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VALUE ADDED TAX — input tax — right to deduct — dealer in mobile phones and computer chips — Commissioners contending that all chains of transactions in period of three months could be traced back to fraudulent tax loss — Appellant conceding tax losses occurred but denying knowledge or means of knowledge — whether warnings and information given by HMRC should have caused Appellant to recognise that none of its trade was untainted — yes — appeal dismissed

MANCHESTER TRIBUNAL CENTRE

MOBILX LIMITED (in administration)

Appellant

- and -

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

Respondents

**Tribunal: Colin Bishopp (Chairman)
Praful Davda FCA**

Sitting in public in London on 25 to 29 February and 3, 5 and 6 March 2008

**Philip Jones QC and Ruth Holtham, counsel, instructed by Dickinson Dees LLP,
for the appellant administrators**

**Mark Cunningham QC and Philip Moser, counsel, instructed by the Solicitor and
General Counsel for HM Revenue and Customs, for the Respondents**

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DECISION

Introduction

1. In three joined appeals the administrators of Mobilx Limited (“Mobilx”) challenge the Commissioners’ refusal to pay to Mobilx sums of input tax for which Mobilx claimed credit in its VAT returns for the months of April, May and June 2006. The aggregate amount in dispute is about £7.3 million; the precise measure of the claims was not an issue before us. Mobilx was, at the time, a dealer in mobile phones and computer chips, buying goods from other traders, like itself VAT-registered within the United Kingdom, and selling them to traders, some within other member States of the European Union and others elsewhere, principally in the United States. The refusal led to Mobilx’s ceasing to trade and to its being placed in administration.

2. During those three months Mobilx made 85 purchases of computer chips. The Commissioners’ case, shortly put, is that all of the goods had been the subject of earlier transactions whose purpose was the fraudulent evasion of tax, that Mobilx, through its directors, had the means of knowing of that purpose (actual knowledge was not alleged) and that its right to deduct the input tax it incurred is consequently lost. Mobilx accepts that, on the balance of probabilities, traders which preceded it in the chains of supply had failed, dishonestly, to account for the output tax due on their supplies and that in consequence tax was dishonestly evaded. It maintains not only that it did not know of that dishonest evasion but that it was an innocent trader engaged in what it believed to be legitimate transactions, that it did everything which could reasonably have been asked of it to ensure that it was not dealing in tainted goods, and that its claims cannot lawfully be refused.

3. Before us, the administrators were represented by Philip Jones QC, leading Ruth Holtham, and the Commissioners by Mark Cunningham QC, leading Philip Moser. We heard the oral evidence of Douglas Armstrong, one of the officers involved in the making of the decisions to refuse the payments requested and the author of the letters communicating those decisions, of Steven Bell, one of Mobilx’s directors, of Adam Thompson, a shareholder and former employee of Mobilx, and of Mark Hetherington, a senior manager employed by PricewaterhouseCoopers (“PwC”), who had acted as Mobilx’s VAT advisers during the period with which we are concerned. We had statements from each of those witnesses other than Mr Hetherington, which set out their evidence in chief, and also the statements of several further witnesses who were not called to give oral evidence: Catherine Prickett and Lisa Orr, both HMRC officers; Stuart Bell, Steven Bell’s father and Mobilx’s other director; Stanley Bell, Stuart Bell’s brother and Steven Bell’s uncle, who is a chartered accountant and whose firm acted as Mobilx’s auditors until Stanley Bell joined Mobilx as a full-time employee; John Robert, Philippa Bernard, Adam Ford and James Siddy, all former employees of Mobilx; and Debra Box, an employee of N F Smith & Associates LP, a customer of Mobilx in the United States.

4. We were also provided with the statement of Roderick Stone, a senior HMRC officer with responsibility for the Commissioners’ approach to what is

commonly known as MTIC fraud. It had been directed that the Commissioners should serve the statements of those witnesses on whose evidence they intended to rely first, that the administrators should follow, and that the Commissioners should then be at liberty to serve further statements in response. Mr Stone's statement was served at that final stage. Mr Jones objected to our admitting Mr Stone's evidence and a second statement made by Mr Armstrong, also produced at the final stage, and, with them, to the Commissioners' intention of pursuing an argument that Mr Thompson should be treated as a *de facto* director of Mobilx.

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5. We dealt with his objections immediately after Mr Cunningham's opening and before we heard any evidence, and we do not need to set out the details now. It is sufficient to record a short outline. We did not allow the Commissioners to advance the argument that Mr Thompson should be treated as if he had been a director of Mobilx. In the statement of case and in Mr Armstrong's first statement it was clearly asserted that he was a shareholder and no more; in our view it was far too late to argue a different case, first raised no more than two weeks before the hearing began. Mr Cunningham agreed not to rely on substantial parts of Mr Stone's evidence. We concluded that, once we had decided to exclude the argument about the treatment of Mr Thomson and the relevant parts of Mr Stone's statement, nothing of substance remained which could not properly be regarded as evidence in response, or which was in some other objectionable manner prejudicial to the administrators.

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6. We were provided with a considerable volume of documentation, extending to over 50 ring binders and lever arch files. During the course of the hearing we were referred to fewer than ten of those files. Though it is right to record that reference to much of the documentation became unnecessary because of concessions and agreements between the parties, and that, between the parties to appeals of this kind, the process of disclosure should be comprehensive, we urge much greater selection, in the interests of economy and manageability, of the documents which find their way into trial bundles. The fact that a document has been disclosed does not imply that it must necessarily be included in those bundles.

MTIC trading and the law

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7. The nature of MTIC (or "missing trader intra-community") trading and its variant, or adjunct, contra-trading, is described in some detail in *R (Just Fabulous UK Ltd) v HMRC* [2007] EWHC 521 (Admin) and will be familiar to most readers of this decision. 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 its sale, either by "going missing" or by 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 a "broker", account correctly for the output tax due on their 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, as Mobilx did in this case, payment
5 from the Commissioners of input tax credit generated by its purchase. Contra-trading consists of a series of transactions, similar in character save that none of the participating traders defaults, which is designed to create the illusion of genuine trading and also to manufacture for the broker in a fraudulent chain an output tax liability, matched by an input tax credit elsewhere, against which it can
10 offset the input tax credit generated in the fraudulent chain, which might otherwise be refused. For the schemes to work, all of the participants, which are almost invariably limited companies, must be VAT-registered, or must have hijacked a genuine registration.

8. In principle the broker is entitled to the payment it claims, by virtue of
15 section 26 of the Value Added Tax Act 1994; but there is an exception, on which the Commissioners rely in this case. In *Axel Kittel v Belgian State* and *Belgian State v Recolta Recycling SPRL* (Joined Cases C-439/04 and C-440/04) [2006] ECR I-6161 the Court of Justice said, after reviewing its earlier jurisprudence in cases in which participation (knowing and unknowing) in fraudulent transactions
20 was alleged, at paragraph 51 of its judgment, that

“... traders who take every precaution which could reasonably be required of them to ensure that their transactions are not connected with fraud, be it the fraudulent evasion of VAT or other fraud, must be able to rely on the legality of those transactions without the risk of losing the right to deduct the input VAT ...”

25 9. However, at paragraph 61 it qualified that statement:

“... where it is ascertained, having regard to objective factors, that the supply is to a taxable person who knew or should have known that, by his purchase, he was participating in a transaction connected with fraudulent evasion of VAT, it is for the national court to refuse that taxable person entitlement to the right to deduct.”

30 10. As we have said, the Commissioners do not go so far as to allege actual knowledge on Mobilx’s part of the fraudulent purpose behind some or all of the antecedent transactions in the relevant chains but they do argue that it could, or should, have known of that purpose. The essence of the dispute between the parties is whether Mobilx took precautions of the standard described at paragraph
35 51 of the judgment, and whether the Commissioners are right in their view that the information available to Mobilx was such that its directors should have realised that the transactions into which it entered in the relevant months were likely to be connected with fraud, with the consequence that paragraph 61 of the judgment must be heeded.

40 11. Further comments on the test set out in paragraph 51 of the judgment are to be found in *Just Fabulous*, in *Dragon Futures Ltd v HMRC* [2006] V & DR 348 and in *Calltell Telecom Ltd and another v HMRC* (2007, Decision 20266). Since there was no dispute between the parties about the nature of the test—the disagreement related to its application—it is sufficient to record for present
45 purposes that it imposes on a trader the obligation to take “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” (see *Dragon Futures*, paragraph 75) and a “positive duty to take precautions” (see *Calltell*, paragraph 46). We should add that Mr Jones did not seek to challenge the conclusion expressed in both *Dragon Futures* and in *Calltell* that the relevant fraud need not have been committed by another trader with which the trader in question had a direct contractual relationship.

12. As is now customary in cases of this kind, the Commissioners led their evidence first, but as many of the facts relevant to these appeals were not in dispute we shall set them out, chronologically, without regard to the sequence of the witnesses and, often, without identifying the evidence from which they are derived. Where, however, there was an area of contention we shall deal with the evidence in detail. It is necessary to set out the history at some length since a great deal depends on what Mobilx’s directors knew, or could reasonably have known, in April, May and June 2006 against the background of over two years’ experience of trade.

The background to Mobilx’s trading

13. Mobilx was incorporated on 16 September 2003. Its directors at all material times were Stuart and Steven Bell, who initially also each held half of the 1000 issued shares. Stuart Bell’s experience was in accountancy and financial services; he had most recently been a mortgage broker. Steven Bell had a background in the mobile phone business, in which he had been engaged almost continually since he left university in 1998. For some of that period he had managed a subsidiary of Carphone Warehouse Limited (“CPW”); later, he worked part-time, as a consultant, for a company called Sound Solutions Limited (“Sound Solutions”). According to Steven Bell’s statement, Sound Solutions was a producer of sound deadening equipment and a customiser of vehicles, installing mobile phones and music equipment. It wished to expand its activities and, through Steven Bell’s intervention, aided by his prior employment by CPW, it began to buy second-hand phones from CPW, which had accepted them in part exchange from customers who wished to obtain newer models. Sound Solutions initially sold the phones on within the UK. In early 2003 it began selling the phones to overseas customers, particularly in developing countries. There was, Steven Bell said, a thriving market for second hand phones (some of which first needed refurbishment) in developing countries, since new handsets were prohibitively expensive for most customers. Mr Bell was, he said, instrumental in developing that trade. In the course of his work he visited trade fairs where, as well as dealers in mobile phones, he met representatives of Smith & Associates (“Smith”) and Converge Inc (“Converge”), American companies whom he identified as suppliers of components to computer manufacturers. Although one forms the impression from Mr Bell’s statement that the business was profitable, he said that Sound Solutions soon lost interest in it with the result that by late summer 2003 CPW was beginning to look for other purchasers. We add in passing that Sound Solutions does not seem, at this time, to have dealt in CPUs or other computer components.

14. Both Steven and Stuart Bell gave up most of their other business activities when Mobilx was formed. Steven Bell indicated in his statement that he intended

that Mobilx should replace Sound Solutions as the purchaser of CPW's used phones, and develop that business by, if possible, entering into similar purchasing contracts with other retail chains. He discussed the idea with his father, who agreed to join him in the venture. Stanley Bell was at no time a director or shareholder of Mobilx, but the firm in which he was a partner became its auditors. In 2005 Stanley Bell retired from his former firm and began to work full time for Mobilx.

