

Neutral Citation Number: [2009] EWHC 1081 (Ch)

Case No: CH 2007 APP 0599

**IN THE HIGH COURT OF JUSTICE
CHANCERY DIVISION
ON APPEAL FROM THE VAT AND DUTIES TRIBUNAL**

Royal Courts of Justice
Strand, London, WC2A 2LL

21/05/2009

Before:

THE HON MR JUSTICE FLOYD

Between:

**CALLTEL TELECOM LIMITED
OPTO TELELINKS (EUROPE) LIMITED Appellants**

- and -

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

**Mr Roderick Cordara QC and Mr Jern-Fei Ng (instructed by Jeffrey Green Russell) for
the Appellants**

**Mr Mark Cunningham QC Mr Philip Moser and Ms Fiona Banks (instructed by The
Solicitor for HM Revenue and Customs) for the Respondents**

Hearing dates: March 17th, 18th, 20th and 23rd 2009

HTML VERSION OF JUDGMENT

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Mr Justice Floyd:

1. This is an appeal from a decision of the VAT and Duties Tribunal (Colin Bishopp, Chairman and Cyril Shaw FCA) dated 20th July 2007. The appeal is against decisions by HMRC to refuse repayment of input tax in respect of claims made for that purpose by the appellants Calltel Telecom Limited ("Calltel") and Opto Telelinks (Europe) Limited ("Opto") in the period January to March 2006. The ground on which the repayment of input tax was refused was that the Appellants knew or had the means of knowing that their dealings in the goods in question were connected with a fraud elsewhere in their chain of supply.
2. The Appellants are related companies under the common ownership of Mohammad Safdar Gohir.

3. The appeals are concerned with Missing Trader Intra Community ("MTIC") fraud. The nature of this type of fraud has been described in a number of judgments, see for example the judgment of Lewison J in *Livewire & Olympia* [2009] EWHC 15 (Ch) at [1]. In its simplest form, the fraud involves a trader who imports goods into the UK and then sells them on within the UK whilst dishonestly failing to account for the output tax on the onward sale. A fraud on the revenue is complete at that point. In more complex forms of the fraud, other traders are involved as well. For example in a "carousel" fraud, the goods are passed through a number of intermediate traders, so-called "buffers", re-exported and may make further circuits through the UK. Carousel trading is not alleged in this case. The present case is mainly concerned with chains of transactions starting with an importation by a defaulter, followed by a set of intermediate transactions through buffers, followed by a sale to, and export by one of the Appellants.
4. "Contra-trading" is a device designed to mask or conceal the sort of MTIC fraud I have thus far described. It is also explained in *Livewire and Olympia* at [1] (iii). This case also involves an allegation of contra-trading.
5. Once goods the subject of an ordinary MTIC fraud are on the market in the UK they may come into the hands of innocent traders who have the right to offset the input tax which they pay on their purchases from the output tax on their sales. After setting off the input tax against the output tax such traders account for any balance to HMRC. As the Tribunal in the present case clearly recognised, innocent traders have an unanswerable right to do this. However, if the trader knows or has the means of knowing that its transactions are involved with the fraud of others it can lose its right to deduct the input tax which it has paid. The leading case in this field is the decision of the ECJ in Joined Cases C-439/04 and C-440/04 *Axel Kittel v Belgium; Belgium v Recolta Recycling* [2006] ECR I-6161; [2008] STC 1537 (hereafter "*Kittel*"). At [51]-[61], the Court states that

"51. In the light of the foregoing, it is apparent that 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 their right to deduct the input VAT (see, to that effect, Case C-384/04 *Federation of Technological Industries and Others* [2006] ECR I-0000, paragraph 33).

52. It follows that, where a recipient of a supply of goods is a taxable person who did not and could not know that the transaction concerned was connected with a fraud committed by the seller, Article 17 of the Sixth Directive must be interpreted as meaning that it precludes a rule of national law under which the fact that the contract of sale is void, by reason of a civil law provision which renders that contract incurably void as contrary to public policy for unlawful basis of the contract attributable to the seller, causes that taxable person to lose the right to deduct the VAT he has paid. It is irrelevant in this respect whether the fact that the contract is void is due to fraudulent evasion of VAT or to other fraud.

53. By contrast, the objective criteria which form the basis of the concepts of 'supply of goods effected by a taxable person acting as such' and 'economic activity' are not met where tax is evaded by the taxable person himself (see *Halifax and Others*, paragraph 59).

54. As the Court has already observed, preventing tax evasion, avoidance and abuse is an objective recognised and encouraged by the Sixth Directive (see Joined Cases C-487/01 and C-7/02 *Gemeente Leusden and Holin Groep* [2004] ECR I-5337, paragraph 76). Community law cannot be relied on for abusive or fraudulent ends (see, inter alia, Case C-367/96 *Kefalas and Others* [1998] ECR I-2843, paragraph 20; Case C-373/97 *Diamantis* [2000] ECR I-1705, paragraph 33; and Case C-32/03 *Fini H* [2005] ECR I-1599, paragraph 32).

55. Where the tax authorities find that the right to deduct has been exercised fraudulently, they are permitted to claim repayment of the deducted sums retroactively (see, *inter alia*, *Rompelman*, paragraph 24; Case C-110/94 *INZO* [1996] [ECR I-857](#), paragraph 24; and *Gabalfrisa*, paragraph 46). It is a matter for the national court to refuse to allow the right to deduct where it is established, on the basis of objective evidence, that that right is being relied on for fraudulent ends (see *Fini H*, paragraph 34).

56. In the same way, a taxable person who knew or should have known that, by his purchase, he was taking part in a transaction connected with fraudulent evasion of VAT must, for the purposes of the Sixth Directive, be regarded as a participant in that fraud, irrespective of whether or not he profited by the resale of the goods.

57. That is because in such a situation the taxable person aids the perpetrators of the fraud and becomes their accomplice.

58. In addition, such an interpretation, by making it more difficult to carry out fraudulent transactions, is apt to prevent them.

59. Therefore, it is for the referring court to refuse entitlement to the right to deduct where it is ascertained, having regard to objective factors, that the taxable person knew or should have known that, by his purchase, he was participating in a transaction connected with fraudulent evasion of VAT, and to do so even where the transaction in question meets the objective criteria which form the basis of the concepts of 'supply of goods effected by a taxable person acting as such' and 'economic activity'.

60. It follows from the foregoing that the answer to the questions must be that where a recipient of a supply of goods is a taxable person who did not and could not know that the transaction concerned was connected with a fraud committed by the seller, Article 17 of the Sixth Directive must be interpreted as meaning that it precludes a rule of national law under which the fact that the contract of sale is void - by reason of a civil law provision which renders that contract incurably void as contrary to public policy for unlawful basis of the contract attributable to the seller - causes that taxable person to lose the right to deduct the VAT he has paid. It is irrelevant in this respect whether the fact that the contract is void is due to fraudulent evasion of VAT or to other fraud.

61. By contrast, 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."

6. *Kittel* was only one (and not the last) in a series of cases concerning VAT fraud considered by the Court of Justice. 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 attempt was made to refuse repayment of input tax to traders in a chain of transactions in which, unknown to them, the goods had been traded in without accounting for VAT. It was argued that the transactions in question did not qualify for repayment, notwithstanding the innocence of the re-claiming trader. The Court rejected this view:

"47. As the Advocate General observed in para 27 of his opinion, each transaction must therefore be regarded on its own merits and the character of a particular transaction in the chain cannot be altered by earlier or subsequent events. ...

51. It follows that transactions such as those at issue in the main proceedings, which are not themselves vitiated by VAT fraud, constitute supplies of goods or services

effected by a taxable person acting as such and an economic activity within the meaning of arts 2(1), 4 and 5(1) of the Sixth Directive, where they fulfil the objective criteria on which the definitions of those terms are based, regardless of the intention of a trader other than the taxable person concerned involved in the same chain of supply and/or the possible fraudulent nature of another transaction in the chain, prior or subsequent to the transaction carried out by that taxable person, of which that taxable person had no knowledge and no means of knowledge.

