

**20570**

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

**LONDON TRIBUNAL CENTRE**

**OLYMPIA TECHNOLOGY LIMITED**

**- and -**

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

**Respondents**

**Tribunal: DR JOHN F AVERY JONES CBE (Chairman)  
SANDI O'NEILL**

**Sitting in public in London on 7-11 and 14 January 2008**

**Kieron Beal, counsel, instructed by BDO Chiltern, for the Appellant**

**Philip Moser, counsel, instructed by Howes Percival, for the Respondents**

**© CROWN COPYRIGHT 2008**

## DECISION

1. This is an appeal by Olympia Technology Limited against two decision letters dated 10 January 2007 and 22 March 2007 refusing to repay input tax of a total of  
5 £1,618,473.68 for periods 04/06 and 05/06. The Appellant was represented by Mr Kieron Beal, and the Respondent (“Customs”) by Mr Philip Moser.

2. The decisions appealed against are to the effect that the Appellant ought to have known it was involved in MTIC [Missing Trader Intra-Community (fraud)] transactions. The issue in this appeal is whether those decisions are correct. The first  
10 decision letter relates to a “straight” chain starting with a defaulting importer and ending with the export by the Appellant. (We shall refer to imports and exports for clarity, acknowledging that this is not the right term within the EU.) The second decision letter relates to alleged contra-trading in which a person exporting goods in  
15 other “dirty” chains entered import transactions in which the goods were sold to the Appellant, with the result that he no longer claims net input tax from Customs so that the fraud in the other chains is less obvious.

### **Introduction to MTIC fraud**

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

30 4. In contra-trading there are, in its simplest theoretical form, two chains of transactions. First, the “dirty chain,” in which there is a defaulting trader (“defaulting trader” for short), comprising A (the defaulting trader) who is the importer of goods into the UK, who sells them to B (the buffer company), who sells them to C who exports the goods, and is thus in a VAT reclaim position. (For simplicity we shall use  
35 the expressions import and export for intra-Community trade, acknowledging that these are not the proper labels.) Secondly, the “clean chain,”<sup>1</sup> in which there are no missing traders, comprising C, who is this time the importer of other goods, who sells to D, who sells to E, the exporter (the Appellant in this appeal is in the position of E in relation to the three alleged contra-trading deals). The effect of the clean chain is  
40 that the net input tax position of C in the dirty chain is cancelled by output VAT in the

---

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

clean chain. There is no direct financial benefit to C in this as C has paid the input tax to B, and therefore C could be in league with the defaulting trader, or could be a trader who is controlled (possibly without knowing it) by a “puppet master” to enter into the cancelling transactions to disguise A’s involvement a fraud, or a trader who happens to carry out both import and export transactions unconnected with any fraud,. The effect of the contra-trades is that C does not excite Customs’ attention as it is not applying for a repayment; the non-payment of tax by A is less noticeable since without a return Customs do not know how much tax A owes. The input tax reclaim that C had in the dirty chain has moved to E who is at the end of a clean chain. The only way for Customs to refuse repayment of E’s input tax is to show that E knew or ought to have known of A’s fraud in a completely different chain, and of C’s involvement in the fraud.

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

6. The fraud in a simple MTIC fraud is that the defaulting trader always intends to default. It will normally be the case that he defaults later than the dates the deals in the chains are executed because he fails to pay the tax due for the period in which the deals occur. One of the problems is that C, the exporter in a simple MTIC fraud, is always separated from the defaulting importer by one or more Bs and may not know of the existence of A. If C enters into a deal that is too good to be true it can be said that he ought to know of the fraud even though he does not know of A’s identity. In a contra-trading fraud the question is whether E knows or ought to have known that C entered into the clean chain transactions to cover A’s intention to default. Again the problem is that E may be separated from C by one or more Ds (although in this case C, the alleged contra-trader sells directly to E, the Appellant).

### **The approach to the case: the straight chains**

7. In relation to the straight chains the issues as:

- (1) Whether there existed a relevant tax loss to the Revenue, which is not disputed;
- (2) Whether that tax loss was caused by fraud (specifically: a defaulting trader), which is disputed;

(3) Whether that fraud was connected to the Appellant, which is not in dispute;

(4) Whether the Appellant should have known that its transactions were linked to fraud, which is disputed.

5 **The law**

8. Mr Beal characterised Mr Moser’s case as involving the following syllogism:

(1) The wholesale market in mobile phones in the UK is beset by fraud;

(2) The Appellant knew that (1) was the case;

10 (3) The Appellant knew that it had to take certain reasonable steps to avoid becoming unwittingly caught up in fraud;

(4) The Appellant either failed to take reasonable steps, or failed to take heed of the results arising from the reasonable steps it did take’

(5) The Appellant accordingly ought to have known that its transactions were part of a fraud.

15 Mr Beal accepted the first three, but contended that (4) and (5) were the wrong questions. Accordingly we look first at the law.

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

25 “46 An obligation on the tax authorities to take account, in order to determine whether a given transaction constitutes a supply by a taxable person acting as such and an economic activity, of the intention of a trader other than the taxable person concerned involved in the same chain of supply and/or the possible fraudulent nature of another transaction in the chain, prior or subsequent to the transaction carried out by that taxable person, of which that taxable person had no knowledge and no means of knowledge, would a fortiori be contrary to those objectives.

30 47 As the Advocate General observed in point 27 of his Opinion, each transaction must therefore be regarded on its own merits and the character of a particular transaction in the chain cannot be altered by earlier or subsequent events.

35 ...  
52 Nor can the right to deduct input VAT of a taxable person who carries out such transactions be affected by the fact that in the chain of supply of which those transactions form part another prior or subsequent transaction is vitiated by VAT fraud, without that taxable person knowing or having any means of knowing.”

40 10. In *Kittel*, Cases C-439/04, 440/04 the taxpayer had entered into a contract with a fraudster. Belgian law treated a contract under which one party had entered into for fraudulent purposes as incurably void. In a case heard at the same time (*Rocolta*

10 “51 In the light of the foregoing, it is apparent that traders who take every precaution which could reasonably be required of them to ensure that their transactions are not connected with fraud, be it the fraudulent evasion of VAT or other fraud, must be able to rely on the legality of those transactions without the risk of losing their right to deduct the input VAT (see, to that effect, Case C-384/04 *Federation of Technological Industries and Others* [2006] ECR I-0000, paragraph 33).

