubtedly dirty chain, without intending to pre-judge the issue of whether it is in fact clean, or part of an overall fraud, as Customs contends.”

particular C there may be many different equivalents to A and E, and for a particular E there may be many equivalents of C, each with more than one equivalents to A. Fourthly, C may not have deliberately entered into imports in the clean chain in order to cancel the input in the dirty chain; C may merely be
5 both an importer and an exporter whose outputs in relation to the former happen roughly to cancel its inputs in relation to the latter. Fifthly, there may be many Bs and Ds in between the importer and exporters.”

4. In MTIC fraud parlance, the characters referred to at paragraph 5 of the *Livewire* decision are as follows:

10 a) in the dirty or defaulter chain:

i) A is both defaulter/missing trader and importer/acquirer. That A has that status has usually to be inferred;

ii) B is a buffer; and

15 iii) C is the contra-trader and acts as broker in selling to a trader in the EU (Future in the instant case)

b) in the clean or contra-trading chain:

i) C is both contra-trader and importer/acquirer (again Future in the instant case);

ii) D is a buffer; and

20 iii) E is also a broker (Brayfal in the instant case)

We should add that in the instant case D does not exist.

5. In the instant case, the parties have agreed that the principal issues requiring our decision are the following:

25 a) Have the Commissioners established fraudulent tax losses in the deal chains of Future, the alleged contra-trader?

b) Are the transactions in respect of which Brayfal seeks input tax credit referable to those tax losses?

30 c) Did Brayfal through Mr Kibbler know or have the means of knowledge at the time of entering into its transactions that they were connected to the fraudulent tax losses?

6. Consequently, in relation to questions (a) and (b) above the Commissioners have to establish:

i) that there was a tax loss in Future’s deal chains;

ii) that the tax loss was referable to the supply chains recreated by the Commissioners; and

iii) that the tax loss referable to those supply chains was fraudulent.

5 Only if the Commissioners do establish the matters at (i) and (ii) do we have to deal with question (iii)

7. In addition there may be two associated issues for determination, and which may be summarised as follows:

10 a) a timing issue- Brayfal contends that the fraudulent tax losses had not been suffered at the time it entered into its transactions and, as such, they cannot be connected with those fraudulent tax losses

b) Brayfal contends that it has been discriminated against compared to other traders in the clean chains

15 8. Before us Brayfal was represented by Michael Patchett-Joyce of counsel, and the Commissioners by John Black QC leading Jonathan Cannan. We took oral evidence from Mr Kibbler, who is both managing director of and only shareholder in Brayfal, David Munro, a barrister and non-executive director of Brayfal, and three
20 officers of the Commissioners: Mrs. Judith Clifford, the assurance officer for Future, Mr. Kane Davies, the assurance officer for Brayfal, and Mr. Simon Devine, the assurance officer for Infinity Holdings Ltd. (“Infinity”). The remaining evidence consisted of copy documents in some 20 lever arch files.

The law

25 9. Sections 24 to 26 of the Value Added Tax Act 1994, which implemented Article 17(1) to (3) of the EC Sixth VAT Directive (applicable at the time the transactions concerned in the appeal were entered into), deal with a taxpayer’s entitlement to input tax credit. Those sections are in mandatory terms and provide that if a trader has incurred input tax which is properly allowable, he is entitled as of right to set it against his output tax liability or to receive a repayment if the input tax
30 credit due to him exceeds his liability. Provided the taxpayer holds evidence to support his claim, his right to deduct or to repayment is absolute; the only element of discretion conferred on the tax authority is to accept lesser evidence than that ordinarily required. The right is immediate, ie it may be exercised “when the deductible tax becomes chargeable” (see Article 17 of the Sixth Directive – now
35 article 167 of Council Directive 2006/112/EC of 28 November 2006).

10. However, the Court of Justice of the European Communities (“the ECJ”) has decided that there is an exception to Article 17 on which the Commissioners rely in this case. In *Axel Kittel v Belgian State* and *Belgian State v Recolta Recycling SPRL* (Joined Cases C-439/04 and C-440/04) [2006] ECR I-6161 the ECJ said, after

reviewing its earlier case law dealing with participation (knowing and unknowing) in fraudulent transactions, at paragraph 51 of its judgment, that

5 “... traders who take every precaution which could reasonably be required of them to ensure that their transactions are not connected with fraud, be it the fraudulent evasion of VAT or other fraud, must be able to rely on the legality of those transactions without the risk of losing the right to deduct the input VAT ...”

11. However, at paragraph 61 the ECJ qualified that statement:

10 “... where it is ascertained, having regard to objective factors, that the supply is to a taxable person who knew or should have known that, by his purchase, he was participating in a transaction connected with fraudulent evasion of VAT, it is for the national court to refuse that taxable person entitlement to the right to deduct.”

12. In the instant case, the Commissioners allege actual knowledge on Brayfal’s part of the fraudulent purpose behind some or all of the antecedent transactions in the relevant chains; alternatively, they argue that it could, or should, have known of that purpose. The essence of the dispute between the parties is whether Brayfal took precautions of the standard described at paragraph 51 of the judgment, and whether the Commissioners are right in their view that the information available to Brayfal was such that its directors should have realised that the transactions into which it entered in the relevant months were likely to be connected with fraud, with the consequence that paragraph 61 of the judgment must be heeded.

13. Further comments on the test set out in paragraph 51 of the judgment are to be found in *R (Just Fabulous (UK) Ltd and others v. HMRC* [2007] EWHC 521 (Admin), in *Dragon Futures Ltd v HMRC* [2006] V & DR 348 and in *Calltell Telecom Ltd and another v HMRC* (2007), Decision 20266. (We should mention that Brayfal was one of the parties to the *Just Fabulous* case). The test itself, as formulated in those cases imposes on a trader the obligation to take “all proportionate steps available to it to ensure that, on the balance of probabilities, no aspect of the transaction is connected with any other party involved in, or any other transaction involving, fraud on the public revenue through the value added tax system” (see *Dragon Futures*, paragraph 75) and that “a trader is not to be judged only by reference to knowledge he could easily have obtained, or information which he has ignored or disregarded, but is under a positive duty to take precautions” (see *Calltell*, paragraph 46). The conclusion expressed in both *Dragon Futures* and in *Calltell* was that the relevant fraud need not have been committed by another trader with which the trader in question had a direct contractual relationship.

The facts

a) Brayfal

14. Brayfal was formed in 1986 and has throughout its history been the vehicle
5 through which Mr. Kibbler has traded. As we have said, he is its only shareholder
and is its executive director. Mrs. Kibbler was company secretary until 2005 when
Mr. Van der Dose took her place. Mr. David Munro, Brayfal's non-executive
director, is responsible for advising on its due diligence.

10 15. On 4 August 1986 Brayfal registered for VAT trading initially in steel stock
holding, an industry in which Mr. Kibbler had some 9 years' experience. In 1987 or
1988 it diversified into dealing in airtime and the wholesale purchase and sale of
mobile phones. Its involvement in steel stock holding ceased in 1989 or 1990. The
15 company's trade classification was changed on 20 September 1990 to that of "other
services", the Commissioners having no separate trade sector classification for
dealings in mobile phones at the time. On 2 November 1993, Brayfal changed from
making quarterly returns to monthly returns, and on 9 October 1996 its trade
classification was again changed, on this occasion to that of "office machinery and
20 equipment". A further classification change occurred on 10 October 2001, when it
became "telecommunications". There it remains.

16. In the Statement of Case, it was said that Brayfal had changed its trade
classification to telecommunications without informing the Commissioners of the
25 change, clearly implying that its move into dealings in mobile phones was less than
honest and open. It is quite plain, and we find, that Brayfal has throughout its history
informed the Commissioners of all the changes it has made to its trading pattern and
the products in which it has dealt.

17. Brayfal started to export mobile phones to Ireland in or about 1990. In 1991
30 or 1992 it also began to export them to Hong Kong, more than 85 per cent of its sales
between 1992 and 1997 being to Legend International, a large distributor in the then
colony. On Legend International being taken over in 1997, Brayfal's supplies to
Hong Kong ceased. From 1997 the majority of its sales were to the German and
Dutch divisions of a major distributor of telephones, and it would have been a
35 repayment trader. In February 2004 Brayfal started purchasing phones from Sabatier,
a large French company, for sale in the UK market. Consequently, Brayfal was a
payment trader in the year to March 2005. It appears that it became disenchanted with
Sabatier as that company required payment of a 20 per cent deposit on all orders and
on occasions failed to supply phones as quickly as Brayfal and its customers would
40 have liked. Brayfal therefore ceased trading with it. In October 2004 Brayfal began
trading with Future. At some time in 2005 Brayfal again began exporting phones to
the European Union, thereby returning to be a repayment trader. Its turnover
increased from £27 million in the year to 31 March 2005 to £42 million in the year to

March 2006. We were provided with no reason for the change in trading pattern that occurred in 2005.

5 18. Mr Kibbler explained Brayfal's "market positioning strategy" as being "to purchase from suppliers as close to the official manufacturers' distribution channel as possible... to minimise the risk of short or late supply of stock and being inadvertently caught up in fraud...[It] has always traded with official distributors of mobile phones which do have direct sources of phones from manufacturers themselves". He claimed that Future "purchased direct from the official
10 manufacturers in Europe". Whether he simply meant "manufacturer", or intended to say "official distributor", we do not know. But whichever be the case, no evidence emerged to satisfy us that in the period with which we are concerned Brayfal did trade with official distributors of phones, or that Future dealt with manufacturers of them.