52. Nor can the right to deduct input VAT of a taxable person who carries out such transactions be affected by the fact that in the chain of supply of which those transactions form part another prior or subsequent transaction is vitiated by VAT fraud, without that taxable person knowing or having any means of knowing."

7. The mere fact that a transaction forms part of a chain in which fraud occurred is not enough to justify the refusal of repayment of input tax. To justify such a refusal the tax authorities must prove that the taxpayer was himself being fraudulent, or knew or had the means of knowledge of fraud by others.
8. It is not therefore enough for the Commissioners to confront a potentially innocent taxpayer with a single chain of transactions in which VAT has been evaded at an earlier stage, and to refuse to repay input tax on this ground alone. A valid refusal of repayment will require more. But the taxpayer who finds himself, by his pattern of trading, repeatedly caught up in chains which he learns are fraudulent cannot protest his innocence for ever. As I said in *Mobilx v HMRC* [\[2009\] EWHC 133 \(Ch\)](#) at [87]:

"I agree entirely with the Tribunal when it said that "there must come a time when a trader, told that every one of his purchases followed a tainted chain, is compelled to recognise that without a significant change in his trading methods every one of his future purchases is more likely than not also to follow a tainted chain"."

9. Because this case involves chains of transactions between the importing fraudster and the Appellants involving intermediate traders or buffers, it is important to define the nature of the connection or link which is required between the impugned transaction of the taxpayer and the fraud. In *HMRC v Livewire and Olympia* [\[2009\] EWHC 15](#) Lewison J has analysed subsequent decisions of the Court of Justice which have expressed the test enunciated in [61] of *Kittel* in modified language. For example he drew attention to the fact that the more recent decision *Netto Supermarkt GmbH & Co OHG v Finanzamt Malchin* [\[2008\] STC 3280](#), the Court held at [24] that:

"..it is not contrary to Community law to require the supplier to take every step which could reasonably be required of him to satisfy himself that the transaction which he is effecting does not result in his participation in tax evasion."

10. Lewison J drew attention to the difference between "participating in a transaction connected with fraudulent evasion of VAT" (in the *Kittel* words) and effecting a "transaction which ... result[s] in his participation in tax evasion" (to use the *Netto* words) and concluded that this had resulted in a narrowing of the test.
11. I will have to return to a debate between the parties as to the nature of the connection later in this judgment.

The facts

Calltel and Opto and their businesses

12. Opto was incorporated in 1998 and Calltel in 1999. Mr Gohir has at all material times been the only shareholder and director of both companies. Opto is the company secretary of Calltel, and Calltel the company secretary of Opto. The two companies

shared trading premises in Bradford, though there was an element of separation in that Calltel occupied one floor and Opto another.

13. Both companies became registered for VAT on 1st December 2001. Both have always been dealers in mobile phones, in the secondary, or "grey", market. Calltel had a fairly high turnover from 2002, while Opto's turnover did not reach significant levels until 2005. Since then Opto has bought almost all of the phones it has sold from Calltel, although the companies have from time to time reversed their rôles. Calltel has bought products both within the United Kingdom and from traders in other member States, and has sold to both United Kingdom and overseas traders, as well as to Opto.
14. Both Appellants were consistently repayment traders, that is, their claims for input tax credit have always exceeded their output tax liabilities. In most, months Opto made only zero-rated sales and had no output tax liability. Until the end of 2005 their claims were met by the Commissioners.
15. Calltel had begun trading in 2002, achieving a turnover of £49 million in that year, rising to almost £406 million by 2005. According to Mr Gohir, the phones in which it deals are mainly surplus stock which an authorised distributor has released onto the grey market at a reduced price, because they will need some kind of modification if they are to be sold.
16. Opto's turnover, in the eight months from September 2005 to April 2006, amounted to almost £120 million.
17. The Tribunal found that Calltel's and Opto's usual practice and, it seems, the practice of other similar traders was to wait for payment before paying one's own supplier. Chains of transactions therefore completed in a short space of time, and goods changed ownership many times in a single day.
18. The evidence before the Tribunal established that Opto, from a standing or near standing start in February 2005, had managed to increase its turnover to more than £43 million per month by March 2006. In its first 14 months of trading, even though, for unexplained reasons, it made no sales in two of the months, its turnover was £190 million. The annualised equivalent of its March 2006 turnover is over £500 million, comparable to that of many listed companies. Opto's repayment claims grew in line with its turnover.
19. So far as Calltel is concerned the evidence before the Tribunal revealed that for the year to 31 August 2005 it had turnover of £405.8 million and a pre-tax profit of £1.8 million.
20. The Tribunal found that these levels of turnover were not unusual in their trade sector. The "buffers" and overseas traders with which Calltel and Opto dealt displayed common themes. Almost all were companies recently formed, or occasionally which had been trading in a completely different business, turning recently to electronic goods. They were, apparently without exception, companies with only one or two directors and few, if any, staff. None seemed to have any significant capital resources (in that respect Calltel and Opto were unusual). All had managed, within a very short period, to achieve turnover measured in millions of pounds per month. With the single exception that two chains had been traced back to Nokia, none of the traders in any chain had a name recognisable as that of a manufacturer, authorised distributor or retailer, nor did Mr Gohir claim that any of them fell into one of those categories. He agreed that neither of the Appellants ever dealt with a manufacturer or retailer, although he had tried without success, he said, to trade with authorised distributors.

The Commissioners become interested in MTIC fraud

21. During 2002 the Commissioners agreed with a number of traders in the mobile phone industry on a Memorandum of Understanding ("MOU"), coupled with a Code of Conduct. The MOU recites the recognition by the mobile phone industry that

"VAT fraud involving mobile phones is widespread and growing significantly".

22. The MOU also records the objective of the industry to reduce the level of VAT fraud by cooperation and by the observance by traders of the Code of Conduct. Calltel was a signatory to the MOU. Opto, through Mr Gohir would have become aware of it.
23. HMRC operated a verification unit at their office in Redhill. It acted as a means by which a trader might verify that another trader with whom it intended to deal had a valid VAT registration, and that other basic details, particularly name and address, provided by the intended counterparty matched those held by HM Customs and Excise and, latterly, HMRC, within their own records. In the relevant period, January to March 2006, Calltel was recorded to have made 242 verification requests and Opto 44.

"Due diligence"

24. Mr Gohir stressed the extent to which he checked the *bona fides* of his immediate counterparties. The evidence showed, however, that most of Calltel's due diligence was carried out after the company had entered into transactions with the supplier. The Tribunal, at [103] to [107] of its decision, reviewed in detail two examples of Calltel's due diligence and then said this about the evidence given by a Mr Leach on behalf of HMRC:

"There are differences of detail between the steps taken by Calltel and Opto in relation to these and the other traders about which Mr Leach provided details, but these two cases are typical. He had criticisms to make in every case and, in essence, his evidence was that such due diligence as was undertaken was too late, superficial and often incomplete; and that the information which was obtained frequently indicated that the trader concerned was not reliable, but was disregarded."

The transactions

25. There was no dispute that the transactions entered into by Calltel and Opto related in all cases to real telephones. The Tribunal summarised a typical chain in the following way at [119]:

"Most of the chains were, at least superficially, straightforward. If Mrs Bushby's [the HMRC officer with responsibility for this case] analysis is right, a typical chain began with a defaulting trader, or with a trader whose identity had been hijacked, who sold to a buffer. The phones then passed through the hands of, usually, two or three further buffers (though occasionally more or fewer) before being bought by Calltel which, in most cases, sold them to Opto, which then sold them to an overseas customer. We take one such chain as an example. On 20 January 2006, a date to which we shall return in another context, Ultimate Security Agency Ltd (which Mr Patchett-Joyce [then counsel for Opto and Calltel] agreed was a defaulter) sold 4780 Samsung D600 phones for £183.55 each to Perrypoint Ltd which, on the same day, sold the same phones to W A Communications at £183.80 each, making a profit of 25p per phone (an aggregate profit of £1,195). They were then sold, also on 20 January, to Global Enterprise (GB) Ltd at £184.45 each, a profit of 65p per phone (£3,107). Global Enterprise immediately sold them to Calltel at £185 each, a profit of 55p each or £2,629. Calltel sold them, on the same day, to a Swiss company, Digi Trading GmbH, at £192.50, a gross profit of £7.50 per phone, or £35,850 in total.