15. Mr Thompson was employed by Sound Solutions at the time when Steven Bell was engaged by it as a consultant, and they struck up a friendship. Mr Thompson remained at Sound Solutions when Steven Bell severed his own relationship with it, but there was an understanding between them that Mr Thompson would join Mobilx if the company was successful. In fact, Mr Thompson left Sound Solutions to become an employee of Mobilx as early as February 2004; he was not appointed a director but each of Stuart and Steven Bell transferred a quarter of their shares to him, so that they were left with 37.5 per cent holdings, and Mr Thomson had a 25 per cent shareholding. From that time on, Steven Bell dealt with sales, Mr Thompson with purchases and Stuart Bell with administration.

Mobilx's application for VAT registration

16. On 15 October 2003 Mr Hetherington submitted an application for registration for VAT on Mobilx's behalf. The application indicated that Mobilx intended to engage in the "wholesale distribution and export of mobile phones". In his covering letter accompanying the application Mr Hetherington made it clear that the company was aware that HM Customs and Excise ("HMCE"), HMRC's predecessor, was monitoring the trade in mobile phones because of the incidence of fraud, and that Mobilx was conscious of the provisions of section 77A of the Value Added Tax Act 1994 (to which we shall return), but explained why it had decided to embark on the proposed activity, and emphasised that Steven Bell (described as the "principal director") had considerable experience of the trade. The letter hinted that sales were to be made to emerging markets (Latin America was mentioned, though in Steven Bell's evidence the proposed purchasers were said to be in South Africa and China), rather than within the European Union, but the application form itself had been completed to show that there was expected to be trade with other EU countries of about £18 million a year. The letter also stated that, once registered for VAT, Mobilx expected an aggregate monthly turnover of about £3 million. A request that Mobilx be permitted to make monthly returns was added.

17. In his statement, Steven Bell gave some background to the request that Mobilx might be allowed to submit its returns monthly. Its being able by that means to recover the repayments of input tax which Mobilx expected to claim in each return meant it would need to borrow less money in order to finance its intended trade. He and his father had injected sufficient ordinary working capital from their own resources, but the proposed trade had a significant cash flow implication, since Mobilx would need to pay VAT on the cost of the supplies it received, but would charge no VAT on its export of the phones; consequently it would need to borrow in order to finance what can conveniently be called the

“input tax cost” until the repayment claims made in its VAT returns were met. Stuart Bell had arranged a suitable borrowing facility, but understandably the directors wished to minimise the borrowing and, with it, the interest Mobilx would be required to pay. Steven Bell’s statement indicates that he did not consider that acceptance by the Commissioners of monthly returns would have any effect on Mobilx’s turnover, which would be limited by the number of used phones CPW had for sale.

18. Against that background it seems to us distinctly odd that Mr Hetherington made no mention of CPW or of Mobilx’s intention to deal only in used phones in either his letter which accompanied the application or his subsequent response to HMCE’s enquiries. A clear statement that Mobilx intended to confine itself to purchases of used phones from substantial retailers might have led not only to rapid acceptance of the application for registration, but also to the concession of monthly returns as Mobilx had requested.

19. As it was, the application was not immediately accepted; HMCE raised some enquiries to which Mr Hetherington responded. He provided the names of, and some documents relating to, three potential UK suppliers and two possible overseas customers, and some material about Mobilx’s proposed funding. We observe in passing that none of the possible suppliers was a high street retailer, one dealt in CPUs but not phones, while another did not indicate in its letter the nature of the goods in which it dealt, and the possible customers were in South Africa and Hong Kong respectively. It appears that Mobilx did not in fact trade at any time with any of those potential suppliers and customers. Steven Bell indicated in his statement that Mobilx did not, at that time, intend to trade with the suppliers (he did not mention the prospective customers) but that they were possible alternative suppliers if trade with CPW did not develop as Mobilx hoped, and that HMCE had been made aware that this was the case.

20. HMCE remained unsatisfied and a meeting was arranged to take place on 17 November 2003. It was attended by Stuart and Steven Bell, Mr Hetherington and one of his colleagues, and by two HMCE officers, one of whom was Bob Martin. We were provided with notes of the meeting, and copies of reports Mr Martin prepared afterwards. Mr Martin remained the officer responsible for Mobilx’s relations with HMRC for most of the period with which we are concerned, until he went on extended sick leave, and Mr Armstrong took over from him for the period from June 2004 to July 2005, though he remained involved in Mobilx’s affairs thereafter and, as we have mentioned, wrote the letters communicating the disputed decisions. Mr Martin has, we are told, returned from sick leave and it is a matter of some surprise that we had no statement from him, and that he was not offered as a witness, since much of Mr Armstrong’s evidence, which related to the entire history of Mobilx’s relations with the Commissioners, was necessarily derived from notes of meetings he had not attended or of telephone conversations to which he was not a party, and from letters he had not written himself. It is perhaps fortunate in those circumstances that Mr Martin’s notes were, for the most part, agreed to contain a fair record of the various discussions which took place between Mobilx and HMCE and, later, HMRC.

21. It is apparent from his minutes and notes of the meeting of 17 November 2003 that Mr Martin was told of the directors’ intention that Mobilx would do as

we have already indicated, that is buy used handsets from CPW and other well-known retailers (if it could: it was said that others had been approached though with what result is not recorded) and sell them initially to customers in China and South Africa, though sales elsewhere, including within the EU, were a future possibility. Mr Martin became aware at the meeting of the introduction of business of this kind to Sound Solutions by Steven Bell, as we have related, that he had been paid by Sound Solutions on a commission-only basis, and that he now wished to exploit the connection himself. The trade was attractive, it was said, because very large quantities of second-hand phones were available and, since the purchasers were willing to pay for the phones before delivery, and CPW would accept payment when Mobilx had itself been paid, the capital required to finance the trade itself was modest enough for the directors to be able to provide it from their own resources. The reasons why Mobilx was anxious to make monthly returns, which we have already set out, were explained. Mobilx's directors emphasised their awareness of the potential for fraud, and their anxiety that Mobilx should not be caught up in it.

22. Despite those assurances Mr Martin's notes reveal that he still had significant misgivings about what he had been told, and was not altogether convinced that the description of the proposed trade he had been given was plausible. He was concerned too about the risk that, once it had a VAT registration, Mobilx would embark on different trading activities. He accepted, however, that Steven Bell had experience in the trade and that, if Mobilx undertook business in the manner which it had represented, there would be little risk of fraud. Whatever the strength of Mr Martin's concerns, Mobilx was registered for VAT on 27 November 2003, but with effect from 1 October.

Section 77A and Public Notice 726

23. On 8 December 2003 Mr Stone sent a letter, in a standard form, to Mobilx, reminding it of the Commissioners' efforts to counter fraud in the industry, and explaining a change in the manner in which traders were expected to verify the VAT registrations of their intended suppliers and customers. The requirement, or at least strong recommendation, that other traders' VAT registrations be verified stems from the Commissioners' Public Notice 726. That notice, issued in August 2003, dealt with the then recently introduced section 77A of the Value Added Tax Act 1994, by which a trader in "specified goods" could be treated as jointly and severally liable, with others who had dealt in the same goods, for any VAT which should have been, but which had not been, accounted for to the Commissioners, if, as subsection (2)(b) puts it, "at the time of the supply [he] knew or had reasonable grounds to suspect that some or all of the VAT payable in respect of that supply, or on any previous or subsequent supply of those goods, would go unpaid".

24. Although Mobilx was reminded, repeatedly, of the possible application to it of the provisions of section 77A, they were never in fact applied to it and there was nothing before us to suggest that the Commissioners ever seriously contemplated adopting that course. Mr Armstrong told us that, so long as Mobilx undertook reasonable due diligence enquiries the Commissioners' view was that they could not apply the joint and several liability provisions to it. Despite that view, there is a close similarity between the test set out in subsection (2)(b) and

that later described in *Kittel*—indeed, the parties agreed that, for present purposes, there is no material difference between the two tests—and much of what appears in the Notice is of relevance to this appeal. The Notice offers guidance to traders in computer components and mobile phones (both of which fell within the description of “specified goods” adopted in section 77A and in the Notice) about what they should do in order to protect themselves, and to avoid becoming involved in chains of transactions in which fraud has occurred; and it also sets out some limits on the scope of the checks HMCE expected traders to undertake.

25. At paragraph 2.1 the Notice sets out, in summary form, the conditions on which joint and several liability might be imposed on a trader, making it clear that knowledge not only of the trader’s own transactions, but also of “any previous or subsequent supply” would be taken into account. Paragraph 2.4 expanded on the conditions, as HMCE intended to apply them:

“You may be held jointly and severally liable for the net tax charged on specified goods if we consider that you ‘knew’ or ‘had reasonable grounds to suspect’ that the VAT on the supply of those goods would go unpaid and you have been served with a notification letter ... In determining whether to serve a notice of liability we will take into account whether you have taken reasonable steps to verify the integrity of your supply chain or any other factors you feel should be brought to our attention. Where we are not satisfied, we may serve you with a notice of liability under which we will hold you jointly and severally liable for the unpaid tax in the supply chain. We will use this measure to combat MTIC fraud ...”

26. Later parts of the Notice deal with the precautionary steps which, it is suggested, traders should take. In section 4, headed “Applying joint and several liability for VAT unpaid on the supply of specified goods”, appear the following passages:

“4.4 How can I avoid being caught up in MTIC fraud?”

It is in your interests to carefully check who you are dealing with. In order to help you avoid being unwittingly caught up in a supply chain where VAT goes unpaid, this notice contains examples of reasonable steps you can take to establish the integrity of your customers, suppliers and supplies.

4.5 What are ‘reasonable steps’?

We advise you to carry out checks to establish the legitimacy of your supplier to avoid being caught up in a supply chain where VAT would go unpaid. There are a number of checks that you probably already undertake in line with good commercial practice such as credit checks. We do not expect you to go beyond what is reasonable. You are not necessarily expected to know your supplier’s supplier or the full range of selling prices throughout your supply chain. However, we would expect you to make a judgement on the integrity of your supply chain.

Factors you may wish to consider include:

- the type and level of checks you carried out to establish the integrity of the supply chain and the action you took as a consequence of those checks;
- the nature of the supply;
- aspects of payments arrangements and conditions; and
- details of the movement of goods involved.

You can find examples of checks at section 8.

4.6 Can you tell me exactly what checks I should undertake?

5 No. The checks contained in this notice are guidelines for the kind of checks you could make to help avoid dealing with high-risk businesses and individuals. The checks you will need to make, and the extent of them, will vary depending on the individual circumstances of your trade and you are free to ask the most appropriate questions required to protect you in the particular circumstances of your individual transactions. A definitive checklist would merely enable fraudsters to ensure that they can satisfy such a list ...

10 4.9 Are there any exceptions?

... If you have genuinely done everything you can to check the integrity of the supply chain, can demonstrate you have done so, have taken heed of any indications that VAT may go unpaid and have no other reason to suspect VAT would go unpaid, the joint and several liability provision will not be applied.”

15 27. As paragraph 4.5 indicates, suggested checks are to be found in section 8 of the Notice. They include verification of suppliers’ and customers’ VAT registration details with HMCE, as well as various other commercial checks. The list of possible checks is divided into two sections, headed “Checks you can undertake to help ensure the integrity of your supply chain” and “Checks carried out by existing businesses”, though the reason for the segregation is not obvious. 20 The former heading is followed by the words “The following are examples of checks you may wish to undertake to help establish the integrity of your supply chain” and the latter by the words “The following are examples of specific checks carried out by existing businesses. These may also help you to decide what checks you should carry out, but this list is not exhaustive and you should decide what checks you need to carry out before dealing with a supplier or customer.”