15 19. Concerned about the perceived level of MTIC fraud, in 2002 the Commissioners agreed with a number of traders in the mobile phone industry a Memorandum of Understanding ("the MOU"), coupled with a Code of Conduct. The MOU contains a recognition by the industry that "VAT fraud involving mobile
20 phones is widespread and growing significantly", and records the objective of the industry with the Commissioners' predecessors, HM Customs and Excise, to reduce the level of VAT fraud by co-operation and observance by traders of the Code of Conduct. As the requirements of the Code are of importance in connection with Brayfal's "due diligence" (the checking on the creditworthiness and reliability of suppliers and customers), we now include that part of it which relates to "Supplying
25 to a new customer":

"The following factors should be considered before supplying stock to a new customer:

- 30 • How long have they been trading and do they have any history in the trade?
- Does the customer have sufficient knowledge of the industry to warrant their level of anticipated business?
- Have they been unable to purchase stock from your competitors – if so why?
- 35 • Does the customer always want to buy, no matter what the price?
- Are the goods to be delivered to the country where the customer is resident or are they to be delivered to another country?
- Will the country of destination of your goods be the same as the country that your customer operates in and will payment originate from
40 that country?
- Is their courier or shipper reputable – if goods are being exported will original documents be available?
- What are the arrangements for payment – do you trust the customer?

- Have you met the customer – if not do you contact them through a third party?
- What knowledge do credit search companies used by you have of the customer?
- 5 • Is the customer’s bank account in a different town or country to their main business address?
- Do you have doubts over the customer’s credibility or feel there is a risk attached to the deal – is it good business acumen to trade with this person?

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If you decide to supply the customer, obtain a copy of the customer’s headed paper and VAT certificate, notify HM Customs and Excise of impending trade and request confirmation from HM Customs and Excise of the validity of the VAT number.

If you decide to go ahead with the sale, notify HM Customs and Excise”

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20. Mr Kibbler explained his view of the primary purpose of due diligence in the following way:

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“Due diligence is not a box ticking exercise. My view of due diligence is you wouldn’t enter into a transaction to purchase a property or a motor vehicle without carrying out at least some basis checks. So when you do transactions with mobile telephones, which many times is much more in value than the two items I have just given you, why should I treat that transaction with any less respect.”

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21. Mr. Kibbler signed the MOU on 9 April 2002, recording the existence of fraud in the industry as a factor in his decision to do so. He signed it with two qualifications:

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a. “I believe that there may be good reason for European companies to maintain a UK bank account and I reserve the right to deal with companies that do so (provided of course that they have already been subject to our own vigorous vetting procedures)

b. I... have reservations about the practicality of IMEI scanning and I do not issue invoices listing IMEI numbers... I do not consider that recording IMEIs is practical in most cases”.

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22. On 15 April 2002 Mr. Kibbler sent the signed MOU to the Commissioners indicating that he would not be recording or retaining IMEI numbers. IMEIs are international mobile equipment identity numbers imprinted on phones by their manufacturers. Every phone has, or should have, a unique IMEI number. The Commissioners consider the scanning and retention of IMEI numbers to be one of the most important checks a trader can make. They regard those numbers as unique and as useful in validating a type of phone, and as indicating whether a phone has been

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connected to a network and, if so, when. Further they observe that IMEI numbers can also show that a phone has been moved or sold by an individual more than once, whether it has been reported lost or stolen, or even if it has existed at all. Collecting IMEI numbers is not a requirement of the Commissioners' Notice 726, and passing the numbers to them is only to their benefit. (They are put on a database called Nemesis, which is not accessible to anyone but themselves).

23. In evidence Mr Kibbler claimed that IMEI numbers were not unique as a number of manufacturers had duplicated the numbers allocated to them. In support of that claim he produced various Internet reports dated 2002. We allowed them to be introduced. We note that the explanation for his failure to record such numbers differs from the reason he originally gave for refusing to record them, and treat his original reason as that for his refusal. The Commissioners treated Mr Kibbler's refusal to keep a record of IMEI numbers as a deliberate attempt to "block" verification of its stock: they took the view that he would take action to protect Brayfal only when it could be confirmed that the company had been involved in MTIC fraud. We accept that Brayfal could, indeed should, have done more to assist the Commissioners in combating MTIC fraud, but that is not evidence of its having been involved in fraud, or knowing of fraud.

24. From Mr Kibbler's signing of the MOU in 2002 until 2006, Brayfal's due diligence checks followed the lines suggested in the MOU, at least to the extent necessary for a trader dealing with its customers only on cash terms. But in January 2006, following discussions between Mr Kibbler and Mr Munro, they were updated. In their new form, as produced by Mr Kibbler, they read:

25 *"Working Procedures ref Due Diligence for Brayfal T/A DRK. Updated 15.1.06*

1. We check the VAT registration of each business with the national help line.
2. The VAT registration number is checked before agreeing each and every transaction, utilising EU Web Page facility.
3. We stay in regular contact with both suppliers and purchasers and undertake twice yearly site visits.
4. Wherever possible we insist on meeting with the principal(s) of any business that we deal with

35 *New Suppliers and Purchasers*

1. In all cases we engage in a site visit at the traders premises.
2. We check all prospective customers and suppliers VAT numbers and addresses with the national help line and also check the VAT number with the EU web site.
3. We check that the VAT registration is for the appropriate classification.
4. A full company search is carried out for all UK registered companies.

5. In the case of EU registered businesses, we take such steps as are practical to ascertain the details of their VAT registration.
6. Trade References are undertaken wherever possible.
7. Checks are undertaken with Freight Forwarding Agents in each case.
- 5 8. I have many years experience in this industry, and my skill and judgment are employed to ascertain the experience and working practices of the personnel of each business with whom we may deal.
- 9 If I do not already know a potential new supplier or purchaser, I will, wherever possible, take steps to meet them and view their business premises whether they are in the UK or the EU.
- 10 10. David Munro LL.B., a barrister in law is our Due-Diligence adviser. He was previously a solicitor in private practice who has advised Brayfal for the past 16 years. He has joined Brayfal Ltd in April 2003 as a Non-Executive director. He has previously “vetted” all new suppliers and purchasers and monitored our Compliance with the Code of Conduct. He will undertake the same objective functions in his new role.
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Additional and ongoing checks

- 20 1. We use the Services of Hawk Precession (sic) Logistics
2. We will not accept or make third party payments.
3. We insist on a full goods inspection check at the forwarders on all product intended for onward shipment to our customers. We require a full inspection report from the shipping agent prior to any payment being made by ourselves.
- 25 4. We have arranged goods in transit insurance via our shipping agent at an annual cost of over £250,000.
5. In the case of any shipment which we export, we retain the following documents on file:
- 30 a. Certificate of Shipment/ Airway Bill
- b. CMR documentation
- c. Ferry tickets where appropriate
- d. Completed SAD/C88 showing exit border control point
- e. Dispatch entry from HMCR CHIEF system
- 35 f. Certificate of insurance
- e.(sic) Charge advise from (sic) forward agent
6. We endeavour to co-operate fully with any reasonable enquiry from HMCE and respond fully and promptly with any information and documentation that is reasonably required
- 40 7. We maintain a ongoing record of our rejection process were (sic) Due-Diligence is not found to favourable (sic) for a prospective customer or supplier.”

25. From Mr Kibbler’s evidence, it emerged that some of the checks actually undertaken by Brayfal in the first half of 2006 differed from those listed, while others were not carried out at all. For instance, he made only 2 checks on Future – the first
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on 13 December 2005 and the other on 9 February 2006. However, even had checks been made before every deal they would have resulted in Future being cleared. Again, although Brayfal states that “Trade references are undertaken whenever possible”, Mr Kibbler’s evidence indicated that even when such references were supplied, he took little or no notice of them. We conclude that Brayfal undertook only such checks as it considered necessary to deal with its customers on cash terms, and that Mr. Kibbler may have relied on his experience with as a businessman to a greater extent than was warranted in the circumstances.

26. Those trading in mobile phones, computer chips and certain other items are recommended to verify the VAT registrations of those with whom they are dealing with the Commissioners’ verification unit at Redhill. However, they need not do so, but may instead verify registration numbers with the Commissioners’ national helpline. Mr Kibbler criticised the service provided by the Redhill office saying that he had determined not to use it having had to wait for up to 3 days for a trader’s registration number to be verified, and its having incorrectly reported to an enquirer that Brayfal was not VAT registered. Instead, he used the national helpline for verification purposes.

27. It is the practice of the Commissioners to inform enquirers at their Redhill office of the deregistration of businesses about which they have made enquiries. They do so by means of what are known as “veto letters”. In claiming that throughout Brayfal had always co-operated fully with the Commissioners and taken all necessary steps to avoid becoming involved in MTIC fraud, Mr Kibbler claimed that it had never received a “veto letter”. We do not find that surprising: such letters are sent only to persons making enquiries at the Redhill office; they are not sent to persons checking VAT registrations through their helpline.

