

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

Royal Courts of Justice
Strand, London, WC2A 2LL

15/01/2010

Before:

MR JUSTICE BRIGGS

Between:

**MEGTIAN LIMITED (IN
ADMINISTRATION)**

Appellant

- and -

**THE COMMISSIONERS OF HER
MAJESTY'S REVENUE & CUSTOMS**

Respondents

**Mr Michael Patchett-Joyce (instructed by The Khan Partnership LLP, 48/49 Russell
Square, London WC1 4JP) for the Appellant
Mr Mark Cunningham QC and Mr Daniel Margolin (instructed by Howes Percival
Solicitors, The Guildyard, 51 Colegate, Norwich NR3 1DD) for the Respondents
Hearing dates: 16th – 17th December 2009**

HTML VERSION OF JUDGMENT

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Mr Justice Briggs :

1. This judgment follows the conclusion of the hearing of Part 1 of the appeal of Megtian Limited (in administration) against the decision of the VAT & Duties Tribunal, released on 11th December 2008, whereby the Tribunal dismissed Megtian's appeal against the decision of the Respondents ("HMRC") to disallow input tax claims and consequential claims for repayments of tax in the aggregate amount of £5,909,067.50, by letters dated 21st May and 10th July 2007. The input tax disallowed was claimed in respect of two one month prescribed accounting periods, namely April and May 2006.
2. HMRC disallowed the claims for input tax credit on the basis that the transactions to which the claims related (of which there were fifteen in each of the two relevant accounting periods) were connected with the fraudulent evasion of VAT, of which Megtian was, or ought to have been, aware. The fraud alleged by HMRC is what has

come to be known as "missing trader" or "MTIC" fraud, an abuse of the VAT system which has caused enormous losses to the revenue of the United Kingdom and, indeed, of other Member States within the EU.

3. There is a concise summary of the way in which MTIC fraud typically operates in paragraphs 5 to 10 of the Decision of the Tribunal. It was not in any way challenged on this appeal, and I can do no better than quote it in full by way of introduction:

"5. In outline MTIC fraud typically operates in the following way. Where goods are bought by a trader (T) registered for VAT in the UK from a trader (E) registered for VAT in another EU country E does not have to charge T VAT on his purchase but when the goods are brought to the UK T has to account for acquisition tax of 17.5%. However, T is also entitled to deduct that amount as input tax and so at that stage the goods are in effect VAT free or tax neutral. If T sells the goods to another trader registered in the UK (T2) he must charge and account for VAT on the sale. If, having collected that VAT from T2 he then absconds without accounting to the authorities for that VAT, T will have made a dishonest profit of 17.5% on the value of the goods. T2 will have deducted the tax he paid to T as input tax and has paid T the tax inclusive price for the goods. T2 will recoup the VAT paid to T from his customers when he sells the goods and, although the authorities have lost the output tax due to them, the direct source of T's illegitimate gain is the money paid to him by T2 and indirectly by T2's customers. Assuming he acted dishonestly that is a straightforward fraud by T.

6. However, such a fraud depends upon T being able to find a purchaser who wants to sell the goods in the UK because otherwise the purchaser will have paid the VAT inclusive price without being able to recoup it by onward sale to customers.

7. MTIC fraud depends upon T2, rather than selling the goods in the UK, exporting them to another country which may or may not be in the EU. In that case T2 makes a zero rated sale to the overseas buyer. He still recovers the tax he paid to T as input tax but does not have to collect and account for any tax from his customer and so not only do the authorities lose the tax that T should have paid when he sold the goods to T2 they are also the source of the money T has absconded with. That is because T2 can afford to pay T the tax inclusive price knowing that he will recover the tax from the authorities as input tax. T's opportunity to deal repeatedly with T2 is therefore increased because there is no need for T2 to find customers in the UK in order to be able to account for output tax after paying T the tax inclusive price.

8. The fraud still depends upon finding customers in the overseas markets but, if whoever is behind the fraud can manipulate that, then the opportunity for repeated fraud can be achieved. Typically, additional UK traders may be interposed between T and T2 to disguise the fact that the fraud is occurring.

9. None of the above means that T2 is necessarily involved in the fraud because he may well not be aware that his overseas customers or T are in any way involved in fraud and both he and any interposed traders may all be innocents who have unknowingly been manipulated by whoever is behind the fraud.

10. In the terminology adopted in such cases T is known as the missing or defaulting trader T2 is known as the broker and any interposed parties are known as buffers."

4. I shall adopt without further explanation the terminology explained in that passage. It is however necessary to introduce a little more by way of jargon. The chain of transactions between T1 and T2 described in the passage from the decision which I have quoted is typically called a "dirty chain", because it involves a fraudulent evasion of tax payable by virtue of a transaction forming part of the chain, in the instant case, the output tax received by T1 upon his sale either to T2 or to the first of any interposed buffers.

5. Dirty chains are to be contrasted with "clean chains". These may be similar chains of transactions, but involve no immediate evasion of tax because T1 accounts for output tax on the sale to the buffer ("B"). Nonetheless they may be connected with MTIC fraud, by being used as a means of concealment, as described in the following two paragraphs of the Decision:

"81. These transactions are alleged to have the following characteristics. Trader A imported goods and sold them to B who sold them to Megtian who exported them. A accounted for output tax on the sale to B who accounted for output tax on the sale to Megtian. Megtian exported the goods and claimed back the input tax from its purchase from B but did not have to account to HMRC for any output tax because the sale was by way of an export. Such a transaction is called a clean chain in the jargon adopted in cases where MTIC fraud is alleged.

82. However, in the same tax period A was involved in other transactions in which it had exported goods and claimed input tax which off-set in whole or in part the output tax due on the Megtian transactions and those exports by A were connected to fraud because in those chains of transactions there was a fraudulent transaction of much the same sort as those already described in the preceding paragraphs. The allegation is that the apparently legitimate transactions were undertaken to disguise A's involvement in the fraudulent chains because it would either not have to claim an actual repayment from HMRC and risk drawing particular attention to itself or if it did make such a claim it would have apparently legitimate transactions to draw to the attention of the authorities to attempt to demonstrate its bona fides. The chains containing fraudulent transactions are called "dirty chain" transactions in the jargon adopted in MTIC fraud cases."

