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*INPUT TAX – MTIC fraud – contra-trading – whether the Appellant knew
or ought to have known about the fraud – no – appeal allowed*

LONDON TRIBUNAL CENTRE

LIVEWIRE TELECOM LIMITED

Appellant

- and -

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

Respondents

**Tribunal: DR JOHN F AVERY JONES CBE (Chairman)
SHEILA WONG CHONG FRICS**

Sitting in public in London on 20-23, 26-28 November 2007

**David Scorey and Jern-Fei Ng, counsel, instructed by Vantis Tax Limited, for the
Appellant**

**Jeremy Benson QC and David Bedenham, counsel, instructed by the General Counsel
and Solicitor to HM Revenue and Customs, for the Respondents**

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DECISION

1. This is an appeal by Livewire Telecom Limited against a decision by the Respondents (“Customs”) contained in a letter of 4 December 2006 refusing to repay input tax of an amount that has been reduced to £2,148,343.02 in respect of 14 transactions in period 04/06. The Appellant was represented by Mr David Scorey and Mr Jern-Fei Ng, and Customs by Mr Jeremy Benson QC and Mr David Bedenham.
2. The decision appealed against is to the effect that the Appellant knew or ought to have known it was involved in MTIC [Missing Trader Intra-Community (fraud)] transactions. The issue in this appeal is whether that decision is correct.

The facts

3. There was an agreed statement of facts as follows:

The Appellant

- (1) The Appellant was incorporated on 1 April 1999 and has, since June 2003, been trading in mobile telephone handsets in the course of business. Approximately 99% of the Appellant’s trades are in relation to new mobile telephones (as opposed to used or re-conditioned mobile telephones).
- (2) The Appellant is registered for VAT in the United Kingdom (VAT registration number 744 3743 25) and accounts for VAT on a monthly basis.
- (3) The sole director and shareholder of the Appellant is Mr Richard Gallant, who is responsible for running the Appellant’s business on a day-to-day basis.
- (4) From the time of commencement of trading up until March 2006, the Appellant has had each and every one of its claims for recovery of input tax credit met by the Respondents (“Customs”).

The deals

- (5) The Appellant carried out 14 deals in April 2006.
- (6) The Appellant bought goods from only 2 suppliers during this period:
- (a) Insignia Telecom (UK) Ltd (“Insignia”); and
 - (b) Primeline (Europe) Ltd (“Primeline”).
- (7) The Appellant sold goods to only 4 customers during this period:
- (a) Brianstom Investment Ltd (“Brianstom”);
 - (b) Compagnie Internationale de Paris (“CIP”);
 - (c) Lavina Trading Ltd (“Lavina”); and
 - (d) MK Digital World (Cyprus) Ltd (“MK Digital World”).

The decision

- (8) On 3 May 2006, the Appellant submitted to Customs a claim for recovery of input tax for the sum of £2,158,459 in respect of the April

2006 period. Notwithstanding this, Customs have subsequently repaid certain amounts of input tax incurred (namely that in relation to freight and overhead charges) amounting to the sum of £10,115.98. The balance of which recovery is being sought is now £2,148,343.02.

5 (9) Upon receipt of the claim for recovery of input tax, Customs embarked on an “extended verification” exercise which lasted for approximately 7 months.

10 (10) During the course, and prior to the completion, of Customs’ extended verification exercise, judicial review proceedings were brought by the Appellant which subsequently came to an end when the decision to deny recovery of input tax was communicated to the Appellant 2 days prior to the hearing of the application for judicial review.

15 (11) By way of a letter dated 4 December 2006 from Mrs Sue Bransgrove (“the Decision”), Customs informed the Appellant that they had made the decision to deny recovery of the input tax that was being sought on the following grounds:

20 “I am satisfied that the transactions set out in the attached appendix form part of an overall scheme to defraud the revenue. I am also satisfied that there are features of those transactions, and conduct on your part, which demonstrate that you knew or should have known that this was the case, in that you either deliberately, or recklessly, ignored factors which indicated that these transactions may have formed part of such an overall scheme.”

Customs’ pleaded case

25 (12) By way of a Statement of Case dated 12 January 2007 (“the Statement of Case”), Customs provided details of their case that the transactions entered into by the Appellant in April 2006 formed part of an overall scheme to defraud the Revenue.

30 (13) It is common ground between the parties that neither the Appellant, nor its suppliers had failed to account properly for the VAT they owed in respect of 14 deals which had been entered into. Customs accept that there were no UK tax losses in the Appellant’s direct supply chains.

35 (14) It is Customs’ case that the purported scheme to defraud the Revenue relates to the fraudulent evasions of VAT which are said to have taken place in other supply chains of which the Appellant was not a part, and in relation to contra-trading or “offset” transactions which are said to have been carried out by two traders, Uni-Brand (Europe) Ltd (“Uni-Brand”) and Sygnet Computing Ltd (“Sygnet”).

40 (15) It is Customs’ case that the fraud is alleged to have involved a number of allegedly missing or defaulting traders in other supply chains which Customs say are connected to the Appellant’s direct supply chains because those chains form part of an overall scheme to defraud. The allegedly missing/defaulting traders said to be are:

- (a) Amstech Phones Ltd (“Amstech”);
- (b) Termina Computer Services Ltd (“Termina”);

- (c) ICM UK Ltd (“ICM”);
- (d) Performance Europe Ltd (“Performance Europe”);
- (e) Data Solutions Northern Ltd (“Data Solutions”);
- (f) Callender Group (“Callender”);
- 5 (g) MG Components (“MG Components”);
- (h) Alpha Sim Ltd (“Alpha Sim”);
- (i) Midwest Communications Ltd (“Midwest”);
- (j) Anfell Traders (“Anfell”);
- (k) Park Supplies Ltd (“Park”);
- 10 (l) Colston Associates Ltd (“Colston”);
- (m) Bullfinch Systems Ltd (“Bullfinch”) and
- (n) Eclipse Windows, Doors and Conservatories Ltd (“Eclipse”)

15 (16) It is not alleged that in the 14 transactions subject to this appeal, the Appellant ever bought directly from, or sold to, any of the allegedly missing, defaulting or contra-trading traders.

(17) It is common ground that none of the goods in the allegedly “dirty” supply chains (in which fraudulent evasions of VAT are said to have occurred) were ever traded in the Appellant’s own “clean” supply chains.

Introduction to contra-trading

20 4. In order to demonstrate where the loss of tax arises from MTIC fraud we start with a simple example of an import of goods by X who sells them to Y who exports them. The tax on acquisition (import) by X is cancelled by input tax of the same amount, and the output tax charged on sale by X will be cancelled by input tax repaid to Y on the export, so that the United Kingdom exchequer receives no net tax. If both
25 X and Y are fraudsters Y will have to finance the output tax charged by X, which is recovered by X not paying the output tax to Customs. The only gain by the fraud is if Customs pay the input tax to Y when the exchequer is left with a loss of the amount of the input tax; the non-payment of output tax by X is merely the recovery of what Y put in. If the exporter is innocent of that fraud he is entitled to repayment of the input
30 tax that he has actually paid to X even though this represents tax never paid by A and the exchequer is left with the same loss of the amount of the input tax.