28. Mr Kibbler was also highly critical of the Commissioners’ behaviour towards the mobile phone industry in general and to Brayfal in particular. He claimed that they had failed to live up to promises to have regular meetings with mobile phone traders and to provide them with support. He alleged that the Commissioners’ initiative to encourage interaction with traders had died out, citing a statement allegedly made by their head of UK tax fraud policy at a Manchester conference in 2003 that the MOU “was not worth the paper it was written on”; and accused them of “acting on an ill informed and predetermined view of the market place”. It was plain that Mr Kibbler sought, indeed demanded would not be too strong a description, confirmation from the Commissioners that were the due diligence checks he had decided upon to be carried out, Brayfal’s input tax claims would be met promptly and without extended verification. Not surprisingly, that confirmation was not forthcoming for, as the Commissioners explain in Notice 726, “A definitive checklist would merely enable fraudsters to ensure that they can satisfy such a list”.

29. Prior to March 2006 Brayfal had two earlier input tax claims disallowed. Both were later paid. The first related to a claim of £45,911.26 in relation to period 01/03.

The Commissioners disallowed the claim on the basis of Brayfal being involved in “non-economic activity”. They did not contend that Brayfal was knowingly a party to any fraudulent activity, nor did they criticise its trading practices or the manner in which it conducted its business. What they did contend was that the transactions in question lacked economic substance, and that a fraud was said to have occurred elsewhere in the supply chain which was unrelated to Brayfal. On the ECJ declaring the non-economic principle to be unlawful in *Optigen Ltd, Fulcrum Electronics Ltd and Bond House Systems Ltd v Customs and Excise Commissioners* (Joined cases C-354/03, C-355/03 and C-484/03) [2006] STC 419, an appeal by Brayfal to these tribunals was allowed, and its claim was met.

30. Secondly, in January 2004 Brayfal was informed by the Commissioners that certain goods in which it had dealt may have emanated from an illegitimate source of supply, and its VAT repayment claim for that month was subjected to verification. It had not dealt directly with the trader who had allegedly failed to account for VAT and the Commissioners accepted that it was not aware of the identity of that trader. Brayfal had bought the goods from ACL Distribution Ltd (“ACL”), an official distributor of Nokia accessories. Although there was no suggestion that ACL was involved in the alleged fraud, Brayfal ceased trading with it. Repayment of the amount claimed by Brayfal was made in March 2004.

31. To those indications that MTIC fraud was a serious problem and that Brayfal should perhaps have recognised that it was involved in an industry in which fraud was not merely widespread, but rife, there is a third we must add. Early in 2005, National Westminster Bank plc, with which Brayfal had dealt since 1986, informed it that its accounts would be closed. Mr Kibbler was informed that the bank and all the other main clearing banks had adopted a policy of closing the accounts of all customers trading in mobile phones as recommended by the Commissioners. Mr Kibbler then approached other high street banks, and indeed made presentations to some, in the hope that Brayfal might obtain facilities from one of them. But they seemingly had all adopted the same, or a very similar, policy to NatWest, so that none was prepared to act. In the event, Brayfal was able to obtain facilities from the Allied Irish Bank and Whiteaway Laidlaw Bank.

32. In relation to the transactions with which we are concerned, Brayfal sourced mobile phones from a supplier only after having received an order from a prospective purchaser, and made a profit on all the deals it undertook. As we mentioned earlier, it started to trade with Future in October 2004, that company having agreed that Brayfal should not pay for stock purchased from it until it had been inspected. It is plain that Future agreed to deliver stock to Brayfal’s freight forwarder, Hawk Precision Logistics Ltd (“Hawk”), for inspection by that company before being paid for it. And on the basis of Brayfal’s bank statements produced to us showing that it never paid Future for stock until it had itself been paid by its own customer for that stock, by when Brayfal’s customer had possession of it (and, according to Brayfal, had become its owner on payment), we further find that Future sold goods on credit to Brayfal.

33. We do not have full details of the due diligence checks carried out by Brayfal on Future before the two commenced trading with each other. We do however know that it made a search on Future at Companies House in October 2004 (which exercise was repeated in August 2005). We were told, and accept, that Mr Munro was asked by Mr Kibbler to prepare a report on Future, and was provided with a “floppy disc” containing his instructions, that disc has now been lost or mislaid, so that it was not produced to us, and we do not know its precise contents.

34. What we do have is a letter from Mr Munro to Mr Kibbler dated 12 October 2004, and various other documents. In the letter, Mr Munro said this:

“Following our telephone discussions I write to confirm that I have now received the information concerning Future Communications UK Ltd.

I understand that with difficulties in securing stock between now and Christmas (a situation that arises in most years), it is desirable to find additional suppliers in order to be able to meet the expected demand for product. Due to the chaos created by the HMCE activities over the past two years, it may well prove more difficult than usual to obtain sources of supply.

It may well be that fraud has become less commonplace than in the past but there remains a clear need to retain the procedures that you have established in order to avoid dealing with supply chains involving missing traders.

I have considered the financial and accounting information that you provided by way of floppy disc in relation to this company. It reveals nothing to the detriment of the company, albeit that the only filed accounts are in an abbreviated form and contain very little detail.

The company has hitherto complied with its legal obligations with regard to the filing of accounts and annual returns.

I note that it has traded for 3 years or thereabouts, but this information has been gleaned from the statements made by the director, Mr Ravjani, rather than from any independent source.

I am reassured by the fact that you have visited the premises, which they appear to own and that you have satisfied yourself that they have good working procedures that correspond to those used by Brayfal.

A commercial reference has been obtained from a freight forwarder [Hawk] who has no reservations about dealing with them and you are satisfied that the sales director at Future Communications has some 4 years plus industry knowledge.

Subject to the usual levels of diligence being maintained there appears to be no reason why Brayfal should not trade with this company.

Please let me know if I can be of any further help.”

5 35. Amongst the copy documents said to have been produced to Mr Munro, and
produced to us, was an abbreviated set of Future’s accounts for the year to 30 April
2004, its VAT registration certificate confirming that it made returns quarterly and
was registered on 19 March 2002, its certificate of incorporation dated 30 April 2001,
its memorandum and articles of association, and a number of manuscript visit reports
10 prepared by Mr Kibbler. The accounts show that in the year to 30 April 2003 Future’s
turnover was £1,117,170, and in the year to 30 April 2004, £52,596,792; that it had an
authorised share capital of £1,000 and issued share capital of £1; and that the net book
value of its assets in 2004 was £8,000. (We do not understand how a limited
company, which must have at least 2 shareholders, can have issued share capital of 1
15 £1 shares). Mr Kibbler’s first visit report, dated 22 September 2004, with spelling
corrections, reads thus:

20 “Visited Commercial House, Honeypot Lane, Stanmore [Future’s trading
premises]. Met with Mr Raj Gathani. Knew sales director him from his
previous employer Leyos Telecom London. All stock owned by them prior to
sale. Good industry background. Known to Hawk Freight. No problems. Bank
with Barclays Bank. Good product knowledge. Has own warehouse. All docs
in order. Confirmed carries out checks on supplier & customer. All stock
funded with own money.”

36. How Mr Kibbler knew that Future “owned all stock”, and how he checked that
the stock was funded with its own money was not explained to us.

25 37. We observe that neither Mr. Kibbler nor Mr. Munro took any notice
whatsoever of Future’s short trading history or its rapid increase in turnover, the
former apparently being over impressed by the fact that it taken over a company
called Unique Distribution, which at one time had been part of the British Leyland
Group.

30 38. We accept that Mr Kibbler paid other visits to Future’s premises, and made
short notes of what he found and did on the visits, but we find it unnecessary to
rehearse their contents.

b) Universal

35 39. Early in December 2005, Mr Jason Davis, an Englishman resident in London,
telephoned Mr Kibbler to introduce his company, Universal Handels GmbH
(“Universal”) of Vienna, and indicated that he wished to commence trading with
Brayfal. Mr Kibbler, who had never met Mr Davis, enquired of his experience of the
mobile phone industry, and discussed with him products and pricing. Mr Davis said

that he had previously worked for Aztec Communications, an airtime provider based in Cheltenham, whose name was known to Mr Kibbler. As a result of their discussions Mr Davis satisfied Mr Kibbler that he had experience of the mobile phone industry. Brayfal and Universal then exchanged company details, and Brayfal was provided with a copy of Universal's VAT certificate and other documents issued by the Austrian revenue authorities. The certificate, which was, of course, in German, showed Universal as having capital of 35,000 euros, and to have been registered on 3 December 2003. That certificate gave the lie to a statement in a standard form letter introducing Universal to Brayfal in which it stated that the company had "over fifteen years experience in the telecommunications sector". On 13 December 2005 Mr Kibbler called the Commissioners' national helpline and verified Universal's registration number. He subsequently also verified it on the EU Taxation and Customs Union website. In addition, Mr Kibbler obtained a credit report on Universal, but from whom the report does not make clear. The report contains a number of interesting statements. Mr Davis is shown as being the holder of 100 per cent of its share capital, and his address is given as Ealing, London. Under "identification details – phone", it is stated "no telephone connection/fixed network". It also gives a "Graydon credit rating" of 8, explained as "an unclassified risk (risk unknown), used on brand new companies as an example".

40. At about the same time Brayfal was provided with details of Universal's bank accounts with First Curacao Investment Bank BV ("FCIB") of the Dutch Antilles, and the Erste Bank of Austria. Kane Davies maintained that Universal had an English bank account with HBOS plc. Whether it did so is unclear and is not a matter we regard as critical. Mr Kibbler informed Mr Davis that Brayfal did not sell goods on credit but required "the money to be in the account before we ship the goods or we want confirmation advice that the money is there". Mr Davis, having apparently accepted Mr Kibbler's requirement as to pre-payment, explained that "the Austrian bank was not a member of the standard wire international funds transfer system and payment [from that source] could take up to three days". He therefore asked, "Is it ok to pay through the FCIB account?", to which Mr Kibbler answered in the affirmative, having had satisfactory previous experience of payments from FCIB.