15 52 It follows that, where a recipient of a supply of goods is a taxable person who did not and could not know that the transaction concerned was connected with a fraud committed by the seller, Article 17 of the Sixth Directive must be interpreted as meaning that it precludes a rule of national law under which the fact that the contract of sale is void, by reason of a civil law provision which renders that contract incurably void as contrary to public policy for unlawful basis of the contract attributable to the seller, causes that  
20 taxable person to lose the right to deduct the VAT he has paid. It is irrelevant in this respect whether the fact that the contract is void is due to fraudulent evasion of VAT or to other fraud.

25 ...  
55 Where the tax authorities find that the right to deduct has been exercised fraudulently, they are permitted to claim repayment of the deducted sums retroactively (see, inter alia, Case 268/83 *Rompelman* [1985] ECR 655, paragraph 24; Case C-110/94 *INZO* [1996] ECR I-857, paragraph 24; and *Gabalfrisa*, paragraph 46). It is a matter for the national court to refuse to allow the right to deduct where it is established, on the basis of objective  
30 evidence, that that right is being relied on for fraudulent ends (see *Fini H*, paragraph 34).

35 56 In the same way, a taxable person who knew or should have known that, by his purchase, he was taking part in a transaction connected with fraudulent evasion of VAT must, for the purposes of the Sixth Directive, be regarded as a participant in that fraud, irrespective of whether or not he profited by the resale of the goods.

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

40 11. In the same way in *Teleos*, Case C-409/04 the Court has again protected the innocent party to a contract where, unknown to it, the other party is a fraudster by preventing Customs from reopening its entitlement to recover input tax on the export:

45 “50 Accordingly, it would be contrary to the principle of legal certainty if a Member State which has laid down the conditions for the application of the exemption of intra-Community supplies by prescribing, among other things, a list of the documents to be presented to the competent authorities, and which has accepted, initially, the documents presented by the supplier as evidence establishing entitlement to the exemption, could subsequently require that

supplier to account for the VAT on that supply, where it transpires that, because of the purchaser's fraud, of which the supplier had and could have had no knowledge, the goods concerned did not actually leave the territory of the Member State of supply."

5 12. The Court therefore allows the existence of two possible extremes: (1) that the  
other party to the contract is innocent in that he did not know, and could not have  
known, of the fraud committed by the other party to the contract, with the result that  
he is entitled to deduct the input tax; or (2) that he is an accomplice of the fraudster in  
that he did know, or should have known, that he was taking part in a transaction  
10 connected with fraudulent evasion of VAT, with the result that he is not so entitled.  
There was some discussion about the relationship of the fundamental principle of the  
right to deduct input tax and the right to deny this in situation (2). Mr Beal contended  
that the former was the fundamental principle and the latter was a derogation to be  
construed strictly. Mr Moser contended that preventing fraud was an objective  
15 recognised by the Sixth Directive. The non-fraudulent party is entitled to expect legal  
certainty; the fraudulent party is entitled to expect that steps will be taken to defeat its  
fraudulent ends. In *R (Just Fabulous (UK) Limited) v HMRC* [2007] All ER (D) 271  
(Mar) Burton J accepted the same argument by Customs and held at [45] that the  
Community law principles of legal certainty was "trumped by the objective  
20 recognised and encouraged by the Sixth Directive of preventing tax evasion,  
avoidance and abuse." We consider that there are two conflicting principles here,  
neither of which in principle is the dominant one, to be applied when appropriate  
according to the facts. Accordingly we do not treat fraud as a derogation from the  
general principle of neutrality to be applied strictly, but as a principle to be applied  
25 when the objective facts require it. As the court said at [55] in *Kittel* "It is a matter for  
the national court to refuse to allow the right to deduct where it is established, on the  
basis of objective evidence, that that right is being relied on for fraudulent ends."

13. Both *Kittel* and *Teleos* concerned the much simpler situation of two parties to a  
contract, one of whom was a fraudster. The Court required it to be ascertained by  
30 objective factors whether the innocent party knew or should have known about the  
fraud of the other party. But the same reasoning applies where the contracts made by  
each of the two parties are separated (*Optigen* at [52]), and as confirmed by Burton J  
in *Just Fabulous*.

14. A person who takes every precaution which could reasonably be required of him  
35 to ensure that their transactions are not connected with fraud falls into category (1)  
because by taking those precautions he could not have known (and obviously did not  
know) of the fraud (*Kittel* at [51]), citing *Federation of Technological Industries*,  
Case C-384/04. Mr Beal points out that in the latter case the Court was dealing with  
s 77A which applies where the person "knew or had reasonable grounds to suspect  
40 that the VAT payable in respect of that supply... would go unpaid." At [32] the Court  
deals with the rebuttable presumption in s 77A(6) that this is the case "if the price  
payable by him for the goods in question – (a) was less than the lowest price that  
might reasonably be expected to be payable for them on the open market, or (b) was  
less than the price payable on any previous supply of those goods" and points out that  
45 presumptions may not be formulated in such a way as to make it practically

15. This case raises for the first time on the evidence the nature of “ought to have known” since *Dragon Futures* was decided on assumed facts and the issue was obiter in *Calltell*. Mr Beal contended that this was equivalent to turning a blind eye, which  
25 involved knowing that there was something there to see: “Nelson at the battle of Copenhagen made a deliberate decision to place the telescope to his blind eye in order to avoid seeing what he knew he would see if he placed it to his good eye.” (*Manifest Shipping Co Ltd v Uni-Polaris Insurance Co Ltd* [2003] AC 469 at [112]). In that case the issue was whether “with the privity of the assured, the ship is sent to sea in an  
30 unseaworthy state,” in which case the insurer is not liable for any loss attributable to unseaworthiness (s 39(5) Marine Insurance Act 1906). The House of Lords held that this required more than negligence. Lord Hobhouse put it at [25] that “The test is subjective: did the assured have direct knowledge of the unseaworthiness or an actual state of mind which the law treats as equivalent to such knowledge?” Lord Scott said  
35 [116] “In summary, blind-eye knowledge requires, in my opinion, a suspicion that the relevant facts do exist and a deliberate decision to avoid confirming that they exist.” He pointed out that suspicion must be firmly grounded and targeted on specific facts. Mr Moser contended that this approach should be applied by analogy meaning in this context that blind-eye knowledge meant a decision to refrain from taking all  
40 reasonable steps to satisfy himself that this transaction is not connected with fraud. This is another way of saying that there is a positive obligation to take all reasonable precautions, which we have found does not follow from *Kittel*.