5. As will be seen from the statement of agreed facts, this appeal is concerned with contra-trading. In contra-trading there are, in its simplest theoretical form, two chains of transactions. First, the “dirty chain,” in which there is a missing trader, defaulting
35 trader, or trader using a hijacked VAT number (“missing trader” for short), comprising A (the missing trader) who is the importer of goods into the UK, who sells them to B, who sells them to C who exports the goods, and is thus in a VAT reclaim position. (For simplicity we shall use the expressions import and export for intra-Community trade, acknowledging that these are not the proper labels.) Secondly, the

“clean chain,”¹ in which there are no missing traders, comprising C, who is this time the importer, who sells to D, who sells to E, the exporter (the Appellant in this appeal is in the position of E). The effect of the clean chain is that the net input tax position of C in the dirty chain is cancelled by output VAT in the clean chain. There is no benefit to C in this as C has paid the input tax to B, and therefore C could be a trader who happens to carry out both import and export transactions unconnected with any fraud, or C could be a trader who is controlled by a “puppet master” to enter into the cancelling transactions to disguise A’s involvement in a fraud. The effect of the contra-trades is that C does not excite Customs’ attention as it is not applying for a repayment; the non-payment of tax by A is less noticeable since without a return Customs do not know how much tax A owes. The input tax reclaim that C had in the dirty chain has moved to E who is at the end of a clean chain. The only way for Customs to refuse repayment of E’s input tax is to show that E knew or ought to have known of A’s fraud in a completely different chain, and possibly of C’s involvement. Since, as we have demonstrated in our example in paragraph 4 above, the only gain from A’s fraud is the recovery of input tax by E this must imply that E is a participant in the fraud and, unless he is the puppet-master, is presumably sharing the tax recovered with someone else. As Mr Scorey pointed out it is difficult to see how a case of E having means of knowledge, rather than actual knowledge, can arise.

6. The nature of contra-trading is easy to state in the above way but the problem in real life is that there is no logical connection between the clean and dirty chains. First, the VAT accounting periods for C and E will not coincide; E may be on a monthly accounting period as it is a habitual exporter, but C may be on a three-monthly period, and C need only arrange that the net tax is nil during that three-monthly period by entering into transactions after E’s transactions. Secondly, the goods dealt in may be different in the two chains. Thirdly, for a particular C there may be many different equivalents to A and E, and for a particular E there may be many equivalents of C, each with more than one equivalents to A. Fourthly, C may not have deliberately entered into imports in the clean chain in order to cancel the input in the dirty chain; C may merely be both an importer and an exporter whose outputs in relation to the former happen roughly to cancel its inputs in relation to the latter. Fifthly, there may be many Bs and Ds in between the importer and exporters.

7. We illustrate this from the following summary of the transactions in relation to this appeal (which should be taken to be findings of fact).

The clean chains

8. The Appellant’s (the equivalent to E in our example) input tax of £2,148,343.02 on 14 transactions entered into between 21 and 26 April 2006 in its monthly period April 2006 is in question. These transactions are what we have termed the clean chain. We summarise them as follows (the reason for the single box for deals 2 and 3, and 11 to 14 is that they are related transactions):

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

No	Date Apr 06	Goods	Importer	Inter-mediate sale	Seller to Apt and price	Purchaser from Apt, price and mark-up	Next purchaser
1	21	5,000 Moto V3I	Uni-Brand	-	Insignia £141.50	Lavina (Cy) £148.50 (4.2%)	Olympic (NL)
2	21	15,000 N 3230	Uni-Brand	-	Insignia £131.50	MK DW (Cy) £138 (4.9%)	Olympic (NL)
3	21	15,000 N 3230	Uni-Brand	-	Insignia £131.50	MK DW (Cy) £138 (4.9%)	Olympic (NL)
4	21	750 N 9500	Sygnnet	Atomic	Insignia £302	CIP (Fr) £317 (4.9%)	Pol Comm Trading (Po)
5	21	3,000 N 6680	Sygnnet	Atomic	Insignia £157.50	CIP (Fr) £165.25 (4.9%)	Pol Comm Trading (Po)
6	21	2,000 N 8800	Sygnnet	Atomic	Primeline £401	CIP (Fr) £421 (5%)	Pol Comm Trading (Po)
7	21	3,000 N 7380	Sygnnet	Atomic	Primeline £251	Brianstom (Cy) £263.50 (5%)	Ascom (Den)
8	21	3,000 SE W900I	Sygnnet	Atomic	Insignia £272.50	Brianstom (Cy) £286 (4.9%)	Ascom (Den)
9	21	1,000 N 9300i	Sygnnet	Atomic	Insignia £308.50	Brianstom (Cy) £324 (5%)	Ascom (Den)
10	21	4,000 Nokia N90	Sygnnet	Atomic	Insignia £265	Brianstom (Cy) £378.25 (4.3%)	Ascom (Den)
11	25	5,000 N 6630	Uni-Brand	-	Insignia £141.50	MK DW (Cy) £148.50 (4.9%)	Olympic (NL)
12	25	6,000 N 6630	Uni-Brand	-	Insignia £141.50	MK DW (Cy) £148.50 (4.9%)	Olympic (NL)
13	26	6,500 N 6630	Uni-Brand	-	Insignia £141.50	MK DW (Cy) £148.50 (4.9%)	Olympic (NL)
14	26	5,000 N 6630	Uni-Brand	-	Insignia £141.50	MK DW (Cy) £148.50 (4.9%)	Olympic (NL)

MKDW=MK Digital World; CIP=Compagnie Internationale de Paris
Cy=Cyprus; NL=the Netherlands; Fr=France; Po=Poland; Den=Denmark.
N=Nokia; Moto=Motorola; SE=Sony Ericsson.

We make two additional points on the deal chains:

- 5 (1) The reason for the absence of any deals before 21 April 2006 is that it was only on 20 April 2006 that the Appellant's VAT repayment claim for 03/06 was approved and without it the Appellant could not trade. The Appellant had been speaking to the parties to line up the deals before then.
- 10 (2) Lavina and Brianstom have the same director and shareholder. The director of Atomic is the brother of the director of Sygnnet.

The dirty chains

9. Customs' investigations show that in Sygnnet's period of March (during which there was no trading) and April 2006 which coincides with the Appellant's 04/06 period it entered into 51 deals. In 42 where Sygnnet was in all cases the exporter, there was a missing trader comprising a total of 8 different missing traders (total tax lost about £4.8m); in the other 9 (7 of which are the chains including the Appellant) it was the importer and there was no tax loss. As Mr Scorey pointed out for deals concluded in April 2006 even if the missing traders were on monthly returns (about which there is no evidence) the tax would be due only on 31 May 2006 which is after the Appellant's deals, and so it is difficult to see how the Appellant could have known that the missing traders did not intend to pay the tax. The net repayment in the return

was about £3.5m. Customs have produced four sample transactions in which there were no direct deals between the missing trader and Sygnet. Sygnet's mark-up on these deals was 10, 7.93, 7.72 and 7.95 per cent respectively. Mr Bowyer considered that Sygnet merely went through the motions of carrying out due diligence checks.