28. We mention at this point that, as Mr Cunningham was to emphasise, the Notice refers repeatedly to the trader’s “supply chain”, and not merely his immediate supply. On the other hand, the suggested checks are, as a matter of practicality, limited to the immediate supplier and customer. 30

29. Although the Notice made it clear that the suggested checks were not mandatory, and—as Mr Armstrong had told us was the Commissioners’ policy—that the provisions of section 77A would not be applied to any trader who took reasonable precautions, one particular check—of intending counterparties’ VAT registrations—was, in practice, regarded as indispensable. (Perhaps surprisingly, verification of VAT registrations appears in the second rather than the first of the categories of checks suggested at section 8 of the Notice). By the time Mobilx began to trade (coincident with Mr Stone’s letter), verification of another trader’s VAT registration had to be undertaken by enquiry of the Commissioners’ office at Redhill; usually the check was designed to discover whether the name, address and registered number supplied by the trader corresponded with the Commissioners’ records. HMCE had strongly recommended the making of such enquiries for some time before the publication of Notice 726. Mr Hetherington and, whether through him or by other means, Mobilx’s directors were well aware before Mobilx was registered for VAT that even if such verification was not mandatory, a persistent failure to undertake it would be likely to attract adverse comment, if not worse. 45

30. The Commissioners accept that Mobilx did check the VAT registrations of its prospective suppliers, and that the other due diligence it carried out into its suppliers and customers was reasonable, and better than that carried out by most other traders in mobile phones and computer components: it was, as Mr
5 Cunningham put it, “at the better end”, and he did not identify, or rely on, any inadequacies in it. The due diligence Mobilx carried out, however, went no further than its immediate suppliers and customers. Mr Cunningham was to argue that due diligence limited in that way was not enough when Mobilx knew, from what
10 it was told by the Commissioners, that it was dealing in goods which had been the subject of prior fraudulent transactions; Mr Jones retorted that Mobilx had followed not only the suggestions of the Notice but also all the other suggestions which the Commissioners had made during its trading life, and could realistically do no more. We shall return to these arguments.

The start of Mobilx’s trade

15 31. Mobilx was told, when it was notified that it had been registered for VAT, that its first return, covering the period from 1 October 2003 to 29 February 2004, was due to be submitted by 31 March 2004; thereafter it was to submit returns at three-monthly intervals. Its request that monthly returns be permitted had, therefore, been refused. The initial requirement was almost immediately amended;
20 the first return was to cover the months of October, November and December 2003, but the requirement of subsequent three-monthly returns remained. The first return was in fact submitted on 7 January 2004. There was then an agreed change of stagger, so that the next return covered January and February 2004, with three-monthly returns to follow.

25 32. All of Mobilx’s transactions in the period covered by its first return took place in December 2003—understandably so in view of the date on which its VAT registration was actually effected. We use the term “transaction” to mean a matched purchase and sale, since Mobilx habitually bought only goods for which it had already secured a customer—its case was that it always “sourced” goods to
30 its customers’ requirements, and did not carry stock. Mobilx had entered into four transactions, two relating to consignments of used phones bought from CPW and sold to United Kingdom customers, and two relating to consignments of computer chips—CPUs—bought from Syskal Distribution Ltd (“Syskal”), a UK supplier; one consignment was sold to Smith and the other to Converge.

35 33. Mobilx entered into five transactions in January 2004, all of which related to second-hand phones. Only one consignment was exported; three were sold to Sound Solutions. In February, there were only three transactions, one in respect of CPUs sold to Smith, and two in respect of second-hand phones sold within the UK. In March there were two transactions in respect of CPUs, and one in respect
40 of new phones, and in April Mobilx undertook only two transactions, both relating to used phones; one consignment was sold to Sound Solutions and the other to Global Trading International Ltd, another UK trader. We comment in passing that the sale to Sound Solutions is odd if, as Steven Bell said, Sound Solutions had lost interest in the trade. Thereafter, Mobilx entered into only one transaction in
45 respect of used phones (in June 2004), one in respect of refurbished phones, one in respect of a product identified as “I-Mate” and another in respect of “Pen

Drives” until 25 April 2006, when it began trading in new phones. Every other transaction between May 2004 and 25 April 2006—of which there were several hundred—consisted of a purchase and matched sale of CPUs.

5 34. On 8 January 2004, the day after its first VAT return was submitted, Mr Hetherington wrote again to HMRC, repeating the request that Mobilx be permitted to make monthly returns. The request was refused, by a letter of 4 February, whose author (not Mr Martin) expressed the view that the one return which had then been submitted could not be taken as representative, and that
10 though he added that the request would be kept under review. Undaunted, Mr Hetherington arranged a meeting to discuss the matter with Mr Martin, which took place on 12 February. Steven and Stuart Bell and another HMCE officer, Suzanne Hurst, from whom we also had no statement, attended as well. Mr Martin’s notes show that the discussion at the meeting focused on transactions in used phones,
15 though trade in CPUs was mentioned; Ms Hurst told Mobilx that the two transactions in CPUs which Mobilx had undertaken in December were being investigated. The point was made for Mobilx, repeatedly, that the refusal to accept monthly returns was adversely affecting its ability to trade; yet it was also said (according to Mr Martin’s notes, and consistently with Steven Bell’s statement)
20 that if HMCE agreed to allow Mobilx to submit monthly returns, the volume of its trade would not increase as a result.

35. On the following day Ms Hurst wrote to Mobilx, commenting again on the scale of fraud within the mobile phone trade, and stating that there were some concerns about traders in the chains of supply of the CPUs which Mobilx had
25 handled in late 2003, although the repayment claimed in its return for the period had been made. Monthly returns were not refused in so many words, but that was the effect of the letter. Both Steven Bell and Mr Hetherington wrote yet again, in the hope of persuading HMRC to agree to accept monthly returns, but they did not receive a substantive reply until 28 April, when Mr Martin wrote pointing out that,
30 despite the assurances given by Mobilx when it began trading, and its claim that it would confine itself to purchases of second-hand phones from large retailers since it was anxious to avoid being caught up in fraudulent trade, it had already dealt in CPUs. One of its December 2003 purchases, he said, had now been traced back to a defaulter. Permission to make monthly returns was again refused.

35 36. The matter rested with Mr Martin’s refusal of 28 April 2004 until 12 July, when Mr Hetherington wrote again. He complained that Mobilx had lost its contract with CPW because it was unable to guarantee a regular supply to its South African customer. The reason was not spelt out at the time but it can be
40 inferred from the context that Mobilx was complaining that it was unable to carry the input tax cost of the trade from its own resources and its available borrowing facility. We observe in passing that Mobilx had sold only two consignments of used phones (out of the overall total of 12 such consignments it handled) to a South African customer: most had been sold to UK traders, including Sound Solutions. Coincidentally a meeting took place on the same day between Stuart
45 and Stanley Bell and Mr Martin and Mr Armstrong, who appears to have become involved in Mobilx’s affairs for the first time at this stage, when the fact that Mobilx was now concentrating on transactions in CPUs, and had effectively

abandoned any hope of dealing in second-hand phones, was made clear. Mr Martin indicated in a subsequent letter that his superior officer, Barry Johnson, would reconsider the request that Mobilx be permitted to make monthly returns in September.

5 37. On 14 September Mr Johnson and Mr Martin met Mr Hetherington and
Stuart and Stanley Bell. Mr Martin told the Bells that HMRC had investigated the
chains of transactions in the CPUs which Mobilx had bought and sold in May and
June 2004. There were 24 such chains; in 17, a defaulter had been found and, Mr
10 Martin said, there were concerns about four of the remaining chains. The other
three were still under investigation. In those circumstances permission to make
monthly returns would not be granted. The Bells and Mr Hetherington are
recorded to have expressed disappointment—not that so many defaulters had been
15 identified, but because the refusal of the request meant (contrary to what had been
said before) that the scale of Mobilx’s trade would be restricted. Mr Hetherington
agreed, when he gave evidence, that what he learnt at the meeting was
“disastrous”. When Steven Bell gave oral evidence he was asked, by Mr
Cunningham, what his own reaction had been when the outcome of the meeting
20 was conveyed to him. He too expressed disappointment; though he claimed that
he was disappointed that so many defaulters had been discovered we are satisfied
from the manner in which he gave this evidence and from the persistence with
which the request that monthly returns be accepted was pursued at that time, and
despite the discovery of so many defaulters, that the true cause of his
disappointment then was that Mobilx’s request had again been rejected.

25 38. Mobilx’s return for the three months ended on 30 September was submitted
in early October. Details of the transactions covered by it, or at least those which
occurred in July and August, had been supplied to HMCE some time before. On
12 October 2004 Mr Armstrong told Stuart Bell, in a telephone conversation in
which Mr Bell was seeking early payment of the sum claimed in that return, that
30 of Mobilx’s eight transactions in July, four had been fully traced, all to defaulters,
and of its 17 August transactions, seven had been fully traced, all to defaulters.
The September transactions had not yet been traced. Mr Bell is recorded to have
asked whether repayments of input tax would be made even if defaulters were
found. We recognise that we have only Mr Armstrong’s note and did not hear oral
evidence from Mr Bell, but it is conspicuous that he is, again, not recorded to have
35 expressed any regret or concern that so many defaulters had been identified.

39. Mr Hetherington’s efforts to persuade HMCE to agree to accept monthly
returns continued. On 22 December he wrote to Mr Johnson complaining that
written reasons for the rejection at the September meeting of Mobilx’s request had
not been given; Mr Johnson replied on 17 January 2005, commenting that a
40 change to monthly returns might expose the Commissioners to an unacceptable
level of risk. His letter, again, did not refuse the request outright, but stated that it
remained under consideration. He expressly disavowed any allegation that Mobilx
was knowingly involved in fraudulent chains of transactions, but also pointed out,
as a material factor, that every one of those of Mobilx’s chains in May, June, July,
45 August and September 2004 which had been fully traced led back to a defaulter.

40. Mr Hetherington replied on 8 February, commenting that Mobilx’s
December 2004 repayment claim had been met and repeating, yet again, the

5 “We have noted the number of missing traders quoted in your letter dated 17
January 2005 but given the detailed checks that Mobilx undertake we do not
understand why the failings of other parties should continue to hinder Mobilx’s
ability to carry out legitimate business activities. In addition, we consider the
introduction of the Joint and Several Liability provisions in Section 77A, VAT Act
1994 with effect from 10 April 2003 provides adequate protection for Customs in
relation to revenue at risk from carousel fraud. However, Mobilx are happy to
10 assist Customs in their attempts to tackle carousel fraud and will implement any
additional due diligence checks which Customs consider to be necessary in relation
to Mobilx’s transactions and will, if required, provide detailed information on a
daily basis to Customs to assist the process of verifying transactions and quicken
the process of identifying rogue businesses.”