16. We are not persuaded that it is right to equate “ought to have known” with blind-eye knowledge, which seems to us to be closer to actual knowledge (“with the privity of the assured” seems to convey the sense of his being privy to it) than “ought to have  
45 known,” since it amounts to firmly suspected knowledge that is deliberately not

confirmed. Certainly blind-eye knowledge would suffice for “ought to have known”, but that does not mean that that is all that satisfies the test. For example, if something is staring the trader in the face but he does not see it, without deliberately failing to look at it, that seems to us to be clearly within “ought to have known.” We consider that on its ordinary wording “ought to have known” is a factual test comprising two limbs. First, one should start with all the facts (a) actually known to the person and ask whether in the light of those facts a reasonable businessman would have known that the transaction in question was connected with fraud. Secondly, it would include (b) those facts that would have been known to the person if he had taken some action to discover them that the reasonable businessman would have taken in the circumstances (which is not necessarily the same as every precaution reasonably required), but which the person did not. Both of these require one to determine the degree of experience of the reasonable businessman, for which we draw by analogy on the contrast made in s 214 of the Insolvency Act 1986:

- “(4) For the purposes of subsections (2) and (3) [which includes that that person knew or ought to have concluded that there was no reasonable prospect that the company would avoid going into insolvent liquidation], the facts which a director of a company ought to know or ascertain, the conclusions which he ought to reach and the steps which he ought to take are those which would be known or ascertained, or reached or taken, by a reasonably diligent person having both—
- (a) the general knowledge, skill and experience that may reasonably be expected of a person carrying out the same functions as are carried out by that director in relation to the company, and
  - (b) the general knowledge, skill and experience that that director has.”

In favour of a test on the lines of subs (4)(a) (or a combination of both tests) is that this is consistent with the director’s duty to the company and its creditors, who can expect a director to have a reasonable standard of experience. In favour of a test on the lines of subs (4)(b) is the argument that taking the director’s actual experience into account is more relevant to what the particular person ought to have known. The parties did not make any submissions on this point. On balance, while we see the merits of the former for consistency, we consider that this is too high a test in the present circumstances which are far removed from a director’s personal liability to creditors and concerns whether Customs can decline to pay input tax to which the company is in principle entitled. The test that we apply is accordingly whether a person with the knowledge, skill and experience of the director concerned would have known that the transactions were connected with fraud. This appeal does not depend on the Appellant failing to take precautions, but more on whether it should have acted differently on information that it had obtained. Something on which both counsel were agreed was that “they jolly well ought to have known” conveyed the right approach.

17. We have identified “the fraud” as being that the defaulting trader always intends to default. In contra-trading fraud only C is in the same chain as E and so E must know that C is covering up A’s fraud, which implies that E knows that there is a fraud

by A to be covered up. Accordingly, these are the frauds about which the question is whether the person ought to have known in the sense we have concluded above.

*Standard and burden of proof*

18. There is no disagreement that the standard of proof is to the normal civil standard but one which takes into account the improbability of fraud. This was graphically explained by Lord Hoffmann in *The Secretary of State for the Home Department v Rehman* [2003] 1 AC 153 at [55]:

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

19. It is common ground that the burden of proof of the question in paragraph 7(2) above is on Customs. There was some disagreement about the burden of proof in relation to the question in paragraph 7(4) above, whether the Appellant ought to have known about the fraud, but having heard the evidence from both parties we are able to decide this issue without its depending on who has the burden of proof. Accordingly we need not decide who has the burden of proof of this issue.

20. We had 9 ring binders of documents and heard evidence from Mr Hassan Habib, director of the Appellant, Mr Roderick Stone, HMRC MTIC Deputy National Coordinator and senior policy advisor, officer Walter Watt, the officer responsible for the Appellant, and officer Helen Harris, the officer responsible for Topnotch Corporation Limited (and also Owl Limited). In addition witness statements from officer Graham Speight, officer responsible for Executive Leisure Limited, and officer Kay Johnston, officer who carried out Nemesis checks, were admitted unopposed.

**The extent of fraud in mobile phone trading**

21. Before turning to the facts relating to the Appellant we should refer to the interesting statistics given by Mr Roderick Stone, MTIC Deputy National Coordinator and senior policy advisor in HMRC Risk and Intelligence Service. He told us that that in 2006 exports of mobile phones reached £14bn. There was a sharp increase in exports in 2005 after the Advocate General’s Opinion in *Bond House* (16 February 2005), with the largest volume following the ECJ decision (12 January 2006). EU exports of mobile phones reached maximum monthly peaks of around £500m in 2002 but then fell sharply in 2003 and 2004. From early 2005 they built up steeply from a low figure to a to a maximum monthly peak of £4bn in the quarter March to June 2006 and a similar but smaller pattern emerged for non-EU exports. Figures given in the House of Lords European Union Committee Report on Stopping the Carousel: Missing Trader Fraud in the EU, 25 May 2007, HL Paper 101 (“House of Lords Committee”) at evidence p 62, show that the value of MTIC-related trade rose from £4.4bn in the quarter to December 2005, to £11.6bn in the quarter to March 2006, and to £14.3bn in the quarter to June 2006, reducing to £2.2bn in the quarter to September

2006 and further reducing to £0.6bn in the quarter to December 2006. In consequence of the reverse charge introduced from 1 May 2007 the trade has dropped to less than £1bn pa that he accepts as including a legitimate grey market. Export deals in the grey market are normally in the region of £10,000 to £50,000. The other £13bn he regards as MTIC fraud. There are between 2,000 and 3,000 traders believed to be involved in MTIC fraud. 324,000 transactions chains have been examined of which 95 per cent are connected with fraud. Most of the overseas customers of the UK brokers have ceased business, which would not be the case if they were part of a genuine grey market. The Nemesis database of IMEI numbers kept by Customs shows that 70 per cent of the phones go round at least once. He described it as an enterprise to steal from the Treasury, rather than trading in phones at all. The phones were merely camouflage. One would expect a UK broker to source his phones on the European mainland and sell directly to the customer who is also on the European mainland. Instead phones are imported from say Spain and then exported to France, which he argued makes no commercial sense.

22. Published figures for Customs' estimate of MTIC fraud in 2004-05 and 2005-06 are £1.12bn to £1.9bn according to his witness statement (but we see from the House of Lords Committee at evidence p 63-4 that Customs originally estimated this as £1.4bn to £2.4bn for 2005-06, but considered that this was not "supported by operational indicators" and discontinued with the method, and produced a revised estimate of £3.5bn to £4.75bn).

23. There are 179,000 traders registered in the telecommunications and computer chip market, which includes all sectors from manufacturers to retailers. Only 178 traders have registered for the reverse charge, which would include all buffer companies.