5 10. Customs' investigations show that in Uni-Brand's three-month period to 05/06 which overlaps the Appellant's 04/06 period it entered into 56 transactions in which it was the exporter, in all of which there was a tax loss totalling about £35m (in none of which Uni-Brand was the direct purchaser from the missing trader, being those listed
10 in paragraph 3(15)(a) to (d) above); and 135 transactions (7 of which are the chains including the Appellant) in which it was an importer. The net tax for the period was £55,910 with the import transactions being 50.17 per cent and the export transactions 49.83 per cent. Of the 56 chains in which there was a tax loss Customs have chosen 17 sample chains and provided full documentation for them. These have been chosen so that the VAT not paid by the missing trader in them equate roughly to the input tax
15 claimed by the Appellant that is in issue. This is the only connection.

11. This summary shows that conceptually there is therefore a problem in understanding what is the fraud about which the Appellant is said to know or ought to have known. If it be the case that Sygnet and Uni-Brand are involved in a fraud in the sense of helping to cover up the missing traders' defaults by arranging for a reduced
20 repayment (Sygnet) or no repayment (Uni-Brand), at least they were a participant in the chain that included the Appellant. But if Sygnet and Uni-Brand were not so involved and the only fraudsters are the missing traders, such missing traders were not involved in any chain that has a logical connection with the chains in which the Appellant is a party, and in any event the tax that was not paid by the missing traders was in most cases due only after the Appellant's deals. In the end Customs conducted
25 the appeal on the basis that both chains were a fraud in which the Appellant was involved, which must imply knowingly involved.

Further findings of fact

12. We had about 20 ring binders of documents and we heard evidence from Richard
30 Gallant (director of the Appellant), David Bridger (manager of the Appellant), Andrew Barnett (officer who was earlier responsible for the Appellant and who was making the statement in the absence of Mrs Bransgrove, the officer responsible at the relevant time who is seriously ill), Christopher Bowyer (officer responsible for Sygnet and making the statement in the absence of Mrs Oonagh Nasta, the officer responsible
35 for Sygnet at the relevant time who is on maternity leave), Fu Sang Lam (officer responsible for Uni-Brand), Joanne Gibbons (officer), Adam Whitehouse (director of TMT First Limited, a company specialising in re-programming and re-configuration of mobile phones, by unopposed witness statement) and make the following further findings of fact:

40 (1) Mr Gallant has worked in the mobile phone industry since 1996, first in his father's company (Eurodale Manufacturing Limited) and then since 2003 with the Appellant (which had existed since 1999 and had changed its name from Livewire Business Limited on his acquisition of it in 2003;

he had acquired an existing company with a VAT registration so that he could trade immediately).

5 (2) The Appellant's business is that of wholesale broker (exporter) of mobile phones, 99 per cent of which are new phones. The Appellant aims to make a profit margin of 4 to 7 per cent. On the deals with which we are concerned it made around 4.9 and 5 per cent on all deals except for one at 4.2 per cent (see the table above). Shipping costs are £1 to £1.75 per unit; inspection and scanning for IMEI [international mobile equipment identity] numbers 10p to 40p per unit; insurance 0.25 per cent of the
10 selling price. Its turnover in the first 15 months was £48m, reducing to £25m in the next year the reduction being caused partly by a commercial (not VAT) fraud of which they were the victim in September 2004. Phones are covered by insurance of £125m. The Appellant tries not to hold stock because it cannot afford to tie up money in stock and also
15 because manufacturers such as Nokia and Sony tend to reduce prices of phones several times a year without warning.

(3) The normal pattern of trading by the Appellant is that after negotiations which start with a prospective customer wanting a particular
20 quantity of phones with a delivery date, the Appellant tries to source such requirement and then informs the customer. The customer issues a purchase order, followed by the Appellant issuing a purchase order. Goods are inspected on behalf of the Appellant by an independent inspection company before they are released by the supplier. The inspection includes noting the IMEI numbers. The Appellant obtained
25 Dun & Bradstreet credit checks on both the supplier and the customer because this was recommended by Customs, although the Appellant doubted the usefulness of this since they sold for cash and the goods were not released until they had been paid. The Appellant also obtained a declaration from its supplier that it was not selling at a price lower than its
30 purchase price, and that it had carried out a list of checks on its supplier. The Appellant obtained a declaration from its customer that the goods would not be supplied to a UK customer if shipped to the UK, and that if any IMEI numbers (see below) of the phones sold are found to be supplied to the Appellant again the Appellant will not make any further supplies to
35 that customer. Primeline reserved title to goods until payment. The Appellant reserved title to the goods until payment.

(4) Mr Gallant was unaware of the concept of contra-trading until late
40 autumn 2006 when he was informed by Customs, which is after the deals with which we are concerned. He was unaware of the existence of Uni-Brand and Sygnet until late 2006.

(5) The grey market in phones arises because official distributors are required to estimate their requirements several months in advance of
45 delivery for which they will offer a discounted price. For example official distributors for Nokia are generally expected to order 50,000 phones per month to qualify for a retrospective discount ("marketing money"). They will tend to over-order with the result that unwanted stock ("overstocks")

(6) The Appellant was visited by Customs on 23 September 2003, 11 November 2003, 15 December 2003, 21-22 January 2004, 23 February 2004, 20 April 2004, 16 June 2004, 5 August 2004, 14 October 2004, 10 November 2004, 7 December 2004, 27 January 2005, 10 February 2005, 9 March 2005, 13 April 2005, 12 May 2005 (joint and several liability discussed and Appellant advised not to make or receive third-party payments), 15 June 2005, 5 October 2005, 2 February 2006. Repayments were in all cases approved following these visits. During this period the points allocated for compliance improved. On 9 May 2006 officers visited the Appellant to collect records relating to the 04/06 return.

(7) In June 2005 the Royal Bank of Scotland informed the Appellant that its accounts would be closed, which they were on 17 August 2005. The Appellant opened an account with Arab Bank plc in June 2005, which was found to be too slow and expensive. On 20 August the Appellant opened an account with HSBC that was used only for paying wages and other overheads. On 31 August 2005 the Appellant opened an account with First Curacao International Bank (“FCIB”).

(8) Every mobile phone has a unique IMEI number. The Appellant arranges to scan these numbers on all phones with which it deals, which are entered into a database that searches for numbers that have been the subject of earlier deals. The Appellant also checks a random sample of IMEI numbers to verify that they are genuine and that the number corresponds with the correct phone model. These numbers were passed by the Appellant to Customs from 1 November 2004. No matches of IMEI numbers were ever found by the Appellant indicating that it had not dealt with any particular phone more than once. Collecting these numbers is not a requirement in Notice 726 and passing these numbers to Customs is a benefit to Customs for which the Appellant, as mentioned above, has to pay 10p to 40p per unit. Customs collect IMEI numbers and put them on a database called Nemesis which is not accessible to anyone outside Customs. This showed that 1,979 of the phones in deals 2 and 3 were previously exported on 28 February 2006 to Switzerland, and 1,500 of them were exported to Dubai on 5 March 2006; 512 were exported to Dubai on 7 March 2006; and 456 were exported to Dubai on 30 March 2006. This information was not available to the Appellant.

(9) The Appellant carried out all the checks suggested in Notice 726 on its customers and suppliers, plus collecting the IMEI numbers. The Appellant’s due diligence measures were implemented by Mr Bridger who was head of the Abbey National Building Society’s investment fraud team from 1988 to 1998.