Some chains of transactions are longer, some shorter, and some also include Opto. In those cases, whichever of the two appellant companies sold to the other made a gross profit of, almost always, £1 or, sometimes, 50p per unit, while the second company, selling to an overseas customer, made a substantial profit. "

26. The Tribunal referred to one particularly odd transaction at [122]:

"Our attention was drawn particularly to one chain. On 31 March 2006—the last day of the period with which we are concerned—Opto bought 1200 Nokia phones from World Communications Imp-Exp at £292 per unit (it appears that all the transactions in every one of the chains with which we are concerned, regardless of the nationality of the participants, were priced in sterling). It sold them, on the same day, to Calltel for £293 per unit. Also on the same day, Calltel sold the consignment to World Communications Sàrl—the French company associated with the Spanish supplier—for £304.70 per unit. The Appellants, between them, made a gross profit of £12.70 per unit, or £15,240. We were not provided with any information about the shipping and storage costs. Mr Gohir was unable to offer any explanation of the purpose, from World Communications' point of view, behind its making a loss of £12.70 per unit when it could as easily have arranged a sale from the Spanish company to its French associate without the Appellants' intervention."

27. The Tribunal described at [125] the detail of everything which occurred on one single trading day on 20th January 2006. Mr Gohir was asked to explain the manner in which all this took place. They described his evidence in the following way:

"We can describe his evidence only as vague in some parts and evasive in others. He mentioned telephone calls and checks on other traders' websites, in order to ascertain what stock was available and who was interested in buying, but he was quite unable to explain, at least to our satisfaction, how it was that Calltel was able to buy goods for which it had a customer from a supplier who had no stock of his own, but had to buy the goods from another trader who, also, had no stock but had to buy from yet another trader with no stock, and how all of the necessary negotiations of model, quantity and price, the paperwork, the payments, the inspections and the release of the goods, in a chain which might involve as many as eight traders, could all take place in the course of a single day. He told us that he and the Appellants' staff viewed other traders' websites and made and received telephone calls, but we were left with no clear impression at all of the process by which they were able to find suppliers of the right quantity of the required model of phone when those suppliers held no stock, nor how they managed to identify purchasers of entire consignments of phones which the Appellants were able to secure."

Dealings between Calltel and Opto

28. Mr Gohir was asked for an explanation of why Calltel and Opto were trading with each other and applying a standard mark-up of £1 or 50p on trades. The Commissioners' case was that such transactions were wholly artificial. Mr Gohir's explanation was that he had been advised by Calltel's UK bankers to spread his trading risk by using two companies and it was for this reason that Opto had begun trading. In order to finance its trade it had had to borrow money and it needed to generate income in order to service the loans. The Tribunal described Mr Gohir's evidence about these transactions in the following way at [129]:

"Mr Gohir was asked why each company had done so, when his objectives of sharing the risk and generating sufficient income for Opto to enable it to service its loans could have been achieved by the expedient of sharing the available deals between the two companies, by their handling the available transactions alternately, or in some similar fashion. He was unable to provide an answer, but merely repeated that the Commissioners were aware of what the companies were doing. We deduce that we

were asked to draw the inference that the mere fact that the Commissioners knew of the practice was sufficient justification of it."

Changes in phone specifications

29. Mr Gohir's evidence was that the Appellants bought phones with a UK specification which required changing to a central European specification. This could sometimes be done with the keypad, but on other occasions required a laptop. Mr Khan, the warehouse manager, was called to give evidence about how this was done. It became plain to the Tribunal that neither Mr Khan nor Mr Gohir in fact knew how it was done. I was asked to read the evidence of Mr Gohir and Mr Khan. I formed the view that the Tribunal was entirely justified in reaching the conclusion that the evidence about specification changes was both incoherent and evasive. When faced with difficulties about the time it would take one person to change an entire consignment of phones, Mr Khan suggested that employees from an adjacent freight-forwarding warehouse would assist: that was evidence that the Tribunal was plainly entitled to reject as invented.

Mr Gohir's knowledge and means of knowledge

30. The Tribunal found at [137] that Mr Gohir was well aware that fraud was rife in the mobile phone trade. He was a signatory of the MOU. Calltel's website carried, prominently, the message:

"Due to the large-scale fraudulent activity in this sector we will only buy and sell goods after rigorous commercial checks and thorough scrutiny of our suppliers and the origin of the goods."

31. Calltel and Opto had attracted the attention of HMRC's investigation officers well before the period in issue in this appeal (January to March 2006).
32. The Tribunal summarised the extent to which HMRC had notified Calltel and Opto of their concerns in the following way at [138] to [140] of the decision:

"138. Between 2002 and 2005 there were several visits by HMRC officers to Calltel and, latterly, Opto at which the continuing levels of VAT fraud in the industry were mentioned to Mr Gohir. During the same period there was correspondence between the parties in which the Commissioners' officers expressed misgivings about Calltel's claims for input tax credit. On 27 February 2004 an officer wrote to Calltel's accountants making the specific assertion, apparently for the first time, that some of the goods purchased by Calltel had been traced back to defaulting traders. On 29 September 2004, at which time only Calltel was trading, two of the Commissioners' officers visited Mr Gohir, and advised him again of their concerns about the provenance of some of the goods in which it was dealing, informing him that many of the consignments had been traced back to defaulters. One of the transactions included in Calltel's VAT return for September 2004 was selected for verification, and Mr Gohir was notified in December 2004 that its repayment claim would not be met until the verification had been concluded. We understand that the repayment was, eventually, made.

139. Mrs Bushby became the assurance officer for both Calltel and Opto, which had recently begun to trade, in April 2005. She paid her first visit to Mr Gohir on 11 April, and a second on 9 May 2005. ... At the second meeting Mrs Bushby told Mr Gohir that almost all of the goods in which Calltel had dealt in July and August 2004 had been traced back to defaulting traders. Mr Gohir assured Mrs Bushby that he was equally concerned about fraud in the industry, and identified a transaction which he had cancelled because he had received adverse information from the Redhill office. There was a lengthy discussion of Calltel's due diligence procedures. Mrs Bushby

wrote further letters to Calltel in September and December 2005. In them, she identified a large number of transactions which, she said, she had traced to a defaulter. One of the letters contained the following passage:

"The continued incidence of MTIC VAT fraud in the verified supply chain (100% of the 4 months covered above) would indicate that a fundamental reappraisal of the due diligence carried out by your company is now appropriate. If the due diligence routinely undertaken by Calltel Ltd in these periods was carried out with the aim of ensuring that the company would not profit in trade from deals emanating from a UK MTIC VAT fraud, then it can be seen, as evidence above, this due diligence has not worked.

... can you please explain how the company can continue to deal in this way in future whilst at the same time claiming neither the knowledge or the grounds to expect that the VAT due on the supply of those goods will go unpaid."

140. In this letter, as on other occasions, the transactions were identified by means of Calltel's or Opto's sales invoice number, from which Mr Gohir was able also to determine the identity of the customer and, indirectly, the supplier (since consignments were not kept in stock but, almost invariably, sold intact), but no information was provided which would have enabled him to identify the trader who, the Commissioners contended, had defaulted. The officers maintained that they were prevented, by various statutory provisions, from providing such information; Mr Gohir and his advisers protested that, without the identity of the defaulting trader, the information was of little or no value. Mr Gohir made the same point, repeatedly, in his evidence: he could and did undertake effective due diligence in respect of his suppliers and customers, and the fact that neither Calltel nor Opto had ever dealt directly with a defaulter or hijacker showed that their due diligence was effective; but he could do no more because he had no means of finding out the identities of other traders who had dealt in the goods."

33. It is significant that the warnings given questioned the manner in which Calltel and Opto were trading. The warnings given showed that in every case where HMRC had finalised analysis of a deal chain, the chain in question had led back to a defaulting trader. By October 2005 some 179 chains had been verified and all had been traced back and found to be "dirty".

