



TC00137

Appeal number LON/2007/1072

Value Added Tax – Input Tax – Disallowance of input tax – MITC fraud – Whether fraudulent tax loss – Yes – Whether Appellant knew or should have known – Yes – Whether Appellant allowed to recover input tax – No – Appeal dismissed

**FIRST-TIER TRIBUNAL
TAX**

EURO STOCK SHOP LIMITED

Appellant

- and -

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

Respondents

**TRIBUNAL: DR K KHAN (Judge)
MR P D DAVDA FCA**

Sitting in public in London on 8-11 September 2008, 23-24 March 2009 and 2 April 2009

For the Appellant Ms Nicola Preston, Counsel, instructed by Wolters Kluwer (UK) Ltd

For the Respondents Mr Christopher Foulkes, instructed by the General Counsel and Solicitor to HM Revenue and Customs

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DECISION

Introduction

1. The disputed decisions of the Commissioners of HM Revenue and Customs
5 (“the Commissioners”) are as follows:-

(a) A decision to deny entitlement to the right to deduct input tax
in the sum of £1,175,485.51 for the period 04/06 and

(b) A decision to deny entitlement to the right to deduct input tax
in the sum of £499,156.88 for the period 05/06.

10 On 29 August 2007, the Commissioners wrote to the Appellant setting out a further
decision to deny input tax in the sum of £36,288.00 claimed in the Vat period 05/06.

2. The Commissioners grounds for their decision is that the input tax incurred by
the Appellant arose from a transaction or transactions connected with the fraudulent
evasion of VAT and the Appellant knew or should have known of this fact.

15 3. By Notice of Appeal dated 13 June 2007 the Appellant appeals against these
decisions. The grounds of appeal may be summarised as follows:

(i) That the decisions of the Commissioners are wrong in fact and
law;

20 (ii) That the decisions of the Commissioners are made without
reference to the relevant case law;

(iii) That the Commissioners interpretation of the effects of the *Axel
Kittel* and *Bond House* judgments is unsustainable;

25 (iv) That the Commissioners have failed to particularise the nature
of each alleged fraudulent evasion of VAT, how each transaction in
which the Appellant participated was connected with the fraudulent
evasion of VAT and how it is said that the Appellant knew or should
have known of such connection at the time it entered into the
transaction in question;

30 (v) That the Appellant enjoys a “right to deduct” the claimed VAT
credit pursuant to Article 167 et seq, of the re-cast VAT Directive,
2006/112/EC, which right must be given effect to immediately, and
ss.24-26 of the (“VATA 1994”) must be construed purposively, ie in
accordance with the relevant provisions of the VAT Directive,

35 (vi) The decision to disallow the claimed input VAT credit is in
breach of fundamental principles of EC law.

Background missing trader inter-community (“MTIC”) fraud

3. This case can only be properly understood with a brief explanation of MTIC fraud which explains the way in which this VAT fraud is perpetrated. The Respondents’ case is that the defaults were fraudulent

5 4. The VAT system when correctly operated allows an amount of VAT charged by one VAT registered trader to another VAT registered trader to be accounted for as output tax. The amount of VAT charged as output tax, may subsequently be reclaimed by the purchaser as input tax. This ensures that the tax is neutral. When a business’
10 input tax claim exceeds the output tax they may be entitled to make a claim for repayment of VAT. In MTIC fraud the output tax is not collected from the “missing” trader but is still claimed as input tax that subsequently results in a claim for a repayment of VAT. It is estimated that substantial sums are lost every year to the Treasury as a result of these transactions.

15 5. A transaction chain in MTIC fraud involves a “missing” trader, a “hijacked” trader or a “defaulting” trader, who acquires (imports) goods from another EU Member State. The goods are sold to a number of UK intermediary companies called “buffer” traders and finally to a “broker” trader. The broker finally re-exports the goods back to the EC. The missing trader is a VAT registered entity in a transaction chain who purports to acquire goods zero-rated from another EU Member State, sells
20 them in the UK charging VAT at the standard rate and disappears before accounting for the acquisition and sales VAT due to HMRC. A missing trader will not complete or submit a VAT return and deliberately does not pay the VAT when it becomes properly due. A hijacked or cloned missing trader, is a trader who adopts the identity of another VAT registered trader and takes the role of the missing trader. The trader who adopts the identity of another VAT registered trader is not himself registered for
25 VAT and therefore does not complete or submit a VAT return and deliberately does not pay the VAT when it becomes properly due. A defaulting trader is a trader who may complete and submit a VAT return but deliberately does not pay the VAT when it becomes properly due. Each participating entity in the transaction chain is known
30 as an intermediary or buffer trader. The traders are each VAT registered and may be entitled to reclaim the VAT charged to him or her as input tax and in turn charge VAT when they make an onward sale. The final entity in the UK transaction chain is known as the broker. The broker will then export the goods to another EU Member State or export them outside the EU. The broker is entitled to reclaim the VAT
35 charged to them by their suppliers and subject to conditions, may zero-rate the removal of the goods from the UK. The trader in the EU Member State who acquires (imports) the goods then despatches (exports) the same goods to another country. They are called conduit traders. The goods may be consigned back to the UK missing trader and the carousel of transactions will start again. When the same goods are
40 identified as circulating again it is known as an MTIC carousel fraud. It is often the case that settlement of the invoices for the goods is done by third party payments. In addition, it is not unusual for traders participating in this type of fraud to have overseas accounts or to make payments from overseas. A broker trader will normally be registered for monthly VAT accounting and a buffer trader would normally be
45 registered for three monthly VAT accounting.

6. There are certain characteristics of a MTIC fraud transaction. The first is third party payments. In a transaction tainted by fraud, the sale of the goods to the buffer trader or would be defaulter would normally give instructions that payment should be made not to them but to a third party. Instead of receiving the full income including the VAT, the would be defaulter may only receive a small amount of money which represents a commission for participating in the transaction. The trader therefore is unlikely to have assets to account for the VAT which arises on the transaction. Secondly, it is a common feature of MTIC fraud that goods used to facilitate the fraud are not delivered to the customer but are delivered to and stored in a freight forwarder's warehouse. The title to the goods changes while being stored in the warehouse. The freight forwarder will normally arrange appropriate documentation with the buying and selling of the goods which means that the deals are done as paper transactions. The storage and other costs of the freight forwarder would normally be met by the broker in the transaction. Each time the goods are sold a release note and appropriate documentation will be prepared by the freight forwarder. Thirdly, the commercial rationale of any genuine business must be to maximise profit. Transactions involving MTIC fraud would normally display a lack of commercial rationale. Fourthly, an MTIC fraud transaction would normally show a tax loss and involve a commodity which is high value but small size, for example, CPUs, camcorders and mobile phones. The transactions in the chain are normally concluded rapidly and it is not unusual for all the transactions to take place in one day.

Case law and legislation

7. Articles 167 and 168 of Council Directive 2006/112/EC of 28 November 2006 on the common system of VAT provides:

25 167 – A right of deduction shall arise at the time the deductible tax becomes charged.

30 168 – In so far as the goods and services are used for the purposes of the taxed transactions of a taxable person, the taxable person shall be entitled, in the Member State in which he carries out these transactions, to deduct the following from the VAT which he is liable to pay:

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

8. Sections 24, 25 and 26 of the VATA 1994 deal with the input tax. Section 24 defines input tax. It provides as follows.

24--“(1)Subject to the following provisions of this section, “input tax”, in relation to a taxable person, means the following tax, that is to say –

(a) VAT on the supply to him of any goods or services;

(b) VAT on the acquisition by him from another Member State of any goods; and

40

(c) VAT paid or payable by him on the importation of any goods from a place outside the Member States,

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

5 (6) Regulations may provide –

(a) for VAT on the supply of goods or services to a taxable person, VAT on the acquisition of goods by a taxable person from other Member States and VAT paid or payable by a taxable person on the importation of goods from places outside the Member States to be treated as his input tax only if and to the extent that the charge to VAT is evidenced and quantified by reference to such documents as may be specified in the regulations or the Commissioners may direct either generally or in particular cases or classes of cases.”

15 Section 25 sets out the obligations on taxable persons to account for and pay VAT in respect of supplies made for each accounting period. It provides:

25-(1) “A taxable person shall –

(a) in respect of supplies made by him, and

(b) in respect of the acquisition by him from other Member States of any goods;

account for and pay VAT by reference to such periods (in this Act referred to as “prescribed accounting periods”) at such time and in such manner as may be determined by or under regulations and regulations may make different provision for different circumstances.

25 (2) Subject to the provisions of this section, he is entitled at the end of each prescribed accounting period to credit for so much of his input tax as is allowable under section 26, and then to deduct that amount from any output tax that is due from him.”

9. Section 26 reads as follows:

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

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

- (a) taxable supplies;
- (b) supplies outside the United Kingdom which would be taxable supplies if made in the United Kingdom.”

10. Section 30(6) of the VATA 1994 allows for zero-rating of exports from the EU to a third country. Section 30(8) VATA 1994 provides that:

“Regulations may provide for the zero-rating of supplies of goods, or of such goods as may be specified in the regulations, in cases where –

(a) The Commissioners are satisfied that the goods have been or are to be exported to a place outside the Member States or that the supply in question involves both -

(i) the removal of the goods from the United Kingdom; and

(ii) their acquisition in another Member State by a person who is liable for VAT on the acquisition in accordance with the provisions of the law of that Member State corresponding, in relation to that Member State, to the provisions of section 10; and

(b) Such other conditions, if any, as may be specified in the regulations or the Commissioners may impose are fulfilled.”

11. Section 83(c) confers jurisdiction on the Tribunal in relation to appeals against the amount of any input tax which may be credited to a person.

12. Regulations 25, 39 and 40 of the VAT Regulations 1995 (SI 1995 No.2518) impose obligations on a trader to file a VAT return accounting for the net VAT due and to pay the same to the Commissioners. Regulation 29(1) states:

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

EU and UK : Case Law

13. The European Court of Justice (“ECJ”) has confirmed that, in the context of MTIC fraud traders “who knew, or should have known”, that the transactions in which they were engaging were connected with such frauds will not be entitled to reclaim any input tax incurred: the Joined Cases C-439/04 and C-440/04 *Axel Kittel v Belgium; Belgium v Recolta Recycling SPRL* (judgment of 6 July 2006, “the *Kittel* judgment”). In particular, in the *Kittel* judgment, the ECJ stated:

5 “56. ... 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.

10 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 affected by a taxable person acting as such’ and ‘economic activity’.”

14. The UK VAT & Duties Tribunal (“the Tribunal”), in the case of *Dragon Futures Ltd* [2006] UK VAT 19861, considered how, in practice, the *Kittel* judgment should be applied. The Tribunal in that case put forward a concise test in question form, as follows:

25 ”75. ... Has the taxable person, at the time of entering a transaction involving payment of value added tax by or to that person, and taking into account the actual knowledge of the taxable person at that time (including knowledge acquired from any enquiry or investigation), taken 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?”.

30 The issue is therefore whether the transactions were connected with the evasion of VAT and whether the Appellant knew or should have known of that fact.

