



**TC00310**

**Appeal numbers: LON/2008/1272  
LON/2008/1293**

*Value Added Tax – Input tax – Whether fraud – Whether MTIC fraud – Both Appellants dealers in computer chips – Blue Sphere Global Ltd and Red 12 Ltd considered – Whether evidence of circularity of funds must be linked to circularity of goods – Whether possible to infer importation from EU – Appeals dismissed*

**FIRST-TIER TRIBUNAL  
TAX CHAMBER**

**M B C TRADING LTD  
KINGSTON COMPONENTS LTD**

**Appellants**

**- and -**

**THE COMMISSIONERS FOR HER MAJESTY'S  
REVENUE AND CUSTOMS (VAT)**

**Respondents**

**TRIBUNAL: MISS J C GORT (Judge)  
MR J N BROWN CBE, FCA, CTA**

**Sitting in public in London on 15 June-2 July and 3 and 4 August 2009**

**Mr P Newman, instructed by Controlled Tax Management, for the Appellants**

**Mr M Holland QC and Mr H Watkinson, instructed by the Solicitor to HM Revenue and Customs for the Respondents**

## DECISION

1. This is an appeal against two decisions of the Commissioners contained in two letters both dated 21 April 2008 denying to each Appellant entitlement to input tax credit. In respect of MBC Trading Ltd (“MBC.”) the denied claim was in the sum of £94,401.57 for the period 08/06. In respect of Kingston Components Ltd (“Kingston”) the claim was in the sum of £182,851.60 and was in respect of the period 07/06.

2. The Commissioners’ grounds for both decisions are that the input tax was incurred by each Appellant in a series of specific transactions connected with the fraudulent evasion of VAT and that both Appellants knew, or should have known of this fact. In respect of MBC two transactions were involved and in respect of Kingston four transactions were involved.

3. Both Appellants appeal on the same basis, namely as set out in their respective grounds of appeal that:

“The Commissioners’ findings are based on the ‘Balance of Probabilities’ and not actual fact. Equally, in reviewing the company’s trading activities they took into account many factors and details that the company could not have known or been expected to know at the time they entered into the transaction. Finally some of their ‘facts’ are also incorrect.”

No further more specific grounds of appeal were served.

4. The Commissioners’ joint statement of case is dated 15 August 2008, in it the case is put in the broad terms set out above. The Commissioners’ primary case is that the evidence shows that both MBC and Kingston, both of whom dealt in Computer Processing Units (“CPUs”), were involved in missing trader intra-community (“MTIC”) fraud (for details of which see below) or carousel fraud and that they knew, or should have known, that this was the case. In the alternative, the Commissioners were entitled to withhold input tax from both Appellants because all the relevant deals were connected with fraud, there being a missing trader or a hijacked VAT number in each of the deal chains, again being a matter which both Kingston and MBC knew or ought to have known.

5. The details of both Appellants’ methods of trading in the goods are set out in the statement of case and reference is made to the use of the First Curacao International Bank (“FCIB”) as showing a connection with fraud in the transactions. In the Commissioners’ outline submissions dated 11 June 2009 significance is attached to a flow chart annexed to the written submissions which purports to demonstrate the flow of funds relating to MBC’s first deal which is the subject of this appeal. It was submitted that there was a carousel fraud operated by MBC amongst others, there being a demonstrable circularity of funds on the basis of evidence obtained from FCIB served by the Commissioners on 1 May 2009 in response to MBC’s witness statements served on 3 April 2009. Further evidence of circularity of

5 funds was produced in the course of the hearing, which will be referred to later. The case of both Kingston and MBC remained that they were bona fide traders in computer chips dealing in the grey market who were not aware of any of the parties in the deal chains produced by the Commissioners other than their immediate suppliers and their customers, and they knew nothing of the circularity of funds.

### MTIC fraud

6. When the VAT system is correctly operated it is axiomatic that:

- (i) an amount of VAT charged by one VAT registered trader to another VAT registered trader should be accounted for as output tax; and then
- 10 (ii) the amount of VAT previously charged as output tax, may subsequently be reclaimed by the purchaser as input tax (so as to ensure that the tax is neutral regardless of how many transactions are involved); and
- (iii) when a business's input tax claim exceeds its output tax it will be entitled to make a claim for a repayment of VAT.

15 7. A typical transaction shown in an MTIC fraud involves a “missing” or “defaulting” trader, who imports goods from another EU Member State and then sells them on to a number of intermediary or “buffer” traders; having passed through a number of different companies the goods are then sold to a “broker” trader, who exports the goods. These transactions will be referred to as “defaulter chains”.

20 8. In a classical case a trader, trader A based in an European Union (“EU”) Member State, sells taxable goods to trader B in the UK. Trader B acquires those goods free of VAT. He then either becomes a defaulting trader (i.e. a trader who incurs liability to VAT but who goes missing without discharging that liability) or uses a hijacked VAT number (i.e. a VAT number belonging to someone else), he then  
25 sells the goods to a UK buffer trader, but goes missing before discharging that liability to the tax authorities. The imported goods are subsequently sold through a number of UK buffer companies, and the last buffer company sells the goods to the UK broker, paying HMRC the output VAT charged after having deducted the input VAT paid. The UK broker then exports the goods to another Member State, or  
30 outside the EU. The exports are zero-rated for VAT purposes, but the UK broker is entitled to claim a refund from HMRC of the input VAT paid on the purchase of goods. Should HMRC make the repayment, the loss of VAT occasioned by trader B is crystallised and goes on to fuel the next round of MTIC transactions.

35 9. MTIC trading was described by the tribunal in the case of *Mobilx Ltd* (Decision 20687) as follows:

40 “... in short, goods – commonly computer chips and mobile phones, though other commodities are also used – are imported into the United Kingdom by one trader and change hands, usually within the space of a single day, several times before they are exported again, usually but not always to another Member State of the European Union. The importing trader does not account for the output tax due on a sale, either by “going missing” or by

5 masquerading as an innocent, unconnected trader and “hijacking” that  
trader’s VAT registration; in either case it is known as a “defaulter”. The  
traders, known as “buffers”, between the defaulter and the exporting trader,  
who is known as “broker”, account correctly for the output tax due on their  
10 respective sales while claiming credit for the input tax they have incurred on  
their purchases. Usually they make a modest profit, and correspondingly  
make small payments to the Commissioners. The broker pays VAT on the  
price of the goods to the buffer from which it has bought them, but (assuming  
the transactions are all genuine) is entitled to zero-rate its sale; it then seeks  
15 ... payment from the Commissioners of input tax credit generated by its  
purchase ... For the scheme to work, all the participants, which are almost  
invariably limited companies, must be VAT-registered, or must have hijacked  
a genuine registration.”

10. The above is a classic pattern but in recent years those involved in this type of  
15 fraud have become more sophisticated and there are variations. In the past, the goods  
in question which were exported to the EU by the broker were frequently re-entered  
into the United Kingdom for the whole circular chain to begin again (hence the name  
‘carousel’), or, in some cases, no goods existed and there was simply a paper trail  
20 attached to the money which changed hands. As the Commissioners became more  
adept at uncovering the fraud, the system changed in various ways. In the present  
case the Commissioners do not allege that there were no goods, but do allege that the  
fraud was based on money from companies based outside the United Kingdom being  
used to fund the alleged fraud, the only profit made by those involved (who were not  
25 all UK traders) being the total value of the value added tax not paid over by the  
missing/hijacked traders in each defaulting chain, and which was distributed  
differently from the apparent profit made by the parties to the trading deal chains.

**The law**

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

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

35 168. In so far as the goods and services are used for the purpose 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:

- 40 (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.

12. Sections 24, 25 and 26 of the VAT Act 1994 (“VATA”) provide:

45 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
- (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 ...

(6) Regulations may provide –

- (a) for VAT on the supply of goods or services to 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;

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.

(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.

26.(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, acquisitions and importations in the period) as is allowable by or under regulations as being attributable to supplies within subsection (2) below.

13. Regulation 29 of the VAT Regulations 1995 provides:

29(1) Subject to paragraph (1A) 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 became chargeable.

(2) At the time of claiming deduction of input tax in accordance with paragraph (1) above, a person shall, if the claim is in respect of –

5 (a) a supply from another taxable person hold the document which is required to be provided under regulation 13;

...

10 provided that where the Commissioners so direct, either generally or in relation to particular cases or classes of cases, a claimant shall hold instead of the document or invoice (as the case may require) specified in sub-paragraph (a) ... above, such other documentary evidence of the charge to VAT as the Commissioners may direct.

15 Thus, if a taxable person has incurred input tax that is properly allowable, he is entitled to set it against his output tax liability and, if the input tax credit due to him exceeds the output tax liability, receive a repayment.

14. However, the European Court of Justice (“the ECJ”), in its judgment dated 6  
20 July 2006 in the joined cases *Axel Kittel v Belgium & Belgium v Recolta Recycling SPRL* (hereafter known as “*the Kittel judgment*”) 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. In particular, in the *Kittel* judgment the ECJ stated:

25 “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 purpose 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.

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

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

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

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

5                   “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?”.

10   16. A taxpayer who involves himself in a chain of transactions which he “knew or should have known” is “connected with fraudulent evasion of VAT” can be denied his Community law right to claim input tax in respect of his involvement in that chain.

15   17. Mr Newman on behalf of the Appellant did not accept that the above cases properly stated the law applicable in the present case, but that is the matter to which we will turn later on in this decision.

18. **Authorities**

20           1. *Optigen Ltd, Fulcrum Electronics Ltd and Bond House Systems Ltd v Commissioners of Customs & Excise* (Case C-354/03, C-355/03 and C-484/03) (2006) Ch.218

2. Opinion of Advocate General Poiares Maduro *Optigen Ltd, Fulcrum Electronics Ltd and Bond House Systems Ltd v Commissioners of Customs & Excise* (Case C-354/03, C-355/03 and C-484/03 [2006] Ch 218 delivered 16 February 2006

25           3. *Axel Kittel and another v Belgium* (Case C-439/04), ECJ Judgment delivered on 6 July 2006

4. Opinion of Advocate General Damaso Ruiz-Jarabo Colomer *Axel Kittel and another v Belgium* (Case C-439/04 and C-440/04), ECJ Judgment delivered on 14 March 2006

30           5. *Dragon Futures Ltd v HMRC* [2006] UK VAT V.19831 (25 October 2006)

6. *Calltell Telecom Ltd, Opto Telelinks (Europe) Ltd v Commissioners for Her Majesty’s Revenue and Customs* [2007] WL 2186909 (20 July 2007)

35           7. *Commissioners for Her Majesty’s Revenue and Customs v Livewire Telecom Ltd and Commissioners for Her Majesty’s Revenue and Customs v Olympia Technology Ltd* [2009] EWHC 15 (Ch) Mr Justice Lewison – Release date 16 January 2009

8. *Mobilx Ltd (in administration) v Commissioners for Her Majesty’s Revenue and Customs* [2009] EWHC 133 (Ch) Mr Justice Floyd – Release date 3 February 2009

9. *Blue Sphere Global Ltd v Commissioners for her Majesty's Revenue and Customs* [2009] EWHC 1150 (Ch) Chancellor of High Court – Released 22 May 2009
- 5 10. *Opto Telelinks (Europe) Ltd & Calltel Telecom Ltd v Commissioners for Her Majesty's Revenue and Customs* [2009] EWHC 1081 (Ch). Mr Justice Floyd – Released on 21 May 2009
11. *Honeyfone Ltd v HMRC* [2009] UK VAT V.20667
12. *S & I Electronics plc v HMRC* [2007] VAT Decision
13. *Red 12 Trading Ltd v HMRC* [2008] UK VAT V.20900
- 10 14. *Jeffrey Charles Stuart v (1) Stephen Goldberg (2) Parlos Vardineyannis* [2008] EWCA Civ 2
15. *P D Concepts Ltd v HMRC* [2009] UK FTT 127 (TC)
16. *Brayfal Ltd v HMRC* DRC No.20781
17. *Red 12 Trading Ltd v HMRC* [2009] EWHC 2563 (Ch)
- 15 18. *Megantic Services Ltd v HMRC* [2006] EWHC 3232 (Admin)

### **The issues**

19. The Tribunal must decide:
- 20 (i) Whether the transactions making up the claimed input tax were connected with the fraudulent evasion of VAT, the burden of proof being on the Commissioners to show that they were, the standard of proof being the balance of probabilities, but the evidence relied on must be cogent.
- (ii) Whether MBC and Kingston knew or should have known of the connection with fraud.
- 25 (iii) On whom lies the burden of proof to show (ii). It is submitted on behalf of MBC and Kingston that the burden of proof to show this is on the Commissioners. The Commissioners submit that, having raised a prima facie case, the burden then shifts to MBC and Kingston to rebut that case, but that, in any event, in this particular case they have produced enough evidence to satisfy any burden which may be upon them.
- 30 (iv) Whether the Tribunal may infer behaviour from one set of transactions in respect of another, or whether the Tribunal must look in isolation at each and every deal carried out by MBC and Kingston.
- (v) Whether in the circumstances of this case it is appropriate to infer an importation from the EU.

(vi) Whether evidence of circularity of funds has to be accompanied by evidence of circularity of goods in respect of which those funds have been made over.

5 There were various issues regarding disclosure which were decided in the course of this case and which we do not propose to set out here.

### **The background**

20. Despite an agreed direction to the effect that there should be an agreed statement of facts provided, none was.

10 21. MBC was registered for VAT with effect from 31 March 2002. The company had originally been registered in the name Manorwood Building Corporation Ltd and its activities described as “general builders”. The sole director was, and remains, Andrew Peters. Since first registration, the company has changed its name twice. On 18 September 2002 it was renamed “MBC Networking”. On 25 November 2002 HMRC were informed that the trading classification had changed to “supplier of  
15 computer equipment”. On 18 September 2005 it was renamed to its present name. Its trading address is the same as that of Kingston and various other companies also operated by Mr Peters. From 2004 MBC’s turnover showed a sudden and considerable rise; for the year ending 31 January 2003 the declared turnover was £574,574, in 2004 it had risen to £1,547,591 and in 2005 to £1,809,903. By 2006 the  
20 estimated sales, based on VAT returns had risen to £4,363,569. In the following seven months the turnover had risen to £6,238,369 which equates to an annual turnover of over £10 million, or a rise of 590% in the previous eighteen months.

25 22. Kingston was first registered for VAT on 25 October 2005 when it was registered in the name of Zeus Networks with Andrew Peters as director. It changed its name on 30 August 2005 to MBC Processors Ltd and again on 15 December 2005 to its present name. On 9 January 2006 Richard White was appointed a director of Kingston. He is also a director of a company called No. 1 Wholesale Ltd, a company which at the time of the appeal was undergoing extended verification by HMRC and is a director of a company called Future Components Ltd, which is currently  
30 appealing a decision by HMRC that its dealings are connected with fraud. Kingston’s turnover showed a sudden rise in the period of the appeal reclaims, namely the end of June 2006. For the year ending February 2006 its turnover and output was £303,975 with a gross profit of £11,361. Between April 2006 and July 2006 it showed an output figure of £1,995,776. The deals with which the tribunal is concerned involve  
35 the sale of CPUs.

### **The evidence**

23. The following witnesses were called on behalf of MBC and Kingston: Andrew Peters and Richard White.

24. The Commissioners called the following eight witnesses, all of whom were VAT officers: Roderick Stone, Louise Arnold (who was the case officer), Norman Tuddenham who gave evidence of one of the missing traders, as did Vivien Parsons, Sarah Wynne and Paul Cole. Terence Mendes and Peter Birchfield gave evidence as to the alleged fraud as evidenced by the financial chain. Numerous bundles of documents were provided.