15 41. Mr Johnson responded, after a reminder, to the effect that he was in the
process of reviewing the request. He indicated that a decision should be made by
the end of March 2005, but it did not materialise and on 13 April Mr Hetherington
wrote instead to Mr Armstrong, demanding a prompt decision, and providing
some further information about Mobilx’s new banking arrangements which,
20 among other things, would enable it to access much larger funds at a considerably
better rate of interest than that it had previously been paying, extolling the quality
of its due diligence, and enclosing a list of Mobilx’s competitors which were
known to it to be making monthly returns. The request that Mobilx be permitted to
do so was finally granted on 3 June 2005, by Mr Johnson. Mr Armstrong told us,
25 in his oral evidence, that he did not agree with the decision, and attempted to
persuade Mr Johnson not to accept monthly returns because he considered the risk
to be too great, but to no avail.

42. Mobilx’s first monthly return covered June 2005. On 7 July 2005,
apparently before the return had been submitted, Mr Armstrong and Mr Martin
30 visited Mobilx to pick up the underlying accounting documents, from which they
intended to investigate the chains of transactions, and took the opportunity of
mentioning that HMRC (as the Commissioners had now become) had discovered
that some of the CPUs in which Mobilx had dealt in previous months had entered
the UK more than once, an indication that they had been used for fraudulent
35 purposes. The affected CPUs were identifiable because the boxes in which they
were packed bore Customs stamps. Steven Bell accepted that Mobilx had dealt in
such chips, as they were offered at a reduced price and were acceptable to their
customers in the United States, who re-packaged them before onward sale. He did,
however, agree that Mobilx would not deal in such chips again. Mr Martin pointed
40 out that the fact that the chips had re-entered the country undermined Mobilx’s
assertion that their customers sold only to end users. Indeed, Mr Bell is recorded
also to have said that he already suspected that one of Mobilx’s US customers
(though not Smith or Converge) had been selling goods back to the UK, and
Mobilx had stopped supplying that customer.

45 43. There were few developments of significance in the six months following
that meeting. HMRC undertook extended enquiries into Mobilx’s VAT returns,
but sent no letters to Mobilx identifying chains which had been traced to
defaulters. Stuart and Steven Bell secured registration for VAT as a partnership

whose purpose was the acquisition of premises from which Mobilx was to trade and in January 2006 a further application for VAT registration was submitted by Mr Hetherington on behalf of ITX International Ltd, a company whose directors were Steven and Stuart Bell. There was, it was said, a possibility that Mobilx might be taken over by one of its US customers, and the Bells wanted to have another company in place in order that they could continue to trade. The stated intention was that the two companies would exchange names and that the new Mobilx would trade in mobile phones and ITX, as Mobilx would by then have become, in CPUs; the possibility that a second company might be formed had been mentioned to HMRC at a meeting in the previous November, held primarily in order to discuss the partnership's application for registration.

44. The further application led to another meeting which began on 13 January 2006 and was completed on 1 February. Mr Martin and Ms Orr were present, but Mr Armstrong was not; Stuart and Steven Bell as well as Mr Hetherington and his assistant attended. During the course of the meeting Mr Martin was shown a brochure recently produced by Mobilx, a copy of which was provided to us. It is an impressive document which has obviously been professionally produced. It describes Mobilx as "one of Europe's leading global exporters of computer components" and sets out to give the impression that it has an extensive worldwide business, considerably more extensive than the scale of Mobilx's past trade truly justified, although the brochure relies more on hints rather than on direct statements and for the most part it contains little more than the exaggeration and hyperbole one has come to expect of such documents. Mr Cunningham made particular mention, however, of two photographs in the brochure, one of the interior of a warehouse and the other of an articulated lorry bearing the name "Mobilx" prominently on the side. Steven Bell told us that the warehouse belonged to a freight forwarder, and confirmed that Mobilx had no warehousing facility of its own; the lorry was artwork, since Mobilx had no such vehicle. It did have a smaller, secure, vehicle. At the resumed meeting Mr Martin mentioned that he had traced one of Mobilx's December 2005 chains to a defaulter.

45. On 7 February 2006 Mobilx bought a consignment of CPUs from Sound Solutions and sold them to Smith. HMRC's Redhill office learnt during the course of the day that the goods had previously been dealt in by someone who had, it was suspected, hijacked a genuine trader's registration, and informed Mobilx, by telephone, of that discovery. Mobilx immediately arranged to have the goods removed from the aircraft on which they had already been loaded, and they were thereafter returned to Sound Solutions, which agreed to rescind the transaction and repay the price of the goods. It is not clear what Sound Solutions did with the goods, though Steven Bell believed they had been returned to Sound Solutions' supplier.

46. Further meetings between Mr Martin and Ms Orr, for HMRC, and Stuart and Stanley Bell took place on 15 and 29 March 2006; Ms Bernard and Mr Ford attended for part of the time. Each of the meetings lasted for more than two hours. On both occasions Mr Martin advised Mobilx that he had identified what he considered to be deficiencies in its due diligence records; it also emerged that it had begun trading with two new suppliers even before it had completed its normal due diligence checks. A warning was given that the concession of monthly returns

was under review, though the review related to all traders in the sector, and not only Mobilx. At the second meeting Mr Martin mentioned that all of the December 2005 and January 2006 chains which had been traced so far led back to defaulters, and promised to provide details.

5 47. Mr Martin's note indicates that at the meeting on 29 March Mobilx's due
diligence (which he criticised in several respects) and the manner in which it
decided whether to trade with a particular supplier or customer were discussed at
great length. Mr Martin is recorded to have said that Mobilx could not rely on
checks on its suppliers and customers alone, but "must accept that they are
10 involved in transaction chains where there is VAT fraud". He is also recorded to
have made the point, several times, that it was not enough to undertake due
diligence on Mobilx's immediate suppliers but that the directors must be able to
justify their decision to enter into any given transaction in the light of all the
information at their disposal. His note also includes the following passage:

15 "I returned to the point that if the company was repeatedly being advised that their
deals were tracing back to defaulting traders then HMRC could come back to the
company to say that they had that knowledge. Stuart Bell disagreed and said that
was a legal decision and in [*sic*] anyway would be after the event. I pointed out that
the information would be bound to be retrospective but could be viewed for future
20 information."

48. The promised details of the traced transaction chains relevant to the January
2006 return were supplied with a letter of 7 April. Whereas, in the past, HMRC
had merely identified the number of chains which had been traced to defaulters,
on this occasion the individual sales were set out in schedule form, the schedule
25 identifying the date and number of Mobilx's sale invoice and its customer. There
were nine sales within the schedule, all said to be traced back to defaulters (and
the letter stated that a further 17 chains were still being investigated). We
interpose in passing that it is a mystery to us why HMRC supplied the information
in that fashion. The concern was not whether Mobilx's sales were properly zero-
rated, but whether its input tax claims should be allowed. It is impossible to
30 understand—and Mr Armstrong was not able to explain, at least to our
satisfaction—why HMRC did not identify the purchases about which it was
concerned, rather than the corresponding sales. However, because of the manner
in which Mobilx did business—that is, buying goods only to satisfy orders it had
received from its customers, and not for stock—it was a simple matter for Stuart
35 Bell to identify the suppliers in each case.

49. He discovered that one of the listed purchases had been made from Leisure
Communications Ltd, one from Rapid Global Ltd and the remainder from 21st
Century Trading Ltd. Soon after—the precise date is not clear—Mobilx sent a
40 copy of the letter to 21st Century Trading, inviting its comments. So far as we are
aware, no comments, or at least none in writing, were ever received. Mobilx did,
however, enter into no further transactions with 21st Century Trading. It took the
view that, as only one purchase from each of Leisure Communications and Rapid
Global had been identified, it was not necessary to cease trading altogether with
45 those companies.

50. On 10 April Mr Hetherington's assistant wrote to Mr Martin, expressing
Mobilx's abhorrence of VAT fraud and extolling the quality of its due diligence

and its willingness to cooperate with HMRC. The letter was unsolicited, but prompted by the newly introduced powers enabling HMRC to direct the keeping of more detailed records (see paragraph 6A of Schedule 11 to the Value Added Tax Act 1994, inserted by section 21(6) of the Finance Act 2006), which would soon come into force, and an invitation was extended to HMRC to tell Mobilx what, if any, additional records it should keep and what more it might do to improve its due diligence or otherwise avoid becoming involved in fraudulent chains. HMRC do not seem to have responded, at least directly, to this letter.

51. On 5 May 2006 Mr Martin wrote two letters to Mobilx. One related to its return for December 2005, the other to its return for January 2006. The former stated that of Mobilx's nine purchases in the month, eight had been traced back to defaulting traders; the latter that of 26 purchases, 13 had been traced back to defaulters. The letters added to the information Mobilx already had about those returns, from the 29 March meeting and the 7 April letter. The letters both indicated that the remaining transactions were still being investigated. They were otherwise in identical terms, reminding Mobilx of the prevalence of fraud in its chosen trade, and of the circumstances in which the Commissioners might apply the joint and several liability provisions of section 77A to it. Each letter was accompanied by a list of the transactions which had been traced back to defaulters, from which Mobilx could easily ascertain the identity of its supplier in each case.

52. Mobilx maintains that it did not receive the letters in May, but became aware of them only at a meeting which took place on 9 August, following which Mr Martin sent copies. There is no clear evidence, such as an acknowledgment or a reply unambiguously referring to the letters, or either of them, which shows that Mobilx did in fact receive the letters shortly after they were written. The Commissioners nevertheless argue that there is circumstantial evidence which points to the conclusion that they were in fact received in May.

53. On 9 May Mr Martin wrote three further letters, one to Mr Hetherington and the others to Mobilx. In the fourth paragraph of the letter to Mr Hetherington, Mr Martin mentioned that he had written to Mobilx on 5 May, but he did not attach copies of the letters (nor did he send a copy of this letter to Mobilx). Mr Hetherington received the letter, but he did not deal with it himself as he was about to go on paternity leave. He did not realise, he said, that there was any particular significance in Mr Martin's having written to Mobilx on 5 May; nor, it seems did any of his colleagues. Neither of the letters to Mobilx, which related to a due diligence review and to Mobilx's April 2006 return respectively, mentioned the 5 May letters, even obliquely. On the same day, 9 May, Mr Martin spoke to both Mr Hetherington and to Stuart Bell. His note of the conversations contains no reference to the 5 May letters.

54. On 15 May, Steven Bell wrote two letters to Mr Martin. One was a reply to his letter of 9 May relating to the due diligence review; it too makes no mention of the letters of 5 May. The other purported to be a reply to a letter from Mr Martin of 6 May; "purported" because Mr Martin had not written to either Mobilx or Mr Hetherington on that day. It appears that Mr Bell was in fact replying to the letter of 7 April to which we have already referred, in which Mr Martin had told Mobilx that, of Mobilx's 26 transactions in January 2006, nine had by then been traced to

defaulters (as we have indicated the primary purpose of the 5 May letter which related to the same return was to inform Mobilx that more transactions had now been traced to defaulters). On 15 May Mr Bell also wrote to 21st Century Trading, telling it that Mobilx “may have no alternative but to suspend trading” with it if
5 21st Century Trading could not satisfy Mobilx that its due diligence procedures were of a sufficiently high standard. The letter is odd—and its reference to prospective suspension odder still—since, as we have mentioned, Mobilx had already sought 21st Century’s comments and by this time it had stopped trading with 21st Century, a point which Mr Bell made in his letter of the same day to Mr
10 Martin. Mobilx’s last deal with 21st Century Trading took place on 31 March 2006.