41. As we have explained, Mr Munro's function within Brayfal was to advise on its due diligence checks; he prepared reports on prospective customers based on information provided for the purpose by Mr Kibbler. (Mr Black submitted, and we accept, that that hardly amounted to objective due diligence, for Mr Munro carried out no original checks of his own). In dealing with evidence relating to the FCIB, Mr Munro said it "was not an organisation that I entirely approved of... I would not want to see [an FCIB account] used unless absolutely necessary... I had nothing before me to suggest that there was anything wrong with the banking institution itself. My concern was that the opinion of the authorities was likely to be exactly what you [Mr Black] have expressed that, if you are using an offshore bank, there has to be some sinister purpose behind it... We now know that there were problems with FCIB, but those were not widely known at the time." (The Dutch authorities have now closed

the FCIB because of suspicions that it aided money-launderers). We doubt that Mr Munro was made aware that Universal would be paying Brayfal through its FCIB account, but despite his likely objection to it, in the event all payments for supplies made to Universal were made through its FCIB account. We do not find payment through FCIB to have been surprising: the UK Government had effectively closed down the accounts of traders in mobile phones with the UK clearing banks (see paragraph [31] above).

42. On a date in January 2006 unknown to us, Brayfal sold a quantity of mobile phones it had bought from Future to Universal in what Mr Kibbler described as a “test transaction”. At the time Brayfal had carried out no due diligence checks on Universal other than those mentioned in the pre-penultimate paragraph. Mr Kibbler explained that he had intended to travel to Vienna to inspect Universal’s premises before commencing trade with it, but had been prevented from doing so by having a heavy cold. He claimed that he considered it necessary to check Future’s VAT registration details with the Commissioners’ helpline only on carrying out alternate deals. As we mentioned earlier, we find that he did not even carry out checks on that basis but as we have already explained, did so only on 13 December 2005 and 9 February 2006.

43. Mr Kibbler recovered sufficiently to visit Vienna on 1 February 2006 when by appointment he met Mr Davis at Universal’s premises. That was the only occasion on which the two ever met. Mr Kibbler described Universal’s premises to be, and to be registered as, a freight forwarder’s warehouse where stock was stored, adding that “It was obvious that he [Jason Davis] was renting a portion of the building as and when he needed it”. Mr Kibbler produced six dated photographs taken during his visit. Before we comment on them, we should note that he explained their purpose merely as “proof that I had actually been to visit”. The first photograph shows a large windowless wall of a warehouse or factory on which is a sign saying “Logotec – High Tech Logistik & Services der Quehenberger – Gruppe”. Two small enclosed horse-box type trailers appear parked against the wall. The second photograph shows a number of boxes or packing crates on each of which the word “Nokia” appears. The third is of an office containing two office chairs, two desks with a few papers on them and little else. The fourth is of the number plate on Herzigasse, the street in which the premises are situated. The fifth photograph is of another wall of the warehouse in which there are some windows and shows a few parked cars, and the sixth is of nothing more than some loading bays all of which have their shuttered doors firmly closed. When asked what in due diligence terms he would be looking for in the photographs, Mr Munro replied, “Substance, real activity, telephones, computers, paperwork, people working there, phones ringing”. Ignoring the last mentioned of those signs as being non-visual, not one of the remainder is present in any of the photographs. The most significant feature of the whole group is that in none of them is there any sign of life or activity of any sort: it was as if the premises had recently been vacated and their previous occupier had left behind a few unwanted items of furniture. Mr Kibbler would have us accept that when he arrived the area was very busy, and the photographs were taken over the lunch break when things were quiet.

We accept that explanation, despite Universal having a monthly turnover in excess of 100 million euros. Mr Munro also explained to us his opinion of the relevance of a site visit as part of due diligence saying that, “you want to see real evidence of trade, which is one of the reasons for going physically to look to see that there is actually business activity taking place; and the more established and the more permanent that appears to be, the greater the re-assurance”.

- 5 44. In February 2006, Brayfal entered into two transactions with Universal, on each occasion making the related purchases from Future. The input tax claim arising from them was duly met by the Commissioners.
- 10 45. In March 2006, Brayfal entered into nine deals with Future for the purchase of mobile phones. In each case Universal was Brayfal’s intended customer. Details of those transactions are contained in the following table:

Supplier to Future	Purchase Invoice	Date	Model	Qty	VAT £	Sales Invoice	Date	Qty	Model
Vertex Alpha Esat	4449	17 March 2006	N8800	1700	133,875	3613 3615	27/03/06	1000 1000	
Vertex	4450	17 March 2006	N8800	1620	127,575	3614 3615 3616	27/03/06 27/03/06 27/03/06	1000 1000 320	
Alpha Vertex	4451	17 March 2006	N9500	1000	70,000	3618	27/03/06	1000	
Alpha	4452	17 March 2006	N9500	1176	82,320	3616 3617	27/03/06 27/03/06	176 1000	
Vertex Alpha	4775	30 March 2006	N9300i N9500 Vertu	656 670 23	99,782	3620 3621	30/03/06 30/03/06	500 500 23 156 170	N9300 N9500 Vertu N9300 N9500
Alpha	4775	30 March 2006	Nokia N70’s Serene*	1585 111	101,115	3619 3621	30/03/06 30/03/06	1000 111	N N70 Serene

Alpha Vertex	4776	30 March 2006	N8800	1500	115,500		April Sale		
Alpha Esat	4776	31 March 2006	N8800	530	40,810		April Sale		
Alpha Racheltel Vertex	4833	31 March 2006	N9500	2000	140,000		April Sale		

Vertex: Vertex Trading Sarl (Luxembourg)

Alpha: Alpha C ApS (Denmark)

Esat: Esat ApS (Denmark)

5 Racheltel: Racheltel (Spain)

* The VAT on the Samsung Serene phones was the subject of the assessment referred to in paragraph 1 of our decision.

46. In relation to Brayfal's transactions in period 03/06, Mr Kibbler said that he
10 "spoke with Universal regarding the stocks it was looking for". By that we understood him to mean that Mr Davis contacted him to ask whether he could obtain supplies of various mobile phones Universal wished to purchase. He continued, "I contacted Future and another trader to enquire whether they had stock available, or whether they were receiving [stock] in the near future; the type of stock I was looking for". Mr
15 Kibbler did not identify that other trader. We find that Brayfal only received supplies from Future in March 2006. Once Future confirmed that it had access to the necessary stock at a suitable price, Universal was asked to and did send Brayfal a purchase order for it. Brayfal in turn submitted a purchase order to Future. When the stock was available, Future delivered it to Hawk as Brayfal's freight forwarder and inspection
20 agent.

47. Hawk is based near Heathrow Airport, about 100 miles from Brayfal's base in the west midlands. Brayfal has always outsourced its warehousing requirements so that it has never had physical possession of the goods it had purchased. Mr Kibbler
25 claimed to have visited Hawk on occasions, but he failed to satisfy us that when he did so he carried out any physical inspection of goods purchased by Brayfal, relying entirely on Hawk's examination of them. Although stock may have left Hawk's premises prior to its being paid for by Universal, it was not released to Universal until either Brayfal was paid for it, or had assurances from its bank that the money was in
30 the process of being transferred to it within the money transfer system.

48. Mr Kibbler produced copies of Brayfal's instructions to Hawk to prepare inspection reports on goods purchased from Future explaining that the instructions

were given in relation to every purchase. On each was a requirement for “full inspection”. Confirmation was requested of:

- 5 1) “The inner packaging retail/ carton is the manufacturer’s original, and the goods are in a new unused saleable condition
- 2) The correct no of telephones are actually present
- 3) Each box contains 1 handset, charger, battery, user manual, warranty information. Disc/Booklet
- 10 4) The telephones are not simm locked in any way.”

15 49. Despite the unequivocal nature of the instructions to Hawk, Mr Kibbler maintained that in the mobile phone industry “full inspection” meant a “100 per cent box count” and checks on “the contents of approximately 20 per cent of boxes”, plus a “sample check” for SIM locked products. That, as we understood him, was the extent of the checks Hawk was intended to carry out.

20 50. Mr Kibbler further maintained that Hawk then provided confirmation that the goods were satisfactory, adding that “Until Brayfal receives confirmation that the goods that have been supplied to Brayfal are exactly as agreed between Brayfal and their supplier they remain the property of the supplier. This is stated on the purchase order”.

51. What is in fact stated on Brayfal’s purchase order is this:

25 “Brayfal Ltd reserve the right to refuse any goods that do not conform exactly (sic) to the specification laid down in this order. If delivery is accepted and [it] is later discovered that the goods differ from those specified in this order, then Brayfal Ltd reserve the right to reject the goods and a refund issued (sic). Brayfal Ltd reserve the right to cancel
30 the above order at any time.”

52. Assuming those to be the terms and conditions on which Brayfal purported to trade, we observe that they contrast with the terms and conditions stated on Future’s invoices. The latter provide:

- 35
- “1. Above goods remain property of Future Communications (UK) Ltd until full and final payment is received in cleared funds.
 2. Allocation of stock is strictly on a first-come, first-serve basis.
 - 40 3. Upon accepting the above goods, the customer certifies that they have carried out all necessary due diligence with their local authorities and otherwise as necessary to determine their customer to be bona fide and of good standing at the time of this transaction.”