6. In the present case, 27 of the transactions in respect of which Megtian was refused input tax credit were alleged by HMRC, and found by the Tribunal, to have been part of dirty chains. Three transactions were found to have been part of clean chains used to conceal fraud in other dirty chains. Those three transactions were referred to by the Tribunal as "the contra-trading transactions". The Tribunal found that the clean chains were sufficiently connected with tax fraud committed by means of related dirty chains, and that Megtian knew or ought to have known that those three transactions, together with the other twenty seven, were connected with fraud.
7. It is common ground that appeals from the VAT & Duties Tribunal are limited to points of law. By its Appellant's Notice filed on 5th February 2009 Megtian identified seven grounds of appeal. Three of them, namely grounds 2, 6 and 7 raised matters of law likely to be affected by the forthcoming hearing by the Court of Appeal of appeals against a series of High Court decisions concerning MTIC fraud, so that determination of those grounds now might prove to be an unprofitable waste of time and costs. By contrast, grounds 1, 4 and 5 were, by agreement between the parties, identified as grounds particular to the Tribunal's analysis of the facts and evidence before it, the outcome of which would be unlikely to be significantly affected by the forthcoming decision of the Court of Appeal. An issue as to whether ground 3 fell into this category as well was resolved in the affirmative by Sales J on an application for case management directions on 10th December 2009. The result is that the hearing to which this judgment relates concerns grounds 1, 3, 4 and 5 of Megtian Grounds of Appeal, but not grounds 2, 6 and 7. Counsel for both parties have assured me that they will not seek to reopen or reargue grounds 1,3,4 and 5 in the light of the outcome of the hearing in the Court of Appeal, so that they can be finally determined now.
8. A common theme in grounds 1, 3, 4 and 5 of the Grounds of Appeal is the allegation that the Tribunal made errors of law in its conduct of its fact-finding task. Thus, each of grounds 1, 4 and 5 asserts that relevant findings of the tribunal were "contrary to the evidence". Ground 3 is put in different terms but, as will appear, is also closely related to the fact-finding process.

9. Grounds of appeal of this type call for cautious treatment by the appeal court, because of their tendency, if not strictly controlled, to degenerate into free-ranging attacks on the correctness of the lower court's evidential conclusions, disconnected from the identification of any specific error of law. In Georgiou v. Customs and Excise Commissioners [1996] STC 463, at 476, Evans LJ said this:

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

He continued:

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

He concluded:

"What is not permitted, in my view, is a roving selection of evidence coupled with a general assertion that the tribunal's conclusion was against the weight of the evidence and was therefore wrong. A failure to appreciate what is the correct approach accounts for much of the time and expense that was occasioned by this appeal to the High Court."

10. It was common ground before me, at least in relation to those aspects of grounds 1, 3, 4 and 5 which asserted errors in the Tribunal's fact-finding process, that Evans LJ's four stage analysis in Georgiou ought to govern the conduct of this appeal. From time to time it seemed to me that Mr Patchett-Joyce who appeared for Megtian on this appeal (but not before the Tribunal) succumbed to the temptation to broaden his submissions into a more generalised attack upon the merits of the Tribunal's factual conclusions, in particular by submitting from time to time that relevant decisions were against the weight of the evidence, rather than unsupported by any, or any sufficient, evidence. I therefore found it necessary from time to time to prevent the hearing turning into a general review of the evidence.
11. There are numerous authoritative statements of the precise meaning of the concept that a finding of fact involves an error of law when it is based upon non-existent or inadequate evidence. They were very recently summarised by Christopher Clarke J in Red 12 Trading Ltd v HMRC [2009] EWHC 2563 (Ch) at paragraphs 113-120. The question is not whether the finding was right or wrong, whether it was against the weight of the evidence, or whether the appeal court would itself have come to a different view. An error of law may be disclosed by a finding based upon no evidence at all, a finding which, on the evidence, is not capable of being rationally or reasonably justified, a finding which is contradicted by all the evidence, or an inference which is not capable of being reasonably drawn from the findings of primary fact. As Lord Radcliffe put it in Edwards v Bairstow [1956] AC 14, at p. 39:

"Their duty is no more than to examine those facts with a decent respect for the tribunal appealed from and if they think that the only reasonable conclusion on the

facts found is inconsistent with the determination come to, to say so without more ado..."

12. The restrictions imposed by an appeal limited to points of law are in addition to the well recognised difficulties facing any appellate court, such as not seeing the witnesses giving evidence, being confined to a review of evidence considered in much greater detail by the court below, and being unable to capture from the judgment (however meticulous) every nuance which played an important part of the evaluation of the court below; see for example per Lord Hoffmann in Biogen Inc v. Medeva plc [1997] RPC 1, at p.45.

GROUND 1: "Certain of the Tribunal's findings of fact that the tax losses in each of the Appellant's supply chains were due to fraud were contrary to the evidence".