Other Relevant Recent Cases

- (1) *HMRC v Livewire Telecom Ltd* (“*Livewire*”) and *HMRC v Olympia Technology Ltd* 2009 EWHC 15 (Ch)
- 35 (2) *Moblix Ltd (in administration) v Revenue and Customs Commissioners* [2009] EWHC 113 (Ch)
- (3) *Honeyfone Ltd v HMRC* [2008] UK VAT 20667
- (4) *Calltel Telecom Ltd v HMRC* [2007] UK VAT 20266

The Appellant's Arguments

15. The Appellant's arguments can be broken down in the following main points:

1. The Appellant says that it is for the Commissioners to prove the supply lines, that is, the chain of transactions leading up to the transactions resulting in the claim for repayment of input tax. If the supply lines are not proved, then the remainder of the Commissioners' case falls away and the Tribunal must allow the appeal.

2. The Appellant says that evidence presented from FL, the freight forwarders, shows that there is more than one credible account of the supply lines and the Commissioners have failed to prove an adequate paper trail to show the actual lines of supply.

3. If the Tribunal accepts the supply lines as alleged by the Commissioners are the correct ones, then the Commissioners must show fraud in the chain. The Appellant accepts that there are four defaulting traders in the various chains, Samson, KEP 2004, Okeda, UK Communication Ltd. While there was a default in each case it is required that the Commissioners must prove that the defaults were fraudulent rather than occurrence from misfortune or oversight. The Appellant says the evidence is inconclusive and it is not enough to say that there "might" be fraud, there must be some mental element on the part of the defaulting trader.

4. The Commissioners then submit that there must be a determination then as to whether the Appellant knew or ought to know of the fraud. A general awareness of fraud is insufficient to show that the Appellant knew or ought to know of the particular fraud in the particular chain. The Appellant says that the Commissioners have failed to identify any such connection and there is no connection with fraudulent traders of which ESS could have known.

The Respondents' Arguments

16. The Respondents' arguments can be summarised as follows:

1. The Appellant's transactions are connected to a tax loss. There is sufficient evidence and invoices, release notes and commercial documents from the Appellant and intermediate buffer traders that shows their connection to defaulting traders. Further evidence of such connection and evidence of the acquisition of goods from traders in other EU countries is provided from the freight forwarder files. The evidence of the connection is provided through a tracing exercise performed by the Commissioners and the Appellant's 19 transactions are connected by a series of deals, a deal chain, to one of four companies who have failed to account for VAT due in respect of those connected deals. Each deal chain is explained in a spreadsheet which analyses the commercial transactions involved.

2. The Respondents say that the defaults were fraudulent. The main argument is that the manner in which the defaults arose is inconsistent with the suggestion that they have arisen by virtue of ordinary business failure. The chain of transactions containing the default were contrived.

3. The Appellant knew or should have known that each transactions was connected to fraud. The fact that the chain is contrived and therefore part of a planned scheme leads to the inference that the participants in the chain are therefore part of the plan and therefore have actual knowledge. They do not accept the Appellant's explanation that the transactions were part of the "grey market" in international wholesale CPUs. The Respondents say that the transactions bear the hallmarks of MTIC fraud including a large number of traders in the chain, goods sold in the same quantities throughout the chain in a short space of time, constant profit, quick payments, third party payment, significant turnover increases and all the supply chains connected to default traders.

4. The last main submission of the Respondents is alternatively, if the Appellants did not actual know fraud, then they should have known. The Appellants did not undertake independent checks on the companies in the trading chain. These include checks at Companies House, annual account, credit check and various other due diligence checks which would have established the true nature of the transaction. The due diligence undertaken by the Appellants was inadequate and the Appellants did not act as reasonable traders in the circumstances. Further reasonable enquiries would have revealed or put the Appellants on notice that the deals were connected to fraud.

Applicable Law : A Summary

17. Let us start by understanding and explaining the applicable law in this area.

18. In the *Kittel* decision the ECJ stated (at para 61):

"... 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".

19. Underlying this statement are two points; firstly, a taxable person is entitled to deduct input tax on taxable supplies made which are used for the purposes of their business and secondly, by way of an exceptional derogation from that principle, an entitlement to input tax may be refused to those who are considered by the national court to be involved in a fraud. The exception to the right to deduct is based on knowledge or means of knowledge of fraud and the test of what constitutes fraud is one for the domestic jurisdiction.

20. In the *Livewire* decision, Mr Justice Lewison summarised the current state of the jurisprudence of the ECJ on the question of fraud and the recovery of input tax. His itemised summary states as follows:

- (i) The objective of preventing evasion of VAT is an objective encouraged by the Sixth Directive;
- (ii) This objective precludes the recovery of input tax where the tax is evaded by the taxable person himself. In such cases, where the right

to deduct has been exercised fraudulently the deduction may be retrospectively disallowed;

(iii) This objective sometimes justifies stringent requirements as regard suppliers' obligations, but any sharing of risk must be compatible with the principle of proportionality;

(iv) It is disproportionate and contrary to Community law to require a person who is a careful and honest trader to assume liability for the frauds of others;

(v) It is also disproportionate to hold a taxable person liable for fraudulent acts of third parties over whom he has no influence;

(vi) A trader who does take every precaution that could reasonably be required of him, and does not realise that he is participating in VAT fraud must be entitled to rely on the legality of his own transaction;

(vii) A person who knew or should have known that by his purchase he was taking part in a transaction connected with the fraudulent evasion of VAT is to be treated in the same way as a person who fraudulently exercises the right to deduct;

(viii) It is not contrary to Community law to require a supplier to take every step that 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;

(ix) Likewise a taxable person can be expected to act with all due diligence and care;

(x) Whether a taxable person knew or should have known that he was participating in a transaction connected with the fraudulent evasion of VAT must be determined having regard to objective facts or factors;

(xi) Community law does not prohibit presumptions, but presumptions must be rebuttable by evidence.

21. This list is helpful since, when the domestic court is acting within the scope of community law or seeking to derogate from it, it must do so in accordance with principles which are fundamental rights recognised by community law. The community law principle of proportionality which is referred to above, would require that measures to prevent fraud, giving effect to a derogation, must not be drawn widely. The principle of equivalency would require that a derogation should not be less favourable to traders involved in community transactions than it would be for those involve in purely domestic transactions. The right to deduct VAT is a fundamental principle of the common system of VAT. The prevention of tax evasion, avoidance and abuse are objective principles recognised by the Sixth Directive. Any derogation must therefore consider and balance these principles and rights.

22. In the *Livewire* decision, the judge recognised that the decision in *Kittel* required a trader to act in good faith and to have taken every reasonable measure to ensure that they were not participating in a VAT fraud. In explaining the relationship between the taking of reasonable measures and knowledge he made reference to the domestic law concept of constructive knowledge. He referred to the decision of Denning J in *Nelson v Larholt* [1948] 1 KB 339, 343 as follows:

5 “He must, I think, be taken to have known what a reasonable man would have known. If, therefore, he knew or is to be taken to have known of the want of authority, as, for instance, if the circumstances was such as to put a reasonable man on inquiry, he made none, or if he was put off by an answer that would not have satisfied a reasonable man, or, in other words, if he was negligent in not perceiving the want of authority, then he is taken to have notice of it”.

10 23. The failure to take reasonable precautions would not automatically mean that one is participating in a fraud and so forfeits the right to deduct input tax. Where, even if precautions had been taken, it would not have been clear that the transaction had a connection with fraud, then the right to deduct input tax would not be lost in such a circumstance. It is important to establish knowledge of the fraud and to identify the fraud with which the trader’s transactions were alleged to be connected and of which he should have known. He should therefore know that there had been a failure to account for VAT by the defaulter or missing trader. He may not know the identity of the missing trader but must know that there was likely to be a missing trader somewhere in the chain. He must also know of a connection between his own transaction and the fraud of the missing trader. It may be difficult to know of the connection directly but, for example, if a trader undertakes a large transaction involving significant profits which is too good to be true he will be taken to have knowledge and will fail the *Kittle* test of knowledge.

25 24. The *Livewire* decision looked at the question of knowledge in some detail. The courts said that the proper test was an objective one which required a consideration of what a reasonable man would know or ought to know. This would include actual knowledge as well as the ability to evaluate facts and to draw appropriate conclusions from those facts. In the *Mobilx* decision, Mr Justice Floyd approved the test for means of knowledge, originally stated in *Dragon Futures* (2006), namely whether “from the evidence before it the trader should have known that, on the balance of probabilities, all its transactions were leading back to defaulting traders”. The evidence presented to the Tribunal is therefore important in establishing this part of the *Kittel* test (test for knowledge or means of knowledge of a connection with VAT fraud).

35 25. The Tribunal in *Dragon Futures* in answering the question of whether a person had the means of knowledge that a VAT fraud is present, in a chain of transactions in which they are involved, said the following should be considered:

40 “(1) The taxable person must be judged by both the level of actual knowledge and the actions taken, or not taken, to acquire knowledge at the time of entry into the commitment that gives rise to the input tax. Hindsight cannot be used. There may be questions in individual cases about the time of entry into the commitment. The taxpoint of a transaction may depend on how the transaction is carried out (for example, where payment precedes delivery).

5 (2) The taxable person must make a proportionate response to information actually known that indicates fraud. That knowledge is not restricted to the immediate context of the supplier or purchaser of relevant goods to or from the taxable person. It includes knowledge of fraud “in the market” for the goods in question as well as knowledge in the public domain or otherwise actually known of fraud by a specific trader. It includes information about all known counterparties in the web of transactions of which the contract forms part, and counterparties that can be identified on proportionate enquiry made within the limits imposed by market confidentiality.

10 (3) The taxable person must take proportionate steps to use all means reasonably available to increase actual knowledge. For example, in these appeals, the tribunal saw the use of checks on the validity of value added tax registration numbers; checks on customs stamps on goods going through a customs inspection; checks with and about individual suppliers and customers; including checks with national registration institutions; checks with credit agencies and inspection agencies, including checks on the IMEI numbers of telephones; use of appropriate terms of contract. Where an initial enquiry gives rise to information suggesting the need for further enquiry, the test is reapplied to assess the need for that further enquiry. What is proportionate and reasonable is a matter of fact, and involves balancing actual cost and the opportunity cost of personal effort against risk.

15 (4) The taxable person, in making these checks, does not have to act to a higher standard of proof than that applied to the underlying claim. If disputed facts are determined by reference to the balance of probabilities, then that is also the standard by which the steps taken by a taxable person should be judged. A taxable person cannot be expected to take steps to ensure a transaction is clear of fraud beyond all reasonable doubt. That would be disproportionate. If, on what the taxable person knows after taking into account all actual knowledge and having made all proportionate enquiries, the better view is that there is probably no fraud connected with the transaction, then the taxable person has met the required standard.

20 (5) Whether the steps taken by a taxable person to avoid being connected with fraud are proportionate in an individual case must be a question of fact taking all the circumstances into account. There can be no presumption that because there is fraud in a chain of transactions then that fraud is known, or should have been known, to all others in that chain.

25 (6) Finally, the concern requiring investigation is with fraud on the public revenue through the value added tax system, not with other forms of fraud such as fraud on a foreign trader.”

26. It is not required that the trader takes every possible precaution but must take those which are reasonably required in the circumstances and are appropriate to ensure that, on the balance of probabilities, there is no connection with transactions involving VAT fraud.