5 (10) As a result of Customs denying the recovery of input tax for April 2006 which is the subject of this appeal, the Appellant was forced to cease trading on 1 May 2006 and all the employees were made redundant. In consequence, the Appellant has been unable to pay its corporation tax, freight forwarding charges of over £58,000 and insurance premiums of about £42,000, and has incurred borrowings of £850,000. From the start of the reverse charge regime on 1 June 2007 the Appellant commenced trading again but trading has been restricted because of cash flow problems, and Customs have informed the Appellant that all non-reverse charge deals will be subject to extended verification before input tax is repaid.

15 (11) Mr Whitehouse’s company TMT First Limited specialises in re-programming and re-configuring mobile phones (known as flashing) from premises of 1,000 square metres employing between 14 and 40 staff. It has over 70 workstations used for this purpose. Mobile phones are essentially identical pieces of hardware. The manufacturer will install its own software dealing with such things as the language. For example Nokia have a single program that enables a phone to be used in most European countries with re-programming. Phones may be programmed to work only on a specific network such as Vodafone or Orange. Phones can be re-programmed to work in other markets (except the US which uses a different configuration) or with other networks. Flashing can take between five seconds and an hour (most not needing the longer programming) and costs between £2 and £8 per handset. The Appellant has in the past had phones flashed for between £1 and £2.75 per handset. One technician can flash a number of phones at the same time. Chargers can be changed from two to three pin and vice versa for £2 to £4 per phone without any change to the phone itself. The Appellant has in the past purchased chargers separately. None of the phones in the deals with which we are concerned were flashed nor were the chargers changed.

The law

35 13. It is not disputed that the Appellant has in principle an immediate right to deduct the input tax in question. In *Optigen*, Cases 354/03, 355/03, the ECJ made it clear that this right was not to be taken away by reference to transactions elsewhere in a chain of transactions unless the taxpayer knew or had the means of knowing about the fraud:

40 “46 An obligation on the tax authorities to take account, in order to determine whether a given transaction constitutes a supply by a taxable person acting as such and an economic activity, of the intention of a trader other than the taxable person concerned involved in the same chain of supply and/or the possible fraudulent nature of another transaction in the chain, prior or subsequent to the transaction carried out by that taxable person, of which that taxable person had no knowledge and no means of knowledge, would a fortiori be contrary to those objectives.

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

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...

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

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14. In *Kittel*, Cases C-439/04, 440/04 the taxpayer had entered into a contract with a fraudster. Belgian law treated a contract under which one party had entered into for fraudulent purposes as incurably void. The question put to the ECJ was on the effect of such a contract where the other party to the contract did not know and could not know that the transaction was part of a fraud. The Court decided:

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“51 In the light of the foregoing, it is apparent that traders who take every precaution which could reasonably be required of them to ensure that their transactions are not connected with fraud, be it the fraudulent evasion of VAT or other fraud, must be able to rely on the legality of those transactions without the risk of losing their right to deduct the input VAT (see, to that effect, Case C-384/04 *Federation of Technological Industries and Others* [2006] ECR I-0000, paragraph 33).

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

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...

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

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

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The Court therefore allows the existence of two possible alternatives: (1) that the recipient of a supply did not, and could not, know of the fraud committed by the other party to the contract, with the result that he is entitled to deduct the input tax; or (2) that he did know, or should have known, that he was taking part in a transaction connected with fraudulent evasion of VAT, with the result that he is not so entitled because he is a participant in the fraud and an accomplice of the fraudster. A person who takes every precaution which could reasonably be required of them to ensure that their transactions are not connected with fraud falls into the former category because

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by taking those precautions he could not have known of the fraud. In the same way in *Teleos*, Case C-409/04 the Court has again protected the innocent party to a contract where, unknown to it, the other party is a fraudster by preventing Customs from reopening its entitlement to recover input tax on the export:

5 “50 Accordingly, it would be contrary to the principle of legal certainty if
a Member State which has laid down the conditions for the application of the
exemption of intra-Community supplies by prescribing, among other things, a
list of the documents to be presented to the competent authorities, and which
has accepted, initially, the documents presented by the supplier as evidence
10 establishing entitlement to the exemption, could subsequently require that
supplier to account for the VAT on that supply, where it transpires that,
because of the purchaser’s fraud, of which the supplier had and could have
had no knowledge, the goods concerned did not actually leave the territory of
the Member State of supply.”

15 15. Both *Kittel* and *Teleos* concerned the much simpler situation of two parties to a
contract, one of whom was a fraudster. The Court required it to be ascertained by
objective factors whether the innocent party knew or should have known about the
fraud of the other party. But there is no reason in principle why the same reasoning
should not apply where the contracts made by each of the two parties are separated.
20 We agree with Mr Scorey’s contention that the authorities establish that it is enough
that the Appellant took reasonable precautions to avoid being involved in a fraud. It
is not obliged to take all measures to police the tax on behalf of Customs.

16. Mr Scorey approaches the case by identifying the following issues: (1) whether
Customs have suffered, and continue to suffer, a tax loss; (2) the tax loss must be
25 attributable to fraud; (3) the taxpayer’s transaction must be connected with that fraud
such that the taxpayer participated in the fraud; (4) the taxpayer knew or had the
means of knowing of the fraudulent evasion of VAT and of its connection with the
transaction; and (5) the taxpayer thereby participated in the fraudulent evasion of
VAT. The fraud must be a particular fraud, as was the case in *Kittel*. He criticised
30 the decision first, in relying on recklessness, which was not found in *Kittel*, and
secondly, in not alleging knowledge of fraud, but merely alleging that the Appellant
should have known that the transactions *may* have been connected with fraud, which
is very different from *Kittel*. He was also critical about Customs’ lack of particularity
in alleging knowledge or means of knowledge of fraud and also in Customs’ reliance
35 on possible fraud by customers downstream from the Appellant which were not relied
upon in the decision letter. Mr Benson’s approach is more general; he agrees with (1)
and (2) and continues: (3) whether the 14 transactions entered into by the Appellant in
period 04/06 were connected to that fraud; (4) whether the Appellant knew or ought to
have known of that connection. In practice we consider that the difference is not
40 great. Mr Benson puts forward all the transactions in the dirty and clean chains and
asks the Tribunal to conclude that everyone is participating in a fraud, which therefore
includes the missing traders and necessarily the contra-traders, Sygnet and Uni-Brand.
This defines the scope of a particular fraud, as required by Mr Scorey’s approach. He
accepts that if the contra-traders are not part of the fraud then it will be extremely
45 unlikely that the Appellant know or ought to have known about the missing traders in
the dirty chain, although the question still has to be asked.

17. We agree with Mr Benson's approach of putting the facts before us to draw inferences which we see as the only possible way of Customs dealing with a case of this type. For that reason we do not object to his not specifying whether he contends that there are separate frauds involving Uni-Brand and Sygnet, or one overall fraud, or many smaller ones. We would, however, make the point that while it is perfectly proper for Customs to give evidence of fraud in transactions after the Appellant had sold the goods in order to show the possible existence of an overall fraud, it is also incumbent on them to address how this could have been known to the Appellant. This is particularly the case with the Nemesis evidence, the mutual assistance information suggesting that Brianstom and Pol Comm were involved in fraud, and the subsequent investigation of FCIB by the Dutch authorities, all of which we regard as purely prejudicial, and ignore as being irrelevant.