45 53. Mr Kibbler’s evidence continued by his claiming that once Brayfal had confirmed that the goods were those for which a purchase order made provision, the

contract was “deemed to have been completed with the supplier and those goods belong to Brayfal, subject to there being no further discoveries that they are not fit for the purpose of the supply. These conditions are not only set out in the terms of the purchase order, but...are implied into any contract by the Sale of Goods Act 1979
5 and/or the Supply of Goods and Services Act 1982, thereby providing Brayfal with certainty and the potential for legal redress”.

54. It is quite plain, and we find, that Brayfal did not enter into contracts with clearly defined terms and conditions: its purchase orders clearly sought to impose some
10 conditions whilst Future’s invoices set out its own terms and conditions, some at least of which differed from those Brayfal claimed to impose.

55. Brayfal’s entire pattern of trading in the period with which we are concerned followed that we have just described, except that on certain specific occasions which
15 are irrelevant in the present context it purchased phones for sale on a speculative basis, i.e. for which it had no purchase order. Further, all the deals to which we have referred were carried out in sterling.

56. In evidence Mr Kibbler claimed that he had discovered quite early in Brayfal’s
20 dealings with Universal that the delivery of phones to Austria would have been quite expensive, and to have suggested to Mr Davis that it would be cheaper for them to be transferred to another nearer country within the EU for combination with a larger load for onward transmission to Austria. Mr Davis asked that the phones be sent to its own freight forwarder, Boston Freight of Veurne, Belgium. As Brayfal was responsible
25 for the cost of both carriage and insurance, so that transport to a country nearer than Austria would have saved it money.

57. Boston Freight provided Brayfal with its “full account fax along with their VAT certification and taxation documents from the Belgium (sic) authority”. It also
30 provided Brayfal with an account opening pack, but as Brayfal was not using Boston Freight’s services, Mr Kibbler found that he had no need to open an account with it. Brayfal carried out no due diligence on Boston Freight, Mr Kibbler refusing to accept that it would be reasonable to do so because it was not his freight forwarder. He maintained that if there had been anything untoward in dealing with it he would have
35 expected Hawk to “mention something to me”. The Commissioners’ evidence indicated quite clearly that Boston Freight was well known to the revenue authorities both in the UK and elsewhere as a firm used by those involved in MTIC fraud. Its premises were described as nothing more than “a barn by the side of a road”. When asked to produce its records by the Belgian authorities, Boston Freight claimed that
40 they had been destroyed in a fire.

58. In its return for period 05/06, Brayfal claimed input tax under invoices for four deals. Two of those deals were, according to Mr Kibbler, “cancelled” in
45 circumstances we shall shortly describe, notwithstanding that Mr Patchett-Joyce submitted that the related claims, and a single claim for period 06/06, should be

5 ignored since they were subsequently withdrawn. He did so saying that it was questionable whether the tribunal had jurisdiction to deal with them, and that the tribunal did not deal with hypothetical questions. In our judgment, we do have jurisdiction to consider them; the claims were made in a period of time with which we are concerned, and are relevant to the issues before us.

10 59. The remaining two deals took place before the “cancelled” ones. On 15 May Brayfal placed two purchase orders with Future for a total of 2800 Nokia 8800 phones at a price of £410 per phone. On the same day Future invoiced Brayfal for its purchases. In invoice no 5662, relating to 1800 phones, it charged £738,000 plus VAT of £129,150, a total of £867,150; and in invoice no 5663, relating to the remaining 1000 phones, it charged £410,000 plus VAT of £71,750, a total of £481,750. On 19 May Brayfal paid the net sum due under each invoice having sold and been paid for the entire consignment by Universal the previous day. And since the sale was to an EU trader, it was, of course, zero rated for VAT purposes. Brayfal made a gross profit on the deals of £68,600.

20 60. Mr Kibbler’s witness statement, which formed the basis of his evidence-in-chief; contained no mention of the underpayments. However, evidence of them had to be dealt with as Brayfal’s bank statements clearly revealed them and the invoices themselves contained Mr Kibbler’s clear manuscript endorsement, “ These goods have been received delivered paid for but only the goods part have been paid for”. Consequently, in an oral supplement to the witness statement the following exchange between Mr Patchett-Joyce and Mr Kibbler (taken from the transcript) took place:

25 Q. Could you turn in bundle 5 to tab 29 and look at page 952 which should be a copy of Future’s invoice to Brayfal, invoice number 5662?

A. Yes

30 Q. And we can see that the total amount net of VAT was £738,000?

A. Yes

Q. To which VAT of £129,000 was added, but, if we look at the paid stamp, it indicates that, in fact, the amount of £738,000 only was paid?

A. That is correct.

Q. Can I ask you to turn on to tab 30 and look at page 960?

35 A. Yes

Q. Is that invoice number 5663?

A. It is

Q. Again, we see that the amount paid was the amount net of VAT and not the VAT inclusive sum?

40 A. That is correct

Q. Now. First of all, is it right that you only paid the £738,000 and the £410,000?

A. That is correct

45 Q. And how did that come about? Was there any intention not to pay the VAT?

A. No, this was an administrative error that I only paid the goods – both payments, I believe, were paid on the same day and inadvertently I only paid for the value of the goods in error.

5 Q. And what steps have you taken in relation to ensuring as to - have you asked Future as to whether they have accounted for the VAT?

A. When I realised this in early June, I spoke to Future Communications and said that I had inadvertently part paid two invoices. They said that their books and records had been uplifted in June and they could not confirm this. I said, well, it is correct.

10 Q. Just a minute, I think you have identified the year, but perhaps you should just be clear about the year that you are talking about, which June?

A. 2006...

Q. Thank you

15 A. ...and I advised Future Communications that I had part paid these invoices in error. Future confirmed to me that in any event the outstanding VAT would be correctly accounted for in their records and it was an error, that these figures have been recorded in our annual accounts, in our annual audited accounts as an extraordinary item for the financial year 06/07.

20 Q. So if anyone wanted to check on that with those financial records there are publicly available financial records?

A. Publicly available at Companies House, that is correct.

Q. So on the evidence you have just given, so far as you are aware, the VAT has been accounted for by Future?

A. That is correct.

25 Q. Therefore, in so far as debt existed, it existed between you and Future?

A. That is correct

Q. And that forms the subject matter of the extraordinary item in the accounts which are not* publicly available?

A. It does.

30

(* Inclusion of the word “not” would appear to be an error in the transcript).

61. The remainder of the evidence relating to Brayfal’s claim is contained in the cross-examination of Mr Kibbler by Mr Black as follows:

35

Q...When these goods which had been acquired and sourced from Future Communication formed part of the transaction for the sale to Universal, when do you say that title in the goods passed to you?

A. In line with Future’s terms and conditions.

40

Q. Well, had you made full payment for the goods?

A. No, but I had made Future aware, when I realised we had inadvertently made a part payment, I did bring it to their attention.

Q. Do you have any documents from Future Communications in relation to that?

A. They have chased the money and they have sent us through statements that the money is owed to Future Communications.

Q. Have you ever paid the money to Future Communications?

5 A. I have discussed it with our solicitors and our accountants and at this stage in time [22 April 2008] that money has not been paid over to Future Communications. It is recorded in our accounts as an extraordinary item.

Q. An extraordinary item. Did you tell Mr Davis that you had not paid Future Communications all of the money that they were expecting to receive?

10 A. Mr Davis had all the bank statements and all the documentation, so I would have presumed that – this documentation was presented to the judicial review so I would have presumed that he would have been aware that we had inadvertently made a part payment to Future.

Q. I think I am really speaking about Mr Jason Davis in Vienna. Did he know about the fact that...

15 A. I am sorry, I thought that you were talking about...

Q. I thought you did. I understand and I realised that you were mistaken. Rather than labour under a misapprehension, Mr Kibbler ...

A. Sorry

20 Q. No, please do not be. I corrected it. Did the Viennese Jason Davis know anything about the fact that you had not paid Future Communications all the money?

A. In my view that is not business of our customer. I cannot recall bringing it up and I cannot see why I would bring that to his attention.

Q. So the answer is that you did not?

25 A. I cannot recall doing so. I cannot see why I would, so I did not.

62. It will be recalled that Mr. Kibbler maintained that the underpayments of invoices 5662 and 5663, totalling £200,900, were “mistakes”. Had they been so, we should have expected them to have been corrected immediately, or at the latest very

30 shortly after, they were discovered. But Brayfal having, according to Mr. Kibbler, discovered and informed Future of the “mistakes” in June 2006, did not correct them by making payment; indeed, it has still not made payment. (In the ordinary way, we find it hard to imagine Mr. Kibbler contacting Future to inform it of the mistakes, and not promising to make payment immediately. Yet, according to Mr. Kibbler, that

35 is what happened). It was implicit in his evidence that there was no question of the consideration for the supplies in question being reduced, or of Future agreeing to forego the payments. Nor did Mr. Kibbler suggest that there was any reason for withholding payment; Brayfal’s onward sale to Universal was completed and payment was made in full by Universal. That Brayfal had monies more than sufficient to cover

40 the total amount due is apparent from our finding that on 18 May 2006 it had on current account with Allied Irish Bank over £1.2 million, to which an additional £500,000 was added later the same month. Further, the sums owed to Future were carried forward in Brayfal’s records to its annual accounts for the year to 31 March 2007 as an “extraordinary item”. In accountancy terms there was nothing

45 “extraordinary” about the underpayments; they were perfectly ordinary sums owed to

a creditor. Mr. Kibbler also maintained that he had been assured by a representative of Future that it had accounted or would be accounting for the tax charged on the two invoices.