27. What is the position regarding the burden and standard of proof? The Commissioners have an evidential burden to discharge and to show, on a balance of probabilities, that fraudulent transactions have taken place. This means in effect that the Commissioners must establish a chain of transactions, the relevant default and the fraudulent purpose of the default. In other words, they must present an answerable case. The burden then shifts to the Appellant to show that they did not have the requisite knowledge or means of knowledge. This shift in proof presumes that it would be the Appellant who has full knowledge of the relevant matters and transactions and should therefore be the person on whom the burden should rest. The burden does not remain with the Commissioners as suggested by the Appellant (*Honeyfone Ltd* [2008] UK VAT 20667).

28. The standard of proof will be on a balance of probabilities. This is standard in civil proceedings. This balance of probabilities means that the tribunal must be satisfied that the occurrence of the event was more likely than not and as such account should be taken of the inherent probability or improbability of an event occurring. There must therefore be cogent evidence. Lord Hoffman in *Secretary of State for Home Department v Rahman* [2001] UK HL 47 stated:

“It would need more cogent evidence to satisfy one that the creature seen walking in Regent’s Park was more likely than not to have been a lioness that to be satisfied to the same standard of probability that it was an Alsatian. On this basis, cogent evidence is generally required to satisfy a civil tribunal that a person has been fraudulent or behave in some other reprehensible manner. The question is always whether the tribunal thinks it more probable than not”

29. What can be deduced from this statement is that the more improbable the evidence, the stronger must be the evidence that it did occur and its occurrence must be established on a balance of probabilities. The final decision in such a matter however lies with the tribunal’s assessment of the evidence.

Glossary of Abbreviations

- (1) Euro Stock Shop Ltd – “ESS”
- (2) Forward Logistics (Heathrow) Ltd – “FL”
- (3) 21st Trading Ltd – “21st Trading”
- (4) Essential Components Ltd – “ECL”
- (5) Qiass Ltd – “Qiass”
- (6) Electronic Folder – “EF”
- (7) The Router Group Ltd - “Router”

- (8) Decode Direct Marketing Ltd – “Decode”
- (9) Alpha Wholesale Services Ltd – “Alpha”
- (10) Time Corporates Ltd – “Time Corporates”
- (11) Samson Traders Ltd – “Sampson”
- 5 (12) Miaotech Trading Ltd – “Miaotech”
- (13) UK Communication Ltd – “UK Communication”
- (14) S-Electrical Store Ltd – “SES”
- (15) KEP 2004 Ltd – “KEP 2004”
- (16) Okeda Ltd – “Okeda”
- 10 (17) ASAP Trading GmbH – “ASAP Trading”
- (18) Panmax GmbH – “Panmax”
- (19) Jool Ltd – “Jool”
- (20) Formosa SA – “Formosa”
- (21) Conway Distribution – “Conway”
- 15 (22) Sundaze Central Trading – “Sundaze Central”
- (23) Suyama Private Ltd – “Suyama”
- (24) Jumbo Line General Trading Co Ltd – “Jumbo Line”
- (25) Enastech – “Enastech”
- (26) Impex FZE – “Impex”
- 20 (27) Asia Power Solutions GmbH – “Asia Power”
- (28) Abyss International FZE – “Abyss”
- (29) Marshall AG – “Marshall”
- (30) Ad Micro Ltd – “Ad Micro”
- (31) Intel Corporation CPU Pentium 4 – “CPU Intel P4”

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30. Before looking at the detail transactions let us look at the history of ESS.

ESS

30 31. ESS was incorporated on 23 February 1998 (company number 03515262) by
 current directors Bharat Shaunak and Moshi Darr. It was registered for VAT with an
 effective registration date of 5 March 1998. It was issued with a VAT registration
 number of 710455370. The main business activity was declared as the sale of
 computer products with a turnover of £2m expected for the first twelve months. The
 35 directors are shareholders with 50% each of the issue share capital.

32. The turnover of the company as provided from HMRC records is as follows:

	2002	£8,351,839
40	2003	£8,397,428
	2004	£9,233,629
	2005	£23,144,998
	2006	£33,110,305
	2007	£6,272,021

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33. The main business activity of ESS is the wholesale of computer hardware such as monitors, keypads, DVD drives, computer cases, computer processing units (CPUs), memory and other computer peripherals and software. The business has two distinct sides, UK wholesale and export. Stock is held at the company's address which is Unit 18, The Metro Centre, Britannia Way, Coronation Road, London, NW10 7PA (PPOB) and at an independent third party premise, usually FL, whose principal activity is that of freight forwarder. Customers are sent stock directly from both ESS and FL premises. Customers may attend ESS place of business to purchase goods directly.

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34. ESS submitted quarterly VAT returns ending March, June, September and December respectively before being amended to monthly returns, at ESS's request, in February 2005. From VAT period 06/01 to 06/04, ESS only submitted "tax due" VAT returns i.e. their net VAT position was to pay HMRC.

15 35. From VAT period 09/04 to 05/06 all VAT returns, apart from the 03/05 VAT return, were repayment claims. This was the result of ESS undertaking zero-rated sales i.e. export and supplies to other EU Member States. The amounts claimed were as follows:

20	09/04 -	£168,066.60 (3 month period)
	12/04 -	£46,197.00 (3 month period)
	02/05 -	£91,630.80 (2 month period)
	04/05 -	£58,624.50
	05/05 -	£30,205.30
	06/05 -	£109,794.33
25	07/05 -	£153,677.12
	08/05 -	£203,845.32
	09/05 -	£343,088.40
	10/05 -	£533,546.09
	11/05 -	£651,894.57
30	12/05 -	£384,782.44
	01/06 -	£189,223.92
	02/06 -	£961,215.70
	03/06 -	£928,957.19
	04/06 -	£1,175,818.95
35	05/06 -	£538,713.16

36. In the period before the VAT period 09/04, ESS's sales to countries outside the UK were negligible. In the period 09/04 to 05/06, goods were supplied to countries outside the UK on a regular basis. From the VAT period 09/04 to 10/05, the majority of sales to businesses outside the UK were to EU Member States. From the VAT period 11/05 to 05/06 sales were made exclusively to countries outside the EU. The non-EU businesses sold to were based mainly in Dubai, Hong Kong, Switzerland and Singapore.

37. ESS routinely e-mailed a summary of their deal logs of last transactions carried out in the period 09/04 to 05/06 to the Wembley VAT office. From this information, a decision was made by the VAT office whether to repay the claim. It was found that not all trades carried out in the VAT period was detailed on the deal logs, only large volume “back to back” deals. Contracts were for the supply of CPU Intel P4. The twelve deals carried out between April 2005 and March 2006 (shown on the deal logs) account for £30,597,611.07 (net of VAT) out of declared sales of £38,297,912.00 or approximately 80%. Of the 112 purchases detailed in the twelve deal logs, 98 were supplied by the VAT registered business 21st Trading. On six occasions, (VAT period 08/05, 09/05, 11/05, 12/05, 01/06 and 03/06), 21st Trading were the sole supplier for the deals detailed on the deal logs which were supplied by ESS. The purchases detailed on all twelve deal logs were stored at the premises of FL and never delivered to ESS premises. Where the goods were sold to countries outside the UK, their transportation was arranged by FL.

38. The increase in ESS’s turnover in 2005 and 2006 (when compared with 2004) coincides with the commencement of sales to countries outside the UK. The increased turnover also coincides with UK registered business 21st Trading becoming a major supplier. Prior to the VAT period 06/05, 21st Trading made very few, if any, supplies to ESS. From the VAT period 06/05 to 04/06, 21st Trading sales to ESS was between 16% and 107% of declared outputs. For the 11/06 VAT period, purchases from 21st Trading accounted for approximately 90% (by value) of ESS declared outputs. It is safe to assume that as 90% of declared inputs are from 21st Trading, then 90% of the outputs (sales) derived from these products.

39. The directors of ESS, Messrs Shaunak and Darr, were also directors of a business called ECL. The business was registered for VAT purposes between 1 May 2000 and 1 June 2004, (VAT registration number 752079526). The business is not currently trading. ECL carried out some zero-rated sales to EU Member States. On 2 October 2001, after a visit by HMRC officers, Mr Shaunak explained that given the incidence of carousel fraud trading, they (ECL) was no longer involved in the sale of CPUs in large quantities but were now trading in computer accessories which were purchased in containers from UK suppliers and all sales were to UK customers.

ESS : Deal Summary

40. Trading by ESS in the VAT period 04/06 shows mainly export transactions. The deal log for the period 04/06 showed twelve separate sales of which ten were export and in all instances the trade was in CPU Intel P4 which were held at the premises of FL. For all 12 sales, the goods (70,560 units) were purchased from 21st Trading. The deal logs supplied by ESS for 05/06 detailed eight separate sales, of which six were export. There were two purchases from 21st Trading, with the remaining six purchases from UK registered business Miaotech. The traded item was CPU Intel P4 and the goods were held at FL, who arranged inspection and transportation of the goods.

Questions to be answered

41. There are three main and one alternative questions to be answered in order for the Commissioners' case to succeed. In the first instance, the three main questions should be answered positively. The questions are:

- 5 1. Whether the Appellant's transactions are connected to a VAT loss;
2. Whether that VAT loss was attributable to fraud;
3. Whether the Appellant knew that its transactions were connected to fraud;
- 10 4. Alternatively, whether the Appellant should have known that each transactions were connected to fraud.

(1) Was there a VAT loss?

15 The Commissioners say that the Appellant's 19 deals are each connected by a series of deal chains to one of four companies, which have failed to account for the VAT due in respect of those deals. It is accepted by the Appellant that each of the four companies in question have failed to account for VAT (without accepting that such failures were fraudulent). The Appellant contends that the evidence does not demonstrate a connection to fraud and further the evidence from the freight forwarders, FL, shows that the deal chains are inaccurate beyond the buffer trader, Qiasm Ltd ("Qiasm"), which was the acquiring trader from the EU in every chain. They therefore dispute the deal chains as outlined by the Respondents.

25 The Tribunal had the benefit of the verification process which traces the supply chain for each transaction by looking at the records of the parties and the freight forwarders and identifying the sale and purchase at each step of the transaction.

(i) Supply Chain and Deals 1 and 2 : 04/06

30 42. These two transactions took place in the VAT period 04/06 and were for the sale of 10,080 CPUs Intel P4. The transactions took place on 31 March. The deal log indicates that Samson, a UK business, which had its VAT registration cancelled and defaulted on its VAT liability, sold to Routers who sold to Alpha who sold to Qiasm who sold to 21st Trading. They were the supplies to ESS who sold the goods overseas to Asia Power on Deal 1 and Formosa in Deal 2. All the companies bar Asia Power and Formosa were UK resident companies. HMRC using their internal computer system called "Electronic Folder" (EF) (which stores traders' records) were able to create the deal log showing the various parties. There is no indication as to who Samson had purchased the goods from and unsuccessful attempts were made to meet the representatives of Samson to establish their suppliers. The Tribunal has reviewed the copious deal documentation provided by the Respondents and can confirm there was a significant tax loss (£36m) at the Samson level of the transaction.