The issues before the Tribunal

34. The Tribunal identified the issues which it had to decide in the following way:

"(1) Has a tax loss referable to the supply chain in question been proved?

(2) If so, has the fraudulent nature of the tax loss been proved?

(3) Had the relevant tax loss been suffered at the time of the Appellants' transactions? If not, what, if any, consequences flow?

(4) Did the Appellants know, or have the means of knowledge, of the relevant tax loss in the supply chain in question at the time of entering into their transactions in that supply chain?"

35. The Tribunal considered that it would be unlikely that HMRC could ever establish (as required by issue 3) that the relevant tax loss had occurred by the time that the Appellants' transactions occurred, and that HMRC had not done so in the present case. It was, in their judgment, enough if HMRC established that the chain of transactions had no rationale other than the perpetration of fraud. The Tribunal tackled issues (3) and (4) before returning to issues (1) and (2), whilst giving itself an

appropriate warning (at [153], which it repeated again when returning to those issues) not to allow its conclusions to colour its conclusions on the first two.

The Tribunal's conclusions

36. The Tribunal first expressed its conclusion as to the nature of the trade in which the Appellants were engaged and Mr Gohir's knowledge of it in the following way at [155] to [156]:

"We ... have stood back from the chains of transactions we have to consider, in order to determine what is their true character. A single chain, taken in isolation and without knowledge or even awareness of any other, might well appear entirely legitimate; but the picture could change fundamentally when what the tribunal in *Dragon Futures* described as a "web of contracts" is examined. Having conducted that examination it is, in our view, perfectly obvious that trade of the kind in which the Appellants were engaged is not legitimate.

While we are quite willing to accept that there is a genuine grey wholesale market in mobile phones we consider it an inescapable conclusion from the evidence we heard and read, and not least Mr Gohir's own evidence, that the Appellants were not engaged in it. We were left in no doubt that almost all, if not, indeed, all, of the transactions into which the Appellants entered were wholly artificial. **We are satisfied that, far from being a means by which those with a genuine surplus can dispose of their unwanted stock to other traders who have a genuine need, it is nothing more than a device by which the taxing authorities, in the United Kingdom and elsewhere, can be cheated.** We are also driven to the conclusion, from the content of Mr Gohir's evidence as well as the manner in which it was given, that he knew perfectly well that the purpose of the chains of transactions in which the Appellants participated was fraudulent, and that the Appellants entered into them in order to benefit from the fraud." (Emphasis supplied).

37. The Tribunal then returned to consider a question as to whether a tax loss had been shown, in particular, when it had not been possible to trace a chain all the way back to a defaulter. At [170] the Tribunal concluded thus:

" The first matter to determine is whether Mrs Bushby correctly drew the conclusion that, where a buffer could be shown to have acquired its supplies from a defaulter in those chains which could be fully traced, it was reasonable to infer that, in those chains which could not be fully traced, it had acquired its supplies from the same source. In our judgment the inference is not merely reasonable, but compelling. It would be remarkable if illicit deals could be traced, while legitimate deals could not. There would be no reason for a buffer to conceal its source in such circumstances; on the contrary, it would be in its interests to be forthcoming about it. The simple fact that Mrs Bushby was unable to complete the chain (accepting as we do that her efforts were diligent) speaks for itself."

38. The Tribunal returned to Mr Gohir's knowledge at [174]:

"We were left in no doubt, from the manner in which he gave his evidence, and on which we have already commented, that Mr Gohir was not an innocent swept into a fraud committed, at several removes, by someone else. On the contrary, we are satisfied that he took great care to distance the Appellants from frauds which he knew were being committed. The Appellants' due diligence served no useful purpose other than the cosmetic one of showing that some steps had been taken. The claim that phones had been modified was transparently false. There is, in our view, almost nothing in the transactions which is consistent with the workings of a genuine market. We are quite sure, from his demeanour and from his untruthful evidence, that Mr Gohir was under no illusion about the nature of the trade in which the Appellants were

engaged. **We think the Commissioners are right to contend that he was one of the ringleaders. But even if he was not, we are satisfied that he was well aware that the Appellants were dealing in goods which were being used as the instrument of fraud.** We are equally satisfied that the transactions were arranged for no other purpose, and that the fact that the defaulters' failure to account for output tax post-dated the Appellants' dealings in the relevant goods is irrelevant. The Appellants, for those reasons, were properly deprived of their right of deduction." (Emphasis supplied).

39. So far as "means of knowledge" is concerned, the Tribunal noted that it did not have to decide the issue, as it was satisfied that actual knowledge of the fraudulent nature of the chains had been established. But they added this at [175]:

"We do not need to deal with the question whether the Appellants had the means of knowledge, since we have concluded that they had actual knowledge of the fraudulent purpose of the transactions. However, even if we had not so found, it would in our view be impossible not to conclude that the Appellants had failed, in the words of the Court of Justice in *Kittel*, to "take every precaution which could reasonably be required of them to ensure that their transactions are not connected with fraud". Their due diligence and their response to it fell, in our judgment, well below the requisite standard."

40. The Tribunal summarised its decision in the following way:

"We are satisfied that:

- Mr Gohir knew that the Appellants were engaged in transactions whose purpose was the commission of a fraud on the Commissioners;
- The Appellants' creation and assembly of the documentation relating to each deal into which they entered and their due diligence were designed only to persuade the Commissioners that they were legitimate traders;
- The transactions between the two Appellants had no true purpose other than to shift their respective VAT liabilities and repayment claims;
- Every one of the transactions, including those described as contra-trading, had as its objective the defrauding of the Commissioners;
- The decision to withhold the Appellants' repayment claims was correct."

The nature of an appeal from the VAT and Duties Tribunal

41. In *Mobilx v HMRC* [\[2009\] EWHC 133 Ch](#), I described the nature of an appeal in a case such as the present in the following way:

"13. Section 11 (1) of the Tribunals and Inquiries Act 1992 provides that an appeal lies to the High Court if a party "... is dissatisfied in point of law" with a decision of the VAT and Duties Tribunal.

14. In *Georgiou v. Customs and Excise Commissioners* [1996] STC 463 CA at 476, Evans LJ refers to excerpts from the speeches of Viscount Simonds and Lord Radcliffe in *Edwards v. Bairstow* [\[1956\] AC 14](#), 14-15) and observes (at 476 f-g) that

" .. it is all too easy for a so-called question of law to become no more than a disguised attack on findings of fact which must be accepted by the courts. As this case demonstrates, it is all too easy for the appeals procedure to the High Court to be abused in this way. Secondly, the nature of the factual inquiry which an appellate court can and does undertake in a proper case is essentially different from the decision-making process which is undertaken by the tribunal of fact. The question is not, has the party upon whom rests the burden of proof established on the balance of probabilities the facts upon which he relies, but was there evidence before the

tribunal which was sufficient to support the finding which it made? In other words was the finding one which the tribunal was entitled to make? Clearly, if there was no evidence, or the evidence was to the contrary effect, the tribunal was not so entitled." [Emphasis added].

15. At page 476H Evans LJ set out a four stage process for examining challenges to findings of fact:

" ... the appellant must first identify the finding which is challenged; secondly, show that it is significant in relation to the conclusion; thirdly, identify the evidence, if any, which was relevant to that finding; and fourthly, show that that finding, on the basis of that evidence, was one which the tribunal was not entitled to make."

16. Complete absence of evidence, or the evidence being to the contrary effect, are two of the grounds on which it may be said that a tribunal was not entitled to reach a conclusion of fact. It is also well settled that a tribunal is not entitled to find serious allegations established against a party who calls relevant witnesses unless those allegations are clearly formulated and put in cross examination. As Briggs J said in *HMRC v Dempster* [2008] EWHC 63 (Ch) (unreported)

".it is a cardinal principle of litigation that if serious allegations, in particular allegations of dishonesty are to be made against a party who is called as a witness they must be both fairly and squarely pleaded, and fairly and squarely put to that witness in cross-examination."

17. For a more extensive analysis of the obligation to put such allegations see Jacob LJ's summary in *Zipher v Markem* [2005] EWCA Civ 267 at [57] – [61]. ...