18. The parties were not agreed about the burden of proof. Mr Benson accepts that the burden is on him to prove (3) but he contends that the burden of proving (4) is on the Appellant, relying on the same contention that Customs had made in *Dragon Futures* (2006) VAT Decision 19831:

“81... Both under European law and under United Kingdom law the burden of proof normally rests on the taxpayer or taxable person to claim the advantage of any benefit or exception.... It follows from the approach traditionally taken in tax systems such as that in the United Kingdom that the taxpayer or taxable person is the person that has or should have full knowledge of relevant matters about income or transactions, and it is therefore that person on whom any burden of proof should rest. The alternative requires both the imposition of, and the extensive use of, intrusive information powers against all taxpayers or taxable persons.”

The Tribunal concluded at [85]:

“Nor does it accept that shifting the burden to the Appellant imposes an impossible or disproportionate burden on it. The tribunal's answer to question (1) is that it must be shown that the taxable person neither knew nor had the means of knowing of any fraud. But that is tested by seeing if the taxable person that had no direct knowledge of the fraud had taken proportionate steps to enquire. The tribunal sees no inherent excessive difficulty in a taxable person establishing what it did or did not know at a particular time, and the steps that it took before and at that time to ensure it met to the required standard the obligation put on it to enquire.”

Mr Scorey contends that it is Customs who are contending for an exception to the general principle of the right to deduction of input tax and so the burden should be on them. Again, we consider that the difference between the parties is not great. Both the Appellant and Customs have given evidence and so it is only if the Tribunal is doubtful about the result that the point arises, and in the light of our decision it does not arise. There is no need for us to make a decision on this point.

19. Finally, the parties are not agreed on the standard of proof required. Mr Scorey relies on *R (McCann) v Crown Court at Manchester* [2003] 1 AC 787 which concerned the standard of proof required for making anti-social behaviour orders, in which Lord Hope said:

5 “82 Mr Crow for the Secretary of State said that his preferred position was that the standard to be applied in these proceedings should be the civil standard. His submission, as it was put in his written case, was that although the civil standard was a single, inflexible test, the inherent probability or improbability of an event was a matter to be taken into account when the evidence was being assessed. He maintained that this view was consistent with the position for which he contended, that these were civil proceedings which should be decided according to the civil evidence rules. But it is not an invariable rule that the lower standard of proof must be applied in civil proceedings. I think that there are good reasons, in the interests of fairness, for applying the higher standard when allegations are made of criminal or quasi-criminal conduct which, if proved, would have serious consequences for the person against whom they are made.”

15 The heightened civil standard was found to be virtually indistinguishable from the criminal standard. The House of Lords held that, given the seriousness of the matters involved, the court should be satisfied to the criminal standard of proof that a defendant had acted in an anti-social manner before making an anti-social behaviour order.

20 20. Mr Benson contends that these are civil proceedings and the normal civil standard applies.

25 21. We consider that the reasons of fairness that caused the near-criminal standard to be applied in *McCann* are not present here even though a finding of involvement in fraud would equally have serious consequences for the people involved. In VAT there is a penalty under s 60 of the VAT Act 1994 for fraudulent evasion of VAT the purpose of which, as an alternative to prosecution, is to enable this to be proved to the civil standard, as the Court of Appeal accepted in *Khan v Customs and Excise Commissioners* [2006] STC 1167 at [79], but one which takes into account the improbability of fraud. This was graphically explained by Lord Hoffmann in *The Secretary of State for the Home Department v Rehman* [2003] 1 AC 153 at [55]:

30 “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 than to be satisfied to the same standard of probability that it was an Alsatian. In this basis, cogent evidence is generally required to satisfy a civil tribunal that a person has been fraudulent or behaved in some other reprehensible manner. But the question is always whether the tribunal thinks it more
35 probable than not.”

40 Here we are not concerned with a penalty but with much the less serious issue of whether input tax is recoverable. It would be illogical if VAT penalties for fraud were decided on the basis of the civil standard applying Lord Hoffmann’s approach but that recovery of input tax in alleged MTIC fraud cases was decided on the basis of a more stringent standard of proof. We therefore consider that the reasons applicable in *McCann* are not present here and we should not depart from the civil standard applied in accordance with Lord Hoffmann’s approach, even though *McCann* is a later authority.

Preliminary matters

22. At the start of the hearing we made rulings on a number of preliminary matters on which we agreed to record our reasons, which are as follows.

23. The first was an application by Customs to admit a second witness statement of Mr Bowyer made on 7 November 2007. This witness statement had three purposes. First, showing that in one of the sample dirty chains relied on by Customs in relation to Sygnet the person before the start of the chain as it was then known was a missing trader. On 30 August 2007 Mr Bowyer found a memo on the electronic folder of Park that Customs had received a black canvas bag full of records of that company on 24 August 2007. On 17 October 2007 he emailed an officer asking for a note to be added to the electronic folder that deal 33 be identified as relating to this appeal. The documents showed that another company was the importer and supplier to Park. On 22 October 2007 Mr Bowyer asked another officer for a disc of these records. An entry on that disc showed the name of a chartered accountant involved with the liquidation of ASR Logistics. He contacted the accountants and obtained a second disc of information which he examined on 23 to 26 October 2007. We considered that the Appellant should be expected to meet Customs' case as at the close of documents on 19 October 2007. Mr Bowyer was a witness in the appeal and was aware of the impending appeal. If by 19 October 2007 he had informed the Appellant that he was currently making further investigations we would have been more sympathetic to their addition. But the Appellant was unaware of these investigations. Customs had agreed to the close of documents on 19 October 2007 and a direction was issued to that effect. In our view they should be bound by that date. In this type of case Customs' investigations will be taking place all the time and whatever cut-off date is imposed there is a danger of further discoveries. As a matter of case management we must impose a cut-off date. There is evidence that Park is a missing trader. Whether that company was the importer or a purchaser from the importer is not of great significance, and only affects one of the sample supplies. The Chairman had dealt with three directions hearings in this appeal at which the Appellant was understandably concerned that the case to be answered would be closed by a certain date.

24. Secondly, in relation to the 42 chains of which Customs had identified concerning Sygnet, and out of which they had chosen four sample ones of which full documentation had been provided, Customs wanted to introduce the underlying documentation relating to the remaining 38 chains. We refused this on the basis that they had chosen to conduct their case on the basis of full details of four chains only and this was a major last-minute change in their case, that would involve the Appellant in considering a large number of additional documents. We assume that the documents will merely back-up information on the deal summaries and will not assist us in the real issue in this appeal.

25. Thirdly, Customs wanted to admit documents showing that Anfell Traders Limited, the first person in three of the sample chains relating to Sygnet was the importer in two of them. We agreed to admit these documents as being a minor addition to Customs' case, as containing evidence of a fact that we might have assumed in any case. We consider that a document supporting Customs' existing case

falls into a different category than one that changes it, as was the case in relation to Park .

Reasons for our decision on the facts

26. We were greatly assisted by both Counsels' written closing submissions, which in
5 Mr Scorey's and Mr Ng's case ran to 57 pages plus three tables. In it they make a
large number of criticisms of Customs' case which we do not propose to summarise
but many will be dealt with in our discussion of the facts.