24. Mr Stone told us that the description of the grey market given by Moses J in *R (Teleos) v Customs and Excise Commissioners* [2004] All ER (D) 73 (May) at [80]-[84], was based on an unchallenged affidavit in judicial review proceedings that Customs was not expecting to be used in this way, and did not accept it as an accurate description.

25. We consider that we should approach this evidence with caution. We do not doubt the statistics but we doubt that the extent of it had been publically revealed or was understood at the time of the deals in question within the trade. If everyone dealing in the mobile phone market in April to June 2006 had been told that there was a 95 per cent chance that the transaction was part of a fraudulent chain we could accept that almost anything out of the ordinary would be a pointer to fraud so that it could be said that the trader should have known about the fraud. This is essentially how Mr Moser put Customs' case. But this assumes that virtually everything is fraudulent, which is the point that is required to be proved. Taking Mr Stone's statement that a UK broker (exporter) in the position of the Appellant should source phones required by a European mainland customer on the European mainland, as an example, that assumes that sourcing them in the UK is fraudulent. If the price is in fact lower elsewhere that is a matter to be proved, and if Customs did prove it that would be a significant factor in showing that the whole chain of transactions was fraudulent, and that the exporter knew or ought to have known this. We are faced

with export deals in which a mainland European customer (and in one case a customer in Dubai) buys phones from a broker in the UK and the transport is included in the price. Unless the transaction is shown to be fraudulent we must assume that the customer is prepared to enter into the transaction because the price is lower in the UK.

- 5 We decline to assume that, because the UK broker buys phones in the UK, which have necessarily been imported since no mobile phones are manufactured in the UK, and sells abroad, this is a mark of a fraudulent transaction. We must start with the actual transaction and assume that it is a valid transaction unless there is evidence to the contrary.

## 10 The deal chains

26. The following table sets out the particulars of the deal chains:

No.	Date 2006	Phones	Defaulter	Buff-ers	Suppl-ier	Price £000	Customer	Price £000	Mark-up %
1558	03-Apr	500 N 8800	AC Electrical	2	Owl	215	URTB (Fr)	228	6.05
1559	04-Apr	1000 N 8801	FX Drona	3	E-Tel	491	Polska Telefonía (P)	524	6.72
1560	04-Apr	1000 SE W800i	FX Drona	3	E-Tel	156	Polska Telefonía (P)	166	6.41
1561	19-Apr	4000 N 6280	Worldwide Ent	3	E-Tel	804	Worldcellular (Fr)	860	6.97
1565	20-Apr	3000 N 9300i	Apollo Communi-cations	3	Owl	918	Dantec Ent (Sp)	973	6.05
1566	20-Apr	800 N N70	Apollo Communi-cations	3	Owl	174	Dantec Ent (Sp)	184	5.96
1567	24-Apr	3000 N 8800	Apollo Communi-cations	3	Owl	1260	URTB (Fr)	1335	5.95
1568	25-Apr	2000 N 9300	Computec Solutions	2	E-Tel	462	Space Telecom (Dubai)	488	5.63
1570	09-May	2759 S D 500	LTH	1	London Mobile	328.32	Paris 2000 (Be) (for 2760)	350.52	6.76
1572	10-May	4000 N 9300i	SS Enterpris-es	4	Owl	1216	URTB (Fr)	1252	2.96
1573	10-May	1000 N N91	SS Enterpris-es	3	Owl	385	URTB (Fr)	396.5	2.99
1574	12-May	2000 SE 810	Regal Emporium	4	Communi-cations World	442	World Communi-cations (Sp)	466	5.43
1575	12-May	2000 S D820	Regal Emporium	4	Communi-cations World	375	World Communi-cations (Sp)	396	5.6
1576	12-May	2000 N 8800	Tressle	3	Owl	774	Navigo (It)	798	3.1
1580	30-May	1000 N 8800	Teknik	4	Owl	381	URTB (Fr)	392.5	3.02
<b>Alleged contra-trades</b>									
1562	20-Apr	500 N 6280	NA	0	Topnotch Corp	101	Sigma Sixty (NL)	107	5.94

1563	20-Apr	3200 N 3230	NA	1 for 1600	Topnotch Corp	419.2	Sigma Sixty (NL)	444.8	6.11
1564	20-Apr	2100 N 6111	NA	0	Topnotch Corp	346.5	Sigma Sixty (NL)	367.5	6.06

*Notes to Table*

(1) N=Nokia; S=Samsung; SE=Sony Ericsson.

(2) Fr=France; P=Poland; Sp=Spain; NL=the Netherlands; It=Italy; Be=Belgium.

5 (3) The column “buffers” gives the number of parties between the defaulting importer and the Appellant’s supplier. In the alleged contra-trades there are no parties other than the ones shown, except that in deal 1563 1,600 phones were sold by Senbettel in Spain (the supplier of all of them) first to Executive Leisure and then to the Appellant.

10 (4) Names of companies are abbreviated; they are stated in full elsewhere in this decision.

(5) We find below that the VAT numbers of Teknik and Regal Emporium have been hijacked and the table should not be taken to imply that the real companies with those names are defaulters.

15 (6) Of the missing invoice numbers (1569, 1571, 1577, 1578, 1579) we were shown Nos 1577 and 1579 which relate to goods other than mobile phones. We find that the other missing numbers also relate to goods other than mobile phones rather than deals that were not concluded

20 27. We find the following facts in relation to the appeal generally. We find further facts in relation to the defaulting traders in paragraph 0 below, and in relation to whether the Appellant ought to have known about the fraud in paragraph 40 below:

25 (1) The Appellant was incorporated in 2000 and has since then until Customs refused the repayments under appeal in April and May 2006 traded in mobile phones. Mr Habib has a degree in business and law. Mr Murtaza (“Monty”) Jivraj was the son of a friend of Mr Habib’s father who was brought in as having some experience of mobile phones, having worked for Synectiv inspecting phones.

30 (2) The Appellant is in constant contact with suppliers and customers attempting to match supply and demand. It has insurance cover, and uses freight forwarders and warehouses approved by the insurers. A physical inspection of the phones is always undertaken by an independent inspection company. IMEI [international mobile equipment identity] numbers are scanned for all phones dealt in. No phones traded by the Appellant have been identified as having been dealt in before by the Appellant. Between 10 and 20 per cent of IMEI numbers are checked to see that they relate to the stated model of phone. No third party payments are made. Customs at Redhill are given details of all transactions. They are provided monthly with all invoices, due diligence material obtained, bank account details and freight documents. The due diligence material  
40 comprises the Appellant’s trading application form, standard business

terms and conditions drawn up by Russell Jones and Walker, solicitors, customer and supplier declarations so that suppliers are aware of Customs' recommendations in Notice 726, trade protocol questionnaire. Examples were given of four companies that the Appellant decided not to deal with as a result of information obtained.