5 63. The “cancelled” deals in period 05/06 involved 3010 Nokia 9500 phones for
which Brayfal prepared purchase orders on 22 May 2006, but which it did not fax to
Future until 25 May. Future must have been aware of the orders prior to receiving the
10 fax for it invoiced Brayfal for the full order on 23 May. The tax inclusive sum
invoiced was £1,343,965. Brayfal claimed to have received written purchase orders
for the goods from Elandour, a French company, before placing the order with Future,
but they were not produced to us. In evidence, Mr Kibbler claimed that as a result of
the Commissioners’ decision of 25 April to subject its 03/06 return to extended
15 verification it “was not in a financial position to take delivery of and pay for some of
the stock”. For the following reasons we do not accept that that was so. As Brayfal did
not release goods to its customers until it had itself been paid for them, and since it
had credit available to it from Future (see paragraph [32] above), it required capital
only to the extent of the potential VAT liability to fund the purchases. (We accept that
Brayfal had exposure to a risk of loss limited to its output tax liability on the deals
less its profit, but regard that as a different matter, and certainly not one that affected
20 its ability to carry out the deals in question. We also accept that extended verification
of its input tax claims may have affected its ability to continue trading in the longer
term, but again it did not affect its ability to carry out the “cancelled” deals). But even
without the benefit of credit from Future, we find that Brayfal had the necessary funds
to pay the invoiced sums. On 18 May 2006, the latest day for which we were shown
25 bank statements, the credit balance on its current account with Allied Irish Bank stood
at £1,221,833.57. Nothing in the evidence indicated that Brayfal had commitments
later in that month which were likely to reduce that sum to any appreciable extent.
Towards the end of May Brayfal received repayment of its input tax claim for period
04/06 in the sum of £518,179, pointing to its then having had cash available of over
30 £1.7 million - a more than adequate sum to discharge the monies owed. Further, as in
both April and May Brayfal entered into other transactions, clearly the
Commissioners’ decision to verify its 03/06 return did not prevent it from continuing
to trade. Finally, we observe that cancellation of the deals occasioned Brayfal no
inconvenience, any liability to compensation or to a penalty, indicating a lack of
35 commerciality in them. We do not accept Mr Kibbler’s evidence of the reasons for
“cancelling” the deals, believing his real reason for “cancelling” them to be potential
losses on future deals in the absence of repayments of input tax by the
Commissioners.

40 64. There is another matter relating to the 05/06 “cancelled” deals which a fortiori
causes us to to reject Mr Kibbler’s evidence as to Brayfal’s being unable to fund its
05/06 purchases. In a schedule of its May transactions submitted to the
Commissioners with the 05/06 return, Brayfal referred to the phones in the deals as
being “in stock”. Mr Kibbler claimed that he agreed with an assurance officer
45 responsible for Brayfal prior to Mrs Clifford that it should record “cancelled” deals in

that way. We accept that such an arrangement was put in place to deal with stock that Brayfal had actually purchased and which it held, but whose sale was held over the end of one month to the beginning of the following one, but we do not accept that it extended to deal with invoices relating to transactions which had been “cancelled”.

5 We also reject that claim.

65. On 4 January 2007, Brayfal, by its solicitors, Messrs Hassan Khan & Co (now The Khan Partnership), informed the Commissioners that it was withdrawing its input tax claims for the “cancelled” deals including one for period 06/06 (see paragraph [70] below), and submitted a voluntary disclosure in respect of them. Later the same month it produced to the Commissioners debit notes it had issued to Future relating to the cancelled deals. Evidently, no credit notes were issued to Brayfal by its customers.

66. In his evidence in chief, Mr Kibbler claimed that “Brayfal took the commercial decision in December 2006 to cancel those purchases”. That contrasts with an admission in cross-examination that he “cancelled” the deals either late in May or very early in June. Brayfal’s return for period 05/06 is dated 3 June 2006. Having considered Mr Kibbler’s evidence most carefully, we conclude and thus find that Brayfal withdrew from the deals before it submitted the return in question.

67. In his closing submissions, Mr Patchett-Joyce maintained that “there is some misunderstanding on the part of the Commissioners regarding the time of supply rules for VAT purposes, in particular as to whether Mr Kibbler could seek recovery of input tax on the invoices received. The tribunal is familiar with the fact that VAT becomes due at the time of supply. The time of supply can be treated as taking place on the occurrence of various steps, including when the parties agree or at the time the tax invoice is issued; not necessarily when the goods are physically supplied”.

68. We regard that submission as totally misconceived, for we are not dealing with a genuine supply. No entitlement to input tax can arise unless any payment relates to a supply of goods or services, even if a VAT invoice is issued. As Advocate-General Leger opined in *Finanzamt Osnabruck-Land v Langhorst* [1997] STC 1357 at 1365:

35 “ 54. In [*Genius Holding BV v Staatssecretaris van Financiën* (Case 342/87) [1991] STC 239 the ECJ] was asked whether the amount of VAT which is owed solely because it is mentioned in an invoice may be taken into account for the exercise of the right to deduct provided for in the Sixth Directive. The court held that it could not, considering that ‘the right to deduct may be exercised only in respect of taxes actually due, that is to say, the taxes corresponding to a transaction subject to VAT or paid in so far as they were due’ [1991] STC 239 at 250]

40 55. The court [251] anxious to combat tax evasion, thus decided that it was necessary to determine the amount of the right to deduct by reference to the taxable transaction, which amounts to depriving invoices of their function of

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evidencing the right to deduct where they do not correspond to any transaction...

56. According to the *Genius Holding* judgment at 250, the information in the invoice does not have as much weight as the reality of the taxable transaction, at least with regard to exercise of the right to deduct...”

69. Brayfal and Mr Kibbler had available to them specialist advice both from the solicitors, Messrs Hassan Khan & Co (who specialise in indirect tax matters), and from Mr Munro. Both, if asked, should have advised that the input tax claims relating to the “cancelled” deals should never have been made. But in any event, it should have been obvious to Mr Kibbler that he was not entitled to recover as input tax VAT which Brayfal had not paid and, if the deals were in fact cancelled, would never be called upon to pay.

70. In relation to period 06/06 Brayfal made a further input tax claim, on this occasion in the sum of £100,100 in respect of a single transaction, again said to have been “cancelled” before completion. By then Mr Kibbler claimed to have decided to obtain supplies from a source other than Future. He chose to deal with Infinity, another company alleged by the Commissioners to be a contra-trader. Initially, Brayfal agreed to purchase phones from Infinity for a proposed sale to Universal but claimed to have cancelled the transaction for the same reasons it had cancelled those in period 05/06. Brayfal’s return for the period is dated 1 July 2006. As in relation to “cancelled” transactions in period 05/06, Mr Kibbler claimed to be unable precisely to remember when Brayfal “cancelled” the transaction with Infinity, but said that it would have been late in June or early in July. Once more, on the basis of his evidence in cross-examination, we find that Brayfal withdrew from the transaction before making its return. Further, Mr Kibbler claimed to be unable to remember why the Infinity deal had been “cancelled”, saying “it would have been financial difficulties as well, but there was an accumulation of reasons: the uncertainty with Infinity, being subject to extended verification, and not knowing what was going on for the first time in 20 years...I just didn’t know what was going on”. He failed to elaborate on those reasons.

c) Future

71. The Commissioners maintain that the contra-trader allegedly involved in the scheme to defraud the revenue with which we are concerned was Future. Future was incorporated on 30 April 2001. It registered for VAT on 19 March 2002, its categorisation being “other electronic and equipment” (sic). Its VAT registration certificate showed that it made returns on a quarterly basis.

72. Mrs Clifford explained that the Commissioners were in the process of investigating Future and its activities. She disclosed that on 1 June 2006 its directors had been arrested, and its records uplifted. The directors were subsequently released, and when the hearing began we were told that Future continued to trade. However, by

April 2008, when Kane Davies gave evidence, he said that its directors had “fled to Dubai”. We accept his evidence in that behalf as fact. By then Future had ceased to trade and had become the subject of a management receivership order made by the Crown Court under section 48 of the Proceeds of Crime Act 2002.

5 73. By November 2007 Future had become, in size, what was described to us as
perhaps the biggest contra-trader the Commissioners had encountered. For the period
from 1 February 2004 to 31 July 2006 the net value of its declared sales was
£3,240,548,174.00, and its net liability to VAT, £133.89. Its uplifted records showed
10 it as having undertaken 5326 deals with a net value close to £2 billion in the first six
months of 2006. Whether all the deals were in mobile phones, we know not. In 3281
of those deals it had acted as a broker, and in the remaining 2045 as a buffer. In 1617
of the latter (79 per cent) the acquisition chains were short: Future acquired the goods
from the EU, and sold them to a UK company such as Brayfal which then exported
them outside the UK with no apparent UK tax loss.