35

40

(ii) Supply Chain and Deals 3-12 : 04/06

43. These transactions have the same parties (as Deal 1 and 2) in the UK but different purchasers overseas. The parties are as follows:- KEP 2004 would sell to Time Corporates, who sell to Decode, who sell to Qiass who sell to 21st Trading who
5 sell to ESS. The overseas purchasers included Asia Power, Marshall AG, Impex, FZE, Jumbo Line and Ad Micro. The latter part of the chain from Qiass to ESS follows a familiar pattern of sales. However higher up the chain, Time Corporate purchased exclusively from the UK resident business KEP 2004 in all deals involving
10 ESS. The director of Time Corporate when interviewed confirmed to HMRC that he did not get paid for the transactions and the transactions were “back to back” and that the goods were held at the premises of a third party. KEP 2004, who supplied Time Corporates, purchased goods from a German based company called Panmax in deals involving ESS in the chain. However there is some doubt as to whether KEP 2004
15 has acted and been involved in the supply of the goods at all as the only paperwork showed that purchase orders raised by Time Corporates had not been processed into a sale. HMRC determined that the sales to Time Corporates appeared not to be under the control of the director of KEP 2004 Ltd and therefore concluded that their VAT registration had effectively been hijacked which resulted in a loss of tax on each transaction purportedly carried out.

20 44. The supply chain in all 12 of the above transactions in VAT period 04/06 all showed a loss of tax. The parties involved in all transactions, aside from Deals 1 and 2 as described, were KEP 2004, Time Corporates, Decode, 21 Trading and ESS. The overseas buyers varied.

25 45. The tribunal has looked through the paperwork and spreadsheet showing supply chain, purchases and sales and while not every piece of paper which evidences each stage of the transaction is available, on the balance of probabilities, is convinced that the tax loss as described has arisen from the transactions. In some cases it is not clear who are the suppliers to Samson and KEP 2004 at the start of the chain. In other cases there is direct forward selling from overseas to Qiass further down the chain.

30 46. The transactions (04/06) in the chain conformed to a pattern in type of goods (CPUs), quantity sold, same day sales, low profit, no physical possession by buyers, commission payment and tax loss.

(iii) Supply Chain and Deals : 05/06

35 47. There are seven deals in this period, all these took place over seven days and involve the sale of “CPU Intel P4”. The parties, though varied at times, are KEP 2004, Time Corporates, Decode, Qiass, 21st Trading, ESS, who then sell to an overseas entity being either, Ad Micro, Asia Power, Suyama, Abyss or ASAP Trading. At the start of the chain, in Deals 3 to 7 is Okeda and Miaotech supply ESS. 21st Trading always purchased from Qiass in their deals involving ESS. In deals in
40 which Miaotech supplied ESS, they also purchased from Qiass. Qiass were supplied by Decode and SES. The Revenue used their EF tracking to identify that Decode purchased from Time Corporates and UK Communications in transactions involving

5 ESS. Decode always purchased the goods in identical quantities and then sold to
Qiass. SES purchased from UK Communication in all deals involving ESS. The
goods were always purchased in identical quantities and sold to Qiass. Time
Corporates purchased from KEP 2004 which operated a hijacked VAT number which
10 resulted in a loss. The EF tracking identified that Decode purchased from Okeda in
deals involving ESS. UK Communication had neither provided purchase information
nor accounted for VAT in sales to SES and it seems reasonable to conclude that UK
Communication had defaulted on their VAT liability in relation to those transactions
which resulted in a loss. It was not possible to identify who Okeda had purchased
10 from and the business could not be traced.

48 UK Communication operated a VAT number in the name of Jool and HMRC
concluded that the use of the VAT number in such circumstances was fraudulent. The
transactions involving Okeda resulted in a significant tax loss.

15 49. All transactions in this VAT period where goods were exported by ESS
showed a loss of tax. The Tribunal has looked through the spreadsheet showing the
chain of supply to ESS and the relevant invoices.

20 50. In its simplest form transactions involving Miaotech involved them purchasing
from Qiass who purchased from Decode who were supplied by Time Corporates who
in turn was supplied by Okeda. There are six UK businesses, including ESS in each
supply chain. The defaulting traders were KEP 2004, Okeda and UK Communication.
In the case of the first two the VAT number was hijacked.

25 51. The Tribunal has looked through the evidence presented on the supply chain
and found that there are great similarities in the deals. The goods traded are the same,
transactions take place on the same day, for low profit, with no physical possession of
the goods being taken, commission payments have been made and a tax loss arises.

(iv) Supply Chains 04/06 and 05/06 : Summary

30 52. In the 19 deal for which evidence has been provided it is clear that there are
four companies who have failed to account for VAT in respect of those deals. The
Appellant has made clear that they accept that the four companies in question have
failed to account for VAT but have not accepted that they have done so fraudulently.
They further say that the Appellant is not connected to those companies and the
evidence of the freight forwarders, FL, shows that the deal chains are not accurate
beyond Qiass, which acquired in some cases directly from the EU.

35 53. The Tribunal was provided with spreadsheets representing the chain of
transactions. Various commercial documents were provided including invoices,
purchase orders, some banking information, goods and quantity sold and time and
date of sales. The Revenue undertook a large tracing exercise to show the connection
and relationship between the parties. This information has been used in presenting the
information given below.

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(v) The Companies in the Supply Chain

54. Let us start by looking at 21st Trading. They were the main suppliers of ESS. They were registered for VAT on 15 November 2002. Their VAT registration is dated 19 April 2007. The VAT 1 listed their business activity as “Visual and Audio Equipment via E-Commerce”. The company has been involved in very large volume transaction especially CPUs. Their annual turnover according to their VAT returns were:

	2003	-	£30,464,007
	2004	-	£67,296,400
10	2005	-	£427,051,501
	2006	-	£339,933,494 (six months)

55. For the VAT periods 04/05 to 05/06 ESS purchased goods from 21st Trading on 98 occasions, though there could have been more purchases which were not entered on the deal log. In the VAT period 04/06, 21st Trading carried out 302 transactions all purchased from Qiass. The goods sold were CPU Intel P4. They sold to UK companies as well as overseas companies including Asia Power, Ad Micro, Impax FZE and Jumbo Line. All these businesses were also customers of ESS in the VAT period 04/06. All the 302 transactions supply chain have been traced to defaulting traders and a loss resulted. What seems to emerge, in spite of the high number of transactions, is two distinct supply chains. The first is where 21st Trading supplies Qiass with goods purchased from Alpha and the supply chain can be traced back to defaulting trading Samson or where Qiass purchased from Decode and the supply chain can be traced back to the hijacked VAT registration KEP 2004. There are two transactions which clearly illustrates these chains. The first transaction takes place on 3 April 2006 where 800 Intel CPU P4s are traded from Samson to Routers to Alpha to Qiass to 21st Trading who then sell overseas to Pars Technology. The second transaction on 18 April for 5,670 Intel CPU P4 takes place between KEP 2004, Time Corporates, Decode, Qiass and 21st Trading. The goods are then sold overseas to Allcom. In the VAT period 05/06, 21st Trading carried out 94 transactions with all goods purchased from Qiass and Miaotech. The product was CPU Intel P4 which was sold to both UK and overseas businesses. Their customer overseas included Ad Micro, who were also customers of ESS during the same VAT period. In the VAT period 04/06, 21st Trading and ESS shared overseas customers for the VAT period 10/05 to 03/06. The common overseas customers were Formosa, Conway Distribution, Suyama, Jumbo Line, Enastech, Impex FZE, Asia Power and Marshall. In all cases, except three, 21st Trading were ESS suppliers when they sold overseas as shown by the trading summaries of 21st Trading for the period 10/05 to 03/06. The tribunal has analyse the purchase invoices and other information provided for those transactions. In sales to overseas businesses, 21st Trading and ESS use the services of FL to arrange the transportation of the goods. Since the customers of ESS were also the customers of 21st Trading, the question can be asked why the overseas businesses would approach ESS when they could have approached 21st Trading directly to obtain a cheaper price for the goods which they had purchased from ESS. This is puzzling. There is one transaction which took place on May 2006 (05/06) where Sanche

Technologies purchased goods from ESS which was sold to Ad Micro in Hong Kong. Ad Micro were a customer of ESS during that VAT period and were also customers of 21st Trading. Again the question arises as to why the circularity of transactions when the direct route, which is to say, Ad Micro buying direct from 21st Trading, would have proved cheaper and more commercial. This leads one to doubt the commerciality of these transactions with overseas customers.

56. In looking at the payment arrangements between ESS and 21st Trading one finds that regular payments were made between the parties on account rather than a deal by deal basis. This would indicate that there was some internal bookkeeping of transactions between the parties and perhaps some form of credit being given on transactions. This can be compared with ESS customers from overseas who made payments normally within one day of receiving their goods.

57. The second supplier to ESS was Miaotech. 21st Trading had their last sale to ESS on 3 May 2006. After that time, ESS purchased from Miaotech. The Tribunal understands that Miaotech had approached ESS. Miaotech had been one of the suppliers to 21st Trading in the period March and May 2006. The change in supplier from 21st Trading to Miaotech does not bear any apparent commercial advantage. Indeed there perhaps could be a disadvantage in that 21st Trading had allowed ESS a line of credit whereas they were required to pay Miaotech in full and no such credit was available. The prices being offered were comparable and all goods sold to Miaotech were from Qiass who were also the supplier of 21st Trading. The goods were similarly situated at the warehouse of FL as they were when supplied by 21st Trading.

58. Miaotech were registered for VAT on 1 December 2005 and their VAT registration was cancelled on 31 October 2006. The VAT 1 lists their business activity as “wholesale, general trade of computers, computer equipment and software”. They had three VAT periods and declared the following sales:

	02/06 -	£20,290,160
	05/05 -	£53,443,853
30	08/06 -	£13,020,136

Miaotech had as a regular customer 21st Trading, as shown by their trade summaries. They also traded with Ad Micro in May 2006, which was a business that ESS had sold to in that month. Their main supplier was Decode and Qiass. It is interesting that paperwork provided by ESS showed that Miaotech provided their direct competitor 21st Trading as a trade reference.

59. Both Miaotech and 21st Trading has been the subject of extended verification by HMRC and in both cases elements of their input tax claim were disallowed. In June 2006, HMRC presented a case to the High Court of Justice alleging that 21st Trading and its sole director had conspired to unlawfully defraud HMRC.

60. Let us turn to the other parties in the chain. The first party is Qiass which featured in the supply chain of all transactions carried out by ESS in the VAT period

04/06 and 05/06. They were registered for VAT on 29 August 2003 with their VAT registration being cancelled on 10 July 2006. The VAT 1 listed their business as “general wholesalers” with an estimated turnover of £2m. They also traded in CPU Intel P4 and used the freight forwarders FL. Their total turnover declared to HMRC was £271,450,977 between 5 September 2005 and 8 June 2006, a period of nine months. Qiass’s only customer was 21st Trading and their suppliers were Alpha and Decode. They carried out 305 transactions in a April 2006. One of their directors, Haldar Jabber, was an official of 21st Trading. There was a connection between the companies. Their customers were principally 21st Trading and Miaotech and they made three overseas sales to Charles Consulting, a Luxembourg company, and Jumbo Line, who were also customers of ESS. Their supplier was Decode and SES. The decision was made by HMRC to disallow elements of their input tax which had been claimed. One point which emerges from the Appellant’s submissions is that, on the basis of documentation, Qiass were importers directly from Europe and this places in doubt the supply chain which is alleged by the Commissioners. This was dealt with by officer Wilkinson in his evidence when he said that the release notes of FL was not a fair reflection of the way goods were traded and he confirmed that Qiass did not normally acquire goods directly from EU companies. The latter explanation is perhaps that there had been some forward trading and we know that when Qiass commenced trading in September 2005, they did not pay their supplier but instead paid a third party as per the customer’s instruction. We also have evidence from officer Yule who confirmed that if deal logs are incomplete then this is overcome by the tracing exercise and the matching between the deals themselves. These show that the deals corresponded with purchases which have been traced.