### The facts

#### 25. Kingston's deals

Kingston's deal chains, according to the evidence from the invoices produced by the Commissioners are as follows:-

##### Deal 1

|    | Supplier     | Purchase Price | Sale Price | Profit Margin | Goods             | Invoice Date |
|----|--------------|----------------|------------|---------------|-------------------|--------------|
| 15 | ETP          |                | £59.00     |               | 3,150<br>SL7 CPUs | 27.06.06     |
|    | Bluestar     | £59.00         | £59.20     | 20p           |                   | 27.06.06     |
|    | Cellest      | £59.20         | £59.40     | 20p           |                   | 27.06.06     |
|    | Commodity    |                |            |               |                   |              |
| 20 | Exports      | £59.40         | £61.00     | £1.60         |                   | 29.06.06     |
|    | Rapid Global | £61.00         | £61.50     | 50p           |                   | 30.06.06     |
|    | Future       |                |            |               |                   |              |
|    | Components   | £61.50         | £63.75     | £2.25         |                   | 27.06.06     |
| 25 | Kingston     |                |            |               |                   |              |
|    | Components   | £63.75         | £67.40     | £3.65         |                   | 26.06.06     |

Futures Brokerage, Switzerland

##### 30 Deal 2

|    |              |        |        |       |                           |          |
|----|--------------|--------|--------|-------|---------------------------|----------|
|    | ETP          |        | £60.45 |       | 3,150 & 1,575<br>SL7 CPUs | 30.06.06 |
| 35 | Bluestar     | £60.45 | £60.60 | 15p   |                           | 30.06.06 |
|    | Cellest      | £60.60 | £60.75 | 15p   | 30.06.06                  |          |
|    | Commodity    |        |        |       |                           |          |
|    | Exports      | £60.75 | £61.00 | 25p   | 30.06.06                  |          |
|    | Rapid Global | £61.00 | £61.50 | 50p   |                           |          |
| 40 | Future       |        |        |       |                           |          |
|    | Components   | £61.50 | £62.15 | 65p   | 29.06.06                  |          |
|    | Kingston     |        |        |       |                           |          |
|    | Components   | £62.15 | £65.30 | £3.15 | 29.06.06                  |          |

45 Futures Brokerage, Switzerland

In Deal 2, the computer chips started off as two consignments of respectively 3,150 and 1,575 before joining into one consignment of 4,725 at the Rapid stage of the chain.

**Deal 3**

|    |                     |         |         |       |                  |          |
|----|---------------------|---------|---------|-------|------------------|----------|
|    | ETP                 |         | £96.40  |       | 4320 Athlon CPUs | 29.06.06 |
| 5  | Bluestar            | £96.40  | £96.60  | 20p   |                  | 29.06.06 |
|    | Cellest             | £96.60  | £97.30  | 70p   |                  | 29.06.06 |
|    | Commodity Exports   | £97.30  | £98.60  | £1.30 |                  |          |
|    | Rapid Global        | £98.60  | £99.50  | 90p   |                  | 29.06.06 |
| 10 | Future Components   | £99.50  | £100.50 | £1.00 |                  | 3.07.09  |
|    | Kingston Components | £100.50 | £105.50 | £5.00 |                  | 3.07.06  |
| 15 | Best Buy, Singapore |         |         |       |                  |          |

**Deal 4**

|    |  |        |        |       |               |         |
|----|--|--------|--------|-------|---------------|---------|
| 20 | Grange Solutions/Wade Booming Technologies |        | £60.80 |       | 1890 SLT CPUs | 3.07.06 |
|    | Miaotech                                   | £60.80 | £60.90 | 10p   |               |         |
|    | Rapid Global                               | £60.90 | £61.00 | 10p   |               |         |
|    | Rapid Global                               | £61.00 | £61.50 | 50p   |               |         |
| 25 | Kingston Components                        | £61.50 | £65.20 | £3.70 |               | 4.07.06 |

Abyss Int FZE, Dubai

30 All the above are UK limited companies, other than Futures Brokerage, Best Buy and Abyss.

**Deals 1, 2 and 3**

35 As can be seen from the above, in all these deals the supplier to Kingston was Mr White's company Future Components Ltd. In Deals 1 and 2 the customer was Futures Brokerage, Zurich. In Deal 3, the customer was Best Buy Singapore. The input tax claimed was £35,142.19 in Deal 1; in Deal 2 it was £51,390.28 and in Deal 3 it was £75,978.

40 All three deals follow the same route of supply as far as Kingston. Beginning with the deals that can be traced back to Environmental Timber Products Ltd ("ETP"), the chips were then sold to Bluestar, to Cellest, to Commodity Exports, to Rapid Global Ltd ("Rapid"), to Future Components Ltd, to Kingston and on to Futures Brokerage in the case of Deals 1 and 2 and on to Best Buy Singapore in the case of Deal 3. ETP was a deregistered trader and Kingston disputed the Commissioners' account of Deal 45 1, but the Tribunal accepts the above deal chains, for reasons to which we turn below.

26. Mr White disputes Deal chain 1, as shown on the Respondents' chart, on the basis that he claims that the wrong amount of CPUs are shown as being exported by Kingston to Futures Brokerage. The Commissioners' chart shows the deal originating on 27 June when ETP sold 3,150 SL 7 chips at £59.00 per unit down the chain. Those 50 were bought by Kingston from Future Components (who had bought from Rapid) on

the same date for £63.75 per unit, giving (according to the Commissioners, see the table on P. X) Kingston a profit of £7,087.50 (exactly the same profit as was made by Future Components on its sale to Kingston) when it sold them on to Futures Brokerage for £67.40 per unit. Mr White claimed that on 23 June Future Components purchased from CEL (not from Rapid) an unspecified quantity of CPUs and arranged shipment to a new US customer, Bluespark International LLC, and the goods were sent that same day. However Bluespark cancelled the order and the goods were returned to the United Kingdom on 26 June. That stock, according to Mr White, was then sold to Futures Brokerage but, according to Mr White, Mr Peters had not cancelled Kingston's purchase order from Future Components for the goods that had been sent to the United States. Mr White claimed that the goods exported by Kingston to Futures Brokerage in Switzerland on 27 June were the goods which had been returned by Bluespark and therefore the amounts on the Commissioners' chart are wrong. He claimed on that occasion that Futures Brokerage had agreed to take stock on the basis of 30 days credit (of which there is no documentary evidence). However, there is no purchase order from Bluespark, no Bluespark invoice from Future Components and no credit note from Bluespark cancelling that order. This, according to Mr White, was because the deal was cancelled and he had therefore deleted the order from his computer. He seemed confused as to why a cancellation note would be necessary, thinking it sufficient that he had deleted the invoice from his own computer system. He produced no paperwork to show that an extra consignment of CPUs had been sold by Kingston to Futures Brokerage. The CEL spreadsheet for 22 June shows that it bought CPUs at a cost of £61.60 per unit and sold them to Future Components at £63.50. These goods, Mr White claims, were then sold on by Future Components to a previously unmentioned United Kingdom company called Glare Electronics, but no documents were produced as to the sale, despite in his witness statement Mr White claiming that he had exhibited all the documents relating to Future Components' transactions. Apart from the inconsistencies in Mr White's own evidence, there is a document originally produced by Mr White which is a fax from Kingston Components to the freight forwarders on 26 June. That fax attaches a delivery note and invoice for goods to be sent out that day and states that the freight forwarders should receive instructions from Rapid to receive ten boxes of SL7 Z9s, i.e. 3,150 CPUs. On 26 June the goods were apparently returned from Bluespark, but Rapid had had no part in that deal according to Mr White and so there was no reason for the goods to be returned to them. Mr White's only explanation for this was that the name "Rapid" had been inserted in error, the document being a cut and paste job. There were various other pieces of evidence, mainly invoices, in relation to the apparent export of goods to Bluespark, and we accept that there may have been such a deal, but no evidence has been produced which suggests that the Commissioners' chart in respect of Deal 1, which is based on documents which have been produced to us, is wrong, and that such a deal did not exist.

27. With regard to Kingston Deal 1, if the Appellants' account were right, then there should be an extra set of CPUs since Rapid supplied three sets to Future consistent with deals 1 to 3. If Commodity supplied one of Kingston's deals, then Future would have an extra set of chips which the Appellants have not accounted for by producing any documents. It would have been in the Appellants' interests to declare to the Commissioners the correct deal chain if they believed that they were not

connected to MTIC fraud. There is a lack of any documentation to support the cancellation of the deal, which undermines the Appellants' accounts thereof. If an invoice had been raised in a normal business transaction, both parties would wish to confirm the cancellation by raising a credit note or cancelling the invoice. Documents instructing the New York shippers to return the goods do not exist. The lack of documentation undermined the credibility of the Appellants' version. We accept that a deal in the amount and to the parties claimed by the Commissioners took place.

28. Kingston Deal chains 2, 3 and 4 were not specifically challenged by Kingston initially, save that Mr Newman questioned the conclusions drawn by HMRC, given in particular the failure of HMRC to question the other parties in the alleged chains. It had been accepted on behalf of Kingston in respect of Deals 1-3 that 'all roads lead back to ETP', however, having given no prior notice, Mr Newman challenged Miss Arnold's evidence in respect of the deal chains produced by a different officer in respect of Future Components which are the subject of a separate appeal, a matter we deal with later. He also questioned whether there is any or sufficient evidence to indicate that there was a UK acquirer purchasing from a company in another Member State, an aspect of MTIC fraud which Mr Stone on behalf of the Commissioners had stated was basic to MTIC fraud, and which we also turn to later, both these matters being referred to in Mr Newman's submissions..

29. **MBC's deals**

The MBC deal chains according to the evidence from the invoices, are as follows. We set out later the evidence relied on by the Commissioners to show financial chains.

**Deal 1**

| Supplier                  | Purchase Price | Sale Price | Profit Margin | Profit £ | Goods            | Invoice Date |
|---------------------------|----------------|------------|---------------|----------|------------------|--------------|
| CWM Distribution          |                | £65.20     |               |          | 3,150 SL729 CPUs | 08.08.06     |
| Movies 4U Athol Marketing | £65.20         | £65.40     | 20p           | 630      |                  | 08.08.06     |
| Rose Communications       | £65.40         | £66.30     | 90p           | 2,835    |                  | 08.08.06     |
| Rapid Global              | £66.30         | £66.50     | 20p           | 630      |                  | 08.08.06     |
| MBC Trading               | £66.50         | £68.50     | £2.00         | 6,300    |                  | 07.08.06     |
|                           | £68.50         | £71.40     | £2.90         | 9,135    |                  | 07.08.06     |

**Futures Brokerage, Switzerland**

## Deal 2

|    | Supplier                 | Purchase Price | Sale Price | Profit Margin | Profit £ | Goods                  | Invoice Date |
|----|--------------------------|----------------|------------|---------------|----------|------------------------|--------------|
| 5  | CWM Distribution         |                | £65.20     |               |          | 2,725<br>SL729<br>CPUs | 04.08.06     |
|    | Movies 4U                | £65.20         | £65.40     | 20p           | 630      |                        | 04.08.06     |
| 10 | Athol Marketing          | £65.40         | £66.30     | 90p           | 2,835    |                        | 04.08.06     |
|    | Rose Communi-<br>cations | £66.30         | £66.50     | 20p           | 630      |                        | 04.08.06     |
|    | Rapid Global             | £66.50         | £68.50     | £2.00         | 6,300    |                        | 09.08.06     |
| 15 | MBC Trading              | £68.50         | £71.40     | £2.90         | 9,135    |                        | 09.08.06     |

### Futures

#### Brokerage, Switzerland

All the above were UK limited companies other than Futures Brokerage.

20 Both deals according to the Commissioners originated with a company called Carpets  
With More Distribution Ltd (“CWM”). This company was registered as a “missing  
trader” in October 2006, having come to the attention of the Commissioners as an  
25 MTIC trader in August 2006. It was registered as a business supplying carpets, going  
into mobile phones for the first time in mid-2006. In both deals CWM sold to Movies  
4U Ltd, who sold to Athol Marketing Ltd, then to Rose Communications Ltd “Rose”),  
on to Rapid and Rapid sold to MBC. In MBC Deal 1 the default was in the sum of  
£35,941.50 and in MBC Deal 2 it was £53,912.25.

30 30. Annex 1 shows the chart provided by the Commissioners which sets out the  
deal chains for both MBC and Kingston and also shows the dates, the type of chips,  
the unit price and the apparent profit made in respect of all the deals. A chart showing  
a comparison of the apparent profits retained by those involved in MBC Deal 1, and  
35 the alleged actual profits from the financial chain contended for by the  
Commissioners which is referred to below is shown at paragraph 31(4)(viii), and a  
chart showing the monies retained as a percentage of the VAT default is shown at  
Annex 5.

### 31. Evidence of Fraud

#### 40 (1) The alleged defaulters

##### (a) ETP

45 ETP was incorporated in 2003 and was originally registered as an importer of  
timber frames. Its director, Nathan Field, asked for a change of trade classification to  
wholesale exporting and warehousing and gave no indication to HMRC that the  
company would be selling CPUs. The company operated from Mr Field’s home  
address. At a visit in 2005 he stated to officers of the Commissioners that he intended  
to trade in digital surveillance cameras and intended to supply end-users. During a

further visit in March 2006 he stated that he was renting offices from his father and was now also dealing in software and PCs, and never sold to end-users. Mr Field thought Intel P4s were software, and the officers concluded that he was asking his customers to make third party payments and did not understand the basics of his business. His supplier, Fitzroy, was a hijacked trader. During a visit in July 2006 Mr Field stated that he had not been trading in May 2006 as he had been in prison. He never declared the deals he made with Bluestar Electronics Ltd (the second company in the deal chain in Kingston deals 1-3), and none of the VAT paid to ETP has been accounted for. Assessments were raised against ETP, against which no appeal was lodged, and no explanation was put forward that ETP had itself paid input tax on its purchases. No evidence was ever provided by ETP as to where the goods had come from. The assessments raised were in the sums of £2,691,000 and £44,320. The Commissioners rely on the overall circumstances to indicate that ETP's intention from the outset was fraudulently to default on the VAT received by it.

In respect of Kingston Deals 1, 2 and 3 it was accepted by Mr Newman that ETP had made the supplies of the CPUs that were eventually purchased by Kingston. It was also accepted that ETP did not account for its output tax but it was not accepted that it was established that there was fraudulent intent on its part nor that there was an EU importation.

**(b) Wade Technology Ltd/Grange Solutons**

(i) The evidence in relation to these companies relied on by the Commissioners is that Wade Technology was originally VAT registered with a Mr Fateh Kashief Ahmed as a sole proprietor under the main business activity of 'off-licence/grocer'. On 1 February 2006 Mr Ahmed submitted an application to transfer the VAT number to a limited company, 'Wade Technology Ltd'. Mr Ahmed was the sole director, its main activity was changed to off-licence and telecommunication sales of mobile phones, there was no mention that it would be selling CPUs. By a letter dated 6 June 2006 the company informed the Commissioners that it wished to change its name to 'Grange Solutons Ltd', but the change of name was never recognised for VAT purposes. During a visit in December 2006 by officers of the Commissioners Mr Ahmed denied ever contacting the Redhill office, denied ever trading in mobile phones or CPUs and no evidence was found at the business premises to suggest that he had. VAT assessments raised against the taxable person purporting to be Grange of around £80-£81m indicated that they had achieved a turnover of around £465m in three months. The assessments raised included one covering the goods that were traced down the chain to Kingston, and have never been paid. No one has ever come forward to say that they are behind those transactions and either Wade/Grange had its VAT number hijacked or Mr Ahmed failed to declare the transaction. Mr Ahmed denied that he had undertaken any of the relevant transactions.

(ii) The Commissioners submitted that the evidence establishes tax losses by Wade/Grange and either its VAT status was hijacked or it fraudulently failed to account for VAT on its sales to Booming Technologies. If it is accepted that the number was hijacked, that is conclusive of fraud; alternatively Mr Ahmed failed to declare his sales of CPUs and mobile phones and either the hijacker or Mr Ahmed

clearly intended fraudulently to default on VAT paid to it from the outset. The Commissioners rely on a passage from *Calltell Telecoms Ltd* at paragraph 118:

5 “It was not disputed that a person who hijacked the identity of another trader was the defaulter, since he did not account for the VAT for which, ostensibly, the victim of the hijack was liable, and that he must be assumed to have had a fraudulent purpose. There was, however, some doubt whether one trader which claimed that its identity had been hijacked was in fact a victim; there was a possibility that he was merely making the claim in order to avoid accounting for the VAT for which it was in truth liable. We can deal with this issue now: it does not seem to us to matter where the truth lies since, in 10 either case, the only possible conclusion is that there was a trader which had engaged in transactions forming part of the chain with a dishonest intention of failing to account for the tax which became due. We are, therefore, satisfied that there was a fraudulent trader in the chain.”