15 74. Not surprisingly, given the sheer number of Future’s transactions, the
Commissioners not only had difficulty in analysing its transaction chains, but found
the process to be very time consuming. Nevertheless, Mrs Clifford informed us that
analysis of over 66 per cent of Future’s broker chains covering the first six months of
20 2006 had been completed, and all the chains had been traced back to a UK tax loss.
As at 19 September 2007, tax losses caused by defaulting, missing or hijacked traders
in those chains had been identified totalling over £115 million. We accept her
evidence in that behalf as fact.

25 75. As pleaded in the Statement of Case dated 17 July 2007, the Commissioners’
case to establish the fraudulent tax losses in Future’s deal chains is as follows:

30 “35. All of these transaction chains [i.e. those for 03/06, 05/06 and 06/06]
were traced back to the UK acquirer Future for these deals [i.e. Brayfal’s
purchases in 03/06, 05/06 and 06/06]. Future is a UK contra trader. No direct
tax losses were established in Brayfal’s deal chains for 03/06, 05/06 and 06/06
but tax losses have been established in Future’s parallel deal chains for the
periods in question. Contra tax losses have also been identified in Future
supply chains to the value of £102,946,508 for supplies made by Future in
35 01/06 to 06/06. In the months the Appellant purchased from Future significant
UK tax losses have been identified. In 03/06, £20.81 million has currently
been identified in UK tax losses. In 05/06, £2.48 million has currently been
identified in UK tax losses.”

40 76. To the Commissioners the evidence suggested that Future, whose returns were
made quarterly, was offsetting deals one against another over the whole of an
accounting period to reduce its net liability to VAT, i.e. the output tax on its buffer
acquisition deals was offset by the repayments generated by its zero-rated broker
deals. Consequently, for its accounting period ended on 31 January 2006, on declared

outputs exceeding £500 million, its net tax liability was 91p, and for the following quarter, on declared outputs exceeding £1 billion, £4.47. Mrs Clifford was able to demonstrate to us by means of a graph she had prepared that Future had “netted off” its acquisition and broker deals to reduce its liability to tax to virtually nothing; that acquisition deals had been completed mainly in the first month of each quarter; and that the balancing broker deals had been undertaken mainly in the second and third months of each quarter. And although information relating to Future’s quarter ended on 31 July 2006 was not included in the documents before us, Mrs Clifford explained, and we accept, that on declared outputs of over £450 million, its VAT liability was £12.36.

77. Next, Mrs Clifford explained to us the characteristics of Future’s deals, as revealed by analysis. Within the 5326 deal chains covering the six months to 30 June 2006, it dealt with a small number of traders, and among them the Commissioners had identified as defaulting traders Okeda, Wade Tech Ltd (“Wade Tech”), Ideas to Go, AS Genstar and C& B Trading Ltd (“C&B”); and in its broker deals, Future sold only to a very small number of traders in the EU. Further, the buffer companies in the defaulter chains all traded amongst themselves: some had the same addresses, others had the same directors and/or company secretaries and/or shareholders.

78. One feature Mrs Clifford particularly noted as adding significantly to the complexity of the Commissioners’ analysis was that until the supply chains reached Future the supplies were back-to-back, i.e. they involved the same numbers and the same models of phones. But on reaching Future they became “split deals”, Future buying phones for sale from a number of different traders for inclusion in individual sales invoices. In many cases, the Commissioners found Future to have purchased from one supplier more than the number of phones it went on to sell in what appeared to be a related deal, and yet in such cases it allocated only a portion of the purchases to an individual invoice, the balance of the sale being made up of phones bought from other suppliers. Nevertheless, even where the deals were split, the Commissioners found the separate supply chains each to show a clearly identifiable consistent pattern of selling prices and profit margins.

79. Mrs Clifford explained to our satisfaction that the transactions in the defaulter chains which led to Future were in what might be described as classic MTIC fraud form and bore the contrived appearance associated therewith. All the traders within the chain had apparently been able to source the phones on the same day, irrespective of their quantity, make or model. All the transactions were back to back; they all took place in a very short period of time, usually a single day; and all resulted in each buffer company receiving a profit on each phone of a nominal £1 or 50p. Further, comparisons of deals which took place on a single day but between different companies in the chains which led from a missing or defaulting trader to Future revealed remarkably similar, if not identical, phone prices at each stage in the chains.

80. Mrs Clifford was highly critical of Future's due diligence, saying that the company had on many occasions been advised of the dangers of MTIC fraud by the Commissioners' officers. She described its attitude to due diligence as "blasé", noting specifically:

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1. that goods were rarely, if ever, inspected;
2. that goods were never insured;
3. that no IMEI numbers were ever retained, despite requests by officers that they be retained;
- 10 4. that on Future's sales manager being asked how he could be sure that goods traded actually existed, he replied that the only guarantee was that customers paid for them;
5. that if stock was ever returned, it would be impossible to trace its supplier since each sale was generated on a number of purchase orders;
- 15 6. that Future completed sales of stock to traders from whom it had earlier bought it; and
7. there was no evidence of any written contracts.

81. Mrs Clifford maintained that the transactions between Future and Brayfal in March and May 2006 were "contra transactions" used by Future to offset its input tax claims in its quarterly accounting periods 04/06 and 07/06. She claimed that significant tax losses appeared in Future's transaction chains in March, April and June 2006, with February and May deals being mainly acquisitions resulting in no apparent tax losses.

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82. For period 03/06 Brayfal claimed input tax of £910,977, and its original claim for period 05/06 was for £401,065. (As we explained earlier, for present purposes the former figure was reduced by £26,223 by the assessment referred to in paragraph 1 above, and the latter figure by £200,165 on claims being withdrawn as attributable to "cancelled" transactions). Mrs Clifford explained that since the Commissioners believed that the input tax being claimed by Brayfal "was being offset by tax losses in Future's broker chains, the equivalent amount in tax loss has been specifically allocated to Brayfal from Future's tax loss chains", adding that she had taken personal responsibility for recording those chains to ensure that the Commissioners had not double counted the input tax claims of other traders whose own input tax claims had been refused. She took the tax losses for the March 2006 transactions between Future and Brayfal from the former's 04/06 return, and for the May transactions from Future's 07/06 return, saying that that was due to Future's "modus operandi" whereby in the first month of each VAT quarter it undertook mainly acquisition deals and in the remaining months disposals.

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83. In April 2006 Future issued 683 sales invoices in eleven batches. Within one such batch (invoices nod 4877 to 4967), Mrs Clifford claimed that the Commissioners had found that invoices nod 4882 to 4962 to relate to 192 transactions, 158 (82 per cent) of which had been traced back to a tax loss. The defaulting trader was C&B. She

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added that all the untraced deals were expected to lead back either to C&B or to another defaulting trader, AS Genstar. None of the supplies purported to have been made by C&B in the 158 transactions had been declared. Hence, all 158 transactions resulted in a tax loss to the Commissioners.

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84. Brayfal's input tax claim for period 03/06 had been related to Future's invoices nod 4882 to 4890 inclusive by Mrs Clifford, the defaulting trader in all the associated chains being C&B. The tax losses associated with C&B's deal chains amounted to £1,045,760.77 in April 2006.

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85. In her evidence in chief, Mrs Clifford claimed that the tax loss attributed to C&B had been included in an assessment made on that company on 23 November 2007 in a sum exceeding £59 million. She was cross-examined on that basis. But towards the end of her cross-examination she asked if she might make a statement. With the consent of counsel for both parties, we agreed that she might do so. Mrs Clifford then disclosed that her earlier evidence had been incorrect: the loss attributed to C&B had not been included in the £59 million assessment, but had been included in an assessment to a sum of £23 million made on 10 November 2006 ("the £23 million assessment"). The latter assessment was listed as having been made in the papers before us and had been referred to in passing, but the assessment itself and the supporting documents had not been disclosed. Mr Black then made application for permission to adduce the £23 million assessment and supporting documents. After having carefully considered his application, which was resolutely opposed by Mr Patchett-Joyce, we determined to refuse it. The Commissioners appealed our decision to the High Court where, on 4 March 2008, Lewison J confirmed our refusal to permit disclosure (see *The Commissioners for HM Revenue and Customs v Brayfal Limited* (2008) CH/2008/APP/082).

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Submissions and conclusion

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86. In our judgment, it is unnecessary for the Commissioners to prove that a tax loss is included in an assessment or assessments. If it were, it would be impossible for them to establish a tax loss in the case of a hijacked VAT number: they do not know the identity of the hijacker, and they would never assess an innocent trader whose registration number had been used by the fraudster. Consequently, we do not regard the absence of the £23 million assessment and the supporting documents as being fatal to the Commissioners' case.

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87. In June 2006 Future issued about 400 sales invoices in six batches. In the batch containing invoices nod 5976 to 6059, Future undertook 164 transactions of which 54 (33 per cent) had been fully traced back to Wade Tech, a company whose registration number was described by Mrs Clifford as a "hijacked VAT number". She claimed that the Commissioners expected all the remaining 110 transactions to be traced back to Wade Tech. None of the supplies purportedly made by Wade Tech had been declared

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to the Commissioners, so that all 54 transactions traced back had resulted in a tax loss to them.

5 88. Although Mrs Clifford described Wade Tech as a “hijacked VAT number”, for reasons we shall now explain we do not consider that to be a correct description. However, before doing so we should say that we accept that Wade Tech failed to account to the Commissioners for the VAT due on transactions its invoices showed it as having carried out and which was paid to it by the persons with whom it was trading, so that the Commissioners thus suffered a tax loss.