13. As is established by the European jurisprudence, for which the leading case is Axel Kittel v. The Belgium State [2008] STC 1537, the disallowance of an input tax claim upon a basis related to MTIC fraud requires HMRC to establish first, that it has suffered a tax loss caused by fraud, secondly that the transactions giving rise to the taxpayer's claim are sufficiently connected with that fraud, and thirdly that the taxpayer knew or ought to have known that his transactions were connected with fraud. Megtian's Ground 1 attacks the Tribunal's fact-finding in relation to the first and second of those three stages.
14. Upon analysis, Ground 1 was subdivided into four sections, the first of which related to Megtian's participation in alleged dirty chains, and the remainder of which related to findings connected with its participation in the three clean chains which the Tribunal found had been constructed as a means of the fraudulent concealment of other dirty chains with which Megtian was not directly connected.
15. Ground 1(1) alleges that the Tribunal's finding that there had been a fraudulent evasion of tax by three named parties to relevant dirty chains was contrary to the evidence. The parties in question were Oracle (UK) Ltd, C&B Trading (UK) Ltd and Worldwide Enterprises Ltd. Each of those three companies occupied the position of T (i.e. the missing or defaulting trader) in one or more of the dirty chains which included relevant transactions upon which Megtian based its input tax claim. It is common ground that each of the three companies defaulted on very substantial VAT liabilities arising in connection with the sale within the United Kingdom of large consignments of imported mobile phones.
16. In relation to each company, the Tribunal set out a summary of the primary facts upon which it concluded that, in each case, the tax losses occasioned to the Revenue by those defaults were caused by fraud. Those primary facts are to be found in relation to Oracle at paragraphs 69 to 70 of the Decision, in relation to C&B Trading at paragraphs 72 to 73, and in relation to Worldwide in paragraphs 74 to 75. Mr Patchett-Joyce did not in his submissions suggest that any of those findings of primary fact in relation to each company were unsupported by sufficient evidence.
17. The common thread in the appeal in relation to these three companies was that, in each case, the relevant default had been precipitated by the issue by HMRC of what is known as a Regulation 25 letter, which has the effect of accelerating the due date for the taxpayer's next VAT return, and therefore the date upon which its next VAT payment becomes due. Mr Patchett-Joyce demonstrated that there was evidence to that effect in relation to each of those three companies. He submitted that, in those circumstances, the Tribunal could not properly conclude that the default in payment of VAT by any of those three companies was the consequence of a premeditated fraud, rather than the consequence of being caught out by the accelerated return and liability dates without the cash flow necessary to pay the tax, something to which the

Tribunal referred in general terms as "unfortunate insolvency" (Decision paragraph 70).

18. In my judgment that sort of challenge is a classic example of a claim that a factual finding is against the weight of the evidence, as indeed Mr Patchett-Joyce was eventually constrained to accept, at least in relation to Oracle. To test its validity would require a comparative assessment of competing evidence, rather than an analysis of the question whether there was sufficient evidence justifying the inference of fraud drawn by the Tribunal. The suggestion that the inference was against the weight of the evidence disclosed no error of law on the part of the Tribunal, and I consider that the primary facts relied upon by the Tribunal for its inferences of fraud in relation to each of those three companies were amply sufficient reasonably to found such an inference. It is no part of the court's function on this appeal to decide whether, in the light of all the evidence, the inference was correct. That was a matter as to which the Tribunal has the last word. Accordingly, Ground 1(1) fails.
19. I need say nothing about ground 1(2) save that, after submissions and a pause for reflection during the short adjournment on the first day of the hearing, it was sensibly abandoned by Mr Patchett-Joyce.
20. Ground 1(3) alleged that the Tribunal's conclusion that a company known as @tomic Ltd knew of fraud in its chains of supply, in paragraph 87 of the Decision, was contrary to the evidence. @tomic occupied the position of Trader A in the explanation of contra-trading transactions provided by the Tribunal in paragraphs 81 and 82 of its Decision quoted above. It was the importer at the head of a clean chain of transactions in relation to which Megtian was the exporter at the foot. It was also the exporter under a series of dirty chains, at the head of which stood various missing or defaulting traders. An essential element in HMRC's case for disallowance of an input tax claim in relation to a contra-trading transaction is that the entity in the position of Trader A used the clean chain as a dishonest means of covering up the tax evasion involved in the associated dirty chain. I shall refer to the entity in the position of Trader A, following the example of Lewison J in HMRC v. Livewire Telecon Ltd [2009] EWHC 15 (Ch) as the contra-trader.
21. It was therefore necessary for HMRC to establish that @tomic, as such a contra-trader, knew that transactions in which it participated at the foot of dirty chains were connected with fraud. Of the twenty allegedly dirty chains affecting @tomic relied upon by HMRC, twelve were admitted as such by Megtian at the hearing before the Tribunal, but no admissions were made as to @tomic's knowledge of fraud.
22. The primary facts found by the Tribunal in relation to that allegation of knowledge on the part of @tomic are set out in paragraph 88 of the Decision. They were, in summary:
 - (a) A meteoric rise in @tomic's turnover from nil in the year ending May 2003 to £234 million in the year ending May 2006, nearly all of which derived from sales of mobile phones.
 - (b) A business plan prepared by the directors and shown to HMRC suggesting, contrary to the fact, that the company's business would mainly be the importation and sale of pizza ovens.
 - (c) The receipt by the company of 49 warnings that others with whom it was dealing were suspected of MTIC fraud.
 - (d) The failure by @tomic to produce evidence, upon request by HMRC, that it insured the goods with which it was dealing, despite their enormous value (save for

insurance which turned out to have been obtained retrospectively, after HMRC's request).

(e) Attempts by @tomic to persuade HMRC not to mark packing cases dealt with by @tomic so as to show they had been inspected either at import or export (a process which the Tribunal considered would be unlikely to affect the value of the goods, but which would considerably facilitate detection of fraud).

23. Again, Mr Patchett-Joyce did not suggest that any of those findings of primary fact was unsupported by sufficient evidence. His submission was that, neither singly nor in the aggregate did they permit, still less justify, an inference of dishonest knowledge on the part of @tomic. In addition, he relied upon the fact (also supported by the evidence) that @tomic had not in fact off-set the whole of its input tax arising from the dirty chains against output tax on sales forming part of the clean chains involving Megtian, but still made a significant input tax reclaim during the relevant period of account.
24. In my judgment the primary facts found by the Tribunal relevant to @tomic's knowledge were, in the aggregate, sufficient to permit the Tribunal, if it thought fit, to make a finding of dishonest knowledge on the part of @tomic. It is in this context important for an appeal court to have regard to the need to appraise the overall effect of primary facts, rather than merely their individual effect viewed separately. As Lewison J put it in *Arif v. Revenue and Customs Commissioners* [\[2006\] EWHC 1262 \(Ch\)](#) at paragraph 22:

"There is one other general comment that is appropriate at this stage. It relates to the evaluation of circumstantial evidence. Pollock CB famously likened circumstantial evidence to strands in a cord, one of which might be quite insufficient to sustain the weight, but three stranded together might be quite sufficient (*R v Exall* (1966) 4 F & F 922). Thus there can be no valid criticism of a tribunal which considers that one piece of evidence, while raising a suspicion, is not enough on its own to find dishonesty; but that several such pieces of evidence, taken cumulatively, lead to that conclusion."