15 Whilst it was accepted that Wade/Grange had not accounted for its input tax, it was submitted on behalf of Kingston that where there was a hijacked trader, as appeared to be the case here, it was almost impossible to know if the company hijacking another VAT number has imported the stock from another EU Member State. If there is no direct proof of such an import, as here, then the situation is the same as in any supply 20 chain where a company fails to account for its output tax and goes missing. Mr Newman pointed to the unusual situation which exists here where a company planning to become a missing trader changed its VAT trade classification to that of a mobile phone trader and conducted its due diligence verifications on three UK companies using its correct address, as Wade/Grange did. It was submitted by him 25 that it was possible that Wade/Grange was planning on accounting for its VAT as a UK to UK trader, but ran into problems. The Tribunal was referred to the decision in the case of *Brayfal* which in part concerned Wade Technology Ltd and in which the tribunal concluded that it did not have its number hijacked, prior to its change of name to Grange Solutons on 12 June 2006, but the tribunal was satisfied that Wade 30 Technology was responsible for a tax loss in the chain in that particular case. Mr Newman also relied on a note recorded by Miss Parsons of a visit to Grange Solutons on 14 September 2006 in which there is reference to an allocation note from a company called UK Communications Ltd to Grange dated 22 August 2006. He submitted that this is evidence that Grange is being supplied by a UK company and 35 therefore is not an importer, and also that there is no evidence that UK Communications Ltd did not account for its VAT. However, this note relates to a period after the deals with which we are concerned. In addition Mr Newman pointed to the evidence of Miss Arnold that Wade Technology changed its name to Grange on 6 June 2006, which was the day that Booming Technologies (the company next down the chain in Kingston Deal 4) was no longer invoiced by Wade Technology but 40 started being invoiced by Grange. It was queried how somebody hijacking a VAT number would know exactly when the change of names had been notified to the Commissioners, and it was also asserted that on the balance of probabilities, Grange was the supplier of the CPUs to Booming and the VAT number was not hijacked. It 45 was also submitted that on the balance of probabilities it should be concluded that Grange purchased the stock from a UK company and there is no evidence of fraud before the Tribunal.

**(c) Carpets With More (“CWM”)**

(i) CWM was registered for VAT from 1 February 2006 until 10 October 2006 under the business activity of carpet retail. There is no written evidence that it had informed the Commissioners that it intended changing its business activity to the wholesaling of CPUs. In August 2006 the director of CWM had handed in its trading records to the Commissioners. Three visits were made by officers of the Commissioners to CWM’s premises in September 2006 which proved to be a locked carpet shop. There was a ‘to let’ sign on the building. The business was clearly no longer trading, no forwarding address was available and the trader was recorded as ‘missing’. Invoices showing that CWM had sold goods to Movies 4U Distributions Ltd on 4 August 2006 and on 8 August 2006 were obtained following a visit to Movies 4U by an officer. No sales to Movies 4U were ever declared by CWM and an assessment was raised on the basis that CWM had imported goods from the EU at a zero-rate. Those goods were eventually traced to MBC down a chain. The Commissioners did not initially produce the deal sheets relating to these transactions, but they were made available to Mr Newman during the course of the hearing. He did not ask for them to be exhibited. Since the issuing of the assessment no one from CWM has claimed that it had paid input tax on those supplies and the assessments have not been appealed or paid. There is no documentary evidence as to where CWM acquired the goods, but on 7 August 2006 CWM made various purchases of other products from a company called Carisma, which is also a missing trader. The net tax loss caused by CWM was just over £1.3m. It was submitted on behalf of the Commissioners that the evidence established tax losses by CWM through its failure to account for VAT on its sales to Movies 4U, and that its intention from the outset was to default on the VAT received by it fraudulently.

(ii) Louise Arnold had given evidence to the effect that she had prepared the deal chains for CWM on the basis of deal sheets, but those deal sheets had not previously been exhibited. We accept that her evidence that her failure to exhibit the deal sheet was due to an oversight. When checking those deal sheets during the course of the hearing as a consequence of realisation of that oversight, she found material relating to another company, Eagle Solutons Ltd, which had been put on to the Commissioners’ electronic database towards the end of April 2009, after Miss Wynne, the officer dealing with CWM, had made her witness statement. This material was disclosed to Mr Newman in the course of the hearing, but after we had ruled that we were not prepared to strike out the Commissioners’ case under the provisions of either Rule 2, 3 or 8(3)(b) of the Tribunal Procedure (First-tier Tribunal) (Tax Chamber) Rules 2009, as Mr Newman had, on the course of the hearing submitted that we should, Mr Newman did not require that evidence to be admitted and therefore we take no account of it. We had decided for reasons advanced by Mr Holland at the time that we would not bar the Commissioners from taking further part in the proceedings, because it was not the case that they had not failed to cooperate with the Tribunal to such an extent that we were unable to deal with the proceedings fairly and justly. The material had only come into the Commissioners’ hands a short time before the hearing and its relevance had only become apparent during the hearing. It would have been open to Mr Newman either to have asked for an

adjournment for time to consider the new material, or to have it admitted and to make submissions on the basis of it. He did not ask us to take either of those courses.

## **(2) The nature of the deal chains**

5 (i) In none of the six deals with which the Tribunal is concerned could the chain of supply be traced back to an authorised distributor and none could be traced to the manufacturer. Similarly none of the purchasers of the goods from either Kingston or MBC were end-users or retailers. None of the companies involved in the supply chain ever actually took possession of the goods which were always bought and sold from a freight forwarder's warehouse. Quest Freight, one of the freight forwarders, 10 had previously come to the attention of the Commissioners as being involved in fraudulent tax transactions and it had a history of non-cooperation with the Commissioners including the destruction of import and export documents.

15 (ii) In all the deal chains the goods were transferred in exactly the same amount, with each purchaser requesting exactly the amount of goods that the last purchaser/present seller had available, or, in the one case where there was a split (Kingston Deal 2), they joined up to make up the exact amount which Kingston's customer had required. It is apparent that all the companies down the chain made a profit. It was part of the Commissioners' case that the above facts are indicia of fraud. They also point to the fact that Rapid, the company which was involved in all 20 the chains, has an extremely high turnover of £167m or more, but credit enquiries only gave it a net worth of £21,807 at the highest. Rapid also banked with FCIB, a company frequently seen by the Commissioners to be involved in the banking transactions of companies known to be connected with MTIC fraud. The transactions were taking place via an internet banking service, which allowed all the financial 25 movements throughout the chains to be controlled by one person, which is another characteristic of MTIC fraud.

30 (iii) Evidence from the deal sheet of Bluestar shows that on 27 June it purchased two quantities of CPUs described as 'Intel P4 3GB 800 Mhz 1Mb SLZ9 CPUs', those purchases were of 3,150 CPUs, the first deal is logged at a cost of £67.60 per unit and the second as £59 per unit. It is the second of these which features in the Commissioners' deal sheet, and by the time the goods have come to Rapid they are described as being Intel P4 2Mb SL7 Z9 chips. This same apparent mistake occurs through not only Kingston Deals 1 and 2, but also through MBC Deals 1 and 2. In all 35 four of these deals the invoices down the respective chains show the sale of 1 Mb chips at the start of the chain, but Rapid's purchase order from Commodity Exports Ltd shows that it apparently bought 2 Mb chips which it then sold on. In the MBC deal chains it is Movies 4U who on the face of the documents bought and sold 1 Mb chips, a description also employed by its purchaser Athol, but Rose's documentation show that it apparently bought 2 Mb chips from Athol. As far as Mr White was 40 concerned, there was no such thing as a 1 Megabyte SL7 Z9 chip, but there was a 1 Megabyte chip which was SL Z9L. His evidence was that both Future Components and Kingston bought 2 Mb SL7 Z9 chips from Rapid.

(iv) In respect of MBC the Commissioners' evidence shows that in Deal 1 Carpets With More apparently sold the chips on 8 August 2006, whereas MBC purchased them on 7 August 2006. In respect of Deal 2 Carpets With More sold the chips on 4 August 2006 and they were purchased by MBC on 9 August 2006. The  
5 Commissioners pointed to the speed of supply, the closeness in date of the deals and the fact that in, MBC Deal 2, MBC received money from Futures Brokerage before it had paid its supplier, Rapid, features which would not be usual in a genuine commercial transaction. They point to the consistency of mark-up at each point in both MBC chains, where it is the same for each company. The mark-ups remain the  
10 same regardless of the price the goods were purchased at. In MBC Deal 2 the consignment began in two parts but was joined into one by Rose. The goods went down a chain of three companies before being bought by Rose who joined the two consignments on the same day that it sold them to Rapid, they contained quantities of goods being exactly as required by Rapid. Despite the consignment beginning as a  
15 split consignment, Movies 4U, the second company in the chain, received the same mark-up of 20p even though the two consignments were purchased at different prices.

### **(3) The directors**

(i) Since the late 1980s Richard White had worked for various companies in the computer components industry and had extensive knowledge of that industry. In  
20 January 2003 (according to his affidavit but in evidence he said it was 2004) he had set up a company called Future Components Ltd through which he purchased CPUs from United Kingdom companies and sold them both in the United Kingdom and abroad. He purchased from various companies including Rapid, having met one of its  
25 directors in the past. He had first met Andrew Peters socially in the 1990s and subsequently had some business dealings with him. We were not told which company Mr Peters was using when he purchased stock from Mr White.

(ii) According to his affidavit, towards the end of 2005 Mr White discussed a joint venture with a Ms Yuen Hung Hui, who was known (and will henceforth be referred  
30 to) as Christine. A meeting took place between Mr White, Christine and Mr Peters to discuss the formation of a new company. The company which was eventually set up was Kingston. Precisely what happened in relation to Christine was unclear, given the contradictory nature of the evidence from Mr Peters and Mr White, and internal inconsistencies in Mr White's own evidence. Whilst Christine's part in the setting up  
35 of the new company is largely irrelevant to what the tribunal has to decide, it is relevant to their credibility that Mr White and Mr Peters' evidence as to it was contradictory, as it was in regard to other matters. It also casts light on the casual attitude of both of them to record-keeping and some doubts on their evidence as to the nature of their trade.

(iii) Mr White in his witness statement claimed that Christine was involved  
40 because it was thought she would bring more suppliers and customers, more stock and more competitive prices. This was in contrast to his oral evidence to the effect that he was satisfied with his suppliers and customers, and that the intention was for Kingston to use Future Components as its supplier. In his witness statement Mr White claimed that Christine had invested £150,000 in Kingston in January 2006 at the time when

Kingston first started trading in CPUs. Mr Peter's evidence was that Christine was not involved at the outset, but invested her money on 26 April 2006, and was repaid on 4 May. Like Mr White, Mr Peters claimed in his witness statement that the relationship ended because they were not satisfied with her approach to due diligence and to paperwork. This was something which Mr Peters effectively retracted in oral evidence. Records in fact show that Christine became a director of Kingston on 30 March 2006. Mr White in his evidence had said that Christine left because she had not brought in any new suppliers or customers. Mr Peters claimed that Christine had taken no part in any of the deals Kingston did in April, which makes it difficult to accept Mr White's claim that she left because they were unsatisfied with her due diligence. There is no record of any written agreement with Christine or the nature of the loan to Kingston of £150,000. Mr Peters' evidence was that was because she was paying the money to them, and he did not feel he needed to protect himself because the money was coming into a bank account over which he had control. We find this an astonishing statement from a man who is an accountant, and who is an experienced businessman. We note that in his oral evidence Mr White had said that Christine's money came in to the company in May at the time when she started; this is in contradiction to his other evidence, to Mr Peters' evidence, and to the documentary evidence.

(iv) There is an evident conflict of interest between Mr White and Mr Peters, and at any time Mr Peters could have cut Mr White's company, Future Components, out from Kingston's deals. Mr White claimed to believe that Rapid were prepared to sell stock to him at Future Components at a better price than they were prepared to sell to Mr Peters. However, throughout the relevant period Mr Peters knew of Rapid, and indeed in Kingston's Deal 4, as can be seen from the deal chains, Future Components was not part of the chain, and for both of MBC's two deals MBC went direct to Rapid and did not use either Kingston or Future Components. There is evidence that in April 2006 MBC was doing due diligence on Rapid. This was prior to the four deals made by Kingston which are subject to this appeal. As part of that due diligence Mr Peters had described a Mr Steve Goodwin, who, as a director of MBC Networking is someone authorised to buy or sell on behalf of the company, as a 'tea-boy'. In his evidence Mr Peters claimed that he had put that description in in order to see whether any notice was taken of what he wrote on such forms, a claim we find completely unbelievable, and evidence of Mr Peters' uncommercial attitude to his business dealings.

(v) At the time that Kingston was set up, both Mr White and Mr Peters had established companies which were on monthly VAT returns, this enabled them to obtain a better cashflow than was obtainable by Kingston, which was on three monthly returns. A further example of the lack of commercial reality in the setting up of Kingston is shown by the imposition of Mr White's company Future Components Ltd between Kingston and Rapid. It was claimed by Mr White that he was content for Future Components to take a lesser profit and not become a broker, and yet still make some of the greater profits of a broker which accrued to Kingston. There was a finite amount of profit to be split between Future Components and Kingston. Mr White, whilst trying to get the best price for Future Components, was in a position to decide how much profit was retained by Future Components when it sold to Kingston.

Previously Mr Peters had run two linked companies, Zeus Networking and MBC Networking, which he then merged because he considered it made more sense to have just one company, yet he then set up a situation where he was likely to incur the same difficulties. Neither Mr White nor Mr Peters made any attempt to purchase from somebody closer to the manufacturer or to import the goods themselves. This would have maximised their profits and minimised the risk of being cut out.

(vi) No evidence was produced of stock records. According to Mr White, Future Components held the relevant stock records, but these were never produced and were never held by Kingston. Although the goods were said to be subject to single chip open box inspections, and a log of box numbers was said to have been recorded by Mr White in his capacity as a director of Future Components, no such log was produced in evidence, and none of the inspection reports produced state that a single chip inspection was carried out. In the case of the inspection report produced for Kingston Deal 2, the fax header is dated 9 October 2006, but the goods had been shipped on 29 June 2006, therefore there cannot have been an inspection report in Kingston's possession at the time the goods were shipped. An inspection report for Kingston Deal 4 was produced. Despite the fact that Future Components had been cut out of this deal by Mr Peters, the report which was completed by Rapid was nonetheless faxed to Future Components who then faxed it to Kingston. This inspection report was in fact not valid as it had not been received directly from the freight forwarder. The log of box numbers was claimed to have been recorded from the inspection sheet for each deal. The inspection report for Kingston Deal 2 has no such numbers on it, making unreliable Mr Peters' claim in evidence that the inspection report linked the stock to the specific transaction and that it was possible for him to go to the deal sheet to see whether the box numbers tied up.

(vii) Mr Peters and Mr White both worked in the same way. They used a single website, International Computer Brokers ("ICB"), which was available to all traders to deduce the market rate and identify the cheapest source of supply. In particular, Mr Peters had found his customer Futures Brokerage from the ICB website in 2005 and had dealt with them regularly since.

(viii) Both companies conducted their trade by using the Instant Messenger ("IM") service, or by telephone or by e-mail. Mr Peters did produce an itemised telephone bill showing calls to Abyss and Best Buy, but other than this no records relating to such communications were produced, in particular no e-mails were produced. There is no record of either company ever having to chase up money from a purchaser. The explanation given by Mr White was that the goods were always sent ship-on-hold and therefore were not released until payment was received. This was clearly not in fact the case in Deal 4 (to which we will turn later), where Mr Peters had sold 1,890 CPUs to a company in Dubai called Abyss Int. FZE ("Abyss") having no contract, and having made no credit check, and there was, according to his witness statement no ship-on-hold instruction) and the majority of the documents received from Abyss were in Arabic, a language understood by neither Mr White nor Mr Peters.

(ix) Mr Peters' explanation of the apparently inconsistent dates shown in both MBC's and Kingston's paperwork is that: "We would receive and send purchase

orders and invoices, but the date on which they were created may depend on when the deal was agreed. ... it may be that I created the paperwork in advance.” (This appears in his first witness statement.) It was also suggested that because of the speed of the deal-making, the paperwork might be done later on certain occasions.

5 (x) In March 2003 Sarah Wynne had explained to Richard White how MTIC fraud was conducted. In May 2006 Mr Peters had been told by the Commissioners that fraud had been found in his supply chain. Mr White was present when the defaulting trader was identified as a company called ‘Sapphire’. He discussed this with Mr White whose response was to ask his supplier Rapid about the matter and, on  
10 being told by Rapid that they no longer dealt with the defaulter, he did no more about it. It may be asked why Rapid had not themselves informed Mr White of this matter. Mr White had claimed that for reasons of commercial confidentiality. Rapid had refused to identify the defaulter. Mr Peters claimed to believe that, because he had been told by officers of the Commissioners that it was the Commissioners’ practice to  
15 inform the broker of any tax loss in the supply chain, that meant that all the supply chains had been, and would continue to be, checked for fraud and he would be notified as soon as a tax loss was identified (as per his first witness statement). The fact that both the MBC and Kingston returns were subject to extended verification by the Commissioners in respect of the period 04/06, and the fact that the input tax for  
20 that period was subsequently repaid, apparently led Mr Peters to conclude that his supply chains were “clean” and that in future the Commissioners would continue to check them and inform him of any tax losses. The fact that Kingston had not kept records of the stock numbers of the goods, and therefore the Commissioners could not adequately check the supplies, apparently did not occur to Mr Peters, although Mr  
25 White in evidence had admitted that that must be the case.