18. Subject to these very tight limitations, it is not open to the High Court to conduct a review of the evidence to see whether it would have reached the same conclusion. An appellate court is poorly placed to assess the value of oral evidence given before the Tribunal. Moreover, if the analysis of the evidence is such that reasonable judicial minds might differ on the outcome, there is no basis for saying that the decision of the tribunal of first instance is wrong."

The grounds of appeal

42. The Notice of Appeal sets out seventeen paragraphs of grounds on which it is alleged that the Tribunal has gone wrong. The Appellants' skeleton argument on this appeal, extends to 128 pages to which are added 10 appendices covering a further 57 pages. The skeleton argument begins with an "Executive Summary", after which the document expressly confesses that it may be thought to be too long to be a skeleton argument. In the event, the oral argument before me was much more focused. There were in the end, as it seemed to me, three main strands to the contention that the Tribunal had made correctable errors.
43. At the forefront of the Appellants' appeal was the submission that the Tribunal's decision was based on two conclusions of fact which were not properly pleaded, and were in any case unsupported by evidence. These were:
- i) The conclusion that the UK high volume, wholesale secondary mobile phone market was wholly or largely corrupt, and without any obvious justification apart from defrauding the Crown of VAT ("the market finding"); and
 - ii) The conclusion that Mr Gohir was himself guilty of fraud (as a ringleader) as opposed to merely having knowledge of the fraud of others ("the fraud finding").

44. This attack on the Tribunal's findings of fact formed the first main strand of the appeal. Mr Cordara QC, who appeared on behalf of the Appellants with Mr Jern-Fei Ng, submitted that these two findings underpinned the Tribunal's decision to such an extent that, if those findings were not open to the Tribunal, the basis for the decision fell away. He made it clear that the most that the Appellants were asking for was that the case be remitted to a differently constituted Tribunal so that the original appeals could be re-heard.
45. The second main strand of the appeal concerned a number of legal challenges to the reasoning of the Tribunal in its application of the *Kittel* test. In summary these related to the requisite levels of knowledge, proximity and participation for the test to be satisfied.
46. The third and final strand of the arguments presented on the appeal concerned the question of whether HMRC could "recover" more than their tax loss.

The first set of grounds: disputed findings of fact

The market finding

47. It is first necessary to identify precisely what the Tribunal found about the market. Mr Cordara sought to characterise the finding as one in which the Tribunal had found:

"that the wholesale market in mobile phones is nothing more than a device by which the taxing authorities, in the United Kingdom and elsewhere, can be cheated."

48. The italicised words are indeed used in [156] of the Decision. But it is important to see the words in the context in which they are used:

"While we are quite willing to accept that there is a genuine grey wholesale market in mobile phones we consider it an inescapable conclusion from the evidence we heard and read, and not least Mr Gohir's own evidence, that the Appellants were not engaged in it. We were left in no doubt that almost all, if not, indeed, all, of the transactions into which the Appellants entered were wholly artificial. We are satisfied that, far from being a means by which those with a genuine surplus can dispose of their unwanted stock to other traders who have a genuine need, it is nothing more than a device by which the taxing authorities, in the United Kingdom and elsewhere, can be cheated"

49. Read as a whole, I think the Tribunal was reaching its conclusions about the trade and the pattern of trade with which the Appellants were concerned. The Tribunal recognised the existence of a genuine market. It found the Appellants were not involved in it. Almost all of the transactions in which the Appellants were engaged were wholly artificial and were a device to cheat the taxing authorities. This is emphasised later at paragraph 174 when the Tribunal says

"... we are satisfied that [Mr Gohir] was well aware that the Appellants were dealing in goods which were being used as the instrument of fraud. We are equally satisfied that the transactions were arranged for no other purpose."

50. It is true that there are passages elsewhere in the Tribunal's decision which can be read as expressing a very high degree of scepticism as to the existence of a legitimate need for a *high volume* secondary market at all: see e.g. [157] and [158]. These were in the context of a tendered explanation that Mr Gohir's business was concerned with over-supply of phones in one country and under-supply in another.
51. Mr Cordara made much of these paragraphs. He pointed out that the Tribunal had no evidence about the legitimate market to enable it to conclude that a high volume

secondary market was implausible. He said that the Tribunal never warned the Appellants that it had it in mind to make such a finding about the high volume market, so that the Appellants were deprived of the opportunity of putting in expert and other evidence to tackle it. Mr Cordara pointed to the judgment of Moses LJ in *R (on the application of Teleos and others) v Customs and Excise Commissioners* [2004] All ER D 73 at [80] – [82]:

"Trade In Mobile Phones

80. In order to place the decision of the Commissioners to assess the claimants in context it is necessary to outline a description of the trade in mobile telephones. The global market for mobile telephone handsets in 2003 is said to be approximately 500 million pieces a year. This number is increasing. Products are designed to operate in any country. The trade in mobile phones has become similar to that in other commodities such as oil, coffee beans and pork bellies. There is a primary market in which mobile phones are supplied directly by manufacturers to distributors, which service for example retail chains.

81. There is also a secondary market described by Mr. Hewetson, director of Rapid Marketing Services Ltd, in his second statement as a "grey wholesale market". It is on that market that the claimants trade. In the primary market there may be delivery delays for up to six months for new models. This results in much speculative ordering, by retailers, distributors and networks. Retailers, distributors and networks may be left with either too few or too many mobile phones of a particular model. The grey market has developed in order to deal with over or under supply and to redistribute products wherever there is an actual retail demand. Manufacturers might also produce, as a matter of speculation, excess stock which, if another model is launched which is more attractive to consumers, will leave that manufacturer with an excess of telephones. The grey market is used also to clear older products. Those retailers or distributors who have ordered too many telephones may sell those, which are excess to their requirements, onto the grey market for immediate cash. If retailers or distributors have under-ordered, because of the delay in production it will be necessary for them to buy from the grey market.

Supply and retail demand and accordingly price, fluctuate daily. A trader may buy a batch of telephones one day, for cash, and discover that the price of telephones has fallen by as much as 20% the next day.

82. The market dictates that transactions have to be completed on the same day. Purchases are usually for cash on delivery and it is uneconomic to purchase volumes of less than 1000 units. If a trader holds onto a product for more than 24 hours it risks losing substantially. Profit margins are low, in the region of 2 to 4 percent. Success is based on turnover. Traders only hold stock for very short periods and, usually, turn over their working capital between four to six times a week. Thus it is important that transactions are completed within the course of one working day.

83. Some warehouses are sufficiently secure for goods of small size and value. Stock is often bought and sold by telephone a number of times a day without moving from the secure warehouse. Such secured warehouses are shared by many companies which pay in proportion to their use of that warehouse."

52. Mr Cordara argued that the Tribunal approached the case with a pre-disposed scepticism as to the legitimacy of the market in which the Appellants traded. Given the conclusions reached in *Teleos* and other cases as to the existence of a large volume, rapidly traded secondary market in mobile phones, the Tribunal should have kept an open mind as to the legitimacy of the trade in which the Appellants were concerned. [157] and [158] of the Decision were, said Mr Cordara, bedrock conclusions which were wholly unreasonable, arrived at without a shred of evidence to support them and which poisoned all that followed. If this was the view the Tribunal

took of the trade in which Mr Gohir was participating, then it is hardly surprising that the Tribunal formed an unfavourable view of him as a witness.