25. Furthermore, although evidence that @tomic made a claim for input tax during the relevant period was of course material to the Tribunal's decision whether to draw an inference that it had dishonest knowledge, it comes nowhere near being sufficient to serve as the basis for a conclusion that the primary facts relied upon were incapable in the aggregate of justifying such an inference, still less that the inference was contrary to all the evidence. No error of law is disclosed by the fact that the Tribunal did not in expressing its conclusions about @tomic's state of knowledge, refer expressly to that evidence.
26. Ground 1(4) amounted to a similar challenge in relation to the Tribunal's finding of dishonest knowledge against another relevant contra-trader, namely Primeline (Europe) Ltd. The primary facts upon the basis of which the Tribunal drew an inference of dishonest knowledge on the part of Primeline are to be found in paragraph 94 of the Decision, and may be summarised as follows:
- (a) Primeline obtained credit check reports in respect of traders recommending very modest credits, but nonetheless traded with them to the tune of many millions of pounds.
- (b) Primeline's turnover grew from some £13,000 odd in the year ending 2000 to £40.7 million odd in the year ending February 2006, and to £152.2 million odd in the three months ending May 2006.
- (c) A director had lied about having been given clearance to trade with another trader.

(d) Primeline had falsely represented the nature of its intended trade to HMRC when applying for VAT registration.

(e) A director of Primeline had previously failed to register for VAT as sole proprietor, despite having a liability to do so.

27. Again, these findings of primary fact were not challenged on appeal as unsupported by sufficient evidence. Mr Patchett-Joyce's case was that they did not, singly or collectively, permit a finding of dishonest knowledge on the part of Primeline. Again, he relied upon evidence that, like @tomic, Primeline had made a repayment claim during the relevant period.
28. Mr Patchett-Joyce's criticisms of the insufficiency of the primary facts in relation to Primeline were a little more focused than in relation to @tomic. He submitted that there was nothing sinister in Primeline's trading at very substantial levels with sellers for whom very modest credit references had been obtained, since such trading did not involve the extension of credit to those sellers. He submitted that the director's failure to register for VAT had occurred many years previously. Finally, he suggested that the extraordinary increase in Primeline's turnover during a short period might be attributable to an easing in the mobile phones market consequent upon a judgment of the Court of Justice relating to carousel fraud.
29. Taking those points individually there is some force in the first and second, but the third strikes me as pure speculation. I consider that, even taking the first and second points into account, there remained amply sufficient material by way of primary fact reasonably to permit a conclusion of dishonest knowledge on the part of Primeline, if the Tribunal exercising its decision-making function thought it right to do so. Accordingly, ground 1(4) also fails.

GROUND 3: "The Tribunal erred in law in failing properly to identify the fraud with which it must be established that the Appellant knew or ought to have known each of its Deals was connected"

30. This ground arose entirely out of the dicta of Lewison J in *Livewire* (*supra*) in connection with the requirement of HMRC to establish, in relation to contra-trading cases, that the broker (in the position of Megtian) knew or ought to have known that its transactions were connected with fraud. It was therefore limited solely to the three contra-trading transactions, rather than to the seventeen dirty chains in which Megtian was directly involved.
31. The issue addressed by Lewison J in *Livewire* concerned the nature of the fraud which it was necessary to demonstrate that the broker at the foot of a clean chain knew or ought to have known was connected with his transaction. In a contra-trading case there are, at least in theory, two potentially distinct frauds. The first is that of the missing or defaulting trader at the head of the dirty chain, who intends to abscond without accounting to HMRC for the tax paid to him by his immediate buyer. The second is that of the contra-trader who seeks to use the clean chain involving the broker as a means of dishonest concealment of the first fraud. As Lewison J put it, at paragraph 102:

"In my judgment in a case of alleged contra-trading, where the taxable person claiming repayment of input tax is not himself the dishonest co-conspirator, there are two potential frauds:

(i) the dishonest failure to account for VAT by a defaulter or missing trader in the dirty chain; and

(ii) the dishonest cover-up of that fraud by the contra-trader."

The issue for Lewison J was whether a disallowance of repayment of input tax claimed by the broker at the foot of the clean chain required it to be shown that he knew or ought to have known of both of those frauds, or merely one or the other of them. He concluded that the second of those alternatives was sufficient, at least in a case where dishonesty had been established as against the contra-trader.

32. Lewison J's conclusion is set out at paragraph 103 of the judgment as follows:

"Thus it must be established that the taxable person knew or should have known of a connection between his own transaction and at least one of those frauds. I do not consider that it is necessary that he knew or should have known of a connection between his own transaction and both of these frauds. If he knows or should have known that the contra-trader is engaging in fraudulent conduct and deals with him, he takes the risk of participating in a fraud, the precise details of which he does not and cannot know. As Millett J put it in *Agip (Africa) Ltd v Jackson* [1992] 4 All ER 385 at 406, [1990] Ch 265 at 295 (in the context of dishonest assistance in a breach of trust):

'... In my judgment, however, it is no answer for a man charged with having knowingly assisted in a fraudulent and dishonest scheme to say that he thought that it was "only" a breach of exchange control or "only" a case of tax evasion. It is not necessary that he should have been aware of the precise nature of the fraud or even of the identity of its victim. A man who consciously assists others by making arrangements which he knows are calculated to conceal what is happening from a third party takes the risk that they are part of a fraud practised on that party.'"

33. Mr Patchett-Joyce's submission under Ground 3 was that, in the light of Livewire, it was necessary in any case where a disallowance of input tax was to be made good as against the broker at the foot of the clean chain in a contra-trading case to demonstrate, and for the Tribunal on appeal to find, that the broker knew or ought to have known specifically of one or other of those two aspects of the underlying fraud. By contrast, Mr Patchett-Joyce submitted (correctly) that in the present case the Tribunal had addressed the question of what Megtian knew or ought to have known as a single question applicable both to the straight transactions and the contra-trading transactions, without any such specific analysis in relation to the latter. Mr Patchett-Joyce was quick to point out that it was understandable that the Tribunal took this course, bearing in mind that Livewire was decided shortly after it released its Decision in the present case. Nonetheless it was, he submitted, a fatal error of law, in relation to the contra-trading transactions.