(xi) Both Mr Peters and Mr White appeared to believe that, because they were exporting outside the EU, their trade could not be subject to carousel fraud which would have involved a circular trade with the same goods coming back in from the European Union. We find it highly unlikely that either of them genuinely believed  
30 that this was the case, given the information they had had from the Commissioners about MTIC fraud, and given their lengthy experience in trade in both mobile phones and CPUs. Mr White’s evidence that he had made thorough checks on all his suppliers but not on his customers because they were outside the European Union shows either naivety or contrivance. In fact Mr White appears not to have carried out  
35 any due diligence on Blue Spark, the company to which he claims Kingston sold the goods which are the subject of Deal 1, as described by the Commissioners. He had said in evidence that there was no risk in dealing with people he did not trust and, when that remark was queried, he repeated it. Whilst Mr Peters had carried out due diligence on Rapid, including visiting the offices and meeting its director, he had no  
40 form of written agreement with that company. In his witness statement he says that he started trading with Rapid on 20 April 2006, which makes it all the more strange that in July 2006 Kingston was not purchasing direct from Rapid, but from Future Components, thereby reducing its profit.

(xii) Mr White’s evidence that the goods were not released until money had been  
45 received from the relevant customer was undermined by Mr Peter’s witness statement

in which he stated that he had traded on over twenty occasions with Futures Brokerage and by the time of the deals in question in this appeal he was happy to extend 30 days credit to them. It is clear that he is referring to allowing this as a director of Kingston, yet Kingston's own invoices state that payment is zero days from the date of invoice. There is nothing in writing to indicate that this condition was waived in respect of Futures Brokerage.

(xiii) The due diligence produced on Futures Brokerage is of a very basic nature and hardly sufficient to satisfy a diligent trader. The due diligence for Best Buy Computers Pte Ltd ("Best Buy") was only in Mr Peters' hands for 14 minutes before he asked them for delivery details and the deal was effectively completed before he received the company's documentation. In any event the documents provided little useful information. In the case of Abyss referred to above the documents were even less informative and mainly in Arabic.

(xiv) Mr White and Mr Peters both claimed to have adequate insurance for the goods, but, given that according to the documents neither company had ownership of the goods until the supplier was paid, and since they did not pay for the goods until after they themselves were paid and the goods shipped out, it is highly unlikely that either company's policy would cover the goods in the event of loss. Certainly there was a great deal of uncertainty as to the time at which either Kingston or MBC owned the goods in question. Mr Peters had a blanket policy that covered storage and transport for certain freight forwarders. Mr White had a policy which operated on a deal by deal basis, but no documents were produced which showed when specific goods were insured, or who bore the risk. Mr White said he would use the air waybill as proof, together with the invoice date from the supplier. However, he did not as a director of Kingston keep a record of the box numbers of the supplies and there is no evidence to support his claim that he had kept them as a director of Future Components. Kingston's terms of trade were that goods were released by Future Components to Kingston only when it was paid by Kingston, but Kingston did not pay Future Components until it was paid by its customers. Future Components invoices say the goods remain its until it is paid, therefore the question arises why would Kingston pay for insurance? A further question arises as to who bears the risk. From an insurance company's point of view, it might appear that the goods belonged to Rapid. Mr White had said in evidence that as soon as the transactions happened he would already have paid the insurance, and before the goods were released to him he would then go on-line to Freightcover.com, the company he used for insurance. When he was initially asked in cross-examination whether the insurance would pay out if goods were lost in transit, he said that he had an agreement with the supplier that he had to be insured to receive the goods in case the goods went missing, and, if there was a break-in, then he had to make sure that he had adequate insurance to cover the loss. This he said was a verbal agreement between him and his supplier about which he had not told his insurers because he did not need to. However, Mr White did produce evidence in the form of a document entitled "Richard White Insurance" in the sum of £2,256.26.

(xv) The freight forwarders used by both companies were registered with the British International Freight Association. There is no evidence of an open box

inspection, but Mr Peters claims that for each transaction he would speak to the warehouse staff and ensure that they had inspected the stock. He claimed not to have bought any goods without that assurance. A waybill showing goods relating to Kingston Deal 4 were imported from Germany was produced by the Commissioners.  
5 One freight forwarder, Quest Freight, informed officers of the Commissioners that the CMRs which would show importation from the EU were not retained by it, although goods were imported from the EU. Two reports Mr Peters claimed to have received in respect of the two MBC transactions were said by him to have been misfiled by a junior member of staff. No effort appears to have been made by him to have copies  
10 provided by the originator of those reports. He did however produce invoices from the freight forwarder that states that boxes were x-rayed as part of the inspection process.

(xvi) Kingston ceased trading when the Commissioners had refused payments to it, despite Mr White's and Mr Peters' contention that it was a highly profitable business with ready access to honest suppliers and customers. Their account that the refusal of the VAT repayments (or their alternative and conflicting account that it stopped following the Commissioners' decision to conduct extended verification on Kingston) made it impossible for Kingston to trade was not credible. The VAT repayment refused totalled £182,851.60, the original capital put into the company by the  
15 Appellants totalled £150,000, Kingston had made a profit on all of its deals and had very low overheads. If Kingston could not afford to trade it could only be because the directors had withdrawn their capital. The decision to cease trading was consistent with the business deriving profit from MTIC fraud which would no longer be possible, rather than from a viable commercial business.

#### 25 **(4) Evidence obtained from FCIB accounts**

(i) The Commissioners not only relied on the above evidence as showing fraud in MBC's deal chains, but also produced evidence obtained from the FCIB bank which, it was submitted, shows a flow of funds from a company called Electrade SA in Luxembourg through to MBC and onwards. The Commissioners' case is that in MBC  
30 Deal 1 Electrade is the start of a circle of financial dealings. They relied in part on the evidence of Roderick Stone, an officer with extensive experience of dealing with MTIC fraud and who is currently working in HMRC's Serious Civil Investigations Directorate. His evidence with regard to MTIC was in part as follows:

35 "In one version of the fraud, a conduit trader in another EU Member State consigns the goods again to the original missing trader or another missing trader in the UK. Further, from my experience, the same business entity may occur at the beginning and end of the same transaction money flow. Consequently, the money flows are circular in nature. When it can be demonstrated that either the movement of the goods or the money flows are  
40 circular in nature, the fraud is known as MTIC 'carousel' fraud. It is possible, however, for the fraud to operate without these features being apparent."

Roderick Stone gave extensive evidence of the damage done to United Kingdom by MTIC fraud, of its various manifestations and the methods used by the Commissioners to combat it. He also gave evidence in relation to the FCIB stating inter alia that between 2005 and 2006 many EU suppliers, UK defaulting traders, buffers, brokers and also overseas customers in the computer and mobile phone sector whose transactions were connected to MTIC fraud opened bank accounts offshore, the most popular offshore bank being the FCIB. Because these parties' money transfers and other financial transactions took place offshore, they lacked transparency and were beyond the reach of the UK's anti-money-laundering laws. On 5 September 2006 the Dutch and local authorities visited FCIB as part of an investigation into alleged money laundering by the bank in relation to alleged VAT fraud by clients of the bank. Subsequently FCIB's banking licence was revoked with effect from 9 October 2006. A criminal investigation into FCIB is being undertaken with which HMRC are co-operating. As a consequence the Dutch authorities provided HMRC with a copy of FCIB's banking server and in August 2008 agreed it could be used by HMRC in civil proceedings.

(ii) We attach flow charts produced by the Commissioners as Annex 2 relating to MBC deal 1 and Annex 3 which relates to MBC deal 2. Whilst the Commissioners did not have full access to all the FCIB account data, the data produced provides evidence of circularity of funds. The evidence is in the form of records of two systems 'Bankmaster Plus' and 'Datastore'. Bankmaster gives a printout of each trader's customer account and therefore can show the flow of money between traders and Datastore sets out the documents presented by the account holder in support of its application to open an FCIB account. Terence Mendes analysed MBC deals 1 and 2. He had obtained MBC's FCIB account number. The Bankmaster system shows in spreadsheet form:

- (a) The date of posting and then the amount of posting in sterling
- (b) The account balance after each posting, then the accrued interest (nil in the case of MBC), the value date (which is the same as the posting date for every entry in these accounts), the reference (all blank here) and the 'type' (all entries are noted either 'DD' or 'FCIB', no explanation is given as to these terms).
- (c) The 'narrative' column shows where the receipts came from or where they went to (in all the relevant cases it was to another FCIB account). Also within the narrative is the Electronic Banking reference which uniquely identifies each money movement. It appears that these numbers were allocated sequentially to the transactions processed by FCIB. The Electronic Banking reference links a payment from one FCIB account to the receipt of that money in another and appears in the narrative of both accounts.
- (d) The final column 'transactions' is a reference number for each transaction within this account, they are allocated consecutively within each account.

(iii) The Datastore documents show inter alia that MBC's referees for setting up the FCIB account were Glare Electronics Ltd and Future Components Ltd.

(iv) The flow charts Annex 2 and 3 are based on information from the deal chains spreadsheets provided by the case officer, Louise Arnold, as well as information from the Bankmaster database. In the flow chart 'EBR' stands for Electronic Banking Reference, it shows the name of the company, the Commissioners' description of that company, e.g. 'Acquirer/missing trader', the FCIB account reference number, the sum of money in that account and the date on which the sum appears in the account. The arrows show the alleged movement of funds from one party to another, however Terence Mendes was not always able to identify sums of money which exactly matched those shown on the invoices.

(v) In addition to the companies shown in the deal chains above Terence Mendes identified three other companies which appear only in the financial chains as follows:

- Electrade SA which is based in Luxembourg and which from the Datastore was found to have a beneficial owner and director who has a UK passport,
- Cubic International ("Cubic"), which is based in the USA, and
- Mountainrix LEA, based in Portugal.

It was the Commissioners' case that Electrade made the first payment, this money passed to Cubic then on to Futures Brokerage and so on backwards down the alleged deal chain as follows: Electrade → Cubic → Futures Brokerage → MBC → Rapid → Rose → Athol → Movies 4U → CWM → Mountain → Electrade. The sums and the dates on which they were alleged to be paid in MBC Deal 1 are as set out in Annex 2, as are the EBR numbers.

(vi) Terence Mendes carried out a similar exercise in relation to MBC Deal 2. The alleged financial chain connected to that deal is far less clear cut. The financial chain originally proposed by Terence Mendes was modified prior to the start of the hearing because he had discovered an error he had made, and that he had incorrectly identified the date and amounts on the sale invoices in relation to Rose, Athol, Movies 4U and CMW on the flow chart he had produced. Following the discovery of this error, and in the absence of Terence Mendes who was not available at the start of the hearing, Peter Birchfield, the MTIC technical and coordination team leader of HMRC examined the FCIB documents and checked the new flow chart which is produced as Annex 3. Mr Birchfield is a man of considerable experience, inter alia he had in 1998 to 2000 represented HMRC at the bi-annual Anglo-German VAT seminar where he spoke on the subject of the exchange of information between EC Member States in relation to the combat of MTIC fraud and, in particular, carousel fraud. From 2000 Mr Birchfield has been engaged full-time in working on MTIC. The team he now heads is part of the national MTIC technical and coordination team of specialist investigations. Following a request from MBC's legal team for additional disclosure of the FCIB evidence, Mr Birchfield printed off all the Bankmaster plus account

prints for all currencies, together with the customer detail sheets identifying the account holder and its address. These documents were produced. The Commissioners asked Mr Birchfield to view the flow chart Annex 3, to check the entries on the flow chart in relation to the movement of funds against the Bankmaster prints and confirm the amounts shown on the charts had moved as shown under the reference quotes. In examining the flow charts Mr Birchfield had looked at all the various payments made between the parties and, whilst where there were two invoices and two payments made on the same day he was unable to say which payments related to which invoice, he was able to say that there appeared to be payments for both invoices which were consistent with the invoices. He carried out the same exercise where there were multiple payments and produced a spreadsheet and he concluded that a circularity of funds could be seen in Annex 3 as in Annex 2. There was no challenge to the admission of the spreadsheet in evidence, and Mr Newman did not cross-examine Mr Birchfield at all.

(vii) In his evidence Terence Mendes, who had become available later in the proceedings but prior to Mr Birchfield actually giving evidence, confirmed that not all the payments he had recorded were made the same day, sometimes there were two payments with a gap between, but the majority were made back to back on the same day. Where the same payments were made on more than one occasion, for example of the same amount on the same day, Mr Mendes had had to select a particular payment as being the relevant one. His method was to start with the invoice date and take the first payment after the invoice date. Mr Mendes would refer to the EBRs, which he believed were sequential and he would assume that the earliest EBR would start the transaction. In cross-examination he accepted that there were at least two instances where the EBRs were out of sequence. Mr Mendes was unable to explain this other than by suggesting that there had been some error in the printing out of the document for which he had not been responsible. Mr Mendes' evidence in relation to Annex 3 was as follows. He had traced forward from a sales invoice raised by MBC on 8 August 2006 showing a despatch of 4,725 Intel CPUs with a sales value of £337,365, the goods being consigned to Futures Brokerage in Switzerland. From the Bankmaster account it appeared that:

(a) Payments for the transaction took place on 10 August 2006 when MBC received a payment of £337,365;

(b) Futures Brokerage sold the goods on to Cubic and received two payments one of £245,000 and another of £165,000;

(c) Cubic sold the goods to Electrade who received two payments one of £250,000 and another of £150,000. By tracing back from the supply to MBC Mr Mendes analysed the apparent supplies and payments as follows:

(i) MBC was supplied with the goods in the UK by Rapid who were paid by MBC on 10 August 2006 £378,000;

(ii) Rapid was supplied with the goods by Rose in the UK, Rose was paid in two amounts one of £269,199.69 and the other of £100,000;

(iii) Rose was supplied with the goods in the UK by Athol who was paid £268,089.31;

(iv) Athol was supplied with goods by Movies 4U in the UK and was paid the sum of £863,092.63;

5 (v) Movies 4U was supplied in the UK by CWM who were paid £361,982.25;

10 (vi) CWM was paid £352,932.62; CWM was supplied with the goods in the UK by Mountain Rix, a Portuguese registered company. Mountain Rix was paid £351,751.37.97. Mountain Rix was supplied with the goods by Electrade, Electrade was paid in three amounts of £250,000, £157,000 and £135,000 making a total of £542,000.