(3) Customs keep a database of IMEI numbers known as Nemesis, which is not available to those outside Customs. This showed that in relation to the April deals for deals 1559 to 1568 (1558 is not mentioned) all but two (1562 and 1563, two of the alleged contra-trading deals) all had been scanned previously, in one case (1561) 7402 times previously. This implies that of the 4,000 phones in the deal one of them could have been previously scanned 8,301 times or all had been scanned about twice or any other combination. Similar figures were given for the May deals and, although the deal numbers in officer Johnston's witness statement did not correspond to the Appellant's deal numbers, we were satisfied from the documents that in all the deals except 1573 the phones had been scanned before the Appellant dealt in them.

(4) The grey market in mobile phones arises from authorised distributors over-ordering from the manufacturer, no doubt being given an incentive to do so, and this results in their releasing the excess phones onto the grey market. No mobile phones are manufactured in the UK and so all phones sold here are imported. The grey market will deal with fluctuations in demand between countries which will result in some exports from the phones imported into the UK.

## **Whether that tax loss was caused by fraud**

28. In relation to the alleged defaulting traders we find the following facts:

(1) Teknik and Regal Emporium are companies whose VAT numbers have been hijacked. In relation to the former there is an officer's note of a telephone conversation with the director of the real Teknik who expressed astonishment about an assessment for over £335,000 and wanted to know whether the letter was really from Customs. On the latter the officer was told in a letter of 29 September 2006 that the company had changed hands on 31 March 2006 and had not traded since.

(2) Mr Watt contacted the officers responsible for all the alleged defaulters. He obtained the following information, which includes information provided by officer Harris:

(a) AC Electrical Limited. The trader told the officer at a visit on 10 May 2006 that they had done no deals after March 2006 and were deregistered then. An assessment was made for over £4.5m on 21 December 2006.

(b) Apollo Communications Centre Limited. A visit was made on 24 April 2006 at which the period for making a return was shortened to and it was deregistered. The VAT on transactions

between 7 and 19 April (including deals 1565-7) amounted to over £23m. The trader filed a VAT return showing net VAT of just over £4,000 as a result of various credit notes. The final unpaid and un-appealed assessed amount was over £42m.

5 (c) Computec Solutions Limited. The trader was registered for software development and consultancy and computer components. Nil returns were submitted from September 2004 to 28 February 2006, and no return for the period to 5 May 2006. Attempted  
10 contact with the trader in May 2006 was unsuccessful and no contact was made and no records are held by Customs. Customs learned about the deals in mobile phones from a freight forwarder. Documents were obtained from their purchaser, Global Access International Limited. There are unpaid and un-appealed  
15 assessments for over £44.9m for the period 1 March 2006 to 5 May 2006 (we think that officer Harris's figure of £331,030 for the tax loss in her witness statement is an error). Mr Watt was not challenged on this evidence.

20 (d) FX Drona Limited. Customs visited the trader on 31 March 2006 and were told that there were no documents. The officer had obtained information from the freight forwarder, Point of Logistics, that the trader had acquired goods from Italy. There are unpaid and un-appealed assessments for over £31m.

25 (e) LTH Limited. Customs visited the business premises on 17 May 2006 and found that an unrelated business had been there for four weeks and there was no forwarding address for the trader, which was then deregistered. A Mr Tilstone telephoned the officer and said that he had purchased the company and gave an address. The officer said that the registration would be reinstated if proof of  
30 trading were produced. No further contact was made by Mr Tilstone. Documents were returned from this address as not known. Assessments were made from information from the customers which are un-appealed and unpaid of over £20m.

35 (f) Regal Emporium Limited. The officer was told by letter of 29 September 2006 that a person had purchased the company on 31 March 2006 and had since done no business. A letter asking for a meeting was returned on 18 October. The trader told the officer on 14 August 2006 that they had made no sales in the previous two quarters. Deregistration was backdated to 1 August 2005. This is a hijacked registration.

40 (g) Tressle Limited. The company was registered under power tools and garden accessories. The officer contacted the trader on 16 May 2006 uplifted paperwork on 17 May 2006, shortened the return period and de-registered the trader, to which there was no response and no return. The director confirmed to the officer that  
45 he purchased goods from Cyprus. There is an un-appealed and

5 unpaid assessment for over £9.9m for the 05/06 quarter. Mr Watt's witness statement said "Mr Aziz [the director] confirmed [to the officer] that he purchased from Cyprus and had not received any payments yet, but had been told by his suppliers that he would receive payment by the end of the month." Presumably the reference to suppliers should be to customers. We notice from the documents that Tressle gave a payment instruction on 12 May 2006 to its customer (Phone Shop (Leicester) Limited) to make a third party payment to its supplier (Macdelta, in Cyprus) of £760,300 and to pay the balance of £1,762.50 (changed by manuscript to £1,975). The total amount (taking the revised figure for Tressle's share) is £415 in excess of the tax-exclusive amount of the invoice; it is not clear whether the tax was ever paid. The amount received by Tressle would not have enabled it to pay the tax on the sale of £133,315. Tressle had presumably been paid its amount when it told the officer that it had not. Mr Watt considered that if the trader had become insolvent the assessment would have been appealed.

20 (h) Worldwide Enterprises Limited. The company declared its activities as general wholesale specifying clothing in reply to a query from Customs. Mail was returned as "gone away" on 1 August 2005, and from a new address on 23 January 2006. The officer had attempted to visit the premises on 19 April 2006 and found that it was a launderette with an insurance broker above. The insurance broker told the officer that the trader had used the property as a mailing address. It was deregistered from 1 June 2005, the date the return showed that it had ceased making supplies. The officer also attempted to visit the address given for the directors but both had recently been demolished. There is an unpaid and un-appealed assessment for over £66m. Mr Watt was not challenged on this evidence.