Tax loss

27. Customs have put forward 4 Sygnet chains and 17 Uni-Brand chains. In each case
10 Mr Bowyer and Mr Lam have given evidence of the amount of the loss and of the
amount assessed. As Mr Scorey points out there is only evidence relating to two of
the Sygnet deals that the missing or defaulting trader is the importer. We consider
that we should take into account the inherent difficulty facing Customs. If a trader is
15 missing or has defaulted they cannot inspect any records in order to demonstrate that
the person is in fact the importer. The person who is likely to owe VAT is the
importer. We are therefore prepared to infer that the missing or defaulting trader at
the head of the chains is the importer.

28. Mr Scorey also criticises the evidence that the tax loss still continues on the basis
that there is either no or insufficient evidence of what Customs have done to recover
20 the lost tax in order to demonstrate that this is likely to be caused by fraud rather than
say insolvency, and also that the loss is still outstanding. On the former we agree that
the evidence is weak but we accept it here as it will not affect our decision. On the
latter we consider that we should rely on Customs to inform us if they have in fact
recovered the tax otherwise they would be misleading the Tribunal, and in the absence
25 of hearing, we should assume that the loss still continues. We make a comment at the
end of this decision on what we hope will be done in future cases.

29. The issue of multiple recovery of the same tax from different traders by Customs
was raised in *R (Just Fabulous (UK) Ltd) v HMRC* [2007] All ER (D) 271 (Mar) at
[54]:

30 “54. If, as I conclude, *Kittel* sanctions the action by the Revenue in this case,
on the assumed facts, then Mr Lasok is right that the effect of those principles
will need to be worked through, depending upon the precise facts, in the
slightly different circumstance of a contra-trade chain. Even in relation to a
35 defaulter chain itself, where the right to refuse deductions is expressly
sanctioned by *Kittel*, the kind of questions which Mr Lasok canvasses, of
penalty and multiple recovery, might arise, but it is certainly true that they are
more likely to arise once the principle applies to an additional chain.”

Mr Benson told us that the losses in the sample chains attributed to this appeal have
not been used elsewhere, and that if he succeeded in this appeal they would not be
40 used in the future, the position about their use being clear from this decision. We are
prepared to accept this assurance, particularly as the point does not arise in our
decision.

The fraud

30. As we have already mentioned, Mr Benson's case is that Sygnet and Uni-Brand are involved in the fraud by covering up the missing trader's fraud by entering into import transactions to offset the net input tax position on the export transactions (wholly in Uni-Brand's case and only partly in Sygnet's case). The problem is to know whether the import transactions were carried out in order to conceal the fraud by the missing trader, or whether they happened in the course of trading by entering into import and export transactions of approximately equal value. This is therefore a situation where cogent evidence is needed to show that the transactions are fraudulent rather than innocent. It is not enough to show that those companies were parties to dirty chains where the missing trader participated earlier in the chain. Mr Bowyer, the officer responsible for Sygnet did not consider that Sygnet were aware of the missing trader's losses:

15 "My opinion is that Sygnet acts upon instructions from a controlling mind. So the answer to your question, sir, is, no, I do not think that Sygnet knew he was taking part in a fraud."

Later he said:

20 "Q. Therefore, do I take it, it is your evidence that, to the extent there is in this case a contra trading transaction, as you call it, which is not sufficient to balance out the other tax liability, there are two possibilities that you are positing to the Tribunal: One is just sheer incompetence on the part of those running Sygnet and the other is that they were told to do it or to do some of the deals, not necessarily all? Is that right?

25 A. I don't think it is incompetence, sir, I think -- he has completed the deals so he is quite competent in doing it. The question is really whether he did as he was told, which is my suspicion."

Similarly, in relation to Uni-Brand, Mr Lam said:

30 "Q. Let us deal with those individually. Let us take deal 60, which we have seen from deal sheets begins with Eclipse. Are you say[ing] that Uni-Brand knew of that fraud by Eclipse?

A. No, I am not saying that, no, sir.

Q. I am going to ask you the same question in respect of the remaining four. Did it know of the fraud by Eclipse --

A. I think it might be partly saying that, you know, to the first --

35 Q. The same for all?

A. Yes."

Later he said:

40 "Q. In paragraph 28 you say: 'As mentioned previously, it appears that Uni-Brand] has organised its affairs in such a way that there is a split.' Is it right that what you are saying there is that Uni-Brand has deliberately organised its affairs in such a manner?

A. Based on the information, it appears so, sir."

In both cases the first and second answers appear to be inconsistent and do not support Customs' case on the involvement of those two companies in a fraud.

5 31. We find the idea of a person being controlled without knowing of it difficult though not impossible. The controller could put import transactions in their way only by starting from the exporter in another country, but the Appellant's evidence (which we accept) was that these deals start with the purchaser. If so, these companies could be importers only if they knew where to source the goods abroad, which presumably they would not know. This suggests that the deals must have started with the exporter in the other country, who could be a controlling mind. But if there was a controlling mind it is odd that Sygnet was left with a £3.5m input tax reclaim for the period if the controlling mind was trying to cover up a fraud by the missing traders. Uni-Brand is more likely to have known it was involved in a cover-up because of the almost equal split of input tax and output tax, but that could equally have happened by entering into equal value imports and exports in the ordinary course of business. The involvement of Sygnet and Uni-Brand in a fraud is something that we would be prepared to find only if there was cogent evidence. We would be making a serious finding against two companies that had not had the opportunity to explain their position. We find that such evidence falls far short of cogent evidence and accordingly find that neither Sygnet nor Uni-Brand were knowingly parties to a fraud and accordingly the only fraud is that committed by the missing traders.

The Appellant's connections with the fraud

25 32. Mr Scorey contended that Customs had not even attempted to prove that the Appellant was connected with any fraud. Mr Benson's formulation was "whether the 14 transactions entered into by the Appellant in period 04/06 are connected to that fraud," which as a result of our decision is the fraud by the missing trader. Bearing in mind that the missing trader takes part in a chain that is only connected to the Appellant via Sygnet and Uni-Brand, who we have decided are not involved in the fraud, the answer must be that there is no such connection and we so decide.

Knowledge or means of knowledge

30 33. In view of the decision above, the Appellant could not have known of the fraud, which is the fraud by the missing traders in the dirty chains. As Mr Scorey pointed out, "ought to have known" is inconsistent with Customs' case that both chains were part of a fraud, which, if true (which we have found it is not), must mean that the Appellant had actual knowledge. However, we set out the rival contentions and our views.

35 34. We start by pointing out that Mr Barnett conceded that there was no evidence that showed that the Appellant knew about a fraud. Customs' case must therefore depend on inferences. The following are Mr Benson's submissions why the Appellant knew or should have known that the 14 transactions were part of transaction chains which were connected with fraud, together with Mr Gallant's response, if applicable (which we accept, unless stated otherwise), and our decisions on each item separately, and at the end, all the items taken together:

- (1) The pattern of the 14 deals suggests that they were contrived. It is unlikely that such a pattern would arise by chance. Our table in paragraph

8 above shows some sort of pattern, for example that Uni-Brand imports end up with Olympic, while Sygnet's end up with Pol Comm or Ascom. But this implies knowledge of the identity of the purchaser from the Appellant's purchaser which the Appellant could not have, and certainly could not have at the time of entering into its transactions. While we accept the existence of some sort of odd pattern, it is not indicative of fraud and is certainly not something the Appellant could have known about.