15 (viii) In addition to the deal charts and the financial flow charts, the Commissioners produced a chart which we now produce as Annex 4 showing the moneys retained as a percentage of the VAT default in respect of MBC deals 1 and 2. It is the Commissioners' case that in MBC deals 1 and 2 there was a circularity of funds which was arranged to distribute the profits. The evidence demonstrates a flow of money 'back to back' around a circle which reimburses the purchaser of goods for his purchase and the prices are arranged in such a way as to leave each participant with a share of the profits and no one with a loss. The Commissioners also rely on the  
20 following profit table in respect of MBC deal 1:

25 ***MBC Deal 1 – parties' apparent profit  
Net of VAT***

| <b><i>Company</i></b>  | <b><i>Calculation of profit retained</i></b> |                            | <b><i>Profit retained</i></b> |
|--|--|----------------------------|-------------------------------|
| <i>MBC</i>   | <i>Buy 68.50 sell 71.40</i>                  | <i>3150 x 2.9 =</i>        | <i>£9,135</i>                 |
| <i>Rapid Global</i>  | <i>Buy 66.5 sell 68.5</i>                    | <i>3150 x 2 =</i>          | <i>£6,300</i>                 |
| <i>Rose Communication</i>  | <i>Buy 66.3 sell 66.5</i>                    | <i>3150 x 0.2 =</i>        | <i>£630</i>                   |
| <i>Athol Marketing</i>   | <i>Buy 65.4 sell 66.3</i>                    | <i>3150 x 0.9 =</i>        | <i>£2,835</i>                 |
| <i>Movies 4 U</i>  | <i>Buy 65.2 sell 65.4</i>                    | <i>3150 x 0.2 =</i>        | <i>£630</i>                   |
| <b><i>Total profit in supply chain = £19,530</i></b>                                     |  |                            |                               |
| <i>Carpets with More<br/>[VAT due £35,941.50]</i>  | <i>Receive £241,321.50</i>                   | <i>Transfer £235,288 =</i> | <i>£6,033.50</i>              |
| <i>Mountain LDA</i>  | <i>Receive £235,288</i>                      | <i>Transfer £234,500 =</i> | <i>£788</i>                   |
| <i>Electrade</i>   | <i>Receive £234,500</i>                      | <i>Transfer £230,000 =</i> | <i>£4,500</i>                 |
| <i>Cubic</i>   | <i>Receive £230,000</i>                      | <i>Transfer £226,000 =</i> | <i>£4,000</i>                 |
| <i>Future Brokerage</i>  | <i>Receive £226,000</i>                      | <i>Transfer £224,910 =</i> | <i>£1,090</i>                 |
| <b><i>Monies retained in financial chain = £16,411.50</i></b>                            |  |                            |                               |
| <b><i>Total 'enrichment' of parties to circle is 19,530 + 16,411.50 = £35,941.50</i></b> |  |                            |                               |

This chart shows that the total gain of the various parties in the deal chain and that the allegedly linked circular funds equal the amount of missing trader VAT default. It demonstrates that the financial payments from CWM to Mountainrix (shown as “Mountain LDA”), to Electrade, to Cubic and then back to Futures Brokerage are indeed payments related to re-circulating funds to finance the deal chain and that this is a ‘carousel’ fraud. If the payment within the financial chain were for reasons unrelated to the deal chain, the amounts would not be expected to match in this way. Furthermore, the circle of funds demonstrates that the missing trader, CWM, has not simply disappeared with the VAT due. The chart shows that CWM have retained just £6,033.50 of the potential fraudulent gain available by non-payment of VAT due from them of £35,941.50. MBC has been permitted to retain the largest part of that sum, £9,135. CWM is the next biggest gainer. If MBC were an unwitting party to the fraud, it was submitted by Mr Holland that the fraudsters would wish to maximise their own profit at the expense of MBC. As the fraudsters have access to the missing trader (and indeed fraudulent buffer companies) they would have a clear idea of the price of the goods as sold within the deal chain. There is no reason to permit MBC such a large mark-up. If it is accepted that MBC deal 1 is a carousel fraud, then the Commissioners argue that similarities within the other Kingston and MBC deals strongly support the argument that these are similar frauds in which neither Appellant can show that they are an unwitting party. In all cases the broker is being permitted to retain unusually high profits in a contrived and non-commercial deal chain. Mr Holland points to the fact that in both MBC deals 1 and 2, if the profit apparently made by Rapid is added to the profit apparently made by Athol Marketing, the total equals the profit apparently made by MBC in selling to Futures Brokerage. This is not indicative of arms length commercial transactions, but rather the division of benefits from fraud. Similarly there is no commercial reason why Rose and Movies 4U should have identical, small profits, it was submitted that equal, small profits are consistent with remuneration for low risk simple buffer companies.

(ix) The profits set out in MBC’s deal chains which are shown in Annex 1 are the apparent profits which appear from the invoices and other documents produced by the Commissioners. However, in relation to MBC, from examination of the FCIB documents the Commissioners point to a different distribution of profits as set out in paragraph 31(4)(viii). The Commissioners also rely on the apparent profits as shown at Annex 1, as demonstrating the fraudsters wish to minimise any profit made by any innocent participant and their wish to retain as much profit as possible for themselves. It was accepted that the broker, in this case MBC, would expect a greater share of the profits because he was at a significant risk of either failing to obtain the repayment of input tax from the Commissioners and/or of criminal investigation. The Commissioners contend that there is no commercial logic dictating that a broker should make more profit than one of his suppliers in a legitimate chain, but there is every reason for a broker participating in a fraudulent chain to do so.

## 32. The Respondents' case

### Burden of proof

5 Whilst, as stated above, the Commissioners did not accept that the burden was upon them to show that Kingston and MBC did know and should have known that they were participating in transactions connected with fraudulent evasion of VAT, it was submitted that they had in fact discharged that burden. Nor was it accepted that it was necessary for the Commissioners to show that the relevant knowledge was knowledge of the actual fraud or even the identity of a particular defaulter, but it was a question of knowledge of the probability of fraud and what the trader can infer from matters he either knows or reasonably could know that was to be considered. In support of their argument that the burden of proof shifted from the Commissioners to the Appellant once the Commissioners had established that there was fraud in the chain and it was for the Appellant to show that they did not know, nor should they have known that their transactions were connected with fraudulent evasion of VAT, 10 the Commissioners referred the Tribunal to the case of *Calltell Telecom Ltd, Opto Telelinks (Europe) Ltd v HMRC* at paragraph 71 where the tribunal concluded:

20 “... we think it is incumbent on the Commissioners to raise a case, not necessarily amounting to proof that to demand an answer, that there were circumstances which support, or at least are consistent with the conclusion that the appellant knew or should have known of fraud in the chain. The mere fact that there was fraud will not be enough; there must be some reason which might lead the tribunal to conclude that the trader knew or could have known of it, or that he should have taken precautions. ... But if the commissioners are able to mount a case which demands some explanation, 25 the burden shifts to the appellant to show that he took the precautions which could reasonably have been required of him and that, despite his having done so, he did not know, and could not have known, of the fraudulent purpose of others.”

30 With regard to the dicta of the Chancellor of the High Court in *Blue Sphere Global Ltd v HMRC*, relied on by Mr Newman, Mr Holland submitted that the Chancellor's judgment was in relation to contra-trading cases only and was not binding on the tribunal in respect of straight defaulting chains. It was submitted that the comments of Clarke J in *Red 12* similarly relied on by Mr Newman, were obiter dicta as to the burden of proof. Judge Clarke said in that case:

35 “52. In the event it does not seem to me necessary for me to decide the incidence of the burden of proof since, as it will become apparent, the tribunal's conclusions were, as it seems to me, not dependent upon it ...”

## 33. Evidence and knowledge of fraud

40 The Tribunal was referred to the case of *Megantic Services* in which Charles J referred to the judgment of Moses J (as he then was) in *R (Deluni Mobile Ltd) v Customs and Excise Commissioners* and to the cases of *R (UK Tradecorp Ltd) v*

*HMRC and R (Mobile Export 365 Ltd) v HMRC* at paragraph 9 and he stated as follows:

5 “It is also clear from those authorities, in particular, for example, the decision of Moses J, that in this industry or in trading of this type (here essentially in mobile phones) those who take part in it are, or certainly should be, aware that they are at risk of being the subject of an investigation by Customs. Standing back from chains of transactions it can, in some cases, be demonstrated that what is being shared out is the 17½% of tax amongst a number of people, and the only real purpose of the chain of transaction is to enable that money to be extracted unlawfully from the Revenue for the benefit of those involved in the chain.”

15 The Tribunal was invited to stand back from the chains of transactions under consideration in order to determine their true character and was also referred to the dicta of Floyd J in *Calltell Telecom Ltd* and *Opto Telelinks (Europe) Ltd v HMRC* where he stated:

20 “Firstly, the tribunal was entirely correct to approach the market in which the appellants were concerned with a significant degree of suspicion. So much was really beyond rational contest. The MOU (Memo of Understanding) had recognised that fraud in the sector was rife ... of course the existence of fraud within a sector, and the entire corruption of a whole sector are different things, but both are powerful reasons for examining with care a claim by a trader to be trading innocently within it.”

25 Again the Tribunal was invited to adopt the above approach and to be suspicious of both Appellants’ claims about their innocent dealings within the CPU market, it being beyond rational contest that the CPU market was rife with fraud, and Mr Peters had acknowledged in evidence that HMRC were telling traders, including those dealing in the CPU market, in 2006 that MTIC fraud was costing billions of pounds per annum.

30 34. With regard to the defaulting or missing traders, it was submitted that the evidence established tax losses by ETP through its failure to account for VAT on its sales to Bluestar, and the overall circumstances clearly indicated that ETP’s intention from the outset was fraudulently to default on the VAT it had received. With regard to Wade, again it was submitted that the evidence established tax losses by Wade and either its VAT status had been hijacked or it had fraudulently failed to account for VAT on its sales to Booming Technologies. In either event there was a clear intent fraudulently to default on the VAT it had paid, and whether there was a hijack, or whether there was a default made no difference to that conclusion. Similarly in the case of CWM the evidence established tax losses by CWM consequent upon its failure to account for VAT on its sales to Movies 4U and the evidence indicated that it was CWM’s intention from the outset fraudulently to default.

40 35. Mr Holland pointed to Mr Stone’s evidence relating to features which were consistent with fraud: long deal chains; back to back dealings which had been considered cumulatively rather than individually; payments abroad from which importation may be inferred – and here Mr Holland pointed to the payments to Mountainrix in respect of the two MBC deals – and he submitted also that one object

of carousel dealing is to move part of the proceeds back to the provider of the capital. In addition Mr Holland pointed to the fact that none of the three defaulting traders had any connection with the CPU market on formation and had names that customers would not connect with the sale of CPUs. The defaulters all generated a substantial turnover in a short period of time, and the fact that these huge turnovers were generated before the companies collapsed leaving huge VAT liabilities was far more indicative of wilful default rather than accidental business failure. It was submitted that on the balance of probabilities the fraud was an MTIC fraud based on an EU importation. Mr Holland adopted the reasoning accepted by the tribunal and later approved by the High Court in the case of *Red 12 Trading Ltd* as follows:

“In cases where there was no direct evidence of EU importation, it would be a perfectly permissible and logical inference that where there is fraud in the chain, the fraud operates to create a benefit to fraudsters arising out of the fact that an earlier stage there has been an EU acquisition, and it is perfectly appropriate therefore to infer EU acquisition.”

It was argued that it was far more likely that those operating in this market who intended to create fraudulent default would have bought goods in the EU rather than in the UK, since goods bought in the UK would require VAT to be paid on acquisition, and that VAT could not be offset by a trader who goes missing, and therefore the value of the fraud is reduced to that VAT which would be due on the difference between the price paid and the price at sale, i.e. 17½% of the profit rather than of the turnover. There is no reason why goods cannot be obtained by a fraudster from VAT-free EU sources, and there is therefore a powerful inference that those engaged in MTIC fraud would wish to conduct it on goods supplied from the EU. The evidence relied on to support that inference was as follows:

- (i) The Appellants believed they were trading in grey market goods, rather than goods sourced directly or indirectly from UK authorised distributors.
- (ii) None of the goods are manufactured in the UK and, unless acquired from an authorised distributor, must therefore be imported from somewhere.
- (iii) The freight forwarder, Quest Freight, had stated to Customs officers that in respect of paperwork there would be an inbound CMR showing Quest Freight as the consignee. They told the officer that goods were being imported but they had not retained the CMRs. The only reason for the construction of import documentation is to prevent the Commissioners from tracing the goods back into the EU. The inference is that the goods that went to Quest Freight in Kingston deals 2 and 3 came in on CMRs from the EU.
- (iv) Evidence of a waybill showing goods relating to Kingston deal 4 being imported from Germany.
- (v) Payment to Mountainrix in Portugal from the missing trader in MBC deals 1 and 2.

(vi) Similar fact/circumstantial cross-over evidence between the MBC deals 1 and 2 and the Kingston deals, particularly the '1 mb chip' point, the common supplier, Rapid, the common customer Futures Brokerage, and the director, Mr Peters, common to MBC and Kingston.

5 (vii) The defaulting traders have not come forward with proof of their having paid UK input tax on their acquisitions to decrease their VAT liability.

(viii) Both Appellants' own assumption that the goods were imported.

10 If the Tribunal were satisfied that the transactions were connected with fraud, and that the Appellants knew or should have known that this was the case, but were not satisfied that the evidence established importation from the EU at some point prior to the Appellants' transactions, it was submitted that the Appellants were still not entitled to deduct input tax under the *Kittel* test.

### 36 **Circularity of funds**

15 Whilst the Commissioners relied on the evidence of circularity of funds, it was acknowledged that this must be approached with care because once one assumes the circle closed, the total apparent profit will remain constant. Varying one figure would not result in the total being different because for every increase and apparent profit there would be a corresponding loss to another point in the circle. However, if it is  
20 assumed that the UK deal chain is unrelated to the off-shore chain of money transactions, as would be expected in a commercial sale where the purchaser is not reimbursed by the seller, there would be no closed circle, so if MBC had made more profit, then the total profit in the UK chain would increase without adjustment to the apparent profits in the unrelated off-shore payments. In those circumstances if MBC  
25 had charged a greater price, then the sum of the profits in the two independent transactions would not equal the VAT loss, as is in fact the case here. If it is assumed that the circle is closed, then the profit within the circle can be varied in any way to split the proceeds of the fraud. In true commercial dealings there would be no such circle. In carousel fraud figures can be arranged to distribute the profit, as it was  
30 submitted is the case here. It was considered to be of particular significance that when one looks at the series of payments which demonstrate money flow 'back to back' around a circle to reimburse the purchaser of goods for his purchase, that the consequence of the prices in that series of payments is to leave each participant with a share of the profit, and no one with a loss. Annex 4 was produced to show the monies retained as a percentage of the VAT default. The circle relied on by the  
35 Commissioners demonstrates what became of the money paid to CWM, which includes VAT due to HMRC, paid by the first buffer company. The importance of the circle is not only that when it is closed, does it give the figures that one might expect in a carousel fraud, which must be an extraordinary coincidence if these are two  
40 independent chains of transactions, but equally, everyone in that circle is making a profit. The closing of the circle demonstrates payments entirely consistent with carousel fraud. The circle of funds demonstrates that the missing trader, CWM, cannot simply have disappeared with the VAT due because it was making payments to Mountainrix, who appeared to be part of the circle, and CWM seemed to be

retaining just £6,000 of the VAT default. This is therefore not simply a trader going missing who is retaining the full 17½% VAT. The fact that MBC has been permitted to retain the largest part of the total is consistent with MBC being a knowing participant in the fraud. It was submitted that it was inconceivable that the fraudsters responsible for the fraud would design it in such a way that an innocent broker retained the largest part of any participant in the circle. If MBC were an unwitting party within a fraudulent circle, the fraudsters would wish to maximise their own profit at the expense of MBC.

37. If the Tribunal is satisfied that MBC Deal 1 is demonstrated to be a carousel fraud, then it was submitted that similarities within the other Kingston and MBC deals would strongly support the argument that these are similar frauds in which the Appellants cannot show that they are an unwitting party. In all cases the broker is being permitted to retain an unusually high profit in a contrived and non-commercial deal chain. It was notable that in both MBC Deals 1 and 2, if the profit apparently made by Rapid is added to the profit apparently made by Athol, the total equals the profit apparently made by MBC in selling to Futures Brokerage. This is not indicative of arm's length commercial transactions but rather the provision of benefit from fraud. Similarly, there was no commercial reason why Rose and Movies 4U should have identical, small profit, and such small profits were consistent with remuneration for low risk, simple buffer companies.

38. It was further submitted by Mr Holland that actual goods were not necessary for there to be a connection to fraud, and for this the Commissioners relied on the opinion of Advocate General Colomer in the case of *Kittel* at paragraph 61 where he said:

“I have already pointed out that, in certain cases, the scheme is worked via the simple circulation of invoices, without any actual transfer of goods.”

Whilst it was not the Commissioners' case that there were no goods involved in the deals, a connection between an exporter's acquisition of CPUs and the defaulting trader's fraud can either be connected by the goods purchased by the exporter being those used to facilitate the defaulter of the fraud, or can be connected by the sale of funds from another party who pays the VAT element on the goods it acquires which flows through a chain of transactions to the defaulter, or by both the goods and the funds. In the present case the financial evidence was unequivocal that there was a flow of funds from MBC up the supply chain back to CWM, all using FCIB bank accounts. For MBC deal 1 both payments were all back to back and in sequence on the same day, with the amount precisely matching invoices produced. For MBC deal 2 they all matched the invoice amounts and flow over a longer period of days. It was submitted that this in itself showed connection with fraud. It was further submitted that it could not be coincidence that there are two circles of fund flow which demonstrate identical profit margins with identical points with the same identified suppliers. If the deal chains are mistaken this would be an extraordinary coincidence. Furthermore the unchallenged evidence of the FCIB expert was that he had accounted for alternative FCIB payments and that in his opinion they would in any event show the same circularity of funds. Also the circle contended for by the Commissioners

appears to give each participant a share of the VAT default at a level consistent with their role in carousel fraud (larger amounts to the missing trader, broker and financier). Had the circle identified by the Commissioners been generated by coincidence, then such a pattern was not to be expected.