10 89. The name of Wade Tech was changed to Grange Solutons (sic) Ltd on 12 June 2006, but the change went unnoticed by the Commissioners. On 14 September 2006 two of their officers, Jenny Taylor and Viv Parsons, paid an unannounced visit to the premises of Wade Tech in its new guise and spoke to Mr Fateh Kashief Ahmed, its
15 director. They found the premises to be an off-licence shop. Mr Ahmed denied that the company traded in mobile phones, and said that while he had been invited by a friend to “get into the wholesaling of mobile phones”, he had decided against it after reading press articles on the subject. He implicitly claimed that Wade Tech’s VAT registration had been hijacked by a person or persons unknown. He then provided the
20 officers with what we regard as a lame excuse for not dealing with their remaining questions, and they arranged to return on the 18 September. On their return they were informed by other persons working at the shop, whom they had seen on their previous visit, that Mr Ahmed’s mother had been rushed into hospital that day and he was unavailable. We doubt that that explanation was a genuine one. However, the officers
25 accepted it and left. They then arranged for the company to be deregistered and for a new registration number to be allocated to Mr Ahmed as a sole trader. Their visit report concludes “no further action”, a recommendation that was seemingly acted upon. Mr Ahmed was unlikely to have been as innocent as he claimed for on 15 May 2007 a company called Bitofeverything.co.uk. Ltd was incorporated with him as
30 director, and on his then applying for the company to be VAT registered, he disclosed its main business activities as “Off licence and telecommunications sales of mobile phones and accessories”. Incredibly, the Commissioners acted on his application and registered the company.

35 90. Mrs Clifford related Brayfal’s input tax claim for period 05/06 to Future’s invoices nod 5976, 5981, 5983 and 5984, the defaulting trader in all associated chains being Wade Tech. The tax losses associated therewith, as calculated by the Commissioners, totalled £545,596.03 in June 2006.

40 91. Mrs Clifford also disclosed that five other companies which had sold goods to Future in April and June 2006 had had input tax claims withheld as part of the Commissioners’ extended verification process

45 92. In summary, Mrs Clifford maintained that Future was operating an overall scheme to defraud the revenue because:

- 5 a) it completed its transactions in a three month trading cycle, the first month being devoted mainly to the acquisition of goods from the EU, and the remaining two months being used mainly to make dispatches of goods to the EU – a pattern seen consistently over a number of accounting periods confirming Future’s status as a contra-trader and implying that its trading activity was contrived;
- 10 b) in Future’s acquisition chains when buying from the EU, it always sold to UK traders who then acted as brokers in sales to EU traders. Thus the brokers achieved a substantial repayment position;
- c) in Future’s broker chains when selling to EU traders, it always purchased from UK traders who had earlier also purchased from UK traders;
- 15 d) of the 66 per cent of Future’s broker deals analysed by the Commissioners, all had been traced back to defaulting, missing or hijacked traders, with tax losses identified of over £115 million. The extent of that tax loss did not reflect normal commercial trading;
- 20 e) Future’s deal chains had a contrived appearance. All traders within the chains appeared to have been able to source the phones on the same day, irrespective of their quantity, make or model; and despite the high value of each transaction, no written contracts relating to sales and purchases were ever entered into;
- 25 f) many of the traders within the transaction chains were linked by common personnel (e.g. shared directors, shareholders or company secretaries) or by common addresses, so that the Commissioners considered they were not involved in arm’s length trading;
- 30 g) Future displayed a complete disregard of due diligence, never to the Commissioners’ knowledge inspecting goods, never insuring them, and never retaining IMEI numbers;
- 35 h) those factors in combination indicated to the Commissioners that in the first six months of 2006 the transactions undertaken by Future did not take place under normal trading conditions. They considered that Future had acted as a contra-trader in an overall scheme designed to disguise its actual tax loss transactions by offsetting them against transactions with numerous traders acting as brokers, thus minimising its own output tax liability and enabling it to recover input tax by those brokers (Brayfal included) in an attempt to defraud the public revenue.

40 93. Mrs. Clifford satisfied us that there was a tax loss in Future’s deal chains, and that it was referable to the supply chains recreated by the Commissioners.

45 94. Further, on the basis of the whole of the evidence presented to us, and notwithstanding that Future had no opportunity to defend itself against the Commissioners’ allegations about its part in events concerning Brayfal (so that we have taken the greatest care in dealing with the evidence relating to it), we are also satisfied that in the first six months of 2006 the transactions it undertook did not take

place under normal trading conditions, and that it acted as a contra-trader in an overall scheme to defraud the public revenue.

5 95. We are satisfied on the balance of probabilities that the Commissioners have identified tax losses totalling over £115 million in Future's default chains, they being the relevant deal chains for the purposes of this appeal.

10 96. Mr Patchett-Joyce's cross-examination of Mrs Clifford focused on showing that the Commissioners had discriminated against Brayfal by comparison with traders in the dirty chain in that they had met input tax claims made by companies involved in transactions in those chains where, e.g. tax invoices they held did not include VAT registration numbers, or were otherwise deficient, yet had rejected Brayfal's claims in the clean chains. We accept that the Commissioners did meet some claims in the
15 circumstances described, but do not consider that of help to Brayfal, its task being to show that it was not involved in a scheme to defraud the revenue and that it took precautions of the standard prescribed at paragraph 51 of the *Kittel* judgment. We agree with the tribunal in *Calltell* where, at paragraph 62 of its decision, in response to submissions in all respects identical to those advanced by Mr Patchett-Joyce before us, it concluded that the argument was misconceived, saying that "The ECJ has
20 sanctioned the withdrawal of the right to deduct in those cases where the trader has participated in a transaction knowing, or with the means of knowing, that the transaction is connected with fraud".

25 97. The only remaining question for us is whether Brayfal through Mr. Kibbler knew or had the means of knowing at the time of entering the transactions that they were connected to the fraudulent tax losses. Notwithstanding that we have found deficiencies in Brayfal's due diligence, and have rejected certain claims made by Mr. Kibbler in evidence, looking at the totality of the evidence it fails to establish that
30 Brayfal knew or had the means of knowing at the time it entered into the transactions in periods 03/06 and 05/06 that they were connected to the fraudulent tax losses in Future's deal chains. In reaching that decision, we should record that we have had regard to Brayfal's failure properly to investigate, or even to consider at all, the rapid rise in Future's turnover and its very short self-explanatory trading history in deciding whether it was a suitable trading partner and consider it worthy of serious criticism, as
35 was its failure likewise to investigate and consider the same matters in relation to Universal.

40 98. In his closing submissions, Mr. Black contended that we could be satisfied that the transactions undertaken by Brayfal were referable to Future's tax losses and the fraudulent scheme from the mere fact that Brayfal was trading with Future: all dealings by Future were contrived and referable to the fraudulent scheme. Further, the evidence as to the circumstances in which Brayfal came to be dealing with Future and Universal in the two periods concerned and the nature of its dealings generally demonstrated that Brayfal's transactions were part of that fraudulent scheme. We
45 accept that Brayfal's transactions formed part of the fraudulent scheme, but evidence

of the circumstances in which it came to be dealing with Future and Universal in our judgment falls short of satisfying us that Brayfal knew or had the means of knowing that it was involved in such a scheme. Consequently, we conclude that the fraud was carried out by the missing traders only, and that Brayfal neither knew nor had the means of knowing about it.

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99. Ordinarily, at this point we should simply have allowed the appeal. However, as Brayfal has failed to pay the VAT on the two invoices on which it based its input tax claim for 05/06 section 26A of the Value Added Tax Act 1994 comes into operation in relation to that claim. Section 26A effectively restricts recovery of input tax where the full consideration has not been paid within six months of the date of supply to the tax which would have been payable on the basis that the consideration in fact paid was tax inclusive. Consequently, in the instant case, Brayfal's claim for period 05/06 must be reduced from £200,900 to £170,978.72, and we reduce it accordingly. (That does not mean that Brayfal's admitted contractual liability to Future is also reduced; it is not, it remains at £200,900).

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100. Mr. Patchett-Joyce made application for Brayfal's costs in the event of the appeal being successful. We accede to his application, but since we have reduced the tax recoverable by almost £30,000, only to the extent of nine-tenths thereof. If agreement cannot be agreed as to the extent of the costs, as calculated on the standard basis, we direct that they be determined by a Tax Judge of the Supreme Court.

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101. We cannot conclude without commenting on the volume of documentary evidence presented to us. Of the over 20 lever arch files presented to us, reference was made to no more than 6 or 7 of them, and the contents of some, e.g. letters from the tribunal centre informing the parties of appointments for interlocutory hearings, were such as to be an irritation rather than a help in assisting us properly to deal with the appeal. We therefore express the hope, indeed demand would not be too strong a word, that in future, the parties, and in this case we believe blame mainly to fall on those representing Brayfal, will ensure that the tribunal is presented only with the documentation necessary for the proper disposal of the appeal. Failure to deal with matters in that way in future appeals may result in costs sanctions being applied.

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102. We should also say that we reject a submission by Mr. Patchett-Joyce that contra-trading is a "flawed concept". Burton J certainly did not consider it to be so in *Just Fabulous*, which case involved the very claim by Brayfal for period 03/06 with which we are dealing; nor do we.

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DAVID DEMACK
CHAIRMAN
Release Date: 22 August 2008

MAN/07/9501