61. The other company in the chain is Alpha, which was registered for VAT on 1 February 2004 with their VAT registration being cancelled on 6 April 2006. Their VAT 1 stated that their main activity was “management consultants – accountancy, fund raising, marketing services for small businesses”. Their estimated turnover for the first year was £165,000. The directors of the business were a Mr Singh and Mr Shelnhmar. On being visited by HMRC officers Quinn and Bowater n 6 April 2006, it became apparent that the directors were often vague when asked about suppliers and customers and how deals were set up. Indeed, the directors were unsure of the business actually undertaken by the company. Records indicated that they carried out 570 transactions between 16 December 2005 and 3 April 2006. Indications are that this company was a business within the supply chain designed to buy and sell goods but did not take physical possession of the goods. It was a buffer company.

62. The next company in the chain is Routers which was registered for VAT on 1 September 2004 with its main activity being “providing pre-paid telephone accounts”. Its first year turnover was £400,000. HMRC interviewed its director Mr Mahenthiran on 25 April 2006 and he explained that after advertising on the website AliBaba.com they were offered large quantities of CPUs and mobile phone handsets which he decided to trade. In a very short period, the business had managed to carry out several hundred large wholesale transactions. The company itself had not received any payments on transactions carried out, which had been paid for by a third party.

63. The next company in the chain is Decode which was registered for VAT on 1 October 2005 with its VAT registration being cancelled on 6 June 2006. The VAT 1 give its main activity as “direct marketing/sales company”. On a visit by HMRC officers Cameron-Watson and Balderstone on 18 May 2006, the director of the company Russell Thomas indicated that he had very little knowledge of the products which were being dealt with namely CPUs and mobile phone handsets. He said he found customers Ali Baba website and the IPT website. Its customers include Qiass and Miaotech. The director admitted he did not have capital but relied on payment from his customers before being able to pay his suppliers. He confirmed that most payments were third party and he received only a commission payment. The commission was roughly 10p per unit whatever the quantity of goods sold.

64. Another company within the chain is Time Corporates which was registered for VAT on 12 September 2005 and whose VAT registration was cancelled on 31 May 2006. The VAT 1 stated that the business activity of the company is “variety of goods wholesaling” with an estimated turnover of £100,000 in the first year. HMRC officers Kandola and Meeds visited the business on 2 May 2006 where they met the director of the company Mr Jhaj who explained that he obtained customers on the Ali Baba website. He traded in CPUs and mobile phones and did not physically see the goods and simply obtained a commission payment of 5p per unit for introducing his customers to suppliers.

65. The next company in the chain is SES which was registered for VAT on 20 July 2005 but whose VAT registration was cancelled on 24 July 2006. The VAT 1 stated the business activity as “electronics, mobile phones buying and selling”. The estimated turnover for the first year is given as £200,000. One of the directors, Mr Ali, visited HMRC on 15 June 2006. He delivered some records of transactions carried out by the business and had a discussion with the officers. He confirmed that he had little control over his stock as they were located at freight forwarders and third party payments were normally made for any goods which he receives. The Tribunal had seen a note of the meeting which took place between Mr Ali and officer Lamb.

66. The next important part of the chain is the freight forwarder. The preferred freight forwarder of ESS and other businesses within the supply chain was FL. They arranged the physical removal and transportation of the goods and also took responsibility for storage, inspection and in some cases testing. The company is familiar with HMRC procedure dealing with MTIC fraud and operated a bonded warehouse. The premises have been visited by HMRC officers on many occasions to collect records and establish the supply chain of transactions.

67. We know that freight forwarders would normally arrange for moving the consignment of goods together with the appropriate documentation. The freight forwarder makes their money by having arrangements with customers who pay for storage charges and transport costs. They would hold the consignment of goods until they are released normally through a release note. The freight forwarder charge administrative fees for their services. They may also provide additional services such as logistics services, counting, inspecting and scanning of IMEI numbers.

68. In each of the CPU deals, the goods were housed at FL after being imported from the EU and the goods were released, by release notes given by the traders. Mrs Angela Deane, managing director of FL indicated that when goods move from one party to another there was a release note. In cross-examination, Mrs Deane indicated that the releasing of goods is not done sequentially. She indicated that “nobody would gain access to the stock until the final release is in place”. The release note seems to indicate which party has control of the goods or which nominated trader had given directions on the goods and its movement. The release note would not seem to indicate that a taxable supply of the goods has been made. In other words, the release note passes possession but not title. Mrs Deane also confirmed that she did not know whether payment was made between the various traders who had control of the goods in the warehouse or indeed whether there was a sale between the parties. Mr Shaunak, in his third statement, produces evidence procured by Mrs Deane from the records of FL indicating that Qiass did import goods directly from the EU (Netherlands on 2 April 2006) which contradicted the supply chain suggested by HMRC. However the Tribunal believes that there is no clear evidence of a sale between an EU company and Qiass. It is possible that the goods were passed directly to Qiass from the defaulting trader. The details of Qiass’s dealings is not always clear from the documentation. However, the tracing by HMRC provides sufficient evidence to establish the deal chain in all of the 19 transactions which are before the Tribunal.

69. The last complement in the deal chain are the customers who exist mainly outside the UK in countries such as Dubai, Switzerland and Singapore. One particular transaction stands out. This is a transaction where goods had been purchased on May 2006 from ESS by Ad Micro, a Hong Kong based company. The goods were delivered to Switzerland. The goods were then sold to a Dubai company, Abyss, within a day of reaching Switzerland. Abyss was the customer of ESS and it seems strange that the goods would go via Hon Kong and Switzerland before ending up in Dubai with Abyss, when they could have been imported directly from ESS.

70. What emerges is that the transactions in the chain involved the sale of one item CPU Intel P4. The goods were sold in the same quantities and on the same day and usually to parties who were involved in more than one transaction. The profit margin was very low and constant and related to the unit price of the product. The profit margin achieved by ESS was greater than the rest of the parties in the supply chain despite the goods being traded on the same day. We heard evidence from Mr Shaunak that the market was very “volatile” but there is no evidence of this in the pricing in the transactions in the chain. The goods were housed at the freight forwarders FL, until their eventual export. This meant that the various sale transactions took place on paper but the goods were never physically seen by the parties purchasing. In many cases, a party was not paid but received a commission from the supplier and there were third party payment made for the goods. Each supply chain incurred a loss of tax on a transaction. These do not appear to be normal commercial transactions where free negotiation, price variations and demand and supply rules applied.

71. While the transactions bear great similarity to each other, there are two transactions which best show the lack of commerciality. The first took place on 11 April 2006 (Deal 3, 04/06) for the sale of 1890 CPU Intel P4. The parties to the transaction are KEP 2004, Time Corporates, Decode, Qiass, 21st Trading, ESS and finally Asia Power (Switzerland). The sale price for the items starting with KEP 2004 is £83 per unit which is then sold for £83.05 per unit and then sold for £83.15 per unit and then sold for £83.25 per unit and then sold for £83.50 per unit and finally sold by ESS for £88.50 per unit. The transaction is for the same number of units and all takes place within one day. The transaction is largely a paper transaction and the goods do not leave the freight forwarders until they are sold overseas. We know that KEP 2004 is a hijacked VAT number and so there is a loss in the chain. Another transaction which possesses the same features is one which takes place on 28 April 2006 in the period 04/06. It is for the sale of 12915 CPU Intel P4. The entire transaction takes place on one day, the profit margin ranges between 5p and 10p until sold overseas and indications are that the goods never left the FL warehouse. The overseas purchaser is Ad Micro of Hong Kong. The payment for the goods is shown on the EF Time Corporates were not paid in full on their sales invoice but were paid a commission for putting the deal together. The defaulting party who did not account for their VAT, is a taxable person purporting to be KEP 2004 which HMRC has established as a hijacked VAT registration.

72. For the VAT period 05/06, when Miaotech was supplying ESS, we see a similar pattern. Let us look at the two transactions which are representative of the transactions in that period. These are a transaction taking place on 18 May 2006 (Deals 3 and 4, 05/06) and one taking place on 23 May 2006 (Deal 5, 05/06). In the first two transactions the sale takes place from Okeda to UK Communication to Decode to Qiass to Miaotech to ESS and then overseas to Suyama, a Singaporean company. The quantity of goods being sold is 9,450. In the deal taking place on 23 May, the parties are the same and the quantity of goods being sold is 6,300. In both cases the goods are CPU Intel P4 and the last party in the chain is ESS. The sale by ESS of 9450 units is broken into two parts of 4725 units each. The mark-up in the units being sold is exactly the same unit mark-up found in the previous (04/06) transaction with mark-ups of 10p and 5p per units with ESS making £5 per unit. The uniformity of mark-ups arises despite the quantities being supplied. There is also no evidence of any possession of the goods by buyers in the supply chain and the goods remain at FL before being moved overseas. The HMRC EF evidence suggest that UK Communication was not expecting to be paid the full price but a commission and the tax loss arises with the defaulting trader Okeda which HMRC has established was a hijack VAT registration.

73. While it is accepted not all of the documentation is present to track the entire deal and some of the invoices may be missing what is apparent from the tracing by HMRC is that the 19 deals, on a balance of probabilities, are as described in the schedules compiled by the HMRC officers responsible for the traders identified in the deal chain and from the information provided by the traders themselves. The deal sheets and spreadsheets representing the chain of connected transaction has sufficient

evidence of invoices, purchase orders, associated commercial documents and banking documents to suggest that the deals did take place in the manner in which they have been described. There is also evidence that there is a defaulting trader in each one of the deals and therefore there is a tax loss.

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2. Was the loss fraudulent?

74. Let us now look at the second question, which is, whether the tax loss was attributable to fraud.

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75. The test for fraud is determined by the domestic legislation. The question of what constitutes fraud has been considered by the Courts in many cases. At the simplest level, a business may fail to account for VAT to the Commissioners. It may have collected the VAT due on a transaction but simply disappeared and failed to account for that VAT. In cases involving missing trader fraud, it is common for there to be payment to third parties from one of the suppliers in the transaction chain. This form of payment allows the missing trader to not have to account for VAT due to the Revenue. Therefore, where a fraud is being perpetrated the transaction follows a familiar pattern, as stated in the case of *Software Core Ltd v Pathan & Others* [2005] EWHC 1845, where Pumfrey J observed;

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“The factors are to be viewed as a whole. They reveal at best a pattern of trading from which, without substantial explanation, a judge could draw an inference of dishonesty. Particularly worrying are the indications that trades are without commercial substance and not negotiated in any real sense, lack of insurance, a failure throughout to investigate suppliers, the fixed profit margin, the third party payments themselves and their strange subdivisions into two parts, the lack of any terms and the untrue suppliers’ declarations”.

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The pattern outlined above illustrates the essential features of the transaction where there is fraud and dishonesty.