53. It is correct to say that the Tribunal's scepticism as to the need for a high volume secondary market in mobile phones was not clearly based on any evidence, and did not form part of the Commissioners' case before them. Nevertheless, the finding does not have the significance which Mr Cordara attached to it.
54. Firstly, the Tribunal was entirely correct to approach the market in which the Appellants were concerned with a significant degree of suspicion. So much was really beyond rational contest. The MOU had recognised that fraud in the sector was rife. The Appellants' own website proclaimed the same message. Of course the existence of fraud *within* a sector, and the entire corruption of a whole sector are different things, but both are powerful reasons for examining with care a claim by a trader to be trading innocently within it.
55. Secondly, the Tribunal's scepticism as to the need for a high volume market was not the sole basis, or anything like it, for its conclusion that the Appellants were fixed with the relevant knowledge of the artificiality and fraudulent nature of the business they were actually conducting.
56. The Tribunal quickly returned to the question of what business the Appellants were actually concerned in. In particular the Tribunal focused on:
 - i) The absence of manufacturers or authorised distributors or recognised high street traders in the supply chains [159]. Given that the explanation proffered of the market was that it originated with traders of this kind, this was a significant and free-standing reason for saying that the Appellants were not concerned in a genuine secondary market;
 - ii) The absence of split consignments which, as a matter of common sense one would expect in a legitimate market [159];
 - iii) The absence of any explanation as to why phones with an incorrect specification would be on the market in the UK and the evasive evidence given about changes [160] and [161], evidence which the Tribunal described as having all the hallmarks of having been invented;
 - iv) The artificial transactions involving World Communications, as to which it was left to counsel for the Appellants to come up with an explanation not proffered by Mr Gohir [162];
 - v) The fact that the "due diligence" conducted by the Appellants was merely window-dressing carried out in most cases after the commencement of trade [163] and [164];
 - vi) The poverty or absence of the contractual conditions, which the Tribunal took as an indication that the deals were pre-arranged [165];
 - vii) The extraordinary size and rapid growth in the turnover of the Appellants [167];
 - viii) The absence of any explanation as to why the Appellants had to secure their supplies through long chains of suppliers; or why Mr Gohir could not identify shorter supply chains despite all his years of experience [168];
 - ix) The trading between Calltel and Opto, and the absence of an explanation beyond Mr Gohir's repeated assertion that HMRC were aware of it [169].

57. The question on which the Tribunal was required to focus was the legitimacy of the business actually conducted by the Appellants: the question before it was not whether it was possible at all to conduct an honest business within the high volume secondary mobile phone market. It seems to me that the Tribunal was more than justified in reaching the conclusions which it did at [156] and [174] whether the market sector in question was one which, as everyone agreed, was rife with VAT fraud, or one in which as the Tribunal thought, was, at least at high volumes, wholly illegitimate. The Appellants' business, which the Tribunal had had the opportunity to examine in great detail over some 12 days of hearing, was not, on any view, legitimate. I therefore reject this ground of appeal.

The fraud finding

58. The fraud finding is contained in [174] of the Tribunal's decision.

"We think the Commissioners are right to contend that [Mr Gohir] was one of the ringleaders. But even if he was not, we are satisfied that he was well aware that the Appellants were dealing in goods which were being used as the instrument of fraud."

59. Mr Cordara quite rightly stressed the seriousness of being found to be a ringleader of a substantial VAT fraud. It was certainly an allegation that was put fairly and squarely to Mr Gohir in cross-examination. Mr Gohir denied that he was one of the ringleaders.

60. Mr Cunningham QC, who appeared for the Commissioners with Mr Philip Moser and Ms Fiona Banks, suggested that the conclusion was one to which the Tribunal was entitled to come on the basis of the evidence, and in particular the demeanour of Mr Gohir when he gave evidence. But, even if he was wrong about that, the Tribunal's critical, and in his submission unassailable finding was that which it made in the very next sentence of its decision, namely that, even if it was wrong about "ringleadership", it was satisfied that Mr Gohir was well aware that the Appellants were dealing in goods which were being used as the instrument of fraud.

61. I think it is fair to say that there was no basis for the Tribunal's finding that Mr Gohir was a "ringleader" if that term is taken to mean that he was involved at the top of the management structure of the fraud. A witness's demeanour cannot, on its own, support an allegation for which there is no other evidence. Nevertheless, it is clear that, in expressing its conclusion in the way in which it did, the Tribunal was making it plain that the finding of ringleadership was not material to its conclusion. In my judgment, the Appellants' attack on the basis for that finding cannot take them home on this appeal.

62. In developing the appeal Mr Cordara drew a distinction between an allegation of fraud against Opto and Calltel themselves, and an allegation of actual knowledge of the fraud of others. The former, he said, was never part of the Commissioners' case. Even the latter, he said, appeared to have been abandoned on the fourth day of the hearing before the Tribunal in favour of an allegation of constructive knowledge alone.

63. Whilst the distinction between fraud and knowledge of the fraud of others is no doubt a clear and important distinction, it needs to be recalled that the Tribunal's actual finding was that Mr Gohir knew that he was dealing in goods which were being used as the instrument of fraud. It is that allegation, therefore, which needed to form part of the Commissioners' case, and to be put to Mr Gohir so that he could answer it.

64. In a VAT appeal of this nature before the Tribunal, the Commissioners are required to produce a Statement of Case. The Statements of Case in the appeals of Calltel and Opto were in similar terms. That in Calltel's case asserted that

"In respect of each of [the impugned purchases] by the Appellant, the Commissioners contend that the Appellant **knew** or should have known that, by its purchase, it was participating in a transaction connected with fraudulent evasion of VAT" (emphasis supplied)

65. In their written opening skeleton the Commissioners put their case in the following way:

"In briefest summary, it is HMRC's case that the relevant transactions underlying the 01/06, 02/06 and 03/06 VAT returns submitted by both companies were transactions connected with such fraudulent evasion of VAT and that the [Appellants] **knew** or should have known that they were participating in transactions of such a character." (emphasis supplied)

66. In his oral opening, Mr Cunningham for the Commissioners made it clear that the Crown would be asking the Tribunal to infer actual knowledge, in the absence of an admission:

"It is of course our case that [the Tribunal] are required to draw inferences here. We would not be here if we had Mr Gohir with a white flag up saying, "I knew". There would not have to be a trial because there would be no issue. His case is, "I did not know" and more than that, "I could not have known". So we cannot tackle that with an admission or a plea of guilty. We can only deal with it by saying, "You had all of this information, **you must have known**, you should have known." (emphasis supplied)

67. To assert that an individual must have known something is of course different from a case of mere constructive knowledge. By asserting that Mr Gohir "must have known" the Commissioners were saying that the objective evidence pointed towards a conclusion of actual knowledge, which Mr Gohir would in due course be called upon to answer.

68. In the course of the fourth day of the hearing before the Tribunal, an exchange took place during the cross-examination of the Commissioners' main witness, Mrs Bushby by counsel then appearing for the Appellants:

"MR CUNNINGHAM: Again, I rise only to help, I hope. Sir, my learned friend is absolutely right, sir, generally. Absent a confession or an admission or a document that amounts to either of those, actual knowledge is not something that we can allege, sir.

MR PATCHETT-JOYCE: I am very grateful.

THE CHAIRMAN: You have not identified any such document.

MR CUNNINGHAM: Quite, sir.

THE CHAIRMAN: But actual knowledge of the hazards of the trade is conceded, is it not, Mr Patchett-Joyce?

MR CUNNINGHAM: That is another matter.

THE CHAIRMAN: That was the first point you put to Mrs Bushby. But actual knowledge of the alleged taintedness of any individual deal is not alleged.

MR CUNNINGHAM: No, sir."