35 (i) SS Enterprises GB Limited. The VAT registration on 3 April 2006 was for retail trading in arts, decorations, furniture, rugs of African and European style, with an estimated annual turnover of £150,000 and an address at 8b Peabody estate, London W10. It did £25m of business in mobile phones between 26 April 2006 and 10 March 2006, virtually all acquired from Macdelta in Cyprus. There is an un-appealed and unpaid assessment for over £4.4m was made on 9 June 2006 for period 3 April 2006 to 10 May 2006 from details obtained from customers including deals 1572 and 1573 (both on 9 May 2006), the invoices for which do not show a VAT number. It was deregistered on 12 May 2006. Apart from the letter notifying the cancellation of the registration we know nothing more about contacts between the trader and Customs, although we infer that there was no response.

29. Mr Beal contends that Customs have failed to produce any direct evidence of fraud by the defaulter. He points out that in relation to two deal chains, Nos 1572 and 1580 Customs have not been able to substantiate the sequential release of goods for payment throughout the chain. For example, in No 1572 there is no purchase order to or invoice from SS Enterprises (the alleged defaulter) by Park Supplies, the first 5 buffer. There are third party payment instructions issued by Park Supplies to Excell Distribution Services Limited (not a party in the chain) and to Performance Specifications Limited (Park Supplies' customer) both to make payments to Macdelta (also not a party in the chain). These were not followed up by Customs. In No 1580 10 there are no purchase orders or invoices relating to Teknik (the alleged defaulter), or Infotel or Foneddealers, the first two buffers, the first document being the purchase order from Kingfishers Traders to Foneddealers. In relation to all of the alleged defaulters the fact that it has received an assessment and has not paid it or appealed is not enough. That could just as well arise with insolvency unconnected with any 15 fraud.

30. Mr Moser contends that ordinary business failure is utterly implausible in the light of Mr Watt's evidence. Mr Moser uses the following in support of his contention: Mr Stone's evidence of the small size of the genuine grey market; that for the reasons given by Mr Stone one should be cautious about Moses J's apparent approval of the 20 grey market in *Teleos*; that statistically only about 1 in 20 wholesale mobile phone transactions were not fraudulent; the importer defaulted in all 36 deals entered into by the Appellant between February and May 2006; in 13 of the deals the same phones had passed through the UK before or after the Appellant's deals; all the EU customers with one exception (Navigo) were subsequently deregistered in their home country; 25 World Communications was found to be fraudulent in *Calltell*; the Appellant's supplier, Owl Limited, sold directly to the Appellant's customers Dantec and URTB in the same period and on two occasions on consecutive days (20 and 21 April 2006). Mr Moser contends that it is proper to use hindsight and to include later events in making this determination.

30 *Reasons for our decision on proof of fraud by the defaulting traders*

31. In relation to the deals specifically mentioned by Mr Beal, in deal No 1572 Customs originally thought that the defaulter was Park Supplies but later a black bag of documents was mysteriously delivered to a Customs office by a taxi driver which indicated that Park Supplies was not the importer, which was SS Enterprises. In deal 35 1580 the identified defaulter is Teknik, which we find below is a case of a hijacked VAT number. We understand that the missing documents in this chain relate to transactions the details of which were obtained from the freight forwarder.

32. We have no objection in principle to Mr Moser's use of hindsight and later transactions to determine default, but we consider that caution is needed in relation to 40 some of his contentions. Customs are trying to prove fraud in relation to particular importers and so general points about the trade do not prove there was fraud in relation to the specific transactions before us. In particular, we do not consider that the later deregistration of the EU customers proves anything about the alleged (importing) defaulters without proof that they were jointly involved in a fraud. If 45 statistically only 1 in 20 deals in total are genuine, this does not mean that only 1 in

20 of the Appellant's deals are genuine. This assumes what Customs are trying to prove about the Appellant's deals (they would no doubt not use this argument in relation to deals by Vodafone's official distributor(s)). If the same phones have passed through the UK more than once this might equally mean that someone is fraudulent either before or after these deals. On his last point, direct deals between the Appellant's suppliers and customers (neither of which are alleged to be defaulters), a possible innocent explanation is that Owl sold a different type of phone direct to Dantec and URTB (Nokia 8800) than it sold to the Appellant which sold on to those companies (Nokia 9200i and N70). While we agree with Mr Moser that the general background is relevant to how sceptical one should be in relation to claims about business failure, it is still a question of looking at the evidence in relation to each alleged defaulter.

33. In determining whether fraud is proved we bear in mind that defaulters are normally missing traders and Customs cannot expect to obtain a perfect set of documents from them. Our decision in relation to each of them is:

(1) We find that the VAT registrations for Regal Emporium Limited and Teknik were hijacked, and accordingly find fraud by the persons using the numbers.

(2) AC Electrical Limited. The visit on 10 May 2006 established that the trader said that it had not entered into deals after 1 March 2006. Deal 1558 is inconsistent with this and we find fraud proved.

(3) Apollo Communications Centre Limited. The credit notes reducing VAT from over £23m to about £4,000 coupled with the unpaid and unappealed assessment is so suspicious that we find fraud proved.

(4) Computec Solutions Limited. We find this to be a trader that disappeared and find fraud proved. We point out that if officer Harris had not given additional evidence about this trader in relation to Topnotch's "dirty" chains we might not have accepted this as proved.

(5) FX Drona Limited. In the light of the visit and the officer being told that there were no documents we find fraud proved.

(6) LTH Limited. In the light of the company moving and not giving a forwarding address coupled with the false address given by Mr Tilstone (if Customs had made a mistake in the address given on the telephone Mr Tilstone would surely have contacted the officer again) this suggests that he was trying to reinstate the VAT registration for fraudulent ends. We are prepared to find fraud proved.

(7) Tressle Limited. The director told Customs that the trader had purchased goods from Cyprus, which ties in deal No 1576 on 12 May 2006 in which the supplier is shown as Macdelta with a Cyprus VAT registration. Therefore on 16 and 17 May 2006 Customs knew that the trader existed and was doing these deals. Apart from the fact of the assessment for the 05/06 quarter we have no further information and we do not know whether Customs took any further action. There is nothing to

5 suggest that the trader has disappeared. While it was registered under power tools and garden accessories, that does not mean that the trader could not have legitimately changed its business. We regard it as significant (although this was not pointed out to us by the witnesses) that the amount of the payment received by the trader from its customer, Phone Shop (Leicester) Limited, would not have enabled it to pay the tax due on the sale. It is also likely that it had been paid when it told the officer that it had not. We find fraud proved.

10 (8) Worldwide Enterprises Limited. On the evidence of the accommodation address and the return showing ceasing of business on 1 June 2005 we find fraud proved.