76. Let us now look at the defaulting traders, Samson, KEP 2004, Okeda and UK Communication. The Appellant accepts that in each case there was a default but require the Commissioners to prove that the defaults were fraudulent rather than due to misfortune or oversight.

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77. First, let us look at Samson. While the company was registered for VAT since March 2005 and had declared sales in March 2006 of 297,158,00 no VAT returns were submitted for the periods 05/05, 11/05 and 12/06. The Commissioners had information on 21 April 2006 that Routers had made purchases from Samson totalling £209,891,337.11 in the period from 10 March to 11 April 2006. Samson’s output tax for that transaction was therefore £36,730,983.99. The business has therefore turned over more than £200m in one month and made no VAT returns for seven months. A notice of assessment in the sum of £36,730,983.99 was raised on 9 May.

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78. A point which emerges from tracing is that the business operated from more than one residential addresses and HMRC officers in visiting and writing to those addresses were unable to find a person who represented the company.

5 79. It is clear that Samson made no attempt to pay the notice of assessment or submit VAT returns for the relevant periods nor have they made any attempt to provide books or records to demonstrate that they carried out a legitimate trade. This would suggest a level of dishonesty. Further, there is no evidence which shows that the company had received any payment for the transactions which were undertaken.

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80. Let us look at the position of KEP 2004 where the Commissioners make an allegation that there is a hijacked VAT number. The evidence surrounding the hijack arises from a visit by HMRC to one of the directors of the company Frederick Vasey ("Mr Vasey") on 9 May 2006. Mr Vasey had confirmed that he was in contact with someone from Time Corporates with a view to supplying them with electrical goods including CPUs. He had also been in contact with a German based business called Panmax which had supplied goods to KEP 2004. KEP 2004 would receive a commission payment on each of the transactions. There were discussions between the parties (very little paperwork or contract) and Mr Vasey confirmed that KEP 2004 had not made any supplies in spite of numerous purchase orders (£291m) having been received from Time Corporates. He felt he was still in the process of negotiating with the parties but it had been agreed that he would receive a commission of between 5p and 10p per unit which will be paid to him by his supplier. The transactions purportedly carried out by KEP 2004 resulted in output tax that was not accounted for (approximately £51m). Mr Vasey confirmed that he had signed blank release forms for the goods which allowed the title to be passed from KEP 2004 to Time Corporates.

81. The Appellant says that there is no evidence that the VAT number was hijacked and Mr Vasey had confirmed that he had undertaken the transactions. They say that HMRC did not properly explore whether Mr Vasey/KEP entered into the transactions with the intention of defrauding HMRC. For this reason, the Appellant says that there is insufficient evidence provided by the Commissioners to show that the default by KEP was fraudulent. The point is that whether or not Mr Vasey/KEP were involved and the transactions were conducted with or without his knowledge, what is clear is that there was a fraudulent scheme to ensure that output VAT on sales of imported goods was not paid. It is clear that Mr Vasey and his company had none of the money which would enabled them to pay the VAT. This is apparent from their bank statement. It is more likely that the fraudulent intent arose on the part of those who contacted Mr Vasey to conduct the deals. The deals were contrived and there were third party payments as confirmed by Jasram Jahj, the director of Time Corporates. There are outstanding assessments totalling £109,972,228.40 against taxable persons purporting to be KEP 2004.

82. The next defaulting trader in the chain is Okeda. We know that there is no record of such a company having been registered for VAT and the VAT number used was that of a company called Jool. Both companies were under a common director

Anjula Perera, who HMRC have been unable to contact. It seems reasonable to assume therefore that Okeda did hijack the VAT number of Jool. The Tribunal is not convinced by the argument of the Appellant that though this may not have been the right thing to do it “may have had the perceived advantage of saving on paperwork”.

5 The Appellant also said that a Mr Miah of UK Communication had been contacted by HMRC and indicated that he was in contact with Okeda but could not remember their address and that HMRC had not made sufficient efforts to follow up on the contact details for Okeda as provided by Mr Miah. Again, this is not a convincing argument. The point is that where a company uses a VAT number which does not belong to
10 them to trade goods which are high value and which gives rise to VAT liability and they fail to render VAT returns or makes an effort to contact HMRC, it is not unreasonable to assume that there was a dishonest intent. These are contrived transaction not ones arising from a simple mistake. It is also apparent from the evidence that the company received no money for the deals conducted and therefore
15 would have been unable to account for VAT due on those transactions. The clear inference here is that there was a fraudulent intent.

83. The next defaulting trader is UK Communication. Mr Miah, who was interviewed by officers of HMRC, confirmed that he was to receive a commission on
20 each transaction completed and that payment for the supplies were to be made by third parties. The purpose of making such payment is to ensure that a defaulting supplier holds no assets and third party payment are designed to frustrate any recovery by HMRC for unpaid tax. UK Communication had never physically seen the goods nor conducted any inspection of goods which they purportedly had
25 purchased. From the report of the meeting conducted by HMRC officers with Mr Miah, it was clear, in his outline of the procedure for a typical Okeda transaction, that there was very little paperwork evidencing the transactions and UK Communication was a conduit who received commission payments. They did not really understand the transactions with which they were involved. The output tax and deals carried out
30 by UK Communication for the VAT period 05/06 were the subject of an unpaid notice of assessment by HMRC.

84. What conclusions can be drawn from the evidence? The first point is that there has been a fraudulent tax loss in the chain. The parties had no intention of
35 accounting for VAT which was due on the transactions. The tracing of the supply chain for goods exported by ESS in the VAT periods 04/06 and 05/06 shows that the four UK businesses which defaulted on their VAT liability had neither provided information on deals nor accounted for the relevant VAT on their VAT return. This is clearly dishonest. The deals with which they were involved showed third party
40 payments, a clear indication of MTIC trading. For completeness, it should be noted that in the *Mobilx Ltd* decision Okeda, UK Communication and Samson have all been found to be fraudulent defaulting traders during the same period.

(3) Did the Appellants know the transactions were connected to fraud?

45

85. We now turn to the third question on the knowledge of the appellants. Did they know there was fraud in the transactions?

86. The Commissioners must prove their assertions of fraud by reference to cogent evidence. Since the allegations are serious, mere assertions are not enough and the evidence must be strong. Where a person simply disregards obvious signs of dishonesty, Nelsonian blindness if you like, then that person cannot say that they were not dishonest. If a person comes by a deal which is too good to be true and ask no questions then they may be knowingly participating in a transaction where there is dishonesty. An honest person would not deliberately close their eyes and not ask questions but will seek to learn more about suspicious transaction. Similarly, a person acting recklessly where there are tell tale signs of dishonesty could be taken to be acting with knowledge. As stated earlier, it cannot be concluded that because a company's turnover increased or they failed to conduct certain checks, that they be seen to be involved with fraud. The test is not a negligence based test of failing to do certain things but rather it rests on the Commissioners to show dishonesty or recklessness. In this sense, the Commissioners must show that the Appellant had entered into the transactions knowing they are part of a wider fraud or turned a blind eye to whether or not they were.

87. The Commissioners must raise a sufficient case for the Appellant to answer and the case must be that the Appellant knew or ought to have known of the fraud. We know that the fact that a person has not taken every precaution or check does not mean they lose the right to deduct input tax. Faulty due diligence does not mean guilt. The evidence presented to the tribunal must be assessed to establish whether the Appellant had the means of knowing that they were participating in a fraud. It is expected that due diligence would be conducted on one's immediate supplier and, if there is an indication that of impropriety higher up in the chain, a "dirty" chain, then comprehensive due diligence should also be conducted at that level. The Appellant should therefore act in a reasonable and proportionate manner to establish the bona fide of transactions and if in doubt about the legitimacy of the transactions, the Appellant should cease to trade with those parties.

88. Let us now look at the evidence and submissions on this point. Let us start by looking at the deals as a whole and the pattern of trading which emerges from those deals.

89. The first point which emerges is that the same parties were involved in the various supply chain. In a competitive marketplace one would have expect to see a variety of supplies sourced from shopping around for best prices in a market where demand outstrips supply and there are ready markets for goods. If demand exceeded supply, it would be expected that the Appellant would have had several suppliers available to supply large quantities of goods at short notice. The idea being to negotiate the lowest price and the biggest profit. The evidence shows that a vast majority of export deals were conducted with only one party, 21st Trading (98 deals in the VAT period 04/05 to 05/06). The number of suppliers to the Appellant for sales in the domestic market was significant and this appears to be more reflective of the competitive marketplace for these products. The Appellants say that the domestic market had more suppliers because these suppliers gave credit. The tribunal is not

convinced by this argument and did not find sufficient evidence to support this argument. Further, there were a significantly larger number of parties in the overseas supply chain which remains unexplained. There is no satisfactory explanation as to why so many traders are necessary when they each perform the same function and the profits are marginal. The goods were sold in the same quantity in a very short time. The Appellant say that the transactions were customer led and that the sales transactions was related to orders by customers. The Respondents say that the large volume of goods and significant number of traders points to the fact that companies earlier in the chain exist only to provide a longer chain and to inflate the price rather than as a legitimate market. This suggests a contrived pattern where high volume deals are done on a single day between five or more traders. The profit margin was constant in each deal, each company had a specific mark-up measured in round numbers to the pence for every unit on every deal. There was no price reduction for greater volumes of goods which was sold. The mark-up by the Appellant exceeded that of any other traders in the chain by a factor of between 8 and 100. Their mark-up was between £2 and £5. The Appellant says that this is explained by the costs of their overheads including shipping, administration, insurance and banking/overdrafts. The Respondents say that shipping and insurance are overheads that a non-exporting trader may also have and say that the mark-up of between £2 and £5 could not be justified for the extra overheads based on the figures which have been provided. The Respondents say that these mark-ups are feature of MTIC fraud. The tribunal agrees with the submissions of the Respondents.

90. In terms of the payment within the chain questions arise on their commerciality. The banking evidence supplied by Barclays to HMRC shows that when making large supplies ESS were paid within seven days of the supply taking place and more often than not within one day of the goods being moved. On being paid, ESS will then pay their supplier within one day of receiving payment themselves. When paying 21st Trading, they would not always pay the full amount in one go but instead make a number of payments in that period of time. When paying Miaotech they paid the full amount usually the same day that they received payment. The banking records of Qiass from First Curacao International Bank (FCIB) show that they paid 21st Trading not on an individual transaction basis but for several transactions at a time. Payment is usually made more than two weeks after the transactions had taken place. Qiass would pay their supplier usually within the same day and again for several transactions. The same sort of bulk payment takes place between Qiass and Miaotech. The FCIB banking information for Decode showed that after receiving payment from Qiass, they then paid various parties but not their supplier. It is not always possible to explain the payments made between businesses in the supply chain including payments to Alpha, Routers, Samson, Time Corporates and SES. What is clear however is that since all the supply chains involve Qiass, all payments to the companies above Qiass would only take place after Qiass had been paid.