69. These exchanges occurred in the course of a passage of the cross-examination of Mr Bushby in which she was being asked whether she was asserting that the Appellants knew the *identity* of any particular defaulting trader. It was in this limited context that Mr Cunningham rose to explain that the Commissioners had nothing to pin down the suggestion that Mr Gohir knew these identities. It is only the last of the exchanges between the Chairman and Mr Cunningham that might be thought to have gone further and abandoned any case of actual knowledge of fraud in any individual deal.
70. Notwithstanding the ambiguity in this one passage in the transcript of evidence, I have been entirely satisfied by Mr Cunningham that the Appellants were not misled by it as to the nature of the Commissioners' continuing case: namely knowing participation in a scheme in which the payment of VAT is evaded. That was the way in which the case was put to Mr Gohir in cross-examination. In the end there was no suggestion in the final submissions on behalf of the Appellants before the Tribunal that the Commissioners had abandoned any case of actual knowledge.
71. The Tribunal said at [3] and [144]:
- "3. Initially [the Commissioners'] position was that the Appellants had the means of knowledge of the fraud, but they did not go so far as to assert actual knowledge. As the hearing progressed, however, their position changed and they added an argument that the Appellants knew of, and indeed were party to, the fraud which, they say, the transactions were designed to perpetrate.
144. The Commissioners' principal argument had become, by the conclusion of the hearing, that Mr Gohir knew of, and was very probably one of the organisers of, an attempt to defraud them. What had, originally, been their principal contention, that he had the means of knowing that there was a fraud, had become a secondary argument. If Mr Gohir did not have actual knowledge of the fraudulent nature of the transactions, they say, it could be only because he had deliberately shut his eyes to it. They point to his admitted awareness of the prevalence of fraud in the mobile phone trade, the poor quality of the Appellants' due diligence procedures and their irrelevance to Mr Gohir's having decided whether or not to enter into any transaction, his failure to heed the repeated warnings given by Mrs Bushby and other officers and what they contend was the incredible evidence of Mr Gohir and Mr Khan about inspection and modification of phones. The whole, they say, leads inexorably to the conclusion that the transactions were contrived and that Mr Gohir was well aware of that fact."
72. I think that the first of these passages may give a slightly incorrect impression of the Commissioners' stance in these proceedings. That stance was always that the Appellants were aware that the transactions in which they were involved were connected with the fraudulent evasion of VAT. At the outset it was put on the basis that the Appellants "must have known": which is an allegation of actual knowledge. They maintained that position through to the end of the hearing.
73. I have therefore come to the very clear conclusion that the Tribunal was entitled to make the finding of actual knowledge which it did in paragraph 174, that it is to say they were entitled to be satisfied that Mr Gohir, Calltel and Opto were well aware that the Appellants were dealing in goods which were being used as the instrument of fraud, and the transactions in which they were themselves engaged were arranged for no other purpose.

The second set of grounds: Did the Tribunal apply the wrong test of knowledge, proximity and causation?

74. Mr Cordara submitted that unless I was satisfied that the Tribunal were intending to and did base their decision on the fact that the Appellants were fraudulent co-

conspirators, as opposed to knowing participants in the fraud of others, then a number of further issues fell for decision. That is because, whilst it is accepted that fraud unravels all, mere knowing participation did not. In the latter case a more careful scrutiny of the basis on which the claim for repayment of input tax was refused is called for – and the Tribunal did not engage, or sufficiently engage in such an exercise.

75. One point at the heart of these further submissions was this. In a typical MTIC fraud chain, the primary fraudulent transaction was the sale of the goods from the importer to its purchaser. If that transaction is carried out with the intention of defaulting on the obligation to account for the VAT collected on the sale, then it is a fraudulent transaction, and everyone can see that the purchaser is participating in it. Nobody would quarrel with the proposition that the purchaser is (to use words from *Kittel*) by his purchase, participating in a transaction connected with the fraudulent evasion of VAT. Equally he would be effecting a "transaction which ... result[s] in his participation in tax evasion" (to use the *Netto* words). His transaction is related causally to the fraud. If either of the relevant types of knowledge is proved against this purchaser, then his claim for repayment of the VAT which he has unwisely handed to the importer (and which has been stolen from the Commissioners) is obviously to be refused.
76. But, says Mr Cordara, the same cannot be said of the purchaser from the purchaser, or other purchasers more remote from the fraudulent transaction. By the time these traders enter the picture, the fraud has been committed. In what way, he asks forensically, can it be said that they participate in a fraud which has already been committed? They have neither participated in it, nor otherwise caused it to occur. I asked Mr Cordara what would happen if a purchaser is offered goods and is told in express terms that the VAT paid on their importation (by another) had not been accounted for to the Revenue. His reply was, in substance, that the purchaser is entitled to say "what concern is that of mine? I will pay the VAT on the purchase to the vendor, and expect to be able to reclaim it back from the Revenue, even though I know that will leave the Revenue out of pocket. My purchase will not assist the fraudster to perpetrate this fraud." That is the logical consequence of his argument. Is it correct?
77. Mr Cordara's submission is that the Tribunal could only validly ignore considerations of proximity and causation if satisfied that it was Calltel and Opto who were orchestrating the fraud. Actual knowledge that they were dealing in goods which were part of an overall scheme by others to defraud the Revenue was not enough.
78. I have no hesitation in rejecting that submission, as did the Tribunal. The Tribunal said at [45]:

"It follows that if a trader in the Appellants' position has actual knowledge that he is participating in a transaction which forms part of a chain whose purpose is the fraudulent evasion of tax, even if he has no privity of contract with the perpetrator of the fraud, he will forfeit his right to deduct."

79. The Tribunal relied on the judgment of Burton J in *R (Just Fabulous (UK) Ltd and others) v HMRC* [2007] EWHC 521 (Admin). In that case, Burton J had to consider the position in relation to contra-trading, a case where by definition the transaction in which the trader is involved is outside the fraudulent chain altogether. At [43] having referred to the passages in *Kittel* which I have cited above, Burton J recorded the Revenue's submission that:

"The words which record these definitive statements are untrammelled by any reference to the need for establishing that the taxable person must be a member of a defaulter chain, or that he must be dealing in the same goods as had been the subject of a defaulter chain."

80. Burton J accepted those submissions without reservation at [50] to [53]. If the Revenue can justifiably refuse repayment of VAT, on the basis of the test in *Kittel*, in the case of a contra-trade, it seems to me that there is no obstacle to applying the same principle to successive members of the defaulter chain itself, provided always that the taxpayer in question satisfies the *Kittel* test. In the case of contra-trading, the impugned transaction is necessarily one which can have no causative relationship with the importer's fraud. No causal connection of the kind suggested as being necessary by Mr Cordara is recognised by Burton J in *Just Fabulous* or by Lewison J in the course of his careful review of the authorities in *Livewire and Olympia*.
81. It will be recalled that the rationale in *Kittel* for refusing repayment where the purchaser knows that he was taking part in a transaction connected with fraudulent evasion of VAT was that he "aids the perpetrators of the fraud and becomes their accomplice". For my part I have no difficulty in seeing how the purchaser who is not in privity of contract with the importer aids the perpetrators of the fraud. He supplies liquidity into the supply chain, both rewarding the perpetrator of the fraud for the specific chain in question, and ensuring that the supply chains remain in place for future transactions. By being ready, despite knowledge of the evasion of VAT, to make purchases, the purchaser makes himself an accomplice in that evasion.
82. Accordingly I would reject this ground of Calltel's and Opto's appeal on this basis.

Multiple recovery/penalty

83. The Appellants also attack the decision on the basis that the *Kittel* principle should not allow the Revenue to "recover", by refusing to repay VAT otherwise repayable, more than the tax lost actually lost by the failure of the fraudulent importer to account. To do so, they say, would offend against fundamental principles of fiscal neutrality of the VAT system, or amount to a penalty.
84. The possibility arises because the selling price of the goods will have increased as the goods are passed down the chain. The tax lost to the Revenue by the failure of the importer to account for the output tax on his sales is therefore likely to be less than the input tax which the Appellants seek to recover from the Revenue on their purchase of the same goods.
85. In *Halifax v Customs & Excise Commissioners* Case C – 255/02; [\[2006\] STC 919](#), the Court of Justice had to consider the circumstances in which the Bank taxpayer could arrange its affairs so as to minimise the incidence of VAT. If the Bank arranged its affairs by directly contracting with developers, it would suffer input tax on the development costs which would be largely irrecoverable. In fact it arranged its affairs so as to involve two other companies, and in such a way as to enable it to make the appropriate input tax recovery. The Revenue challenged the arrangements on the basis that the sole reason for the interposition of the two companies was to avoid or mitigate the liability of the Bank for VAT. Relying on the principle that Community law could not be relied upon for abusive ends, the Court held at [74] and [75] that, firstly, an abusive practice could be found to exist where the accrual of the tax advantage would be contrary to the purpose of the provisions in question and, secondly, the essential aim of the activity is to obtain that tax advantage. At [92]-[93], the Court added:
- "92. It is important, however, to note in that respect that the measures which the Member States may adopt under art 22(8) of the Sixth Directive in order to ensure the correct levying and collection of the tax and for the prevention of fraud must not go further than is necessary to attain such objectives (see *Gabalfrisa* [2002] STC 535, [2000] ECR I-1577, paragraph 52, and the order in *Transport Service* [2004] ECR I-1991, paragraph 29). They may not therefore be used in such a way that they would have the effect of undermining the neutrality of VAT, which is a fundamental principle of the common system of VAT established by the relevant Community legislation (see

Schmeink & Cofreth AG & Co KG v Finanzamt Borken, Strobel v Finanzamt Esslingen (Case C-454/98) [2000] STC 810, [2000] ECR I-6973, para 59).