15 (9) SS Enterprises GB Limited. It was registered for VAT on 3 April 2006 with a trading classification of retail arts, decorations, furniture, and rugs, and then bought £25m of mobile phones between 26 April 2006 and 10 May 2006, leaving an unpaid assessment for over £4.4m. There is nothing to suggest that the trader has received the notice of deregistration or has disappeared, but the facts are so suspicious that we find fraud proved.

34. Accordingly, we find fraud proved in relation to all the above traders. We feel, however, that the evidence could have been presented to us in a more helpful manner.

## 20 **Whether the Appellant ought to have known about the fraud in the straight chains**

### *Guidance from Customs about MTIC fraud*

25 35. Since we equate “ought to have known” with a reasonable man test in paragraph 16 above we set out the guidance issued by Customs in relation to joint and several liability, which is not applicable to the facts of this appeal but Mr Stone considered the guidance to be equally applicable.

36. Notice No 726 on Joint and Several Liability (issued in August 2003) contains following guidance to traders to avoid becoming involved in MTIC fraud:

30 “2.3...The fraud relies heavily on the ability of fraudulent businesses to undertake trade in goods with other businesses that may be either complicit in the fraud, turn a blind eye, or are not sufficiently circumspect about their trading connections.

...

### *2.5 How will you establish ‘reasonable grounds to suspect’?*

35 You shall be presumed to have reasonable grounds for suspecting that the VAT on the supply would go unpaid if you have purchased the specified goods for less than:

- the lowest open market value of the goods; or
- the price payable for them by any previous supplier.

These tests, which are rebuttable presumptions (see section 3), are made without prejudice to any other way of establishing reasonable grounds for suspicion.

...

5 *3.3 Why do these factors demonstrate reasonable grounds to suspect?*

It is clear, from consultation, that businesses involved in the affected sectors are aware of the problems. In order for the fraud to be perpetrated the price has to be cut within the supply chain. This measure is aimed at businesses that either know who is carrying out the frauds, or choose to turn a blind eye. These businesses, if they do get caught up in the fraud, will have purchased goods that are priced either below the market price or at a lower price than that paid by a previous supplier in the chain. This is to the detriment of legitimate trade. Businesses that check the integrity of their supplies and the supply chain should not be affected by this measure.

15 ...

*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.

25 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;
- 30 • aspects of payments arrangements and conditions; and
- details of the movement of goods involved.

You can find examples of checks at section 8.

...

35 *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.

40 ...

*8. Dealing with other businesses - How to ensure the integrity of your supply chain*

### *8.1 Checks you can undertake to help ensure the integrity of your supply chain*

The following are examples of checks you make wish to undertake to help establish the integrity of your supply chain.

5 1) Undertaking reasonable commercial checks to consider the legitimacy of customers or suppliers. For example:

- What is the supplier's history in the trade?
- Are normal commercial arrangements in place for the financing of the goods?
- 10 • Are the goods adequately insured?
- What recourse is there if the goods are not as described?

2) Undertaking reasonable checks to ensure the commercial viability of the transaction. For example:

- 15 • Is there a market for this type of goods - such as superseded or outdated mobile phone models?
- Is it commercially viable for the price of the goods to increase within the short duration of the supply chain?
- Have normal commercial practices been adopted in negotiating prices?
- 20 • Is there a commercial reason for any third party payments?

3) Undertaking reasonable checks to ensure the goods will be as described by your supplier. For example:

- Do the goods exist?
- Have they been previously supplied to you?
- 25 • Are they in good condition and not damaged?

We recommend that sufficient checks be carried out in each of the above categories to ensure that you are not caught in a fraudulent supply chain.

### *8.2 Checks carried out by existing businesses*

30 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:

- obtain copies of Certificates of Incorporation and VAT registration certificates;
- 35 • verify VAT registration details with Customs and Excise;
- obtain letters of introduction on headed paper;
- obtain some form of trade reference, either written or verbal;
- obtain credit checks or other background checks from an independent third party;

- insist on personal contact with a senior officer of the prospective supplier, making an initial visit to their premises whenever possible;
- obtain the prospective supplier's bank details, to check whether:  
5 (a) payments would be made to a third party; and  
(b) that in the case of import, the supplier and their bank shared the same country of residence.
- check details provided against other sources, eg website, letterheads, BT landline records.

10 Paperwork in addition to invoices may be received in relation to the supplies you purchase and sell. We believe that this documentation should be kept as evidence of a transaction's legitimacy. The following are examples of additional paperwork that some businesses retain:

- purchase orders;
- pro-forma invoices;
- 15 • delivery notes;
- CMRs (Convention Merchandises Routiers) or airway bills;
- allocation notification;
- inspection reports.

20 Again this is not an exhaustive list, but does show some of the more common subsidiary documentation."

37. Customs provide a service checking the validity of VAT registration details of customers and suppliers in this industry. The reply is in the following terms:

25 "I can confirm that the VAT registrations listed below/above are valid at this time. This confirmation is not to be regarded as an authorisation by this Department for you to enter into commercial transactions with this trader and any input tax claims you make may be subject to subsequent verification."

*Memorandum of Understanding between Customs and the Mobile Phone Industry*

30 38. The Appellant together with 81 other companies is a signatory to a Memorandum of Understanding between Customs and the Mobile Phone Industry which contains the following Code of Conduct.

"Major distributors who are signatories to the Memorandum of Understanding have agreed that they will adhere to the following procedures when purchasing mobile phones from a new supplier or supplying mobile phones to a new customer.

35 The following factors will be considered before purchasing stock from a new supplier [supplying stock to a new customer]<sup>2</sup>

- How long have they been trading and do they have any history in the trade?

---

<sup>2</sup> We have merged two lists in the first seven bullet points, and accordingly the order of items is different from the two separate lists.

- Does the supplier [customer] have sufficient knowledge of the industry to warrant their level of anticipated business?
- Have they been unable to sell to [purchase stock from] your competitors—if so why?
- 5      • What knowledge do credit search companies used by you have of the supplier [customer]?
- Is the supplier's [customer's] bank account in a different town or country to their main business address?
- 10     • Have you met the supplier [customer]—if not do you have to contact them through a third party?
- Do you have doubts over the supplier's [customer's] credibility or feel there is a risk attached to the deal—is it good business acumen to trade with this person?