91. Companies such as Routers, Decode and ESS all have clauses in their sales contracts stating that the ownership of goods remains with them until full payment is received. We know that ESS received payment for goods before anyone else in the

supply chain and in the some cases by several weeks. It is clear therefore that trading is taking place before payment had been made and in some cases companies did not receive any payment at all. This raises questions of the commerciality of their payment structure and the transactions themselves. We know from looking at the
5 paperwork at FL that goods are “released” but this meant that possession passes between the various parties rather than a taxable supply being made. It would seem that a release in fact allowed goods to be traded without being paid for. It is also clear that payment within the entire chain depended on whether ESS themselves were paid by the overseas business to whom they supplied. The practice of releasing goods
10 without being paid meant that parties within the chain were exposing themselves to potentially high bad debt. This is not a commercially sensible practice. It is apparent that although a large amount of trade was carried on by a number of businesses with each other over a period of time, there was never advance payments to ease trading or financial constraints. This is unusual.

15 92. Within the chain there were third party payments and commission payments rather than payment for the goods supplied. Time Corporates and UK Communication did not receive full value payments but rather small commissions. Decode made third party payments to a number of parties other than their supplier and Alpha also made
20 third party payments. We known these are features of MTIC fraud.

93. The supply chain had other unusual features. We also know that goods were released directly from EU companies (in one case Northcom APS) directly to a trader half up the chain, which was Qiass. This meant that the EU supplier had the identity and details of Qiass and the traders above Qiass wish to remain anonymous. The
25 acquirer of the goods and early traders would have served no purpose other than to distance themselves from the input VAT repayment claim and the output VAT liability, and in the case of the acquirer, to default on that liability. This would suggest that the chain was designed and contrived with a view to avoiding the
30 payment of VAT. The files from FL support the fact that goods were being sold up the chain before they were imported into the UK. Once the goods were imported into the UK they were immediately re-exported on the same day. The purchase and sale through several companies on the same day and then the re-export of the goods to an overseas company is a familiar pattern in MTIC fraud.

35 94. The turnover increase in businesses was significant. The Appellant’s turnover increased, annual figure of £8-9m in 2002-2004 to £23m in 2005 and £33m in 2006. The figure reduced to approximately £6m in 2007 and export deals ceased. It should be said at the start that the increase in turnover is not evidence of knowledge of fraud. The Appellant had stated to HMRC in 2001 that they were not interested in trading in
40 the wholesale CPU market because of VAT fraud. It appears however that they started trading in that very market in 2004 because, they say, there were improved due diligence procedures and they found new markets as a result of visiting trade shows in 2004, 2005 and 2006. The increase in turnover coincided with increased trading with Miaotech and 21st Trading, their main suppliers for overseas sales. After November
45 2005 the Appellant exported solely to countries outside the EU. This represented a change in the export business of ESS. The Respondents say that such a change arose because it is well known that the information from non-EU Government agencies in

respect of trades with their country is more difficult to verify than from within the EU and it makes the detection of MTIC fraud more difficult. The Appellant says that they were not aware of this fact.

5 95. We have explored before that supplies connected to the Appellant in the relevant periods was connected to a loss of tax and that the loss of tax was fraudulent. Every one of the 302 deals conducted by 21st Trading in the VAT period 04/06 has been traced back to a defaulting trader and a loss of tax. 21st Trading was the main supplier of ESS. 21st Trading acted as both a buffer and a broker exporting goods to
10 eight of ESS ten customers in the six months preceding the 04/06 period. When selling overseas, 21st Trading had a greater mark-up than on its UK deals. FL were used as freight forwarders in each transactions. The same is true of Miaotech, who not only supplied 21st Trading but also the Appellant and the Appellant's customer, Ad Micro. If a customer knows the suppliers, they would buy directly from the suppliers at a cheaper price rather than buying from another party in the chain, Mr
15 Shaunak in his evidence sought to explain this by saying that the customer may have approached him rather than the supplier because the supplier had cashflow problems ("no VAT money"). This seems an unlikely position for a company with a turnover of £339m in the first half of 2006. The Appellant's explanation is not a satisfactory one.

20 96. The Appellant offered to rebut the evidence which suggested that the transactions were not commercial. Firstly, in rebuttal of officer Hughes' evidence that there was no written contract, ESS say that they only traded with suppliers on terms that they acquired title upon the release of goods. In other words, ESS did not enter into purchase contracts containing a term where title did not pass on release. This was
25 sound commercial practice and it is accepted by the Tribunal. In looking at the pattern of payments made by ESS, the Appellant says that despite the fact ESS had been paid in full by its customers it did not pay 21st Trading in full. They say that this allowed a line of credit which was favourable to ESS and exposed it to the least financial risk. While it is accepted that having this form of delayed payment would be
30 beneficial, what emerges if one looks at the entire chain is that no party within the chain of supply received payment until ESS had been paid and then the payment would, as it were, flow through the chain as explained earlier. The Appellant challenged the Respondents' point regarding end-users. The Commissioners asserted that there was no end-user for the goods. This was evident, from a transaction
35 explained earlier, where the goods were sold to Hong Kong but ended up in Dubai via Switzerland with all overseas buyers being customers of ESS. The Commissioners say that this form of circular transaction between customers of ESS does not make commercial sense and appears contrived. The Appellant says that all the transactions were commercial. They say that there is nothing suspicious about the mark-ups
40 between £2 and £5 by ESS since they are in the business of making profit and cannot be criticised for maximising their profit in this way. Their pricing is not based on a cost plus formula but rather to get the best price in the market. They say that increase in turnover can be easily explained when one considers that they attended trade fairs such as CEBIT and developed good trading contacts and customers at those fairs.
45 The tribunal believes that the mark-up in the goods is not as easily explained as suggested by the Appellant. The mark-up from Time Corporates is 5p per unit,

Decode 10p per unit, Qiass 25p per unit and ESS £5 per unit. The mark-up is the same regardless of the quantity of goods which have been sold and in the two transactions which were explained earlier involving different numbers of unit (1890 and 12915) the mark-up was the same. It is this standardisation of mark-up which gives rise to suspicion in the transaction. The turnover of ESS for 2005 and 2006 when compared with 2004 coincides with sales to countries outside the UK and supplies being made to ESS by 21st Trading. There was no corresponding increase in the domestic market sale in the same period. Further, there is no clear evidence that actual contacts made at the trade fair resulted in an increase in overseas sales and of the significant increases in turnover of ESS.

97. The Appellant says that the “back to back” nature of the transactions were to hedge against a volatile market and no dealer in goods wanted to have unsold goods in their warehouse. This is a sensible way to proceed in order to minimise risk and finance cost and it was “the way the London Stock Exchange operated before Big Bang, with settlement taking place on the last day of the Period”. The tribunal does not believe that these transactions can be explained by using this analogy or simplification. The features of the transactions suggest they did not come about in a normal commercial way but were predetermined in terms of profit, quantity and sales. Significant quantities of goods passed through the entire chain of companies in one day and did not leave the freight forwarders until their export. The Appellant says that it is not surprising that the goods remained in their warehouse for to have removed the goods would have been expensive and insurance would have been required. The figures presented to the tribunal for insurance does not suggest that this would have made the transaction uneconomic. In the transactions in question, there is no evidence that any of the businesses in the supply chain ever took possession of the goods at their own premises or in fact saw the goods and in many cases did not have any due diligence conducted on the goods. This is unusual. In explaining the fact that title to the goods passed without payment, the Appellant says it all depends on the terms of the contract. There is no evidence of the terms and conditions of traders in the chain other than ESS. We know that Routers, Decode and ESS all had terms which stated that the goods remained in their possession until full payment but this was not honoured in most cases. We therefore remain unconvinced that the contractual terms allowed such passing of title before full payment.

98. There are two areas where the Appellant makes submissions which we shall examine. These are first the grey market and second the question of due diligence.

99. The grey market is one which exist in International Wholesale CPU Trading. The grey market refers to the flow of new goods through distribution networks other than those authorised or intended by the manufacturer or producer. It is not an illegal market. It is simply a market where goods are sold outside the normal distribution channels by companies which may have no relationship with the producer of the goods. The market exists because there is consumer demands. Once VAT is properly accounted for, it is irrelevant whether the goods are sold by an authorised or independent trader. However, where the goods are being traded outside of normal distribution channels, industry experience suggests that there is more likelihood of fraud being undertaking in those transactions. The Appellant says that their business

operations are more suited to the grey market. They say that HMRC suggest that the transactions are non-commercial or unusual but would not be unusual in the grey market and to that extent commercial practice varies depending on where one conducts one's trading activities. The Tribunal believes that insufficient information
5 has been provided about the grey market and its practices and whether the practices of the Appellant would be considered commercial or non-commercial in that market. What can be said, however, is that transaction should be lawful and VAT should be accounted for regardless of the market in which trading takes place.

100. Let us look now at due diligence. The transactions under review involve high
10 value and low volume goods. The products which are being sold, computer parts and accessories and mobile phones, is in sector where HMRC have asked the traders to be vigilant and to undertake checks. ESS were asked to confirm the checks which they undertook and confirmed that they did the following tests:

- (1) Europa VAT Number Check
- 15 (2) Redhill
- (3) Trading Application Form (Customer)
- (4) Site Visit Form

101. A Europa check is one where the VAT number is checked at the European
20 Commission website. This check will tell the enquirer whether a VAT registration number is valid as of the date of enquiry. It does not give any other information. The Redhill is made to a team based at the Redhill VAT office. This team has responsibility for checking the VAT registration details of businesses. When a check is made the team will confirm the VAT registration number is current together with the name, address and banking information provided to see if they correspond with
25 those on the HMRC database. ESS also produce a trading application form which is completed by prospective customers/suppliers. It asked for information including company details, bank details, name and address of directors, name and address of freight forwarders, trade references and commercial practices including inspections, logging of boxes and serial numbers, monthly and quarterly VAT returns, paperwork
30 retained, information on missing trader, information on joint and several liability, VAT status and inspection reports. There is information required in dealing with VAT certification, new registration documents, company letterheads and copies of directors' passports. The site visit form records visits to potential suppliers and customers.

35 102. ESS confirmed to HMRC that they did not carry out credit checks on their overseas customers nor any further checks other than those outlined above. It was suggested to the directors of ESS at a meeting with HMRC on 13 June 2006, that they may wish to carry out independent credit checks or more in-depth interrogation of the information obtained from Companies House. A company check on 21t Trading
40 would have revealed that the company had a share capital of £1 and a recommended credit limit of £15,000 and was described as "an above average risk company". A

similar report on Miaotech shows that the company had a share capital of £1 and was unable to show a credit rating for the business. It is clear that the directors of ESS in asking for information on the trading application form regarding joint and several liability (section 6 and 7) indicated that they were aware of the risks associated with MTIC fraud as explained in HMRC Notice 726 (August 2003). The checks which were carried out by ESS confirmed the businesses existed but gives no substantial information on its financial position. There is conflicting evidence as to whether HMRC were satisfied with the due diligence conducted by ESS. Officer Brooks in his statement does not indicate whether further checks were requested in his meeting with the Appellant. The Appellants have confirmed that they visited business premises and met with directors of the companies. ESS say that they were criticised for not obtaining more information on 21st Trading given that their balance sheet indicated that there was a high level of creditors (5.1m) and debtors (4.7m) and few capital assets. They say that this information was only available at the end of the year and not at the time ESS were dealing with the company. The Appellant says that it is not correct to say that such checks would have prompted an enquiry but whether an enquiry would have revealed any relevant information. In the circumstances, the Appellant says that the due diligence undertaken by ESS was reasonable for a company in its position in the market. They say that there is no indication that further due diligence undertaken by ESS would have disclosed some specific facts which should have alerted ESS to a fraud in the chain. They accept that they did not undertake credit checks which would have revealed that some traders were not in a financially strong position. They also say that their checks would not have revealed the identity of the companies which were supplying 21st Trading. The tribunal believes that these are reasonable checks which should have been undertaken to establish the legitimacy of their supplier.