34. I disagree. I do not read Lewison J's analysis of the issue as to what must be shown that the broker knew or ought to have known in a contra-trading case as amounting to a rigid prescription that, as a matter of law, such an analysis must be performed in every contra-trading case, such that it will be defective unless it identifies one or other of the alternative frauds as being that which the broker knew or ought to have known.

35. In the first place, Lewison J was, as he made very clear, addressing the question what had to be demonstrated against an honest broker who was not a dishonest co-conspirator in the tax fraud. In the present case, the Tribunal's conclusion, after hearing oral evidence from and cross-examination of Mr Andreou, Megtian's shareholder and principal manager, was that Megtian knew that the transactions on which it based its claim were connected with fraud: see paragraph 112 of the Decision. Participation in a transaction which the broker knows is connected with a tax fraud is a dishonest participation in that fraud: see below.

36. Secondly, Lewison J acknowledged that in many if not most cases of contra-trading, the clean chain and the dirty chain were likely to be part of a single overall scheme to defraud the Revenue. As he put it, at paragraph 109:

"Indeed it seems to me that the whole concept of contra-trading (which is HMRC's own coinage) necessarily assumes that to be so."

37. In my judgment, there are likely to be many cases in which a participant in a sophisticated fraud is shown to have actual or blind-eye knowledge that the transaction in which he is participating is connected with that fraud, without knowing, for example, whether his chain is a clean or dirty chain, whether contra-trading is necessarily involved at all, or whether the fraud has at its heart merely a dishonest intention to abscond without paying tax, or that intention plus one or more multifarious means of achieving a cover-up while the absconding takes place.
38. Similarly, I consider that there are likely to be many cases in which facts about the transaction known to the broker are sufficient to enable it to be said that the broker ought to have known that his transaction was connected with a tax fraud, without it having to be, or even being possible for it to be, demonstrated precisely which aspects of a sophisticated multifaceted fraud he would have discovered, had he made reasonable inquiries. In my judgment, sophisticated frauds in the real world are not invariably susceptible, as a matter of law, to being carved up into self-contained boxes even though, on the facts of particular cases, including Livewire, that may be an appropriate basis for analysis.
39. It follows in my judgment that the Tribunal did not in the present case make any error of law in approaching the question what Megtian knew or ought to have known on the general rather than segmented basis for which Mr Patchett-Joyce contends. Ground 3 accordingly fails.

GROUND 4 AND 5: "The Tribunal's conclusion that the Appellant knew that each of its Deals was connected with fraud was contrary to the evidence. The Tribunal's conclusion that the Appellant ought to have known that each of its Deals was connected with fraud was contrary to the evidence."

40. In the context of an appeal limited to matters of law, grounds framed in that way amount either to an assertion that there was no sufficient evidence upon which findings that Megtian knew or ought to have known of the connection between its transactions and fraud could properly be made, or that all the evidence was to the contrary. Nonetheless, Mr Patchett-Joyce opened his submissions on these two grounds of appeal (which he took together) with three quite separate matters of complaint. The first was that the Tribunal had failed with sufficient clarity to state whether its conclusion was that Megtian knew, or alternatively ought to have known, of the relevant connection between its transactions and fraud. The second was that it was not open to the Tribunal to find that Megtian knew (rather than merely ought to have known) of the connection, because an allegation of knowledge did not with sufficient clarity form part of HMRC's case before the Tribunal. Thirdly he submitted that the conclusion that Megtian knew of the connection was unsatisfactory because of the Tribunal's failure to identify with sufficient specificity the evidence upon which that finding was based.
41. It is important to bear in mind, although the phrase "knew or ought to have known" slips easily off the tongue, that when applied for the purpose of identifying the state of mind of a person who has participated in a transaction which is in fact connected with a fraud, it encompasses two very different states of mind. A person who knows that a transaction in which he participates is connected with fraudulent tax evasion is a participant in that fraud. That person has a dishonest state of mind. By contrast, a person who merely ought to have known of the relevant connection is not dishonest, but has a state of mind broadly equivalent to negligence.
42. The distinction between dishonesty and negligence is of fundamental importance, even in cases such as the present where proof of either of them will suffice for the opposing party's purpose. For that reason, an allegation of dishonesty in civil litigation

must be clearly and specifically pleaded, and, if the person against whom dishonesty is alleged gives oral evidence, it must be specifically put in cross-examination. These principles apply to all civil litigation, including tax appeals: see for example Revenue and Customs Commissioners v. Noel Dempster [2008] EWHC 63 (Ch).

43. The passage in which the Tribunal expressed its conclusions as to Megtian's state of mind is paragraph 112 of the Decision, which needs to be quoted in full:

"112. HMRC accepted there is no direct evidence that Megtian knew or must have known that the 30 transactions in question were connected with fraud. But we have no hesitation in finding that the cumulative effect of the evidence we have heard over eleven days of hearing and extensive examination of the documents placed before us in 41 lever arch files including the evidence we have summarised above but not limited to that evidence; has satisfied us that Megtian knew that the transactions were connected with fraud. Mr Andreou is a highly intelligent man and a very experienced businessman and so the case for a conclusion that Megtian ought to have known of those facts is strong. It is not therefore necessary for us to determine whether the test of what someone ought to have known is subjective or objective and whether it should take account of the person's experience and ability. Clearly if the correct test is that it should be viewed objectively the answer would be the same in this case."

44. It is in my judgment perfectly clear from that paragraph that the Tribunal concluded that Megtian knew that the transactions upon which it based its input tax claim were connected with fraud. The fact that the Tribunal also concluded, by way of alternative, that if such knowledge had not been established, the evidence would nonetheless have justified a conclusion that Megtian ought to have known of the connection with fraud in no way detracts from the clarity of its primary finding of knowledge.