5 39. With regard to knowledge and means of knowledge, the test contended for by the Commissioners was whether the Appellants knew or should have known that their transactions were connected to, or were likely to be connected to, fraud. We were referred on this to the case of *Livewire Telecom* and *Mobilx Ltd* where at paragraph 7 Floyd J stated:

10 “Paragraph 51 [of *Kittel*] may, in some cases, involve ceasing to trade in specified goods in a particular market, at least in the particular manner in which the trader undertakes that trade. Such a situation may conceivably arise where, from other indications available to the trader, the trader knew or  
15 should have known that it is more likely than not that, despite all due diligence checking, any further goods traded in the same way will be implicated in VAT fraud.”

We were referred to other authorities for the submission that the test of knowledge or means of knowledge is to be determined having regard to objective factors and the time at which the knowledge of an Appellant is to be tested is the time when the  
20 transaction takes place, his knowledge cannot be affected by something he learned later on. The standard of knowledge to be applied is at least that of the reasonable director.

40. The Tribunal must ask itself whether the Appellant took every precaution which could reasonably be required of them to ensure that their transactions are not  
25 connected with fraud, be it fraudulent evasion of VAT or other fraud (see *Kittel*). However the Commissioners accepted that there was no positive duty upon a taxable person to take such proportionate step or precaution but as Lewison J stated in *Livewire* at paragraph 75:

30 “The taking of all reasonable precautions (acting on the basis of what he discovers as a result of taking those precautions) provides him with an impenetrable shield against any attack by HMRC.”

The Tribunal must ask itself whether by taking those precautions the Appellants would have discovered the likely connection with fraud.

41. One of the factors pointed to by the Commissioners in showing knowledge of  
35 fraud is that, in a fraud where the broker participates, it is to be expected that the broker would be permitted a significant share of the proceeds of the fraud. In true commercial dealings there is no reason why any particular party in a chain should consistently make more profit than any other, the relative profit should vary from deal chain to deal chain depending on how successful negotiations are. In each of the  
40 deals here both appellant companies’ profit seems to be around 20% of the VAT default. The distribution of gain from the fraud to the appellant companies implies knowing participation.

42. If the deal chains did involve an innocent broker, that entailed a risk to the fraudster because that innocent broker may make enquiries which reveal the fraud and alert the authorities. A healthy profit to a broker supports an inference of knowing participation. The MTIC fraudster needs the ability to ensure the broker approaches the right company as a source of goods to ensure the chain leads back to the missing trader. It was both Appellants' case that they were not manipulated to deal with any particular customer or supplier. It was significant that both Appellants used Rapid as their supplier for all six deals. In the CPU market there are many potential suppliers, some of whom are cheaper than Rapid and if the Appellants were acting as a normal commercial business one would expect to see a variety of suppliers. To source goods from one supplier who is not the cheapest source of supply is not consistent with normal business practice, and in the absence of the Appellants being manipulated by the fraudsters, is indicative of knowing participation.

43. The Tribunal was invited to infer from the totality of the evidence that all of the six deals were fraudulently controlled by the same controlling mind or minds. The deal chains themselves linked the various deals, and matters such as the 1mb chip mistake linked MBC's defaults with Kingston's defaults.

44. It was submitted by Mr Holland that there is no commercial rationale to the formation of Kingston and the Tribunal was entitled to infer that the company formation was for fraudulent purposes. There were no arrangements to deal with the conflict of interest created by the formation of Kingston which implies that there was in fact no need, because both parties knew there would be no competitive commercial deals as the deals were contrived. Both Mr White and Mr Peters had established companies which were already on monthly returns, which enabled better cashflow. The creation of new companies benefitted those engaged in MTIC fraud, making it more complicated for HMRC to investigate, and limiting the exposure in any investigation which took place. The imposition of Future Components between Kingston and Rapid was an indicator of the lack of commercial reality of the chains. Mr White confirmed that he was able to decide how much profit he kept in Kingston and in Future Components respectively when the latter sold to the former. The introduction of Future Components showed that this was not true commercial dealing but simply the means of distributing gain between the parties.

45. It was further submitted that both Mr White and Mr Peters must have been aware that their customer might cut them out as middle men, given that on their own case cheaper supplies of the goods were available and easily locatable from a website. Equally their customers were established and experienced. Their customers' best interests clearly lay in getting as close to the source of supply as possible, given that they were dealing in grey market goods it might be expected that the Appellants would import them themselves. Not only would this maximise their profits and minimise the risk of being cut out, it would also have meant that no VAT repayment would need to be sought, thereby improving the Appellant companies' cashflow. Their lack of effort in this regard could be taken as an indication of their knowing participation in MTIC fraud.

46. It was the Commissioners' case that the Tribunal was entitled to conclude that, given similarities in the supply chain, and the 1mb chip point, that the system seen in MBC Deal 1 extended to the Kingston deals as Mr Peters effectively controlled Kingston, and that Kingston as well as MBC was knowingly participating in MTIC fraud. Neither Mr Peters nor Mr White appeared familiar with the financial position of Kingston with regard to the disposal of profit, indicating that there was no true commercial object in running the company. No stock records were retained and, had they been true commercial deals, the parties would wish to ensure they could trace stock in case of any claim by a customer relating to defect or non-delivery. The lack of such records indicates that the parties knew there would be no such query, because the object of the deal was not the supply of goods, but the creation of the VAT repayment claim. Mr White had claimed such stock records were compiled in the case of Future Components, but none was produced. The Tribunal was invited to infer that either the records were false or they would not support Mr White's evidence. None of the inspection reports state that a single chip inspection was carried out, despite the Appellants' assertion that their goods were subject to single chip open box inspection. In the case of the inspection report for Kingston Deal 2, the fax header is dated 9 October 2006, whereas the goods were shipped on 29 June 2006 and it can be concluded that at the time the goods had been shipped, Kingston had no inspection report in its possession. The inspection report for Kingston Deal 4 was, as Mr White accepted completed for Rapid and faxed to Future who had faxed it to Kingston. The Appellants were happy to accept the inspection report despite it not being valid as it had not been received directly from Forward as stated in the header to the document.

47. It was known by the Appellants from the Respondents' statement of case that their lack of record keeping was in issue, yet the Commissioners pointed out, there is no mention of such record in any of their witness statements, and they failed to produce the claimed record of lot and box numbers. There was no record of any of the calculations which if the Appellants' evidence is correct must have been made on a daily basis, with regard to the daily trading prices. The existence of a single website available to all from which the market rate to be deduced, and the sources of cheap supply identified, undermined the suggestion that the Appellants' businesses were viable without MTIC fraud. They were neither adding value to the goods, nor using bulk buying to achieve lower costs for sourcing the goods, commercial pressures would ensure that their profit was minimal, or indeed that they were cut out as middle men.

48. There was a lack of proper due diligence, and the Appellants did not take it seriously as demonstrated by the reference by Mr Peters to one of the directors being a 'tea boy'. There was no proper due diligence check upon customers, which was thought not to be necessary, despite the fact that MTIC fraud had been explained to both directors on a number of occasions, in particular on 26 August 2005. There was an inconsistency between Mr White and Mr Peters with regard to what they were told by Rapid about there being a problem in the supply chain. Mr White claimed Rapid refused to identify the problem company for commercial reasons, while Mr Peters claimed that a company called Sapphire had been identified to him as the problem trader at a meeting where Mr White was present. The Appellants did not react to the

warning in a way consistent with those seeking to avoid the deals likely to be connected with fraud.

49. **Ought to have known**

5 In addition to the above the Tribunal was invited to consider that both  
directors were experienced in the market and had been repeatedly made aware of the  
risk of becoming involved in MTIC deals. Had they made enquiries of their freight  
forwarders, they could have confirmed that the goods were being imported from the  
EU and by whom and the un-commercial length of the deal chains, if not the identity  
10 of the companies within it. Had the freight forwarders refused to divulge such non-  
sensitive information, their suspicions should have been aroused. They would have  
become aware that the CMR documentation was being destroyed by the freight  
forwarders, alerting them to the risk that they were involved in fraud.

50. Despite being warned that there were tax losses in their deal chains, the  
Appellants continued to trade with the same suppliers and customers. There was no  
15 proper due diligence following the discovery that Rapid had tax losses in its supply  
chains in 2005. It was suggested that the Appellants could have asked the freight  
forwarders, or a nominated third party with non-disclosure agreements in place, to  
check with the freight forwarders, what type of business the importer was. Had the  
Appellants known that a carpet shop or a timber merchant was selling CPUs, that  
20 would have put a reasonable businessman on notice that he was carrying out  
transactions connected with fraud.

51. The goods were on occasion shipped before payment despite the Appellants  
maintaining the goods were not to be released before payment. They ought to have  
25 considered that in their volatile market a delay in payment meant that the purchaser  
was risking that the chips might be worth substantially less on release than they were  
worth when shipped. The Appellant ought to have realised that they were not dealing  
on normal commercial terms, and the profit being made for little or no effort was too  
good to be true, so they ought to have known it was likely they were involved in deal  
chains with fraudulent default.

30 **The Appellants' case**

52. **Principal submissions**

It was submitted by Mr Newman that the burden of proof rests with the  
Commissioners to prove all matters relating to the relevant tax losses, i.e. that the  
alleged defaulting party had failed properly to account for VAT, that the party was an  
35 importer from another EU Member State, that the failure to account was fraudulent,  
that the failure properly to account was referable to the relevant chain of supply and  
that it is proportionate to deny MBC and Kingston their right to deduct. We were  
referred to the case of *Blue Sphere Global Ltd* in the High Court, a contra-trading case  
in which the Chancellor noted that the tribunal below “had failed to recognise that the  
40 burden of proof lay on HMRC”. It was submitted that there was no objective basis  
for having a different burden of proof in contra trading cases to other cases involving

allegations of MTIC fraud, as the Commissioners had claimed in the present case. The Commissioners make the allegation, and it should be for them to prove it to the civil standard. The Commissioners must do so with evidence that was cogent, to require the Appellants to prove that they did not have the knowledge, or the means of knowledge, would impose an unreasonable burden of proving a negative on them. Mr Newman pointed to the fact that the case officer, Miss Arnold, could not identify one enquiry that the Appellants could have conducted to identify the alleged fraud. We were referred to the judgment of Clarke J in the High Court in the case of *Red 12* where at paragraph 53, having referred to the case of *Blue Sphere Global Ltd*, he set out his agreement with the Chancellor's conclusion in that case and said: "... it seems to me that, if the Commissioners seek to deny the taxpayer a right to repayment of input tax paid on taxable supplies on the grounds of the taxpayer's knowledge (actual or constructive) of a connection to fraud, it is for them to establish that."

53. In addition to the above the following principal submissions were made by Mr Newman:

- (i) no tax loss had been identified;
- (ii) the Commissioners had not identified the correct supply chains;
- (iii) no fraud had been established by means of evidence.

54. **No evidence of knowledge or means of knowledge**

There was no evidence before the Tribunal that demonstrated that, if the Appellants had taken a particular course of action, they would have identified fraud. It was not clear whether the Commissioners, when in cross-examination they had put to Mr Peters and Mr White that they could have instructed an independent firm to conduct a supply chain verification, that they could have asked the freight forwarder to provide information regarding the supply chain and they could have visited the freight forwarder to inspect the boxes, were suggesting that these should be historical checks, or made on the day of a particular deal. If it was suggested that a full supply chain verification could be conducted on the day of a deal, the Commissioners were mistaken: it would be neither practicable, nor possible. There is also no fraud on the day of a deal, and it is only when a company fails to account for its output tax and goes missing that fraud has been perpetrated. It was the Appellants' case that they had believed that the Commissioners themselves had conducted enquiries into the companies immediately before the periods in question when they were carrying out extended verification. Mr Newman pointed to Mr Stone's evidence to the Tribunal that the extended verification process was an investigative tool to establish whether or not there is a tax loss, and also to his evidence that there had been a great deal of publicity about this process when traders were notified. The Tribunal was asked to bear in mind not only what enquiries the Appellants could reasonably have conducted, but also what they had reasonably understood to be the enquiries conducted by the Commissioners. In respect of the period 04/06 Mr Peters had been informed by the Commissioners that the transactions were subject to extended verification and repayment claims would not be paid until that was concluded. That being the case, it

was not reasonable or necessary for the Appellants to embark on their own verification. The Appellants main supplier, Rapid, was a long-standing, experienced CPU trader that had large offices, several staff and solid financial records. There are no more due diligence enquiries that the Appellants could reasonably have conducted that would have identified the alleged fraud. There is no evidence that the Appellants were ever told by the Commissioners to do more than they were already doing.

55. Mr Newman submitted that the Appellants were entitled to rely on the reassurance from Rapid regarding the earlier default in the supply chain, Mr White having known the director of Rapid for many years. Future Components in the past had purchased several times from a company called Zentron Technology Ltd who are importers from Hong Kong. This came from the Commissioners' own evidence and there was no evidence before the Tribunal that proved fraud in those particular chains, and the CPUs were evidently not imported from the EU. The Zentron purchases demonstrated that the supply chains can be very short, and therefore Mr Peters was right to think that the 04/06 chains could be verified quickly by the Commissioners and secondly not all of the Appellants' associated supply chains are fraudulent. From the Rapid's VAT returns which were within Rapid's due diligence file which was examined by Mr Peters, it can be seen that Rapid was an importer in the first three periods of 2006, where there were substantial imports from other EU Member States. This not only showed Mr Peters that the supply chain might only include Rapid, but, also added credibility to the way Rapid traded in that they actively sourced stock.

56. It had never been suggested by the Commissioners at the time that a possible means of verifying a supply chain was to rely on its freight forwarder to conduct due diligence on companies in the chain. It was submitted by Mr Newman that it was for the Commissioners to establish what would have been likely to have been identified by the Appellants on such an enquiry being made, and not simply to say the Appellant could have tried this. There was no evidence before the Tribunal to say how many companies were normally in a legitimate grey market supply chain. There are no freight forwarder records in evidence for Kingston deals 1-3 and MBC deals 1 and 2, and therefore it is unclear which part of these supply chains the freight forwarder handled. Similarly with the Commissioners' suggestion that the Appellants could have visited the freight forwarders and looked at the boxes to ascertain what labels or markings were on them, the burden of proof is upon the Commissioners to say what they would have been likely to discover.

57. **EU importation**

It was accepted by Mr Newman that ETP made the supplies of CPUs that were eventually purchased by Kingston in Deals 1-3, and that ETP did not account for its output tax, nonetheless there was no evidence that showed that ETP was a UK acquirer from another EU Member State as was incumbent upon the Commissioners to show. Mr Newman pointed to Mr Stone's evidence where he said that in order to prove an MTIC fraud, the Commissioners would need to have evidence of a purchase from a company in another EU Member State. Mr Newman in his closing submissions suggested that Mr Stone had referred to the Commissioners' need to link

payments to stock, however we note that this is not precisely what Mr Stone said. His evidence was:

5 “There are steps taken by individuals in the fraud to try, obviously, to ensure that sort of documentation does not exist in order to frustrate the investigation. You also then are able to follow the money in certain instances, and therefore the inference may be drawn that if the money has been transferred abroad, the reason for the transfer is for the purchase of the commodity.”

The following questions and answers then followed:

10 Q. But in general you would agree that it is important to link any transfer to a transaction?

A. Yes.

Q. In other words a sale and purchase order?

15 A. Not quite because ... the fraud itself is a financial fraud. It is the introduction of capital at the beginning – or at some point in the transaction chain which then passes to the broker in the UK who contributes the VAT element which is subsequently reclaimed from the UK – from Revenue and Customs. The purpose of the fraud is to take the VAT out of the system and return part of it with the original capital investment back to the original investor or fraudster. The commodity and paperwork and the documents overlie that movement in support of the VAT repayment claim.

20 Q. Thank you. You have already accepted, however, that what you are referring to in paragraph 11 were goods?

25 A. Yes.

Q. So you are not suggesting that what you are referring to in your evidence would include a goods free transaction?

30 A. If the fraud can be perpetrated without goods existing, but the onus would be on us to prove that and establish that. So therefore unless that can be established we accept that there are goods.”

58. Further in relation to ETP the Tribunal was referred to the case of *S & I Electronics Ltd* at paragraph 77 where the tribunal stated:

35 “In the circumstances where we find a fraud at the start of the deal chains, but cannot conclude either that that trader was an importer, or that there was an earlier fraudulent importer and where, as a result, the only fraud we identify is in relation to that trader’s margin, it seems to us that to deny the whole of *S&I’s* input tax rather than just relating to that trader’s margin would be tantamount to a penalty. In such cases, therefore, we find that only the VAT on that trader’s margin should be denied.”