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(2) The Appellant makes onward supplies to customers known to be involved in fraud, such as Brianstom and Pol Comm, about whom there is information obtained from mutual assistance that indicated involvement with fraud. Mr Scorey rightly contends that this assumes what Customs are trying to prove. On the assumption that these companies are involved in fraud, about which we have no other evidence, this does not suggest that the Appellant knew that they were.

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(3) The deals were all back-to back, nobody held any stock and the same quantity of goods passed down the whole chain. This is much more a criticism of how trade is conducted in this market, which was described without any disapproval by Moses J in *R (Teleos) v Customs and Excise Commissioners* [2004] All ER (D) 73 (May) at [80]-[84], than an indication of the Appellant's knowledge. Mr Scorey pointed out that many normal commercial disputes arise through back to back transactions in the same quantities of goods, such as with bills of lading. There is also nothing different in the transactions in this period from the Appellant's earlier transactions that Customs had approved.

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(4) All 14 deals took place on three days. Mr Scorey points out that there were negotiations that took place earlier, and the Appellant's telephone log was produced showing many calls being made. The deals could and, we find, would, have taken place earlier if Customs had made the previous month's repayment earlier, this being required to fund the VAT on the purchases. Customs were therefore the cause of this point. Again, transactions on the same day were described as perfectly normal in *Teleos*.

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(5) The terms of business of the Appellant's suppliers were effectively sale or return. We find that this was not the case. Mr Gallant's witness statement could be read in the way suggested by Mr Benson. We believe that the reason is that Mr Gallant thought that if his supplier reserved title (as did Primeline) the Appellant could return the goods without adverse consequences so long as they had not been paid for. Mr Gallant's oral evidence was that he needed to take title to the goods for insurance purposes and that if the Appellant's sale went off he was in a stronger bargaining position if he had not paid for the goods. There is nothing unusual in itself in title passing on the contract (indeed if this is not to occur the seller has to reserve title as a term of the contract). This is different from saying that the seller was obliged to take them back.

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5 (6) The Appellant was paid by its customers before it paid its suppliers, but held title to the phones, which was too good to be true. Mr Gallant responded that taking title was a requirement of his insurance, and he deliberately did not sell on credit. We agree that the Appellant was fortunate to be able to trade on such terms but there is nothing sinister about selling for cash and buying on credit; that is exactly what, for example, retailers do all the time (although we appreciate the Appellant was not a retailer).

10 (7) In all the 14 deals the phones were exported to a warehouse in Uithoorn, the Netherlands (which we believe is near Schiphol airport in Amsterdam). The purchasers under those deals were Lavina (Cyprus), MK Digital World (Cyprus), CIP (France), and Brianstom (Cyprus), none of which is in the Netherlands. Mr Gallant responded that he did not find this odd. It was a secure warehouse and CIP and some of the other
15 companies wanted them delivered to the Netherlands, and the others were content for them to be sent there. Mr Scorey pointed out that 83.5 per cent of the total number of phones (63.8 per cent by value) were immediately sold on to Olympic, a Dutch company. Again, we agree that this is an unusual feature, but does not in itself indicate knowledge (or means of
20 knowledge) of a fraud.

(8) The Appellant's due diligence was flawed in particular by:

25 (a) Primeline, according to the Dun and Bradstreet report of 28 February 2006, had a negative worth and a credit rating of £9,000. Although the Appellant was buying on credit this suggests that Primeline might not be able to pay its suppliers thus risking the supply of goods to the Appellant and its customers. Primeline had not been visited by the Appellant until 4 May 2006 which is after the deals. Mr Scorey pointed out that 12 of the 14 deals were with
30 Insignia, which had a credit rating of £500,000, resulting in a VAT reclaim of over £1.8m, and the reclaim referable to purchases from Primeline was £272,125. Mr Gallant had limited interest in credit ratings since the Appellant sold for cash and the supplier's credit rating was more of a matter for its supplier.

35 (b) Insignia was not visited by the Appellant before the deals and a trade reference came from JAG Telecom which was not known to the Appellant.

(c) No meaningful checks were undertaken into the Appellant's customers even though the Appellant was at risk from having exported the goods if it were not paid.

40 (d) Lavina's introduction letter stated that the company dealt in mobile phones for the Cyprus market as well as Europe but the Dun and Bradstreet report stated that it did not sell there.

(e) Lavina and Brianstom shared the same director and the Appellant did not ask why two companies were needed.

(f) Tax losses were also found in deal chains in the 08/05 and 03/06 period thus demonstrating that due diligence checks were not adequate.

5 (g) Trade references were not taken up and those that were did not ask for any figures and so were useless. The Appellant's standard form asked the referee to say "I confirm that I have dealt with [...] since [...] during which time they have always made payments reliably, in full and on time. I can confidently recommend [...] as a solid and reliable supplier/customer, and experts in their field."

10 We quite agree that the due diligence was flawed and we are surprised that the Appellant did not take this more seriously, particularly as they had already been victims of a fraud. We suspect that much of the due diligence was carried out because Customs asked to see it on their monthly visits, rather than because the Appellant thought it assisted them. So far as trading risk was concerned Mr Gallant may have relied on his hunch as a
15 businessman, which is not an indication that he knew about a fraud. There are also explanations for several of the above items. For example, the Dun and Bradstreet report on Primeline does not indicate that it was then trading in mobile phones (an associated company Primeline Telecom Limited is mentioned) and the latest accounts referred to were those to 31
20 December 2004. Another Dun & Bradstreet report of 21 April 2006 stated that Lavina was an "IBC (offshore company)." We have no evidence about this but even if it was prohibited from engaging in the Cyprus market as the Dun & Bradstreet report stated, presumably it could sell
25 outside Cyprus to an importer into Cyprus; indeed, how would the Appellant know what its purchaser intended to do with the goods? With regard to Lavina and Brianstom, we are certainly not prepared to draw any conclusions against the use of two companies by the same person. It is worth pointing out that even if the Appellant had conducted perfect due
30 diligence on its suppliers and customers it could not have indicated the fraud by the missing traders in the dirty chain. While the trade references would have been better if they had included figures we could understand a referee's reluctance to include figures, and we do not accept that such references were useless.

35 (9) Many of the companies referred to including the Appellant (but not Insignia) had bank accounts with the FCIB, which is currently the subject of a criminal investigation by the Dutch tax administration in relation to money laundering. Mr Gallant responds that they offered 24 hour banking and an online service that could not be obtained anywhere else. He had
40 difficulty in obtaining banking facilities after the Royal Bank of Scotland refused to deal with mobile phone traders, and HSBC would have an account only for payment of overheads. We agree that this feature is odd but Mr Gallant's evidence of 24 hour banking could have been the reason for the general use of FCIB by mobile phone traders in the grey market,
45 who are not necessarily engaged in fraudulent deals. The investigation by the Dutch authorities was after the time of the deals and so the Appellant

35. The above were the indicators summarised by Mr. Benson in his closing submissions but the following points were made during the appeal on which we comment in order to give the fullest picture because Mr Benson's contentions may have been a summary only, although it is fair to say that since they were not relied on by Mr Benson at the end Mr Scorey did not specifically comment on them:

(1) Mr Gallant was fully aware of the risks of MTIC fraud. His father's company had been assessed in connection with its involvement in a carousel fraud, the assessment being subsequently withdrawn. Customs officers had regularly visited him to verify repayments and discussed MTIC fraud. None of this is disputed. We do not consider that this is relevant.