45. Nor do I discern in that paragraph any disabling lack of precision in the Tribunal's identification of the primary facts upon which it based its inference that Megtian had the requisite knowledge. Those facts are set out in considerable detail in paragraphs 97 to 111 of the Decision, and are referred to in paragraph 112 by the phrase "including the evidence we have summarised above". The purpose of the Tribunal's reference to the cumulative effect of the whole of the evidence gathered from an eleven day hearing together with extensive examination of 41 lever arch files of documents was to show, perfectly properly, that it addressed the evidence probative of dishonest knowledge in the context of the whole of the evidence. It demonstrates not that the Tribunal kept up its sleeve other unspecified evidence as probative of knowledge, but that the Tribunal carried out its fact-finding function thoroughly, carefully and lawfully. It follows that the first and third of Mr Patchett-Joyce's preliminary objections fall away.

46. I was, initially at least, rather more troubled by his second point, to the effect that knowledge (as opposed to negligence) was not HMRC's case, so that it would have been improper for the Tribunal to determine the appeal by reference to a finding necessarily involving dishonesty which was neither pleaded nor put to the Appellant's witnesses. In paragraph 4 of the Decision the Tribunal said this:

"The case is one in which the respondents allege "MTIC" fraud has occurred and that the appellant should have known that each of the transactions in question was connected with fraud. The respondents did not make a specific assertion that the appellant knew of such fraud but did invite the Tribunal to make such a finding if the evidence justifies it."

47. If that had been the way in which the case had been pleaded and put by HMRC, there would in my judgment have been real substance in this objection, even though it did not form a specific part of the Grounds of Appeal. It was raised by Megtian's skeleton argument for this appeal, dated 26th February 2009, and was pursued more than once by Mr Patchett-Joyce in his oral submissions.

48. Mr Cunningham QC for HMRC (who also appeared before the Tribunal) told me that this passage in the Decision was by no means an accurate description of the way in which the case had been put against Megtian. He showed me the two letters in which HMRC disallowed Megtian's claims, he took me through the relevant parts of the Amended Statement of Case of HMRC, used before the Tribunal, to passages in the transcript of his Respondent's opening on the first day of the appeal, to passages in his cross-examination of Megtian's witness Mr Andreou, and to a passage in his closing submissions on the last day of the hearing.
49. Those references demonstrated to me that, from start to finish, HMRC advanced a case that Megtian knew that the transactions upon which it based its input tax claims were connected with tax fraud, and a case in the alternative that, if it did not know of the connection, it ought so to have known. Indeed, my reading of those materials is that HMRC's primary case was that, from start to finish, Megtian was a knowing participant in a contrived, pre-ordained series of transactions designed to achieve the evasion of tax rather than, as Mr Andreou maintained in his evidence (and upon which he was disbelieved) that those transactions were separate arm's length commercial deals negotiated with individual and independent traders in a competitive fast-moving market.
50. Mr Patchett-Joyce frankly and very properly acknowledged (so as to avoid a time consuming trawl through the transcript of the lengthy cross-examination of Mr Andreou) that a case that Megtian knew that the relevant transactions were connected with tax fraud, in the sense which I have just described, was properly put by way of cross-examination. No objection appears to have been taken at any stage in the proceedings to the repeated assertions on HMRC's behalf of a case of that nature, either during the opening, the cross-examination or the closing. In the circumstances Mr Patchett-Joyce's objection that a finding of dishonest knowledge was not open to the Tribunal is manifestly unsustainable, notwithstanding paragraph 4 of the Decision. It may be that this was a less than ideally worded reference to Mr Cunningham's frank acknowledgement in opening the case before the Tribunal that HMRC could not portray Megtian as itself an absconder, or as having dealt directly with the various missing traders, or as being the designer, orchestrator, ringleader or puppet master of the sophisticated fraud, viewed as a whole. But those concessions came nowhere near to the abandonment of the pleaded case that Megtian dishonestly participated in contrived transactions which it knew were connected with tax fraud.
51. I return therefore to the specific grounds that the Tribunal's finding of knowledge, and its alternative finding that Megtian ought to have known of the relevant connection between its transactions and tax fraud, were both contrary to the evidence. Mr Patchett-Joyce did not distinguish between those alternative findings in his analysis of the evidence, and nor shall I. His submissions included both detailed attacks on the legitimacy of the findings of primary fact identified by the Tribunal in paragraphs 97 to 111 of the Decision, and a general attack upon the legitimacy of using them, singly or in the aggregate, as the basis for an inference of the alternative states of mind of knowledge and negligence.
52. I wish to make it clear at the outset that Mr Patchett-Joyce's submissions, taken both singly and in the aggregate, came nowhere near persuading me that the Tribunal's findings as to Megtian's state of mind involved any error of law, as being contrary to the evidence in the relevant sense. There was in my judgment amply sufficient evidence to justify a rational, reasonable conclusion that Megtian knew that the transactions upon which it based its input tax claim were connected with a tax fraud and, *a fortiori*, that the circumstances were such in which, had it not known, it ought to have known of that connection. Nonetheless, out of respect for Mr Patchett-Joyce's detailed and industrious examination of the evidence, I shall follow him into some of that detail, in expressing my reasons for that conclusion.