55. We were provided with Mr Martin’s notes of a telephone conversation he had with someone identified only as “Mr Bell”—we think it probable it was Stuart Bell—on 22 May, and of a meeting between Mr Martin and Stuart Bell on 1 June,
15 when the still outstanding application for VAT registration of ITX International Ltd was discussed. That matter is not relevant for present purposes; what is significant is that Mr Martin’s notes do not suggest that the letters of 5 May were mentioned, while Mr Bell was told that the repayment claimed in Mobilx’s March return would be made, albeit on a “without prejudice” basis, even though nine of
20 39 chains had been traced to defaulters, a point which was repeated in a letter Mr Martin wrote to Mobilx on the same day; attached to the letter was a list of the transactions in respect of which the antecedent chains had been traced. We add in passing that it seems that Mobilx’s February 2006 repayment claim was met without comment.

25 56. There were various further exchanges, of letters and telephone calls, between Mr Martin, Mobilx and Mr Hetherington’s office over the following weeks, including letters of 17, 20 and 27 July in which Mr Martin addressed Mobilx’s March and April 2006 returns. The first of the letters stated that the
30 number of March chains which had been traced back to defaulters had now reached 21; the second that 20 of the 28 April chains had been traced to defaulters. There is nothing in either of those letters, or in Mr Martin’s notes of the telephone conversations, which suggests that Mobilx was made aware of the existence of the two letters of 5 May, and the December 2005 and January 2006 returns were not revisited in the course of those exchanges. The letter of 27 July,
35 which was sent to Mr Hetherington and not copied by HMRC to Mobilx, mentioned the 5 May letters, though merely within a list of letters by which, Mr Martin said, Mobilx had been notified that its transactions had been traced back to defaulters.

40 57. On 9 August 2006 a meeting took place between Mr Martin and two other officers for HMRC, and Mr Hetherington, his assistant and Stuart, Stanley and Steven Bell for Mobilx. According to Mr Martin’s note, the meeting lasted almost four hours, and a great many topics were discussed. If the note treats the matters discussed chronologically, it is apparent that it was only near the conclusion of the meeting that the two letters of 5 May were discussed and it emerged that Mobilx
45 had not received them, or at least claimed not to have received them. On 14 August Mr Martin sent copies of the letters and of the schedules which accompanied them; his note of the 9 August meeting indicates that he provided

copies of the letters, but not the schedules, at the meeting. The copy letters sent on 14 August appear to have been prepared from the originals, that is, from letters which are on headed paper and bear Mr Martin's signature.

5 58. Mr Cunningham argued that there was strong circumstantial evidence to indicate that the 5 May letters had been received shortly after they were written: they were referred to in a near-contemporaneous letter to Mr Hetherington, yet neither Mr Hetherington or any of his colleagues, or Mobilx, said then that the letters had not been received; there was at least some ambiguity in Steven Bell's letter of 15 May referring to the purported letter of 6 May, which could easily
10 have been a mistake for 5 May; they were referred to again in Mr Martin's letter to Mr Hetherington of 27 July; and there was no indication that any other letter HMRC had sent to Mobilx had gone astray. It would, he said, be very convenient for Mobilx if these letters had gone astray in view of the clear information in them of the number of defaulters in Mobilx's chains.

15 59. Steven Bell denied, when he gave oral evidence, that the letters had been received, and he was firm in his denial. Despite what we say elsewhere about Mr Bell's credibility, we are satisfied that this part of his evidence is reliable. Both Stanley and Stuart Bell maintained, in their statements, that the letters had not been received in May, and Mr Cunningham elected not to cross-examine them on
20 those assertions. Mr Martin was in the habit of writing to both Mr Hetherington and Mobilx, and often did not send copies of letters written to one of them to the other. Though his reference in his letter to Mr Hetherington of 9 May to the two letters of 5 May might in some circumstances have led Mr Hetherington to realise that the letters had not been received, it is in our view significant that the reference was not central to the letter of 9 May and, particularly bearing in mind the coincidence of his paternity leave, it is not surprising that Mr Hetherington did not in fact discover then that the letters had not reached Mobilx. We consider it more probable that Steven Bell's letter of 15 May replying to a letter said to be
25 dated 6 May was in fact a reply to the letter of 7 April; while there is certainly some ambiguity Mr Bell's statement that Mobilx had ceased trading with 21st Century fits more naturally with the letter of 7 April than with either of the letters of 5 May. Although, again, the letter of 27 July might have put Mr Hetherington on notice that letters had been written on 5 May, and that he had not seen them, he would not have made that discovery without going back over all the
30 correspondence, a task which we do not think would have been prompted naturally by the letter of 27 July. There is nothing in the remaining exchanges, prior to the meeting of 9 August, which might have caused Mr Hetherington or Mobilx to realise that the two letters had gone astray. Mr Armstrong told us that, unlike most HMRC officers, Mr Martin was in the habit of keeping paper (rather than purely electronic) records and it is possible, though certainly no more, that by
35 mistake he put the letters he intended to send with his paper records and not in the post. It is, again, unfortunate that we do not have Mr Martin's evidence. Mobilx has responded to other letters—including letters similar in content to those of 5 May—reasonably promptly.

40 60. Although Mr Cunningham hinted at a contention that Mobilx has claimed falsely that these letters were not received, he put to Steven Bell only that he was mistaken in his belief and, as we have said, he chose not to cross examine either

Stuart or Stanley Bell on the point. We do not think it is open to us in those circumstances to find that the Bells have falsely denied receiving the letters, but in any event we are satisfied from the evidence we did have that the letters were not received in May 2006.

5 61. We have mentioned already that Mr Martin wrote to Mobilx about the verification of its April 2006 return—the first of those in issue in this appeal—on 9 May. The letter was similar to several he had sent before, all of which reminded Mobilx of the scale of the losses of revenue which HMRC believed were occurring, by way of explanation of the extended verification, with a promise of a prompt response. Similar letters were sent on 20 June, in relation to the May return, and on 11 July in relation to the June return.

10 62. In the meantime, on 1 June, Mr Martin wrote to Mobilx about its March 2006 return, stating that in the nine (out of a total of 39) transactions which had been fully traced a defaulter had been found; a list of the traced transactions was enclosed. At a meeting on the same day, he told Mobilx that HMRC had established that some boxes of CPUs it had sold to an American customer had re-entered the UK and had been sold, again, by Mobilx to a UK customer. Mobilx investigated what had happened and discovered that, by mistake, the checks it normally carried out had not been done. Steven Bell sent an explanatory email to Mr Martin on the following day. A few days later, unprompted, he advised Mr Martin that Mobilx had discovered another, similar, incident. On 13 June Stuart Bell wrote to Mr Martin to say that, although it had a long-standing relationship with its American customer it had decided to suspend trading with it because Mobilx had been led to believe, by the customer, that it sold only to US companies, which it was now clear was not the case. That decision would be reviewed, he said, if a satisfactory explanation were forthcoming.

15 63. All the remaining exchanges between HMRC and Mobilx, or Mr Hetherington on its behalf, took place after the end of the period with which we are concerned, and nothing said by HMRC is relevant to Mobilx's knowledge when it entered into the April, May and June transactions. It is, however, necessary to mention that on 17 July, Mr Martin wrote again about the March 2006 return, informing Mobilx that HMRC had now traced 21 chains, all of which led back to defaulters; and on 20 July he wrote about the April return, stating that 20, of a total of 28, chains had been traced, all to defaulters. It does not seem that similar letters were written about the May and June 2006 returns, but Mobilx accepted, through Mr Jones, that in fact every one of the chains of transactions in which Mobilx engaged in April, May and June 2006 had been traced back to a defaulting trader. We should also mention that, from May 2006 onwards, Mr Hetherington wrote to Mr Martin, on several occasions, pressing for payment of the amounts claimed in the three returns, contending that as Mobilx had no knowledge that others who preceded them in the chains of transactions had acted fraudulently, HMRC could not legitimately refuse the claims. It is apparent from the letters that Mobilx's financial position was deteriorating because its claims had not been met, and we have no doubt that the directors and, on their instructions, Mr Hetherington felt obliged to put pressure on the Respondents, but we are bound to say that it is conspicuous that there is no expression of concern in

Mr Hetherington's letters that so many chains had been traced, and all of them to defaulters.

Mr Thompson's position

5 64. We have mentioned that Mr Thompson joined Mobilx from Sound Solutions in February 2004, when he became an employee and shareholder, but not a director, and that his role at Mobilx was to procure the goods, while Steven Bell handled sales and Stuart Bell administration. Mobilx had a list of approved suppliers, on which it had undertaken what it considered to be appropriate due diligence checks. Personal acquaintance with the directors of a company was
10 regarded as a significant safeguard and Sound Solutions was in this category because of Steven Bell's and Mr Thompson's past experience with the company. Mr Thompson was allowed to obtain goods from any of the approved suppliers and he could also arrange, with the Bells' approval, that other suppliers who passed the relevant tests be added to the list. Although he was not a director of
15 Mobilx, Steven Bell described him as a vital member of the team, and it was clear that he was granted considerable discretion.

65. In early 2005 Mr Thompson became a shareholder and director of another company, Greystone International Ltd ("Greystone"). That company had been recently established, for the purpose of dealing in CPUs. Mr Thompson concealed
20 the company's existence from the Bell family, and we are satisfied (and Mr Cunningham did not argue otherwise) that they were wholly ignorant of it, and of Mr Thompson's involvement, until it was made known to them, well after the period with which we are concerned, not by Mr Thompson, but by HMRC who became aware of Mr Thompson's dual role in the course of their investigations. In
25 his statement Mr Thompson played down the scale of Greystone's trade, claiming that it was modest, and that Greystone had entered only into transactions which Mobilx could not handle but, as he conceded as he gave his oral evidence, that was not true. Greystone, too, made large repayment claims which, eventually, HMRC refused to meet.

30 66. The particular significance of Mr Thompson's involvement with Greystone is that its trade, conducted largely by Mr Thompson, was very similar to that of Mobilx: he took care to ensure that the two companies did not trade with each other, but there was otherwise considerable similarity in their trading patterns. They bought from the same group of suppliers, and sold to the same group of
35 customers, and used the same freight forwarders. There was evidence, undisputed by Mobilx, that although the two companies had not traded directly with each other, they had handled the same goods. All of Greystone's transactions which HMRC were able to trace also led back to defaulters.

67. In early 2006 both companies were buying supplies of CPUs from
40 Multisystems International Ltd ("MIL"). At a board meeting on 19 May 2006, in the face of evidence produced to them by HMRC, particularly but not only to the effect that all the supplies Greystone had bought from MIL had been traced back to defaulters, Greystone's directors came to the conclusion that trade in CPUs was connected with fraud, and resolved to abandon that trade. They advised HMRC of
45 that decision very soon after. The minutes of the meeting, a copy of which was sent to HMRC, show that Mr Thompson was present at the meeting, and voted in

favour of the resolution. Greystone did indeed abandon trading in CPUs, and made no more purchases from MIL. Mobilx, however, and acting by Mr Thompson, continued to buy CPUs from MIL.

5 68. The Bell family was, of course, as ignorant of Greystone's board meeting and of its contacts with HMRC as it was of Greystone's existence. At this stage—
10 May 2006—the Bell family had also not been given information about Mobilx's purchases from MIL which was as specific as that given to Greystone. The Respondents rely on the fact that Mr Thompson, though he knew by reason of his being a director of Greystone that supplies by MIL originated with a defaulter,
15 continued to buy goods from MIL for Mobilx. They say it does not matter that he was not a director (nor, following our ruling, that he is not to be treated as if he were a director) and that the actual directors did not know what he knew; he was a senior employee, whose duty was the purchase of supplies, he had the discretion to choose Mobilx's suppliers, and he was authorised to deal with any of the suppliers on the approved list.