93. It must also be borne in mind that a finding of abusive practice must not lead to a penalty, for which a clear and unambiguous legal basis would be necessary, but rather to an obligation to repay, simply as a consequence of that finding, which rendered undue all or part of the deductions of input VAT (see, to that effect, *Emsland Stärke* [2000] ECR I-11569, paragraph 56)."

86. The Appellants submit that this principle applies equally to MTIC fraud.

87. In *R (Just Fabulous (UK) Ltd and others) v HMRC* [2007] EWHC 521 (Admin) it was argued by the Revenue (see [48] final sentence) that "recoupment of a sum more than the loss caused by the original defaulter, simply by virtue of the markups on each buffer transaction along the chain" did not constitute a penalty. At [50] Burton J said that he was wholly persuaded by the Revenue's arguments, but then went on to draw specific conclusions of his own. In the end he did not decide the question of penalty, saying instead at [54] that:

"If, as I conclude, *Kittel* sanctions the action by the Revenue in this case, on the assumed facts, then [counsel for one of the claimants] is right that the effect of those principles will need to be worked through, depending upon the precise facts, in the slightly different circumstance of a contra-trade chain. Even in relation to a defaulter chain itself, where the right to refuse deductions is expressly sanctioned by *Kittel*, the kind of questions which [counsel] canvasses, of penalty and multiple recovery, might arise, but it is certainly true that they are more likely to arise once the principle applies to an additional chain. However, I am far from persuaded that, once the effects of these three cases are analysed, it will necessarily be the case that any questions of multiple or double recovery will arise, and I am certainly not persuaded that they are bound to arise."

88. In its decision, at [53] to [60], the Tribunal rejected the argument that there was any question of a penalty. The Tribunal asked itself the question "whether the loss of the right to deduct is properly to be regarded as a penalty, either to the extent that the value of the lost right exceeds the tax loss elsewhere, or to the extent that it is not regained when tax originally lost elsewhere is recovered." At [60] it said this:

"In our judgment the loss of the right, in either circumstance, is not to be equated with a penalty: in that, we take the same view as Burton J in *Just Fabulous* (see [48] to [50]). If the Commissioners are right in their factual analysis of the Appellants' activities (and for the purpose of considering this argument we must assume they are), they were participants or, as the Court of Justice said, accomplices in the perpetration of a fraud. The objective of the fraud is to extract from the Commissioners the very input tax which is the subject of the appeals. If that objective is not achieved, there is no purpose at all behind the transactions, if the Commissioners' perception of them is correct. It cannot be said that preventing the participants from achieving that objective is tantamount to the imposition on them of a penalty, just as one would not regard the preventing of a thief from taking the property he intended to steal amounted to the imposition on him of a penalty. Viewed in that way, it is immaterial whether there is any relation between the value of the tax for which, elsewhere in the chain, another trader has failed to account: what the Commissioners are seeking to do is to prevent a theft, rather than to recover a loss. In our judgment there is no basis on which it can be said that they are seeking to impose a penalty on the Appellants, and we do not accept that what was said by the Court of Justice at paragraph 93 of its judgment in *Halifax* is of any application in this case."

89. Mr Cordara criticises this reasoning on the basis that the "theft" in question is the upstream fraud, not the repayment claim. In responding to this appeal, Mr Cunningham relies on the arguments which the Revenue advanced before Burton J.
90. In *Halifax*, the question which the Court of Justice was answering was (see [87]:
- "under what conditions VAT may be recovered where an abusive practice has been found to exist"
91. The question was answered at [98]:
- "It follows that the answer to [the question] must be that, where an abusive practice has been found to exist, the transactions involved must be redefined so as to re-establish the situation that would have prevailed in the absence of the transactions constituting that abusive practice."
92. The principle which the Court of Justice is espousing is that transactions which have been artificially structured must be re-examined to see what their fiscal impact would have been if they had been structured in the normal way. The taxpayer is not to be put in a worse position than he would have been if he had adopted a normal structure. Otherwise he is being subjected to a penalty.
93. It does not seem to me that that principle is one on which the Appellants can rely in this appeal. What, in this case, is the hypothetical normal structure against which the incidence of a penalty is to be tested? If the hypothetical "normal" structure is that in which no fraud has occurred, then the result would be that the Appellants would be able to exercise their right to repayment in full and the withholding of the entire repayment would be a penalty. This is obviously not the correct analysis. Alternatively, if the notional normal structure is one in which the transaction did not occur at all, the right to repayment would not have arisen either. In those circumstances, to deny the right to repayment is not a penalty.
94. The principle for which the Appellants contend is, as it seems to me, a quite different one. It is that the right to repayment of input tax can continue to be exercised, notwithstanding knowledge of the fraud of the importer, to the extent that the claim for repayment exceeds the loss to the Revenue.
95. The possibility for such an excess arises in the following way. In a non-fraudulent chain HMRC ought to recover the VAT on the importer's selling price, and VAT on the markups of the various intermediate traders. They would then repay the total of that VAT to the exporter. By contrast, in a fraudulent chain HMRC only recover VAT on the markups. Nevertheless, if they withhold repayment of VAT to the exporter, it can be said that HMRC are better off than they would have been in the case of the non-fraudulent chain, by an amount equal to the VAT on the markups, and that this sum, at least, should be repaid to the Appellants.
96. In my judgment there is no principle which requires HMRC to acknowledge a claim to repayment to the extent that the claim exceeds HMRC's tax loss. Firstly, as Mr Cordara emphasised in other connections, the correct unit of fiscal analysis is not the entire chain but the individual transaction. This proposition was emphasised in both *Optigen* and *Kittel* (supra). The question is accordingly whether the taxpayer has or does not have the right to deduct or reclaim his input tax in respect of an individual transaction. Consideration of this question does not justify recourse to the overall fiscal impact on HMRC of all the transactions in the chain.
97. Secondly, none of the statements in *Kittel* suggest that the right is lost only to the extent that tax is lost elsewhere in the chain. It is true that measures adopted by Member States to combat MTIC fraud must be proportionate: see e.g. *Netto* (supra)

at [18]-[23]. Thus irrebuttable presumptions of illegality, for example, are not permitted: *Garage Molenheide* Joined Cases C-286/94; C-340/95; C-401/95 and C-47/96: [\[1998\] STC 126](#) at [52]. But, once it is established that a taxpayer has, by his purchase, participated in the fraudulent evasion of VAT, it seems to me to be impossible to argue that, by withholding repayment of VAT in respect of that very purchase the taxpayer is being subjected to a disproportionate remedy. In fact, to use the VAT legislation to achieve any benefit from such a purchase seems to me to be wrong in principle.

98. Thirdly, although fiscal neutrality is a fundamental feature of the system of VAT, and the right of any trader to deduct input tax is an important feature of the system of ensuring fiscal neutrality (see e.g. *Kittel* at [48]), the fiscal neutrality of an individual transaction will, as *Kittel* shows, have to give way to the objective of combating fraud.

99. It seems to me that the objective of not recognising the right to repayment is not simply to ensure that the exchequer is not harmed by fraud: the objective includes combating fraud and discouraging taxpayers from entering into transactions of this nature. In that context, considerations of fiscal neutrality of the impugned transaction are, it seems to me, beside the point.

100. For those principal reasons I reject the grounds of appeal concerned with penalty and excess recovery.

Conclusion

101. I have not been able to discover any error in the decision of the Tribunal which would justify intervention by this Court. It follows that the appeal will have to be dismissed.