53. The first factor upon which the Tribunal placed significant weight was the disparity between, on the one hand, Megtian's description, through Mr Andreou's evidence, of the nature of its trading in mobile phones and, on the other hand, the objectively ascertained facts about the chains to which Megtian was a party: see paragraphs 97 to 103 of the Decision. Mr Andreou's description portrayed each transaction as having been separately negotiated in a fast moving, volatile and competitive market through the application of hard work by Megtian's staff, building up trade connections that enabled Mr Andreou to find buyers and sellers. By contrast, the Tribunal referred to a number of features of the chains of transaction in which Megtian participated which suggested a very different reality. The particular features relied upon included:
- (a) Megtian's consistent achievement of large gross profits on every transaction, substantially higher than normally achievable in the relevant grey market.
 - (b) Minimal and sometimes consistent mark-ups, achieved in round figures by the buffer traders, in amounts which appeared to be unresponsive to the number and make of the phones in the different transactions.
 - (c) Substantial sales of phones in bulk to buyers outside the EU in countries for which the handbooks were in incorrect languages, and for which there were warranties incapable of being relied upon by buyers in those countries.
54. Mr Patchett-Joyce took issue with each of these findings. As to the profit margins made by Megtian on its deals, he submitted that the making of consistent profits was not of itself a badge of fraud, and that although there was evidence from HMRC's expert Mr Taylor that Megtian's gross margins were on the high side, the Tribunal ignored the unchallenged evidence to the contrary of Megtian's expert Dr Veljanovski.
55. It was common ground that Megtian's purchases and sales of each tranche of phones were effectively back to back: i.e. that it both bought and sold virtually simultaneously, and took no credit risk since sales were on "ship on hold" terms. The Tribunal's point was that it was on the face of it unlikely that a series of thirty transactions in a competitive volatile grey market on terms which involved the incurring of no significant risk by Megtian would yield uniform and substantial gross profits in the absence of some artificiality or orchestration. They found Mr Andreou's evidence to the contrary to be implausible.
56. I was shown the evidence of Mr Taylor which justified the Tribunal's finding that the gross margins achieved by Megtian were higher than normally available in the grey market. There was evidence that such margins could be achieved on purchases from manufacturers, due to the availability of manufacturer discounts, but such purchases did not form any part of the grey market transactions under review.
57. While it is true that Dr Veljanovski's evidence was not challenged by cross-examination, the passages in it to which I was taken appeared to me to consist mainly of broad generalisations about the grey market, rather than any specific challenge to the evidence of Mr Taylor upon which the Tribunal relied. There was therefore in my judgment evidence upon which the Tribunal could properly make the findings of primary fact about the surprisingly high level of Megtian's gross profit margins, and the improbability that such consistently high margins could be uniformly achieved over a chain of thirty large purchases and sales, had they been, as Mr Andreou insisted, separately negotiated with independent counterparties.
58. The Tribunal was criticised by Mr Patchett-Joyce for having described the buffer traders as "men of straw", on the basis that the only evidence precisely to that effect came from a generic description of the role played by buffer traders in MTIC fraud, rather than a description applied to the particular buffers with whom Megtian contracted. Furthermore, Mr Patchett-Joyce submitted that there was no evidence

that Megtian knew of the minimal and uniform round figure margins made by the buffers.

59. In my judgment these criticisms entirely miss the point. The Tribunal was contrasting Mr Andreou's description of vigorous negotiation in an open market with independent sellers on the one hand, with the unchallenged evidence provided by HMRC as to the precise margins made by each buffer in each chain with which Megtian was associated. Of course that evidence had been gathered by intensive forensic work by HMRC some time after the relevant transactions took place, and there was no direct evidence that Megtian knew what those buffers' margins were. Nonetheless the Tribunal was in my judgment perfectly entitled to contrast the known and uncontroversial facts about the chains of transactions involving the buffers, all of which pointed strongly to orchestrated structures in which the buffers played a purely automatic and prearranged part for minimal reward with, on the other hand, the vigorous open market peopled by independent traders in their own right portrayed by Mr Andreou. The reference to the buffers as "men of straw" was, I have no doubt, the Tribunal's phrase for persons playing a formal prearranged role, in stark contrast with independent traders seeking to maximise their own commercial advantage. If the buffers were no more than puppets, as the unchallenged statistical evidence shows, then there cannot have been the vigorous open market negotiation between them and Megtian which Mr Andreou attempted to portray.
60. Finally under this heading, Mr Patchett-Joyce made no significant inroads into the Tribunal's finding about substantial sales of phones with inappropriate handbooks and invalid warranties. He pointed to evidence that handbooks in almost any language for certain types of mobile phone can be found on the internet, and to the fact that buyers within the EU could avail themselves of Europe-wide warranty protection. I was wholly unpersuaded by the suggestion that the availability of an appropriate language handbook on the internet satisfactorily answered a case as to the limited marketability of mobile phones with handbooks unreadable in the country to which they were exported. Since large quantities of the phones were exported to countries outside Europe, the suggestion that some buyers could avail themselves of Europe-wide warranty protection went nowhere. The evidence of substantial sales of phones with limited marketability in the countries to which they were exported was amply sufficient to stand as an indication that the sales were part of an artificial scheme designed to achieve an ulterior purpose, rather than transactions typical of a successful entrepreneur in a vigorous and competitive market place. Each one of those facts could in my judgment properly form part of an aggregate of indicators pointing to a conclusion that Megtian's case as to the nature of its trading was untrue, and that the untruth could not be put down to an innocent mis-recollection, as opposed to a deliberate lie.
61. The next significant factor relied upon by the Tribunal consisted of evidence tending to show that Megtian obtained reports that its phones had been individually inspected before export for the purpose of seeking falsely to satisfy HMRC that its transactions were genuine, rather than for any legitimate commercial purpose: see paragraphs 104 to 108 of the Decision.
62. Statistical evidence about the volume of trading showed that it would have been necessary for its chosen inspection company A1 Inspection Limited to have inspected as many as 28,500 individual phone packages in a single day. The Tribunal were satisfied after seeing Mr Andreou give evidence that the falsity of reports to that effect should have been apparent to him, and that he paid for the reports as mere window dressing to satisfy HMRC, rather than as genuine certificates of the truth of their content.
63. Megtian did itself no good at the hearing before the Tribunal by seeking to rely upon the evidence of a Mr Hersh Patel, the manager of A1 Inspection Limited, to the effect that, for example, he employed a team of labourers to carry out the inspections, since

when cross-examined Mr Patel simply refused to answer for fear of incriminating himself.