69. We were referred to several authorities on this issue, but do not think we need to refer to more than one since, in our view, it brings together all the relevant principles. In *Meridian Global Funds Management Asia v Securities Commission* [1995] AC 500 the Privy Council was required to consider a case in which a
20 company's chief investment officer, acting within his authority but unknown to the board of directors, of which he was not a member, bought on the company's account a holding in a public issuer, sufficiently large to make it necessary, in accordance with New Zealand law, for the company to register that holding with the respondent commission. The company did not register the holding, and the
25 commission brought proceedings against it. At page 511 Lord Hoffman, giving the only judgment, said:

30 "Notice must be given as soon as [a] person knows that he has become a substantial security holder. In the case of a corporate security holder, what rule should be implied as to the person whose knowledge for this purpose is to count as the knowledge of the company? Surely the person who, with the authority of the company, acquired the relevant interest. Otherwise the policy of the Act would be defeated. Companies would be able to allow employees to acquire interests on their behalf which made them substantial security holders but would not have to report them until the board or someone else in senior management got to know about it.
35 This would put a premium on the board paying as little attention as possible to what its investment managers were doing. Their Lordships would therefore hold that upon the true construction of [the relevant legislation], the company knows that it has become a substantial security holder when that is known to the person who had authority to do the deal."

40 70. It seems to us that the same principle must apply in a case of this kind, and for the same reasons. It cannot be open to the directors of a trading company to avoid the consequences of the Court of Justice's judgment in *Kittel* by delegating the day-to-day operation of the company to a non-director employee and closing their eyes to the employee's activities. It is true that Mr Thompson had gained the
45 relevant information in a different capacity, one which he had concealed from the Bells, and that, even had they asked, he is unlikely to have divulged the information he had for fear of revealing the existence of Greystone. But the Privy Council's views in *Meridian* were unaffected by the fact that there, too, the

employee had deceived his employer. In addition, it emerged that some of the relevant information had been obtained by Mr Thompson in the course of his employment by Mobilx when, acting for Mobilx, he made a telephone call to MIL, mentioned what he had learnt as a director of Greystone and sought and
5 obtained an assurance that there would be no repetition. The directors of Mobilx relied on Mr Thompson to undertake some of its due diligence enquiries and, in our view, there can be no real doubt that this call is to be regarded as such an enquiry. We have concluded that Mr Thompson's knowledge about MIL must be treated as the knowledge of Mobilx.

10 *Mobilx's change of trade*

71. As we have mentioned, Mobilx stated in its application for VAT registration that it was intending to trade in mobile phones, that its request for permission to make monthly returns was motivated by a desire to minimise its borrowings, and that the grant of such permission would not lead to an increase in turnover. There
15 is a link between those three contentions. No doubt the second was, and remained, correct and the third was not the subject of any challenge by Mr Cunningham. The first turned out to be incorrect. Mobilx began dealing in CPUs immediately, and within a very short period had abandoned trade in second hand mobile phones altogether, although it began trading in new handsets in April 2006.

72. Steven Bell's explanation of the change in the nature of Mobilx's trade coincided with what Mr Hetherington had said in his letter of 12 July 2004 (to which we referred at paragraph 36 above), but with one difference. He agreed that without the facility to make monthly returns, and correspondingly to recover the input tax it had incurred more quickly, Mobilx could not finance purchases of
20 used phones of the projected scale; but it was CPW, rather than the South African customers, which had looked elsewhere. We observe in passing that we had no evidence from CPW or from any overseas purchaser of used phones. Mr Bell also said that, realising even as early as December 2003 that the requirement that it make its returns quarterly, and the consequent input tax cost, would impede
25 Mobilx's ability to trade, he explored other activities with a view to achieving the turnover and profitability which Mobilx had projected.

73. Mobilx's first purchase of CPUs took place on 9 December 2003, less than two weeks after it had been registered and had become aware that its request that it might make monthly returns had been rejected. This was, indeed, the second of
35 its purchases, the first being of a consignment of used phones obtained from CPW. Mr Bell told us that Adam Thompson—who had not yet joined Mobilx, though he and Steven Bell were in close contact—recommended in December 2003 that Mobilx purchase CPUs from Syskal, a company he knew to have been established for some time, and with whose director he was acquainted. Syskal sold
40 CPUs to Smith and Converge, but had insufficient funds available to enable it to carry the input tax cost of two supplies which they were seeking, whereas Mobilx was at that time able to do so. As Mr Bell had already met representatives of Smith and Converge at a trade fair in the US and understood that both were suppliers to computer manufacturers he believed, he said, that the risk that Mobilx
45 might become involved in fraudulent transactions was slight and, having

undertaken satisfactory due diligence enquiries about Syskal, Smith and Converge, Mobilx began to deal in CPUs.

74. We found Steven Bell's evidence on this point quite unconvincing. We have already commented on the absence from Mr Hetherington's letter accompanying Mobilx's application for VAT registration of any mention of CPW or, indeed, of Mobilx's stated intention of trading only in used phones. There is inconsistency between Mr Hetherington's reference in the letter to Latin America and Steven Bell's evidence that the intended customers were located in South Africa and China. Mr Hetherington's evidence was that he was surprised when he discovered, some time after it had begun doing so, that Mobilx had started trading in CPUs. Mr Hetherington, as an experienced VAT adviser and indeed a former employee of HMCE, would have been well aware that VAT registration and monthly returns would be more easily obtained if Mobilx had said to HMCE, at the outset, that it intended to buy used phones from CPW and sell them to developing countries. That he did not communicate that intention on Mobilx's behalf can only suggest that he was not told about it. What is clear is that he believed that Mobilx intended to deal in phones; the cause of his surprise was that it had started dealing in CPUs. We also found Mr Bell's explanation of Mobilx's decision to deal in CPUs unconvincing. Neither he nor his father had any prior experience of trade in computer parts. That he acquainted himself with Smith and Converge at a trade fair he attended as a dealer in mobile phones is surprising, if no more. Mobilx was able to undertake appropriate due diligence enquiries in a remarkably short period; as we have said, its first transaction with Syskal and Converge took place as early as 9 December 2003.

75. We asked during the hearing for an explanation of the turnover projected in the application for registration of £36 million and were surprised to discover—since Steven Bell has a degree in business management, Stanley Bell is a chartered accountant and PwC had been engaged as Mobilx's advisers—that it was not readily forthcoming, although one did emerge, based entirely on trade in used phones. Mobilx did achieve turnover at that level, though not immediately, and at a time when it was trading exclusively in CPUs. The VAT cost, as we have mentioned, was to be funded by borrowing. Eventually Mobilx secured borrowing facilities with a clearing bank but at the beginning of its trading life it was dependent on borrowing, to a maximum of £500,000, at an interest rate which was set at 10 per cent of each VAT refund secured. That is, in our view, a most unusual way of setting an interest rate, and the rate achieved by this method of calculation is very high, which amply explains Mobilx's anxiety to secure the concession of monthly returns. What it does not explain is why Mobilx gave up the relatively risk-free trade in used phones which, after a few months' experience, might well have led the Commissioners to permit monthly returns, but instead embarked on trade in CPUs, with a very similar input tax cost, when it must have been clear to Mr Hetherington even if it was not clear to the Bells that its prospects of securing monthly returns would be diminished.

76. We have come to the conclusion on the totality of that evidence that Mobilx was not wholly candid with its own advisers, and consequently with HMCE. Its very rapid move into dealing almost exclusively in CPUs, and its correspondingly rapid abandonment of trade in phones, are in our view consistent only with a

prior, at the time undisclosed, intention to deal in CPUs even if occasional trade in phones might continue. In short, we reject the contention that Mobilx was forced, by the Commissioners' refusal to accept monthly returns, to abandon trade in used phones and deal instead in CPUs. Mobilx did deal in used phones, but it did so for a short period and even then sold most of the phones it bought to other United Kingdom traders, including Sound Solutions which had supposedly lost interest in the trade. We are satisfied that, while Mobilx may well have intended to deal in phones, it intended also, from the outset, to deal in CPUs.

Mobilx's relations with the Commissioners

77. Steven Bell said several times as he gave his evidence that Mobilx's relations with the Commissioners were cordial and that he and his father and uncle were fortified by that cordiality in their belief that they were trading in a manner which met with the Commissioners' approval. It is, perhaps, unfortunate in this context too that we did not have the benefit of any evidence from Mr Martin. Mr Armstrong, who of course dealt with Mobilx's affairs for a much shorter period than Mr Martin, was willing to accept no more than that relations were courteous. It may be that, in face to face meetings, Mr Martin gave a different impression; but the tone of his letters to Mobilx, and to PwC, was invariably formal and in almost every respect critical, even if sometimes only mildly critical. We find nothing in the letters which could reasonably be construed by Mobilx or PwC as an endorsement of Mobilx's trading methods. Mr Martin's notes of the various meetings which took place, too, reveal continuing concern about the risk to the revenue which, as we perceive, he felt Mobilx's trade presented, and that he was persistent in reminding Mobilx that its due diligence, however good it was (though he was usually critical), was not protecting Mobilx from dealing in tainted goods. We are not persuaded that Mr Martin or Mr Armstrong did or said anything which Mobilx could reasonably have thought to amount to approval of its trade. We recognise that the concession of monthly returns is in contrast to that conclusion, and we shall return to the inferences to be drawn from that concession.

Mobilx's turnover and profitability

78. We were shown Mobilx's accounts for the period to 31 December 2005. They were prepared by PwC, following an audit, and finalised in or about November 2006. The accounts covered a period of 44 weeks, from 1 March 2005, since Mobilx had changed its year end. In that period, Mobilx had a turnover of over £115 million, yielding a gross profit of £5.2 million. Ordinary administrative expenses amounted to £502,000 and, leaving an extraordinary item to one side, the net pre-tax profit after interest charges amounted to £2.745 million. The extraordinary item was the writing off, or waiver as the accounts put it, of three loans, one to each of Stuart and Steven Bell and another to Mr Thompson, each loan being of approximately £1 million. The effect of the waiver was that Mobilx made a loss for the year, before tax, of £544,000. Directors' remuneration is shown in the accounts at only £25,000, and no dividend payment was recommended. The two directors and Mr Thompson were, therefore, remunerated during that 44-week period almost entirely by the making and then waiving of loans. We did not discover how, and by what amount, the directors and Mr

Thompson were remunerated in the preceding period, though we observe that the directors' remuneration in that period was recorded as nil, yet Steven Bell did not suggest that he, his father and Mr Thompson had not been rewarded.

5 79. The unorthodox means by which Stuart and Steven Bell and Mr Thompson were remunerated is not a matter which we consider to be of any lasting importance, but Mr Cunningham sought to make a great deal of two factors: that all three had earned a great deal of money in a short period trading in goods of which they had little or no prior experience, without adding any value to the goods and (since Mobilx bought only goods for which it already had a customer, and was always paid by its customer before it had to pay its own supplier) with negligible trading risk; and that the waiver of the loans had led to Mobilx's making a loss for the period. Those were indications, he said, that the three were motivated entirely by the desire to make money; and that motivation, he said, caused them to enter into transactions when, had they put monetary considerations to one side, they would, or should, have realised that those transactions were ill-advised or worse; and the scale of Mobilx's profits should have caused them to realise that it was making money more easily than was credible.