This case was relied on to show that it was for the Commissioners to prove that there is a fraudulent tax loss, other than one based on the profit margin of UK to UK traders, and they have to prove that the identified fraudster purchased the goods from a non-UK, EU-based company. It was particularly relevant when dealing with stock manufactured outside the EU, as all CPUs are. The stock is manufactured in China and if discovered in the UK, one would assume it had been imported direct from China unless there was evidence to the contrary. We were referred to the case of *Red 12 Trading Ltd* in which the Tribunal was not satisfied in a case where the origin of the goods was China that there was an EU importation. It was submitted that in the present case there were no similar fact supply chains from which the Tribunal could draw a conclusion. The Tribunal was invited to award payment of input tax based on the full amount claimed by the Appellants, as there was no evidence of any profit by ETP; it should not be left to the Commissioners to determine what they will repay.

59. Mr Newman reminded the Tribunal that in the present case there is no allegation or evidence of third party payments, and no suggestion by the Commissioners that any VAT element has been sent out of the UK in respect of any of the deals. The fact that a company has gone missing owing a relatively small amount of VAT on the mark-up may be explained simply by reason of the business failing, rather than there having been a deliberate attempt to commit fraud at the time of entering into the transaction. It was incumbent on the Commissioners to have investigated this, which they had not done properly.

60. In respect of CWM, whilst it was not disputed that it had not accounted for its output tax, it was initially submitted by Mr Newman that HMRC had failed to supply evidence to support the chain, there being no deal sheets in evidence and therefore no evidence of what each company had bought and sold (but see paragraph 31(c)(ii) above). The Commissioners had relied on the money transfers related to stock movements which it was submitted was inconsistent with the Commissioners' case that they relied on the circularity of funds and not the circularity of stock. In addition Mr Newman pointed to the fact that MBC's immediate trading partners, Rapid and Futures Brokerage, both used two separate banks to trade through as well as FCIB. The Commissioners had not provided evidence to show the purchases of every company and they had not provided evidence of the non-FCIB bank account details. It was further submitted that there was no invoice from Mountainrix to CWM for any supply of product, Mountainrix being a company which was only uncovered by the Commissioners when the FCIB accounts were looked into. It was therefore not possible to identify what actual stock or goods were transferred. It followed that it was not possible to identify any applicable unit price for such goods as were transferred. Mr Newman pointed to the fact that on MBC Deal 1, where there are invoices to support unit prices for CPUs, the Commissioners had produced total figures on those invoices to the nearest 10p, without any need for rounding up. Where there are no invoices, as there are not between Mountainrix and CWM, then, if it is assumed that it is the same product and the same quantity, the sums do not divide to the nearest 10p. It therefore appeared unlikely that this related to the same product as shown on the invoices.

61. Further with regard to CWM, it was submitted by Mr Newman that because there were no spreadsheets in evidence, there was therefore no evidence of what each company bought and sold. It showed how important it was to link any flow of money to supplies of stock, and to the relevant stock. The Commissioners had chosen to rely  
5 on the concept that money transfers related to stock movement, initially, but subsequently the Commissioners had relied on the circularity of funds, not the circularity of stock.

62. **The FCIB selection process**

Mr Newman submitted that the Commissioners' position had changed from  
10 circularity of stock prior to trial, to simple circularity of funds at the outset and, towards the end, simply a circle of companies. It was the Appellants' case that a circle of companies can easily be formed when CPU traders are obtaining stock from a limited number of trading websites. The chain of companies is naturally formed by  
15 traders buying and selling to others and very quickly it is possible for a chain of traders to appear. To illustrate this Mr Newman produced an extraordinarily complicated and colourful chart, but when analysed it seemed to show nothing other than that it was possible to create a series of linked companies and products. (We did not find it helpful and we do not reproduce it here.) It was submitted that if one  
20 interrogated a bank server used primarily by CPU and other electronic traders who import and export on a daily or frequent basis, one would almost inevitably find circles of companies and flows of funds between those companies. The ICB website promoted the FCIB and many traders used it. It allowed companies who held the same account to make instant payments, and it was attractive for more and more  
25 traders to use this facility. With regard to MBC Deal 1, it was submitted that the Commissioners had shown funds of £253,535.63 coming in to Rapid from MBC on 8 August and £246,133.13 being paid out to Rose, when MBC made this payment, Rapid already had £384,097.69 in their account and there was a payment in immediately before MBC's. Therefore the money was mixed money in the account and it cannot be classified as the same money moving in a circle. Mr Newman makes  
30 the same comment in respect of Athol's bank balance. Mr Newman did not attempt further analysis of the alleged financial chain in respect of MBC Deal 1.

63. In respect of MBC Deal 2 Mr Newman pointed to evidence that the funds travelled half way around the chain on 9 August 2006 until coming to Rapid. Rapid used those funds to pay for other goods and their account is emptied and replenished  
35 several times over the next few days. The Commissioners had suggested that, six days later, on 15 August 2006, the chain then continued and a circle was formed. It was submitted that this was unfounded and only served to highlight that the money paid by MBC to Rapid for MBC Deal 2 was not used to pay Rapid's supplier Rose, if indeed Rose were the supplier. An argument that Electrade are funding a specific  
40 deal cannot be sustained as the funds were not used for the alleged chain. Evidence shows that Athol paid for the stock on 8 August in part, and not on 15 August as the Commissioners had suggested.

64. It was submitted that it can be seen from additional FCIB statements disclosed that Rapid is buying from and selling to other companies. It is the stock that must be

followed, not the money. The importer of the stock is important in these cases and it is whether the UK acquirer has accounted for its output tax that is at issue, which has nothing to do with money movements.

5 65. It was accepted by Mr Newman that the evidence shows that where Athol have written FCIB payment details on its deal sheet it could be seen that Athol paid for the stock invoiced on 8 August on 17 August under FCIB reference 1184537, and on the right it shows the date the funds were received from Rose. It was suggested that this is the only evidence the Commissioners have regarding what payments relate to what transactions and therefore it was likely that other payments identified related to completely separate transactions.  
10

15 66. It was further submitted by Mr Newman that it was possible that the companies were simply paying the most important or pressing invoices when they received money from their customer, and the funds do not necessarily relate to that date's invoice or to the same stock. MBC may pay Rapid for the CPUs and, although Rapid makes payment to a CPU supplier, it does not have to relate to the same CPUs, it may well relate to an old invoice that is being chased up and then paid. Without the transaction sheets identifying which company bought which stock, it was pure guesswork to know who was supplying Rapid with what stock. Many companies have UK accounts, so there is no reason why some payments for stock are not made to, or by, Rapid through their UK account. For example there is evidence that Rose has a UK business bank account. Commodity Export also has a UK business bank account. To rely on FCIB evidence alone is too narrow. Athol received nearly £2m on 14 August from a different company which demonstrates that Athol is not supplying all its stock to Rose. Since the Commissioners contend that the payment received by Rapid from MBC in Deal 2 was passed on to Rose six days later, on the balance of probabilities Rapid did not pay Rose on 8 August 2006 for the stock sold to MBC in Deal 1. The Tribunal may conclude that Rapid did not purchase from Rose the stock that it sold to MBC; therefore the Commissioners have not identified where the stock came from and do not appear to have identified a tax loss. If, as the Commissioners imply, there must have been a controlling mind funding the transaction chain, why did the controlling mind not ensure that the money continued through the circle in MBC 2, rather than stopping at Rapid, which suggested there was no controlling mind and that Rapid in effect could do what it liked with the money? The Commissioners did not continue to follow the same money through Rapid and to other suppliers paid by Rapid on 9 August.  
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40 67. It was submitted that it was clear from the transaction enquiry report that the source of money in MBC Deal 1 money chain was fixed from the beginning. There is a payment shown of £121,270 in from an unknown account which is mixed with the payment in from Mountainrix on the next line. The payment on the fourth line goes out to Cubics in the US for £230,000 and this is the alleged start of the money chain. It was queried why the chain was not alleged to start with the payment in from Mountainrix. It was suggested that since the chain involves companies outside the EU, that would mean import duty and VAT being paid on entry of goods to the EU and import duty and taxes on entry to the US. If the Commissioners' account is to be accepted, the stock had entered the UK from the EU and then travelled outside the UK  
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to Switzerland, on to the US (duties being paid at import) and then back into the EU for more import duty and VAT. It therefore does not make sense that this is the same stock, and this casts doubt on the MBC 1 and 2 money trails.

5 68.. Mr Newman pointed to several anomalies in the deal schedules for MBC1 and 2 and submitted that, whilst it is logical that payments for MBC Deal 1 were made before the payments for invoices on MBC 2, the invoice dates for the first four companies in the MBC 1 supply chain are dated 8 August and the Rapid and MBC invoices are dated 7 August, yet on MBC Deal 2 the Commissioners have evidenced 10 invoices dated 4 August for the first four companies in the supply chain and 9 August for the Rapid and MBC invoices. It is doubtful in MBC Deal 1 that Rapid and MBC raised invoices the day before others in the supply chain. It is even more unlikely that in MBC Deal 2, Rapid and MBC raised invoices five days after others in the supply chain. It is also unlikely that the companies made payments for invoices dated 8 August (MBC Deal 1) before making payments for invoices dated 4 August (MBC 15 Deal 2). This it is submitted is further evidence that the payments identified through FCIB are unlikely to relate to the transactions in question. The Tribunal was invited to conclude that the Commissioners had selected a series of payments not relating to transactions, but to ones which formed only a circularity of money.

20 69. In his closing submission Mr Newman had referred to deal sheets showing invoices used in respect of the Future Components' supply chain. We were informed that Future Components had launched a separate appeal to be heard subsequently. Mr Newman had attempted to cross examine Miss Arnold about these deal sheets, but they were not ones which she had prepared, and no issue had previously been raised regarding the invoices, despite them having been available from very early on in the 25 proceedings. In his closing written submissions, but not in his oral submissions, Mr Newman invited the Tribunal itself to examine this chain of invoices. Having looked at his written submissions, we conclude that it would be inappropriate for us to examine the invoices in detail, since Mr Newman was asking us to draw from them the conclusion that the reliability of the Commissioners' supply chains was seriously 30 in question, and this argument was not put to any of the officers, nor was the comparison made by Mr Newman between these deal chains and MBC's Deal 2, which we were also invited to make. We consider it inappropriate to draw conclusions from matters which have not been properly put to the Respondents' witnesses and which they have had no opportunity to deal with.

35 70. **Evidence re trading practice**

With regard to the evidence in respect of Rapid, it was submitted by Mr Newman that it was important to concentrate on the tracing of stock, not merely to follow sums of money unrelated to the relevant stock because Rapid's spreadsheets for June 2006 show that they regularly made multiple purchases of CPUs on, or 40 around, the same date. In respect of CWM, he pointed to evidence that it made purchases from a UK company, Carisma Ltd. The Commissioners had not put any evidence before the Tribunal as to Carisma's VAT compliance, and there was no evidence of any payment from CWM to Carisma, therefore both companies may have had other bank accounts, either in the UK, or abroad. We were invited to draw the

conclusion that there is no evidence that Carisma has not accounted for its output tax, therefore, even if the Commissioners have identified the right supply chain to CWM, they had identified the wrong money chain and may have simply identified a chain with a compliant importer.

5 71. With regard to the releasing of stock without payment, it was submitted that  
this was only the case when dealing with Future Brokerage, a long standing customer.  
With regard to Best Buy in Singapore in Kingston Deal 3, the goods were shipped on  
hold on 5 July 2006, bearing in mind the flight time and time difference, the goods  
10 could not have reached Singapore until 6 July 2006 which was when payment was  
received. There was no evidence of the timing of the payment compared to the time  
of release, and only hours of credit could have been given. It was quite possible given  
the likelihood of delays such as Customs clearance times, that the stock was not  
released until payment to Kingston's account. In any case Kingston's position is that  
15 payment had already been confirmed as being on its way. With regard to Kingston  
Deal 4, the shipment to Abyss, despite the goods being due to arrive in Dubai on 5  
July 2006, and payment being received on 6 July 2006, it was Kingston's position that  
no credit was provided, but that confirmation of payment had been sent. This  
confirmation had not been retained.

20 72. With regard to insurance it was the Appellants' case that they had at all times  
believed that all the goods were insured. It was submitted that even if the goods were  
not insured, it was questionable whether by insuring them the Appellants would have  
been alerted to fraud in the supply chain. There was evidence in the exhibits of a  
payment entitled "Richard White Insurance" in the sum of £2,256.26. It would be  
25 odd to pay such an amount for each consignment without making any reasonable  
effort actually to be insured. Mr Peters had exhibited an itemised telephone bill from  
MBC which showed evidence of calls to Abyss and Best Buy. It was submitted that  
this was evidence of Mr Peters controlling his own sales. It was accepted that  
inspection reports had gone astray, but the due diligence report on Forward Logistics  
30 showed that electronic testings were conducted on 97% of the CPUs that entered their  
warehouse. No such reports were available for the deals in question, but they were  
evidence of the calibre of that company. Even an open box inspection on every  
occasion would not have told the Appellants about fraud in their supply chain.  
Evidence confirmed that confidentiality was vital to the freight forwarders, and a  
trader would not be told anything about the relevant supply chains, whereas the  
35 Commissioners themselves attended freight forwarders and conducted weekly supply  
chain checks. It was contended by Mr Newman that the case should be treated at face  
value, and the Tribunal should look at what the Appellants knew at the time when  
they were trading as a normal business trading with a reliable supplier.

### 73. **Appellants' Legal submissions**

40 With regard to *Kittel*, it was the Appellants' position that the case was of  
narrow application, and should only be applied in cases of a taxable purchase of a  
counterparty to a fraudulent transaction. Neither of the Appellants had purchased  
from any company that has been shown to have perpetrated a fraud, therefore there

was no basis for them to have known that there was a fraud and they cannot be said to have been connected with fraud.

74 The Tribunal was referred to Article 17(1) of the Sixth VAT Directive (since replaced by Article 167 of Council Directive 2006/112/EC) which provides that “the right to deduct shall arise at the time when the deductible tax becomes chargeable.” The Tribunal was also referred to section 24-26 of VATA which implemented the Directive in domestic law. Mr Newman referred to the case of *Dragon Futures Ltd v HMRC* where the tribunal at paragraph 73 and 74 advanced the proposition that hindsight is irrelevant, whereas in the present case the Commissioners’ approach had been based on the application of hindsight. It was submitted that the Commissioners’ approach of inviting the Tribunal first of all to find there was a fraudulent scheme and then to view the Appellants in the context of that fraudulent scheme was flawed, and was highly prejudicial and unfair. The Tribunal was invited to commence with the position of both Appellants, and then to go on to consider what they knew, or should have known, on the basis of the information available to them at the time.

75. Mr Newman further relied on the case of *Red 12* in the High Court for his submission that the Commissioners must supply cogent evidence that a purchase had been made from a supplier in another EU country.

76. A letter dated 17 August was sent to the Tribunal on behalf of both Appellants stating inter alia that the movement of funds relating to MBC Deal 2 as demonstrated in Annex 3 (created by Mr Birchfield) is incorrect and setting out reasons for this view. The letter was sent by a director of CTM Ltd, the firm which had instructed Mr Newman, but it was apparently not sent with Mr Newman’s knowledge. It was most certainly not sent with leave of the Tribunal. We have not been asked to re-open the hearing to allow the Commissioners to make any representations of their own on the matter and we propose to take no account of these further submission, not least because of the failure to put them to Mr Birchfield when given the opportunity to do so.

77. **Reasons for decision**

30 Although Kingston and MBC are separate companies, the majority of the evidence is pertinent to both companies. There are some matters which appear to be relevant to only one company and not the other, where that is the case we have considered that company separately initially, but in our judgment those companies cannot be regarded as independent of each other for the purposes of this appeal. We were at no time invited by Mr Newman to deal with them separately, beyond his submitting that we should not draw inferences from MBC’s trading patterns in respect of Kingston’s, an argument which we do not accept for reasons set out below. We turn now to the issues to be decided as set out in paragraph 19 above.