103. Let us look at what was required of traders operating in this industry. HMRC Notice 726 in respect of joint and several liability asked traders to look at their supplier and customers as well as the integrity of the supply chain beyond those parties and to identify whether the goods have previously been traded in the market. This suggests that one should make further enquiry if it is reasonable to do so. It is well known that there is significant fraud in the industry and it would be reasonable and proportionate for a trader to have carried out further checks, including Company House checks, annual accounts, third party credit checks in particular where credit was being given to customers such as overseas customers, who did not pay for the goods before it was received.

104. The inspection reports conducted by FL shows some due diligence was conducted. FL carried out “close box inspections”. These inspections detailed the make and model, the number of boxes and the quantity of CPUs contained within. The report only comments on the condition of the packaging of the CPU not the items themselves. The boxes are not subject to close inspection and would not have been opened so the contents would not have been subjected to a visual inspection or tested. The report rates the conditions of the boxes from 1 to 6 with 1 being a new box and 6 being the box in poor condition. Most of the boxes inspected on behalf of ESS were in average to poor condition. The report states that most of the boxes were opened and not properly sealed. The report comments on whether the boxes have been

modified or handled and indicates whether there are pen marks, scruff marks, knives marks, Customs stamps, tape or label, pen and label, back seal end, double label, torn label and refill. All indicators are of the condition and history of the boxes. The analysis in the report shows that the boxes have been subject to several of those features. The implication is that the boxes and the goods were not new and may have been handled several times by different freight forwarders. In spite of the condition of the boxes, ESS accepted the goods and never questioned the suppliers on the condition of the boxes. Mr Shaunak in his evidence said that if the goods were in poor condition they would have been refused by the customer and there was no damage to the contents of the boxes. In other words Mr Shaunak is saying the goods were in good condition in spite of the boxes perhaps being not in very good condition.

105. The Appellant says that the information relating to ESL several years ago can have no bearing on this appeal other than to show that the directors of the Appellant were aware of fraud within the industry. ESL were trading in CPU Intel P4 with turnover figures as follows: 02/01- £65m approximately; 05/01 - £30m approximately and 08/01 - £105m approximately. ESL were in a tax due position for all their VAT periods except VAT period 05/01 in which they claimed £70,617.37 and 11/01 in which they claimed £1,452.50. The Tribunal agrees that the trading of ESL is not relevant to this appeal, except as indicated. The Tribunal also agrees that the veto letters to the Appellant of July 2002 informing them of companies with which they had dealt had been deregistered for VAT is not relevant to this appeal.

106. Let us now look at a summary of the position regarding the Appellant's knowledge on fraud.

107. It is clear that there is evidence of a scheme to defraud HMRC. The deals which have been examined from the spreadsheets and supporting evidence created by the Respondents shows various characteristics. The first is that in looking at all 19 transactions, they are remarkably similar in terms of the way they were undertaken, the parties involved and goods traded. The supply chain in the transactions for the VAT period 04/06 and 05/06 are more or less the same companies. The goods which are traded are CPU Intel P4 throughout the transactions. The number of steps in each transactions are between six and seven (if one counts the overseas buyer), and follow a pattern throughout all the deals. The transactions are what can be described as "back to back" which is to say that the same number and type of goods is traded between all the parties in very quick succession usually within one day. There is a consistency of price and profit margin except with the last sale to the overseas party. In this case, the sale from ESS has a profit margin of up to a hundred times more than that at the start of the chain. The goods have all been located at the premises of FL and traded from there. The transactions are conducted on paper only and the party buying does not take physical possession of the goods nor inspects or undertakes due diligence on their purchases. The payments in the chain are dependent on ESS being paid and other parties being paid within the chain once that payment has taken place. In some cases parties simply receive a commission payment. There are significant third party payments. This means that would be defaulters who had no genuine intention to discharge their VAT would not be accountable. Where a party simply receive a commission for participating in the transaction, the would be defaulter

would give instruction that payment should not be made to the supplier under the sale contract, but to a third party, usually out of the jurisdiction. This would make defaulting traders difficult to trace. From the evidence presented, it was apparent that the freight forwarders were not clear on who were the owners of the goods. They were given release documents which meant that different parties had possessory title but these were not necessarily the parties who had undertaken a taxable supply. It was therefore difficult to establish who owned the goods at given times since the release did not mean a sale had taken place. There were often releases before payment was made. It is clear that in each chain there was a fraudulent loss of tax in the supply chain. The transactions were clearly not subject to normal commercial rules and were not normal commercial transactions in the way they were conducted.

108. It was clear that the directors of ESS Messrs Shaunak and Darr were aware of MTIC fraud and its operation as far back as 2001. This was the reason that they closed their ESL business. When they resumed overseas trading in 2004, they felt that there were adequate safeguards in the industry to protect against MTIC fraud. They were aware of Notice 726 which explained the measures being introduced to stop MTIC fraud and the checks which businesses were expected to undertake of suppliers and customers. The directors had over 13 years experience in the computer business supplying both the domestic and overseas market. From the pattern of the transactions in which they were involved, the Tribunal believes, on a balance of probabilities, that the Appellant knew that the transactions were not legitimate. They may not have known the identity of the defaulting trader but they are likely to have known there was a missing trader somewhere in the chain and of a connection of that transaction to their transactions. The chain of transactions were planned and the clear inference is that the participants had actual knowledge of the fraud.

109. The turnover of ESS increased significantly between 2002 and 2006. The growth in the business had been due to increases in the wholesale export sector within the EU. The domestic business has remained the same size. An increase in turnover is not indicative of fraud, it is significant that the dramatic increase in their turnover coincided with sales outside the country and in having 21st Trading as a major supplier. In the 11/03 VAT periods, purchases from 21st Trading accounted for approximately 90% by value of ESS declared input and the substantial amount of their purchases in the 05/06 period came from Miaotech. These were their two suppliers. In all cases the product being traded was CPU Intel P4. While ESS did carry out due diligence on their customers and suppliers, third party credit checks carried out on ESS suppliers would have showed that they were unlikely to be able to support the transactions in which they were involved. ESS did not carry out credit checks on their customers even though payment of their own suppliers depended upon their customers paying for the goods. Should these checks have been carried out on suppliers, it would have raised further enquiries on their financial viability in undertaking the transactions in which they were involved.

110. The inspections which were carried out by FL were closed box inspections. We know that these inspections commented on the quality of the box rather than the contents. The inspection report gave an assessment of their external packaging. It was frequently the opinion of FL that the packaging was of poor quality. It would

have been apparent to someone familiar with the industry such as Messrs Shaunak and Darr that the goods were not new and perhaps had been moved and traded several times with little prospects of them reaching an end-user. ESS have contradicted this evidence by saying that the actual product inside the box was of good quality.
5 However if an assessment was being made the box itself before looking at the contents, then it is fair to assume that a reasonable trader may have rejected the boxes. If the implication is that the boxes had been traded before as evidenced by their poor quality then given the knowledge of fraud in the industry an appropriate action would have been to reject the boxes. However this was not an action taken by the directors
10 at any point. The Tribunal would have expected the Appellants to make a judgment on the integrity of the supply or the supply chain given the quality of the goods which were being presented. These were warning signs which should have alerted the Appellants that all was not right.

111. Whilst trading as ESL, the directors traded in quantities of CPU declaring sales of approximately 201 million in 2001. The directors decided that they did not want to be implicated in VAT fraud and decided against trading in that sector. They resumed trading in 2004 ostensibly on the grounds that the checks within the industry were greater and it was safer to enter the market. In a letter from ESL signed by Mr Shaunak to the Staines VAT office dated 8 August 2001 he stated:

20 “It was with great regret we took this step (cease trading) but feel as a business we have no other option. As you are well aware the industry that we are in is rife with unscrupulous traders who are out to defraud Customs and Excise of the VAT element of the transactions carried out. We feel as a business that we are nor no longer able to trade
25 effectively without constantly looking over our shoulder to make sure that we do not get implicated in such practices”.

112. It seems strange that such a letter would be written in 2001 and they would see it fit to enter the market in 2004 when VAT fraud had if anything increased. The letter does show that the Appellant had adequate knowledge of industry wide VAT
30 fraud and did not want to do business in an industry where they had to “constantly looking over our shoulder to make sure that we do not get implicated in such practices”. A general industry wide knowledge of fraud does not mean that the Appellants is involved in fraud. However, the transactions in which they were involved would require the Appellant to have taken proportionate steps to increase
35 their knowledge.

113. ESS in the period under review experienced an unprecedented increase in their business. They attributed this to the visit to the trade fairs and a customer led market. The market is highly competitive in CPUs. It is true that the Appellant visited trade fairs in 2004 to 2006 but there was no supporting increase in marketing or other
40 marketing initiatives, the obtaining of products exclusivity or competitive contract negotiation to support the trade fair initiative. Further, given their experience of the market and in particular the domestic market, the transactions in which they were involved with back to back selling and significant profit mark-up would have appeared too good to be true. It should have raised concerns. They also relied heavily

on two suppliers rather than shop around for competitive prices. This seems unusual in a competitive market place. When they stopped trading with 21st Trading, they started to trade with a competitor company with whom they did not have a previous relationship. Further, 21st Trading was a trade reference for Miaotech, their new supplier. This strikes the tribunal as strange in a very competitive industry, where a company refers its substantial customer to a competitor to take over its business. Further, every supply chain connected to the Appellant in the period was connected to a loss of tax.

114. The Tribunal feels that the deals were back to back. The customer always wanted precisely what was sourced in quantity and type of goods which were bought and sold in a short period with substantial profits and the paperwork and transportation was being dealt with by an independent freight forwarder. The suppliers never undertook any proper due diligence, goods inspection or verification. This is not standard nor the action of a commercial transaction but rather a contrived and facilitated transaction. Lack of probity and due diligence by ESS in undertaking these substantial transactions was not proportionate or reasonable in the circumstances. The evidence suggests that the Appellants were more willing to overlook shortcomings in the transactions and did not heed warning signs of suspicion because they knew the transactions were connected to fraud and they were willing participants.

115. The directors, at the time of entering into the transactions had substantial experience and knowledge of the industry. They understood the transactions with which they were involved. The trading revealed a pattern which, without substantial explanation provided by the Appellant allows one to draw the inference of dishonesty. The Appellants have not rebutted the case which has been put to them. The evidence of Mr Shaunak was not convincing or credible. He understood MTIC fraud but asserted that he did not understand how it worked and operated. The tribunal believes that he knew more than he disclosed at the hearing. The transactions were without commercial substance and are contrived. The tribunal has no hesitation in saying that directors of ESS, Bharat Shaunak and Moshin Darr, were fully aware of the risk inherent in trading substantial quantities of CPUs and of the fraud in that industry and they knew the transactions which they undertook in the VAT periods 04/06 and 05/06 were part of the scheme to defraud the Revenue.

116. For the reasons given the Appeal is dismissed.

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DR K KHAN
TRIBUNAL JUDGE
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