64. Mr Patchett-Joyce's criticism of this finding was that, having employed an apparently reputable company to carry out the inspections, there was no basis upon which Megtian could properly have been fixed with knowledge of the falsity of its reports. In my judgment this submission wholly fails to address itself to the facts, firstly, that the Tribunal heard and disbelieved Mr Andreou's account of the matter, and secondly that Megtian's attempt to prove the authenticity of the inspection reports ended in something little better than farce. In my judgment the Tribunal was entitled to make the findings which it did about the inspection reports, and to rely upon those findings as probative of HMRC's case that Mr Andreou both paid for and then used those reports as a dishonest means of concealing from HMRC a fraud of which he was aware.
65. At paragraph 109 of the Decision the Tribunal found, in addition, that Megtian's records purporting to show the due diligence checks carried out in respect of each deal were so deficient as to suggest that the due diligence process was "partly at least a sham, intended to persuade HMRC falsely that Megtian had carried out proper inquiries when it had not". Mr Patchett-Joyce challenged that finding on the basis that the Tribunal had placed wholly undue weight on three small matters, and failed to weigh that evidence in the light of the substantial due diligence records maintained by his client at the relevant time.
66. These criticisms were again, in my judgment, misplaced. It is true that the Tribunal contented itself in a relatively terse description of this feature of the evidence with examples, rather than with a complete description of all the instances probative of a sham due diligence exercise revealed by a very long hearing, and the study of numerous documents. Mr Cunningham demonstrated in his reply that these were indeed just examples, and that others were to be found among the evidence, taken as a whole.
67. Nothing in the Decision satisfies me that the Tribunal ignored the evidence that Megtian performed a substantial number of due diligence processes and kept voluminous due diligence records. The Tribunal's finding was that this process was an elaborate sham, rather than it did not take place. In my judgment the Tribunal was entitled to reach that conclusion about the due diligence process, and made no error of law in doing so.
68. At paragraph 110 of the Decision the Tribunal described in considerable detail an episode during Mr Andreou's cross-examination in which, in the Tribunal's view, he accidentally revealed an awareness of the existence of the chains of which Megtian's transactions formed part. This was roundly challenged by Mr Patchett-Joyce as having been based upon a misconception as to Mr Andreou's meaning, and as being wholly insufficient to suggest that Mr Andreou was aware of any fraud. I was for that purpose taken almost line by line through the relevant part of Mr Andreou's cross-examination. This is to my mind a classic example of the difficulty facing an appeal court when asked to second guess the impression formed by the lower court of an important witness's oral evidence, even in a case unconstrained by the requirement to demonstrate an error of law.
69. I do not consider that it is possible for me to reach a different conclusion as to the inference properly to be drawn from this part of Mr Andreou's cross-examination, and even if I did, that would not of itself be sufficient to demonstrate that the view taken of that episode by the Tribunal was perverse, irrational or unreasonable. On any view Mr Andreou was evasive when pressed about the meaning of the phrase "everyone was still in the supply chain" which he had introduced on his own initiative. The relevance of the point was not that it constituted a direct admission of knowledge of fraud on his part, but that it was wholly in conflict with, and destructive of, the gist of

his evidence, to the effect that he had no idea what parties there were in any chain, other than Megtian's immediate supplier and purchaser. The Tribunal was in my judgment entitled to conclude that this episode was a factor (whether or not on its own a sufficient factor) pointing to a conclusion that Mr Andreou's evidence in response to cross-examination to the effect that he was a knowing participant in a fraud was not merely inaccurate, but deliberately untrue.

70. The last specific factor relied upon by the Tribunal and challenged on appeal was that described in paragraph 111 of the Decision, namely that in some cases Megtian dealt in very substantial sums with companies about which it had received reports from a reference agency called Veracis containing warnings about those companies, or statements that they were only good for very much smaller amounts. The Tribunal acknowledged in that paragraph that Megtian's terms of trading did not involve extending credit to those companies, but nonetheless concluded that the Veracis reports were sufficient to raise doubts in the mind of any honest trader as to the *bona fides* of the transactions, which Megtian ignored.
71. Mr Patchett-Joyce challenged this finding upon the basis of Mr Andreou's evidence that he knew enough about the counterparties with whom he traded, from his established dealings with them, not to have to be worried by apparently inaccurate warnings about them in the Veracis reports. To my question why should Mr Andreou pay for inaccurate reports which were, to his knowledge, not worth the paper they written on, Mr Patchett-Joyce replied that in order to satisfy HMRC about the legitimacy of import/export dealings with mobile phones, it was necessary to conduct due diligence even where it merely produced independent verification of that which the trader already knew.
72. To my mind, that explanation came perilously close to asserting that important aspects of Megtian's due diligence processes were merely designed to create window dressing. It is one thing to obtain reputable due diligence reports which confirm a trader's own belief about the *bona fides* of a counterparty. It is something else to obtain reports which contradict that belief, and yet to continue to trade with that counterparty, and to pay for continued reports from the same source. Accordingly, this challenge also fails.
73. If I had concluded that one or more of Mr Patchett-Joyce's criticisms of the specific factors which the Tribunal took into account in concluding that Megtian had the requisite knowledge of fraud was made out, it might have been necessary for me to consider whether the remainder, taken together with those factors relied upon by the Tribunal which were not challenged, nonetheless constituted a sufficient basis for its conclusion. Since I have however rejected each of Mr Patchett-Joyce's criticisms, it remains only to consider whether they did, taken in the aggregate, form a basis of primary fact upon which the Tribunal could, rationally and without error or law, infer that Megtian had the requisite knowledge of fraud. In my judgment the primary facts set out in paragraphs 97 to 111 of the Decision plainly constituted a sufficient evidential basis for that conclusion. It follows that Ground 4 fails in its entirety.
74. Furthermore, I consider that the same findings of primary fact plainly constitute a sufficient basis for the Tribunal's alternative conclusion that, if Megtian did not know that its transactions were connected with fraud, it ought so to have known. Taken together, the primary findings amount to a whole series of alarm bells which would have caused any honest and reasonable trader in Megtian's position to ask the most searching questions about the propriety of the transactions in which it was engaged and, in the light of what is now known about those transactions, Megtian could not possibly have obtained satisfactory answers to its inquiries.
75. For those reasons, Grounds 1, 3, 4 and 5 fail to constitute any basis for allowing the appeal. The merits of Grounds 2, 6 and 7 remain to be considered at a further hearing.