(2) Brianstom (the purchaser in four transactions) in its purchase order specified "no customs stamps" for which there was no legitimate explanation and which would facilitate the goods being used in carousel chains. Mr Gallant responded in oral evidence that he told the director that he could not guarantee that Customs would not stamp the goods on export, which the director accepted. He considered that the requirement meant no older Customs stamps, which we accept as probable since clearly the Appellant would have no control over the existence of Customs stamps on the goods leaving the UK after the Appellant had sold them. On the other hand, in his witness statement Mr Gallant said that he understood the requirement to mean that the phones should be new as opposed to used or reconditioned. We do not accept this as we doubt if the purchase order for what we assume is a current model of phone could be understood by anyone concerned as relating to second-hand phones. We find that this point is ambiguous in relation to knowledge of fraud. It could be either that Brianstom wanted to start a fraud with clean looking goods, or it could be the opposite that it wanted to deal only with goods that had not been in and out of the country which might have been involved in a fraud. We do not therefore give any weight to this point.

(3) The phones are of Central European specification. Mobile phones are not manufactured in the UK and so must have been imported. Mr Gallant's response is that UK phones are within the Central European specification and the only difference is the two pin charger, which could be changed, and the language of the manual which was often in several languages. We consider that Customs have misunderstood the meaning of Central European specification. It is certainly odd that phones with two pin chargers have been imported into the UK (since they are not manufactured here) but in itself this does not mean that the Appellant had knowledge of a fraud when it was exporting them to countries that would require two pin chargers. However, the Appellant did not (on this occasion) import them and if it found in the UK market goods that it

required for the export market we do not draw any adverse inference from this.

5 (4) The Appellant could have sourced European specification telephones from the continent thereby limiting the risk of becoming involved in fraud. Mr Gallant responds that he had purchased phones with two pin chargers from Nokia distributors in the UK. We suspect that the reason for not sourcing the phones abroad is that the Appellant, which only does export transactions, finds it much easier to source the phones in the UK market with which it was familiar. The fact that it can do such business suggests that the customer finds a lower price in the UK than in its home market.

10 (5) Mr Barnett suggested that the Appellant check with the freight forwarder how many times the phones had been traded while in the freight forwarders' warehouse. Mr Gallant responds that he could not get an answer from Mr Barnett as to how many times should make him suspicious. We do not think this information would have helped even if it had been obtained. In seven of the cases there was only one deal between the importer and the Appellant and in the other seven there were two, which would not have excited suspicion.

15 (6) The Chairman in *Calltell* had said he found it impossible to believe that day after day many thousands of surplus phones are released onto the grey market to pass through the hands of several traders before finding a willing buyer in another member state. We have found as a fact how the grey market arises (see paragraph 12(5)) about which we see nothing suspicious. The evidence may have been different in *Calltell*.

20 (7) In the 04/06 period CIP was directly supplied by Primeline, demonstrating that the Appellant's involvement in deal 6 was unnecessary. Although not relied on, we notice that Sygnet also sold to that company in deal 33. The most that this indicates is that CIP knew of the existence of Primeline (and Sygnet); it does not indicate that on 21 April 2006 when the company wanted to purchase particular phones to fulfil its order from Pol Comm, Primeline could supply them on the right delivery terms. We notice that two of the three orders were supplied to the Appellant by Insignia and not Primeline.

25 (8) The Appellant stated in its letter introducing itself that it was established in 1999 to supply cellular products within the global wholesale sector. Mr Gallant agreed that while the Appellant had been established in 1999 it did not deal in phones until 2004. We are hardly surprised to find advertising material that does not tell the whole truth.

30 (9) Mr Bridger told officer Mrs Bransgrove that the Appellant knew that there was no missing trader in their chains, from which Mr Barnett drew the inference that the Appellant must have known all the other traders in their supply chains in order to state this. Mr Gallant explained that how he knew this was because on being informed by Mrs Bransgrove on 20 June 2007 that there were irregularities in the supply chain leading to the Appellant, he contacted both Insignia and Primeline to obtain confirmation

that there was nothing irregular in the chains. This they confirmed without disclosing any names and therefore he was able to make the statement to Mrs Bransgrove on the telephone on 30 June 2007. There was therefore an innocent explanation about the Appellant's ability to make this statement.

5 36. Looking at the totality of the evidence above, we have identified a small number
of odd features but neither separately nor when taken together do they come anywhere
near to indicating knowledge or means of knowledge of the fraud (ie the fraud by the
missing traders) by the Appellant. Indeed, even if we had found that Sygnet and Uni-
Brand were involved in the fraud (which we have not) we would not have decided
10 that the above points showed that Appellant either knew, or had the means of
knowledge, of such fraud. We consider that Customs may have been influenced by
their knowledge of the existence of other alleged frauds, such as by Brianstom and
Pol Comm and FCIB, and the subsequent dealings in the same phones detected by
Nemesis, which it is clear the Appellant could not possibly have known about at the
15 time of the deals. We fully understand the need for Customs to be free to put forward
the fullest evidence of any fraud, from which they contend the Tribunal should
conclude that the taxpayer had knowledge or the means of knowledge of a particular
fraud, but unless it can be said that the taxpayer was in a position to have known
about it, we do not consider that such evidence can be relevant.

20 37. Accordingly our decision is that the fraud carried out by the missing traders only;
that Uni-Brand and Sygnet are not parties to any fraud; and that the Appellant neither
knew nor ought to have known about the fraud, and we allow the appeal.

38. Mr Scorey reserved his position on the basis of costs. If the Appellant has any
application to make for an order other than costs on the standard basis we direct that
25 this should be made to the Tribunal within 21 days of the date of release of this
decision, failing which without further direction we award the costs of, incidental to,
and consequent upon, the appeal to the Appellant on the standard basis to be
determined in default of agreement by a Taxing Master of the Supreme Court.

39. Mr Scorey also reserved his position on interest on the input tax repayment. We
30 direct that any application by the Appellant relating to interest be made to the
Tribunal with a copy to Customs within 21 days of the date of release of this decision.

40. We should like to make three comments on the evidence. In relation to the loss of
tax we accepted the evidence as showing default rather than inability to pay the tax,
which is not in any case material to our decision, but we express the hope that in
35 future cases Customs will include more in the way of proof of this. Secondly, we had
the impression, which we accept may be wrong, that points which could have cleared
up a misunderstanding were never put to Mr Gallant. We have in mind particularly
Customs' suspicions about Central European specification phones when we
understood from Mr Gallant that that phones for the UK market are included in that
40 specification, and it is only the chargers that are different in the UK, and the
Appellant's knowledge that there were no defaulters in the clean chains. Thirdly,
Customs were in a difficult position over evidence from officers with Mr Barnett and
Mr Bowyer who had to stand in for the officers who had first-hand knowledge. If this

arises in other cases we wonder whether it would not be better merely to exhibit the notebooks and other records of the officer who is unavailable, rather than have another officer without first-hand knowledge give evidence.

5 41. At the end of the proceedings the Chairman issued a general invitation to anyone concerned with the appeal to communicate with him directly and in confidence with any suggestions for improving the conduct of appeals of this nature in the light of lessons learned in this appeal that might be useful to the tribunal in giving directions in similar future appeals, and he repeats this invitation.

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JOHN F AVERY JONES

CHAIRMAN

RELEASE DATE: 10 January 2008

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LON/06/1365