20 80. Steven Bell's statement laid considerable emphasis on Mobilx's sponsorship of local charities and its engagement in other socially desirable activities. Mr Cunningham did not challenge that evidence but sought to counter it by Mr Bell's admission that for some years he had failed to make personal tax returns to what was then the Inland Revenue, and had in consequence avoided paying any personal tax during that time. Mr Bell told us that he was putting the matter right, but he did not offer a satisfactory explanation, beyond poor organisation, for his failure to file the returns.

25 81. Mr Jones did not seek to challenge the factual basis of Mr Cunningham's arguments, and we shall return at a later stage to their significance as we see them.

The administrators' case

30 82. The essence of the administrators' position is that Mobilx did everything it reasonably could, short of ceasing altogether to trade, to ensure that it did not enter into tainted transactions. It undertook due diligence which, as Mr Cunningham had agreed, was better than that undertaken by most traders; it actively sought HMRC's advice and heeded all of the advice which was given; and it reacted appropriately to the information it received from HMRC, particularly by ceasing to trade with suppliers from whom it could be shown to have bought tainted goods. It was entitled to conclude from HMRC's agreement in June 2005 to its making monthly returns that its record was acceptable to HMRC, and that it could continue trading in the future as it had done in the past, provided it also continued, as it did, to act upon the information it received. There was no significant change in the nature of Mobilx's trade, or its methods of dealing with its customers and suppliers, between June 2005, when monthly returns were authorised, and June 2006, the end of the relevant period.

40 83. Moreover, the letter of 21 June 2005 to PwC by which Mobilx was told monthly returns could now be made contained the passage:

“This change has exceptionally been granted based upon and specific to the current checks your client undertakes whilst conducting the business activities of the company. Please note, however, that any changes to this may result in the facility of monthly returns being reconsidered.”

5 Mobilx had not reduced the quality or range of the checks it undertook and the facility had not been withdrawn or, so far as was known, reconsidered; the Commissioners’ decision to refuse to pay the input tax credit sought was inconsistent with what had gone before.

10 84. Mr Jones emphasised several factors which, he said, indicated that Mobilx had a legitimate business, carefully managed in a way designed to protect it from involvement in fraudulent transactions. About half of its sales were to Smith and Converge, both of which supplied end users, computer manufacturers—evidence which the Commissioners did not dispute—demonstrating that Mobilx was trading in goods for which there was a true need. Mobilx’s membership of the
15 Intel Channel Re-Sellers’ Programme (a group of traders authorised by Intel to deal in its products), its engagement from the outset of PwC as its auditors and tax advisers, its use only of UK bankers, its securing of insurance cover for goods in transit, its use of professionally prepared terms and conditions of trade (we asked to see the conditions, but they were not produced), its acceptance of the return of
20 faulty goods, its possession of testing facilities, its acquisition of a secure vehicle and its local sponsorship activities (again, facts undisputed by the Commissioners) were all the marks of a legitimate business, quite different from those commonly encountered in MTIC cases. As Mr Armstrong acknowledged, Mr Martin had spoken highly of Mobilx, comparing it favourably with other companies engaged
25 in the same trade.

85. Mobilx’s directors were well aware of the prevalence of fraud in the trade in CPUs, but they had, Mr Jones said, acted on that awareness by taking proper precautions. There was no case in which Mobilx could be shown to have bought directly from a defaulter. He accepted that HMRC had told Mobilx of chains
30 which had been traced back to a defaulter but he criticised the information which had been provided because it was insufficiently precise to enable Mobilx to identify those of its suppliers from which it had bought tainted goods.

86. At the meeting on 29 March 2006 Mr Martin had told Mobilx that if it repeatedly received tainted stock from a supplier, it should ask searching
35 questions of that supplier. Inferentially, an isolated tainted supply should not be a cause for major concern. Until then, HMRC had not provided Mobilx with information which would have enabled it to discover whether it was receiving tainted stock repeatedly from any of its suppliers—all that was said was that some of its purchases had been traced back to defaulters, but the individual transactions were
40 not identifiable. On 7 April 2006, Mr Martin provided, for the first time, more detailed information about the traced deals. Mobilx was able immediately to establish that most of the relevant supplies were from 21st Century. It did not merely ask searching questions; it immediately stopped trading with 21st Century. It continued trading with the other two identified suppliers, since they had each
45 made only one tainted supply. Mobilx had, therefore, done exactly as HMRC had asked. Similarly it had acted entirely properly when it was told of the hijacked identity on 7 February 2006, and its conduct when it was told that some of the

goods in which it dealt had re-entered the country was likewise entirely correct—indeed, Mobilx had volunteered to HMRC that it had detected another similar incident.

5 87. Mobilx had, from the beginning, done all that was required of it by Public Notice 726, and had followed every suggestion for improvement which Mr Martin and other officers had made. It had, therefore, taken “every precaution which could reasonably be required”, and satisfied the test set out at paragraph 51 of the judgment in *Kittel*. It was not open to HMRC, with their superior ability to secure
10 information, to provide only some of that information to Mobilx, advise it about the precautions it should take, and then penalise it when it took those very precautions. The duty imposed on a trader was not absolute; it required him to do no more than take reasonable precautions: see *Customs and Excise Commissioners v Federation of Technology Industries* (Case C-384/04) [2006] STC 1483, at paragraphs 32 to 33. Mobilx had, moreover, taken and acted upon
15 the professional advice of both Stanley Bell and PwC, but neither had advised it to do as the Commissioners now argued it should have done, that is to stop trading in CPUs altogether. It was significant that, even at the meeting on 29 March 2006, Mr Martin had not said to Mobilx that it should cease trading; that was being suggested only now. All HMRC had done at that meeting, and thereafter, was to
20 advise Mobilx to improve its due diligence. And, despite stating that transactions had been traced back to defaulters, HMRC said in several letters that they did not contend that Mobilx was knowingly involved in illegitimate transactions, and continued to meet its repayment claims in full. Against that background the directors’ view that they were doing all that could reasonably be required of them
25 was justified and appropriate.

88. HMRC could not, and in the Public Notice did not, contend that trade in CPUs was inherently fraudulent or otherwise illegitimate and it was not disputed that Mobilx was making sales to suppliers to computer manufacturers. It may well be that much of the trade was in fact generated by fraudsters; but it was not by that
30 fact, if it be a fact, that Mobilx was to be judged. What was important was the state of knowledge of those controlling it at the time it entered into the relevant transactions, and that knowledge had to be judged without the benefit of hindsight. While the directors were aware, in a general sense, that there was fraud in the trade, they did not, and could not, know in April, May and June 2006 that it
35 was as prevalent as it now turned out to have been. The directors were reasonable businessmen, and should be judged accordingly. There was nothing in Stuart Bell’s statement which suggested that he was anything other than a responsible and cautious businessman. The Commissioners had chosen not to cross-examine him at the hearing and could not now suggest the contrary.

40 89. The reality, Mr Jones argued, was that in 2006 HMRC “moved the goalposts”. Even at the beginning of June, when Mobilx’s March repayment claim was met despite the discovery of a defaulter in each of the nine (out of a total of 39) chains which had been fully traced, Mr Martin was not advocating cessation of trade, but no more than constant review by Mobilx of its due diligence
45 procedures, and Mobilx’s concession of monthly returns was not withdrawn. The decision, without warning, to disallow the repayment claims in the April, May and June returns was unsustainable.

The Commissioners' case

90. The Commissioners' case was originally based on a number of factors but by the time of the hearing only one remained of importance because, Mr Cunningham said, Mobilx's having accepted that there was fraud in all of the relevant chains made it unnecessary to deal with the quality of its due diligence, the circularity, or apparent circularity, of some of the transactions and some other minor points. All that remained was the nature of Mobilx's knowledge. The Commissioners rely in part, though in reality by way of background, on Mobilx's undisputed awareness that fraud was prevalent in the trade in mobile phones and computer chips. More specifically, they rely on the specific warnings it had received about its own chains of transactions.

91. Steven Bell in particular knew not only that fraud was rife, but how it was committed and that it depended on the creation of chains of transactions; he knew, as he had accepted when he gave evidence, that the Commissioners were concerned, as indeed Public Notice 726 made clear, about chains of transactions and that they expected traders to verify, or at least make a reasoned judgment about, their chains, and not merely their immediate suppliers; he knew that Mobilx could not fully verify its chains; and he was aware, as he also conceded, that Mobilx's move from trade in second hand phones to trade in CPUs increased the risk it ran.

92. Mr Cunningham was very critical of the directors' reaction to their being told that defaulters had been traced. It was not to cease trading with suppliers whom they could have identified if they had chosen to do so. It was true that until April 2006 the Commissioners had said no more than that a specified number of the transactions in a given month had been traced to defaulters but Mr Hetherington, if not Steven Bell, had agreed that, even when it was told only the number of traced chains in the relevant month, Mobilx could, by process of elimination, have established quickly which of their suppliers must have supplied tainted goods, yet the exercise was not even attempted. Instead the directors took action only when faced with evidence they could not dismiss as lacking in detail. Bad news led, as Steven Bell repeatedly put it, to "consulting with stakeholders", which effectively meant carrying on as before. It was only when it was inescapable, as when they were told of the hijacked trader on 7 February 2006 or were given information requiring no real analysis that several supplies by 21st Century had been traced back to defaulters, that the directors reacted positively to information provided to them. The directors, he said, had the means of knowing of fraud in the chains; they chose not to use those means.

93. It is, the Commissioners argue, conspicuous that all of the chains of transactions in CPUs which they were able to trace, without exception, revealed the presence of a defaulter. In his oral evidence Steven Bell had attempted to minimise the significance of that fact by relating the traced chains to the entirety of the transactions ever entered into by Mobilx rather than, as he should, the deals in the individual month investigated. That approach was, Mr Cunningham said, symptomatic of Mobilx's approach of disregarding information unless it was impossible to do so. Steven Bell and Mr Hetherington, he said, both knew very well that it was the chains which mattered, yet neither was even willing to accept, until pressed, that if 100 per cent of the traced chains were found to lead back to

defaulters, the only safe course was to stop trading. It was not a realistic criticism of HMRC that they had not advocated that course since it was not open to them to offer such advice to any trader, still less to force a trader to cease trading.

5 94. The cumulative effect of the information available to the directors, Mr Cunningham said, should have led them to the conclusion that they could never be satisfied, on the balance of probabilities, that any supply Mobilx bought was untainted by fraud. That being so, the only prudent course was to stop, or at least suspend, trading. If Mobilx nevertheless chose to carry on trading it could not shelter behind the supposed quality of its due diligence; if that due diligence had not succeeded in preventing Mobilx from purchasing tainted goods in the past 10 there was no reason to suppose it would do so in the future. By April 2006 the directors could no longer be in any reasonable doubt that they were trading in tainted goods, and the Commissioners were accordingly right to refuse the input tax credit which was claimed.

15 *Conclusions*

95. It is, we think, appropriate to begin with a brief recapitulation of what the Court of Justice said in *Kittel*. In paragraph 51 of its judgment it spoke of the ability of a trader taking “every precaution which could reasonably be required” of him to rely on the legality of his transactions; in paragraph 61 it indicated that a trader must forfeit the right to deduct if he “knew or should have known that ... he was participating in a transaction connected with the fraudulent evasion of VAT”. 20

96. How those comments are to be converted into a question the tribunal should ask itself was discussed at some length in *Dragon Futures* and summarised at paragraph 75 of the decision:

25 “Has the taxable person, at the time of entering [into] 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 30 any other party involved in, or any other transaction involving, fraud on the public revenue through the value added tax system?”