78. (i) *Whether the transactions were connected with the fraudulent evasion of VAT the burden of proof being on the Commissioners to show that they were, the standard of proof being the balance of probabilities, but the evidence relied on must be cogent.*

We have set out above the evidence in respect of the alleged defaulters, ETP, Wade/Grange and CWM. In respect of ETP we find that it had defaulted by failing to account for the tax on any of its sales to Bluestar. Wade/Grange was either a missing trader or a hijacked trader. We come to the same conclusion as the tribunal in the case of *Brayfal* referred to above, namely that Wade did not have its number hijacked, and that it was responsible for the tax loss in the chain. We follow the reasoning of the tribunal in the case of *Calltell* set out at paragraph 31(b)(ii) above and find that whether there was a hijacking of Wade's number or a failure by it to account for its input tax is irrelevant. With regard to Mr Newman's submissions as to Wade/Grange, and as to the timing of the name change and the dates of the invoices, we find these matters make it more likely that, as the tribunal had concluded in *Brayfal*, Wade did not have its number hijacked, and we conclude that the name change was a clumsy attempt to make it appear that this was the case. We find that both ETP and Wade are missing traders and responsible for large tax losses. The case in respect of CWM is different in that there is not only evidence of a tax loss, and of it apparently being a missing trader, but also evidence, which we accept, that it did receive a payment of £241,321.50 in respect of MBC Deal 1, out of which it retained a profit of £6,033.50 (see Chart at Paragraph ), and from which it paid £235,288 to Monies 4 U. It is not therefore the case that it had simply disappeared with the VAT payment it had received from Monies 4 U. We find that CWM not only is a defaulter, but that its default was fraudulent.

79. We do not find it appropriate to look at these three defaulters in isolation from the wider picture and we do not think it right to look at the activities of the Appellants solely from the point of view which they present. The burden of proof is upon the Respondents to show that there is a fraud, and therefore the first stage must be for the Tribunal to look at all the available evidence to see whether or not a fraud has been committed. It would, in our view, be unrealistic to look at the Appellants' situation in isolation from all the other evidence, and purely from the perspective they choose to present. Any company which was complicit in a fraud chain would have to do little more than to destroy all documents, or maintain no documents, or construct a false chain of documents, for them to give the appearance of innocence, as indeed in part appears to be the situation here. Both Kingston and MBC have retained no evidence of any relevant telephone calls or communications with the parties with whom they are trading, beyond minimal evidence of landline telephone calls from MBC to Abyss and Best Buy. They did not retain, or they failed to create, relevant documents in relation to their dealings with Christine and many other matters. If we were merely to look at events from the Appellants' apparent point of view we would hve a very incomplete picture.

80. We therefore turn to the deal chains themselves which, as we have already stated, we find are as claimed by the Commissioners. We ask why Future Components did not sell direct to the end purchaser rather than supplying Kingston Components for them to sell on, the effect of which was to reduce the profit margin of Future Components, or why Kingston did not itself go direct to Rapid in Deals 1-3? There is no commercial rationale for the long chains involved in these supplies, there being nothing done to the goods, or value added in any way. There is no evidence that any of the parties ever took possession of any of the goods prior to their export.

In Kingston Deal 1 the first three suppliers in the chain, plus Kingston's supplier, Future Components, issued their sales invoices on the same date, 27 June 2006, Commodity Export had issued its sales invoice on 29 June 2006 and Rapid on 30 June 2006, whilst the Appellant actually dated its invoice on 26 June 2006, the day before they apparently purchased the goods from their supplier. In Kingston Deal 2, the first three buffers issued sales invoices on the same day, 30 June 2006, whilst Commodity, Rapid, Future Components and Kingston dated their sales invoices the day before, 29 June 2006. In Kingston Deal 3, the first four suppliers in the chain all dated their sales invoices 29 June 2006, Rapid dated its sales invoices 30 June 2006, whilst Future Components and Kingston both dated their invoices 3 July 2006. In Kingston Deal 4, all the buffers dated their transactions on the same date, i.e. 3 July 2006, whilst Kingston dated its sales invoice the following day, 4 July 2006. The fact that no trader made a loss through any of the transactions in all four of the deal chains we consider to be unrealistic, and not within the normal commercial marketplace where there are fluctuating prices and levels of demand.

81. Each deal involves a chain of transactions which can be characterised as 'back to back' in that they appear to be paper transactions in a short period of time without delivery of goods between the traders involved, and no sensible commercial purpose can be identified for these transactions. No initial trader would wish to sell to an intermediary unnecessarily as to do so reduces the profit available by dealing direct with the customer. There is no evidence of either Kingston or MBC attempting to purchase from an authorised distributor or to sell to an end-user. Selling unnecessarily to intermediaries reduces the profit that would be available by dealing direct with an end-user. No final purchaser would wish to deal through intermediaries because it increases the cost of the goods to be purchased, he would prefer to deal direct with the initial supplier. For the above reasons market forces dictate that in commercial deals deal chains should be as short as possible, as those wishing to sell wish to negotiate the highest price, whilst those wishing to buy wish to negotiate the lowest price. In these deals there is evidence of repeat purchasers in the same bulk trade, and therefore the dealers might be expected to be familiar with the market and from where goods can be obtained at the lowest prices. Futures Brokerage (the end purchaser in all the deal chains) is a repeat trader who was prepared to pay £67.40 per unit for goods which could be acquired in the market for £59 per unit, as in Kingston Deal 1. This was in effect a premium of 14% which cost Futures Brokerage more than £26,000. Similarly Kingston could have saved nearly £15,000 by buying at £59 per unit if that were the true market price.

82. The lack of care with which documents were produced and the mis-description of a key part of the specification of the goods (as in the change from 1 megabyte to 2 megabytes, see paragraph 31(2)(iii) above) is of considerable significance and leads to the inference that the object of the deal chains was fraudulent, and the mis-description of the goods being sold demonstrates that the purchaser and seller had no real interest in trading goods, as opposed to creating a paper trail to provide buffers between the missing trader and the broker. The fact that this mis-description appears in both the Kingston's and MBC's deal chains is also relevant because, on the face of it, the Kingston and MBC deal chains are entirely different at the stage at which this 'mistake' occurs, in that they involve entirely different companies. We draw the

inference that the same controlling minds are involved in both sets of chains, and that efforts were made to make it look as if the sources of the chips were entirely different. We adopt Mr Holland's summary of the factors in the deal chains and in the surrounding matters which indicate that they are fraudulent:

- 5 (a) the lack of any value being added to justify the profits made;
- (b) the lack of commercial rationale for the final customer buying at prices so far above the price apparently available on the open market;
- 10 (c) the lack of commercial rationale for the length of the deal chains;
- (d) the lack of commercial rationale for Kingston being set up, and then MBC replacing it;
- (e) the lack of commercial rationale for directors of competing businesses to set up a joint enterprise and then seek to trade with the other competing companies they control 'at arms length';
- 15 (f) the inconsistent dating of invoices;
- (g) the lack of clarity in relation to business terms in high value transactions;
- 20 (h) the lack of clarity in relation to risk and ownership of goods;
- (i) the lack of any arrangements to be able to deal with queries about defective, faulty or missing goods (inferring all knew there would be no such queries);
- (j) the fact that no party made a loss;
- 25 (k) the fact that the total profit made in the chain of UK companies never totals more than the VAT default by the missing trader; if the total price increase from a sale by a missing trader to a sale by the broker exceeded 17.5% of the starting price the chain could not be distributing the profit of defaulting. The fact that this never happens in this case suggests the total price increase is not simply the result of skilled negotiations in a specialist and volatile market;
- 30 (l) back to back deals where no party requires any other to bind itself to sale or purchase, suggested all know that the prices will be agreed in order to distribute the profits of fraud rather than being commercially negotiated in a way which might lead to a loss;
- 35 (m) the ability to source exactly the customer's requirements without need for splitting of goods (except in Kingston deal 2 where there is a goods split earlier in the chain);
- 40 (n) the lack of any participation in any of the chains of an authorised distributor or end user of the goods concerned;
- (o) the way in which no pressure was applied by those higher in the chain of supply to demand payment before payment had been received from those lower in the chain;
- 45 (p) the fact that the buffer companies made small profits while permitting the missing trader and broker to retain higher

profits; in commercial transactions where no value is being added profit should only turn on the effectiveness of negotiation, which ought not to lead to such consistent patterns; (q) the exact consistency of profit in the deal chains of MBC Deals 1 and 2, and the way in which the relative profits compare.

For all the above reasons we find that not only CWM but also the other two defaulters, ETP and Wade/Grange were part of a chain created with the purpose of fraudulently evading VAT.

83. (ii) *Whether MBC and Kingston knew or should have known of the connection with fraud*

We have already stated that we found neither Mr White nor Mr Peters to be credible witnesses. Their evidence was riddled with inconsistencies and sometimes was contradictory. Neither of them behaved as we would expect reasonable businessmen to behave. Indeed so uncommercial do we find their business practices, and so unreliable their evidence, that we can only conclude that both Kingston and MBC were knowing parties to the fraud that we find was perpetrated in respect of all the deal chains in issue, and we point to matters (a)-q) above..

84. (iii) *On whom lies the burden of proof?*

We find that the Commissioners have satisfied us not only that the deals were fraudulent, but also that the Appellants were both parties to that fraud, and so this is no longer a relevant consideration.

85. (iv) *Whether the Tribunal may infer behaviour from one set of transactions in respect of another, or whether we must look in isolation at each and every deal?*

In the case of *Red 12* Clarke J made it clear that such an inference was permissible. At paragraphs 109-111 he said as follows:

“109. Examining individual transactions on their merits does not, however, require them to be regarded in isolation without regard to their attendant circumstances and context. Nor does it require the tribunal to ignore compelling similarities between one transaction and another or preclude the drawing of inferences, where appropriate, from a pattern of transactions of which the individual transaction in question forms part, as to its true nature e.g. that it is part of a fraudulent scheme. The character of an individual transaction may be discerned from material other than the bare facts of the transaction itself, including circumstantial and “similar fact” evidence. That is not to alter its character by reference to earlier or later transactions but to discern it.

5 110. To look only at the purchase in respect of which input tax was  
sought to be deducted would be wholly artificial. A sale of 1,000  
mobile telephones may be entirely regular, or entirely regular so far as  
the taxpayer is (or ought to be) aware. If so, the fact that there is fraud  
10 somewhere else in the chain cannot disentitle the taxpayer to a return  
of input tax. The same transaction may be viewed differently if it is the  
fourth in line of a chain of transactions all of which have identical  
percentage mark ups, made by a trader who has practically no capital  
as part of a huge and unexplained turnover with no left over stock, and  
15 mirrored by over 40 other similar chains in all of which the taxpayer  
has participated and in each of which there has been a defaulting  
trader. A tribunal could legitimately think it unlikely that the fact that  
all 46 of the transactions in issue can be traced to tax losses to HMRC  
is a result of innocent coincidence. Similarly, three suspicious  
involvements may pale into insignificance if the trader has been  
obviously honest in thousands.

20 111. Further in determining what it was that the taxpayer knew or  
ought to have known the tribunal is entitled to look at the totality of the  
deals effected by the taxpayer (and their characteristics), and at what  
the taxpayer did or omitted to do, and what it could have done,  
together with the surrounding circumstances in respect of all of them.”

We find that in the present case such an inference is permissible, for the reasons given  
by Mr Holland.

25 86. ((v) *Whether in the circumstances of this case it is appropriate to infer  
importation from the EU?*

30 Whilst the Commissioners cannot point specifically to evidence of EU  
importation, it is their case that it is appropriate to infer importation from the EU on  
the basis that the whole rationale of these deal chains is based on the recovery of the  
VAT and there would be no purpose in these long deal chains if there were not the  
prospect of recovering the unpaid VAT given that Clarke J in *Red 12* did not criticise  
the Tribunal’s drawing a similar inference in that case and said:

35 “In cases where there was no direct evidence of EU acquisition, it  
would be a perfectly permissible and logical inference that where there  
is fraud in the chain, the fraud operates to create a benefit to the  
fraudsters arising out of the fact that at an earlier stage there had been  
an EU acquisition, and it is perfectly appropriate therefore to infer EU  
acquisition.”

Clarke J also held in that case that the Commissioners did not have to prove that the  
defaulter was the importer of the goods.

40

87. Whilst we accept that such an inference is permissible, here the facts are very different from the case of *Red 12*, where in some instances there was direct evidence of EU importation. In the present case we are invited to draw that inference on the basis of the evidence obtained by the Commissioners from the FCIB of circularity of funds as well as from the overall circumstances of the case, as set out above. The apparent distribution of profits was set out by the Commissioners in the table produced at Annex 4.

88. We find that this, as well as the table at Annex 1 shows a distribution which could not be accounted for if trades were all being conducted independently and in a commercial market. Taken together with other factors set out above, we conclude that even without the FCIB evidence the only reason for these unrealistic trades is to obtain the VAT on which those at the start of the goods chains defaulted and to divide it between the parties and furthermore that the trades originated with a purchase from the EU. If we are wrong in that conclusion, and we then take account of the FCIB evidence, a different distribution of profit appears, as shown at paragraph 31(4)(viii). We accept without reservation the evidence of Peter Birchfield who had checked Mr Mendes' work, and were surprised that, despite being given the opportunity of an overnight adjournment to consider the issue, Mr Newman chose not to cross-examine him. Mr Newman, having called for additional FCIB evidence, cross-examined Mr Mendes alone on it despite it being suggested by Mr Holland that Mr Birchfield, as Mr Mendes' superior, was the more appropriate person of whom to ask those questions. In his closing submissions Mr Newman then set out a variety of hypotheses and matters with which Mr Birchfield had not been invited to deal and nor, in several instances, had they been put to Mr Mendes. We prefer Mr Birchfield's evidence as set out above, that there were recurring amounts of money all of which he followed, and which went around in a circle.

89. With regard to MBC Deal 1, we conclude that, on the balance of probabilities, Annex 2 is a cogent representation of what happened to the funds in connection with that deal. We accept Mr Holland's submissions in regard to there being a circularity of funds, and in particular give weight to his argument with regard to the amount and distribution of the profit. We conclude that the only purpose of this circularity is fraudulent, the intention being to distribute the profit made by CWM by defaulting on its VAT and the fact that the financial buffer Mountainrix is situated in the European Union is evidence that this is an MTIC fraud.

90. (vi) *Whether evidence of circularity of funds has to be accompanied by evidence of circularity of goods in respect of which those funds have been made over?*

We can find no authority to support Mr Newman's submission that a direct connection must be shown between goods sold and the financial transactions shown in the FCIB documents, and it does not seem to us to be logically necessary to do so. However, whilst in our judgment it is not necessary for it to be demonstrated that the funds relate to the sale of specific goods for there to be an MTIC fraud, there has to be a connection between the funds and the invoices in respect of which the VAT is being

fraudulently claimed. In MBC Deal 1 the funds do match the invoice amounts, and the dates correspond, and we therefore accept this as evidence of fraud.

91. Having accepted the Commissioners' evidence and argument with regard to MBC Deal 1, we also accept their evidence and argument with regard to MBC Deal 2, albeit the FCIB evidence is less clear cut. In respect of this deal as well, the funds shown in Annex 3 match the amounts on the invoices, although the payments are made over a longer period and there are other funds which are of the similar amounts. We find it beyond coincidence that the two circles of fund flow have identical profit margins with the same suppliers as in the deal chains, and the profits are consistent with each participant's role in the carousel fraud. Mr Newman had submitted in respect of MBC Deal 1 that, because there were other funds in Rapid's and Athol's account at the time MBC made its payment, therefore the money could not be classified as being the same funds. It was never suggested by the Commissioners that the funds were identical, only that an inference could be drawn from the amounts moving in and out of the accounts that they were paid in respect of MBC Deal 1, an inference which we accept. For the avoidance of doubt, we accept that in respect of both MBC deals there is evidence of funds being supplied from the EU from which we infer that the goods MBC claims to have sold and to which the funds relate, were imported to the UK from the EU.

92. In all the circumstances and for the above reasons the Commissioners have satisfied us on the balance of probabilities and on the basis of cogent evidence that there was a fraudulent evasion of VAT in respect of each of the deals, that it was an MTIC fraud and that both Appellants knew that that was the case. For the avoidance of doubt, we find that the purpose of this fraud was to evade the full amount of missing VAT in these deals, and therefore the question raised in the case of *S & I* (above) that the Appellants might only be liable for VAT on the margin is irrelevant. This appeal is dismissed. The Appellants to pay the Respondents' costs, in the event of failure to agree, liberty to apply to the Tribunal as to liability, the issue of quantum to be decided by a Costs Judge of the High Court.

**MISS J C GORT**

**TRIBUNAL JUDGE**  
**RELEASE DATE: 17 December 2009**