97. That question was set out in *R (Just Fabulous (UK) Ltd and others v HMRC* [2007] EWHC 521 (Admin) without adverse comment, although the nature of the question was not of central importance in that case, and approved in *Calltell* (by a tribunal of which the present chairman was also the chairman). As the parties 35 agreed for the purposes of this appeal that the law was correctly stated in *Calltell*, that is the question we propose to ask ourselves. We shall do so by reference to what was known, or if they had used the information available to them fully would have been known, to the directors at the beginning of April 2006, 40 augmented by the information they received in Mr Martin’s letter of 7 April and the information about MIL which came into Mr Thompson’s possession, though we should mention that we think that, in a practical sense, the latter information adds little. For the reasons we have given we leave the two letters of 5 May out of account.

98. The difficulty facing the administrators, as we view the matter, is that Mr Jones' arguments focused on only part of the relevant test, that is the part set out at paragraph 51 of the judgment in *Kittel*, and the quality of Mobilx's due diligence, while largely ignoring paragraph 61, and the totality of the directors' knowledge. It is true, and if no other factors were of relevance it might arguably be a complete answer, that until April 2006, whatever they may have thought of Mobilx's due diligence and general prudence, the Commissioners had continued to meet Mobilx's claims, even if they had repeatedly urged improvements in its due diligence procedures, giving Mobilx an expectation, to put it no higher, that if it continued trading as it had been doing it could assume its future claims would also be met. Although Steven Bell accepted that none of these factors allowed Mobilx to assume that it did not need to take precautions, it was clear to us that Mobilx's directors, as well as Mr Hetherington, took comfort from the meeting of Mobilx's repayment claims, the permission to make monthly returns, and the absence of any attempt to withdraw that concession or to impose the provisions of section 77A on Mobilx. But one can equally look at the matter in a different way: that until March 2006 the Commissioners had given Mobilx the benefit of the doubt, but ceased to do so from April or, more probably, took the view that there was no longer any real room for doubt.

99. There are, we think, three factors of importance in this case. First, that, despite the declared intention of dealing in second-hand phones, Mobilx began trading in CPUs immediately. We have already dealt with this point at some length, and have set out our conclusion that Mobilx always intended to deal in CPUs, a commodity of which the directors had no experience, and which they knew exposed them to greater risk than would have been the case had they dealt only in used phones. The second factor is the manner in which the directors and Mr Thompson benefited from Mobilx's trade. The third, and in our view decisive, factor is the directors' response to the fact that every traced transaction led back to a defaulter.

100. As we have mentioned, each of Steven and Stuart Bell and Mr Thompson benefited from Mobilx's profits to the extent of about £1 million in the year to 31 December 2005. There is, of course, nothing inherently wrong in making large profits, and we read nothing into the rather unorthodox manner in which the three were actually remunerated. The question, rather, is whether the substantial income which the three were able to secure led them to err in favour of entering into transactions when prudence should have dictated greater caution—that is, can one infer that, as Mr Cunningham put it to Steven Bell, he, his father and Mr Thompson were motivated by greed rather than the desire to earn a living, even if a good one, by prudent conduct of Mobilx's affairs?

101. We are not prepared to make such a finding in Stuart Bell's case. He was not cross-examined on the matter and has correspondingly had no opportunity of answering the allegation. We do not accept Steven Bell's claim that he failed to make personal tax returns because of poor organisation. He is an intelligent, well-educated man. One oversight, or delay, might be excusable, but his failure to make returns extended over a prolonged period and must be considered deliberate. We are quite sure, too, that Mr Thompson (like Steven Bell, intelligent and well-educated) knew perfectly well that his directorship of and activities on behalf of

Greystone were not legitimate—indeed, the fact that he took care to conceal them from the Bells speaks for itself. His and Steven Bell’s honesty is, therefore, questionable.

5 102. This was a business in which very large sums were earned, within two years
of a standing start, by two young men (Steven Bell and Mr Thompson were aged
under 30 at the time) buying and selling goods of which they had little or no prior
experience. There was minimal trading risk: Mobilx held no stock but bought only
to meet its customers’ requirements, and was invariably paid before it was
10 required to pay its own supplier. At the least the directors and Mr Thompson
should have asked themselves how it was possible to make so much money so
easily. We have no doubt, from the manner in which Steven Bell and Mr
Thompson gave their evidence, that the fact that they were able to do so led them
away from asking that obvious question, and from examining Mobilx’s activities
15 as critically as they should have done. We suspect—we can put it no higher—that
Stuart Bell was swept along by them. We are fortified in that conclusion by his
comment, at one of the meetings we have mentioned, that if Mobilx gave up
dealing with its supposedly reliable suppliers and found others the incidence of
tainted chains might become worse. Superficially the comment seems to be
evidence of prudence, but the reality is that Mobilx’s track record, that every
20 traced chain led back to a defaulter, could not have become any worse, and it does
not seem to have occurred to Mr Bell or anyone else controlling Mobilx’s
activities that the problem might be, as they now accept, that almost all the trade
exists for no purpose other than the commission of fraud.

25 103. We come, therefore, to the third factor. It is true that in a market of the kind
in which Mobilx contends it was engaged few traders can look beyond their
immediate suppliers. There is an obvious dissimilarity with supply chains which
lead from the manufacturer to a wholesaler, and thence to retailer and end
consumer, where none has any motive to conceal the identity of any other. We
accept (and Mr Cunningham did not suggest otherwise) that traders in a “grey”
30 market will not wish to disclose the identity of their suppliers, for fear of being cut
out or by-passed in future. Of necessity, therefore, due diligence in the shape of
credit checks, verification of registration particulars and the like can be applied
only to a trader’s immediate suppliers and customers. But we accept the
Commissioners’ argument that due diligence of that kind is not enough.

35 104. The Commissioners’ Public Notice makes it clear that they expect traders to
satisfy themselves not merely that their immediate suppliers, but also those who
preceded them, will account properly for the VAT due on their supplies. As we
have mentioned, the Notice was written in the context of the requirements of
section 77A of the Value Added Tax Act 1994, and it represents the
40 Commissioners’ views, which do not necessarily correctly reflect the law. But, as
Mr Jones agreed, the requirements set out in the Notice do in fact match those
which the Court of Justice set out in *Kittel*. His arguments concentrated upon
Mobilx’s having made the checks recommended by the Notice, and he invited us
to conclude that, as Mobilx had made those checks, its repayment claims must be
45 met. But in our view he cannot claim the benefit of the Notice in that way while
ignoring what it actually says (and of which Steven Bell and his colleagues were
well aware), that the integrity of the entire supply chain must be established.

105. Of course, that is a difficult task and a trader in Mobilx's position is almost certain to know less, and possibly nothing at all, of suppliers at one or more removes; but that is not to his prejudice, as he is to be fixed only with knowledge which he has, or could obtain "by taking every precaution which could reasonably be required". We do not think it could be argued that, for example, a trader in Mobilx's position should be required to demand of his supplier that the supplier disclose the identity of his own supplier, in order that the first trader can carry out his own due diligence into that supplier, still less is it realistic to expect him to go all the way up the chain. But there must come a time when a trader, told repeatedly that every one of his purchases followed a tainted chain, is compelled to recognise that without a significant change in his trading methods every one of his future purchases is more likely than not also to follow a tainted chain—in other words, he cannot possibly be satisfied, on the balance of probabilities, that each transaction he enters into will not be connected with fraud. Both Steven Bell and Mr Hetherington were, at best, reluctant to accept that this was so, but in our view it is inescapable.

106. This is not a case in which an occasional purchase can be traced back to defaulters while most are untainted, nor one where a trader has dealt with only one supplier of tainted goods, while other suppliers' goods have been untainted. As the administrators accepted, every one of those chains of transactions in CPUs which HMRC had been able to trace led back to a defaulter, regardless of the identity of Mobilx's immediate supplier or, indeed, its purchaser. Had that been the case only in Mobilx's first few months of trading it might be attributable to misfortune or inexperience; but by the end of March 2006 Mobilx had been trading for over two years, using the same fairly small circle of suppliers. As we have recorded, Mr Hetherington agreed that the information Mobilx received at the meeting which took place on 14 September 2004 (that 17 out of 24 chains in May and June had been traced to defaulters) was "a disaster" from Mobilx's point of view, and there were several further indications by HMRC in a similar vein before the beginning of April 2006, particularly at both of the meetings in March 2006. There was no improvement: not one traced chain turned out to be legitimate. Mr Martin's letters of 7 April and 1 June 2006, received by Mobilx within the relevant period, contained yet more of the same information. Yet throughout Mobilx carried on dealing in CPUs, using the same suppliers unless, faced with what it could accept only as overwhelming and inescapable evidence, it felt obliged to suspend trading; in that we agree entirely with Mr Cunningham.

107. Mobilx's attitude (and, indeed, Mr Hetherington's) was not that to be expected of a company whose directors, as Steven Bell in particular emphasised, had high ethical standards, and were extremely anxious to avoid becoming drawn into fraudulent transactions. The response to HMRC's letters notifying Mobilx of tainted chains which they had traced was concern and disappointment, but not that Mobilx had been drawn into fraudulent chains; in fact there was a marked lack of curiosity about the identity of the suppliers who had sold tainted goods. It is true that the information the Commissioners provided was lacking in detail but, as Mr Hetherington eventually agreed, Mobilx could have made much greater use of it than it did (and, had it done so, would have realised by mid-2005 that it was repeatedly buying tainted goods from Sound Solutions, with which it continued to trade). Rather, the concern was that HMRC might withhold payment of Mobilx's

claims, and the cause for disappointment was that the claims were not paid immediately, but only after investigation of the chains. Particularly significant were Stuart Bell's enquiry whether claims would be paid even if prior defaults had been found, with no hint that the mere fact that such defaults had been discovered was itself a matter which should cause Mobilx to think again about the business it was in, and Mr Hetherington's surprising reluctance to agree, when it was put to him, that HMRC's finding that every single chain which could be traced led back to a defaulter could point only to the conclusion that an honest trader anxious to avoid being involved in fraud must cease that type of trade. It may be that PwC could not tell a client to cease trading; Mr Hetherington was reluctant to accept even that they might advise him to do so.

108. In our judgment, by the beginning of April 2006, if not sooner, Mobilx could not be confident of the integrity of its supply chains. It may be that its due diligence was good, but for *Kittel* purposes that is not the only test. Indeed, all the Bells and Mr Thompson accepted that due diligence was not enough on its own. It is true, too, that despite adverse findings the Commissioners had allowed Mobilx to make monthly returns, and that they had paid its claims, but their doing so cannot excuse Mobilx from compliance with the *Kittel* test. The essential question is a simple one: was it, or should it have been, apparent to Mobilx, by the beginning of April 2006, that if it continued to deal in CPUs as it had been doing for the last two years, its transactions were more likely than not to be connected with fraud? The only possible answer to that question is the one we have given: yes. It is in our view clear that Mobilx has forfeited the right of deduction which it claimed.

109. We accordingly dismiss the appeals. It seems to us that, in principle, the Commissioners should have their costs, but we make no immediate direction in that respect; instead we give the parties permission, as they requested, to seek appropriate directions.

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COLIN BISHOPP
CHAIRMAN
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