[The following are items relating to the supplier only]

- 15      • Is the business registered for VAT?
- If the trader is new to the business how can he have the contacts to provide products at such an attractive price?
  - Is the suggested price per unit too low for the type, age and model of the phone?
  - 20      ○ Should this product be provided at this price at this time?
- Are the delivery arrangements for the goods financially viable and do you know where they come from?
- Will the IMEI numbers of each phone be shown on invoices?
- Do you recognise the person supplying you with the mobile phones; have they changed their name or other details to present a new identity?
- 25      • Does the supplier use a local address; do you know if the address is a residential or accommodation address?
- Is payment or part-payment for the mobile phones being made to a third party?
- 30      • Is there a similarity between the invoices/paperwork of different suppliers?

[The following are items relating to the customer only]

- Does the customer always want to buy, no matter what the price?
- 35      • Are the goods to be delivered to the country where the customer is resident or are they to be delivered to another country?
- Will the country of destination of your goods be the same as the country that your customer operates in and will payment originate from that country?
- 40      • Is their courier or shipper reputable—if goods are being exported will original documents be available?

- What are the arrangements for payment—do you trust the customer?”

*The Appellant’s evidence to the House of Lords Committee*

39. The Appellant provided written evidence to the House of Lords Committee. Included in their evidence is the following:

5                   “Obtaining an individual derogation is not a sustainable solution in the long-term, what HMRC need to do is the following and these are only my suggestions.

...

10                  10. Transactions which are in a chain and represent more than three or five people should not be authorised or conducted unless the taxpayer, supplier and customers can demonstrate all those in the chain are identifiable, registered for VAT purposes under the trade classification of ‘Telecoms,’ and conducting business for more than one year and all information possessed by HMRC on their system match the ones sent by the trader.”

15    *Findings of fact*

40. We find the following facts in relation to this aspect:

(1) The Appellant was aware of the identity of its supplier and customer and since it knew that the supplier was not the importer it knew that there was at least the supplier’s supplier in the chain.

20                  (2) Information, including Graydon credit reports, was obtained for both customers and suppliers. These showed:

*Suppliers*

25                  (a) Owl Limited. 2 Graydon reports dated 16 January 2006 and 4 April 2006 (deal 3 April 2006, rest 20 April 2006 or later). Normal credit risk, guide £1,750 per month (at 16 January 2006); low normal credit risk, guide £15,000 per month (at 4 April 2006); shareholders’ funds at 16 January 2004 £2,000 increased to £80,000 at 4 April 2006; trade classification telecommunications. The Appellant has had a business relationship with them since

30

(b) E-Tel Limited. Graydon report dated 25 January 2006. Last filed accounts were for 2004. Shareholders’ funds at 31 December 2004 £169,000; turnover not required to be disclosed but likely to be £2.8m to £11.2m; trade classification telecommunications; the company was in dispute with HMRC. The Appellant has had a business relationship with them since July 2005.

35

(c) London Mobile Communications Limited. Graydon report dated 17 January 2006. Sole trader, above normal credit risk; non-trading at 30 September 2004; amended VAT registration 18 January 2006 showing trade classification retail of mobile telephones. Letter from the accountants of 17 January 2006 informed the Appellant that the company was trading but gave no further information. The Appellant has known the director for “some years” (witness statement), changed to “maybe six or seven months” (cross-examination), then changed to “maybe a year then,

45

or two” when the discrepancy was pointed out, before the deals in question.

5 (d) Communications World Limited. Graydon report dated 12 May 2006 (the day of the deal). Credit rating high risk; VAT registration amended 18 July 2005, trade classification telecommunications; latest accounts 31 December 2004 shareholders’ funds minus £123,000. The Appellant has had a business relationship with them since May 2005.

10 (e) (Topnotch Corporation Limited is considered under the heading *Alleged contra-trading* below)

*Customers*

15 (f) URTB Sarl (France). Graydon report dated 16 March 2006. Credit rating 2 (out of 5; 1 being highest risk), previously 9 (used for non-trading companies); latest accounts 31 December 2002 which showed negative shareholders funds; requirement to file annually; business *Autres commerces de gross de biens de consommation* (French VAT registration), “import export telecommunication cosmetique et textile, restaurants (traditional)” (Graydon report) “5530 licensed restaurants and cafes including fast food outlets, take aways and mobiles” (NACE code in Graydon report). The Appellant has had a business relationship with them since March 2006 but never met the director.

20 (g) Polska Telefonía (Poland). Graydon report dated 19 April 2006 (after the deal) (business name of sole trader Jan Strzelecki); credit rating 8 (risk unknown); no other financial information given; first registered 28 August 2005.

25 (h) World Cellular Sarl (France). Graydon report dated 7 March 2006. Credit rating 2 (out of 5); no other financial information given; activity wholesale of components and other electric equipments (Graydon); *l’achat et la vente de tout materiel electronique et notamment des telephones portables et accessoires* (trade register). The Appellant has had a business relationship with them since March 2005.

30 (i) Dantec Enterprises SL (Spain). Company registered on 13 January 2005. Graydon report dated 20 January 2006. Credit risk unclassified; wholesale of radioelectric appliance, wholesale of electrical household appliances and radio and television goods. The Appellant has had a business relationship with them since January 2006.

35 (j) Space Telecom Company FZE (free zone company) (Sharjah UAE). Graydon report dated 16 March 2006. Credit risk 3 (out of 5) medium risk; guide Eur 6,145 per month. Licence Certificate issued on 19 September 2004 is for “export/import of telecommunication equipment.”

5 (k) Paris 2000 Sarl (Belgium). Graydon report dated 9 May 2006. Credit risk 1 (highest risk out of 5); latest accounts 31 December 2003; activities wholesale of clothing and footwear; sale of shares on 12 and 13 January 2006 to Manor Sheriff but Mr Habib was unaware of this; Belgian VAT Registration Certificate dated 13 March 2006 gives the activity as *importation et exportation de materiel telephonique mobile*.

10 (l) World Communications Imp-Exp SLU (Spain). Graydon report dated 12 May 2006. Sole trader. Credit risk 3 (out of 5); business—wholesaler of electrical household goods; latest accounts 31 December 2003 loss of Eur 1.2m on sales of 1.8m; shareholders' funds Eur 3,760. The signed copy of the Appellant's trading conditions was dated 15 May 2006 (deal 12 May 2006); Mr Habib explained that this customer did not understand them and wanted to be sure of the goods before signing. He never met the  
15 director.

20 (m) Navigo.It Spa (Italy); Graydon report 22 May 2006 (deal 12 May 2006). Credit rating 5 (out of 5) low risk; sales Eur 113m, profit Eur 1.6m, shareholders funds Eur 2.9mn in 2004. Graydon activity: wholesale of various machines, tools and equipment for industry, trade, navigation, handcraft & agriculture, wholesale of radio-electric, telephonic and television materials. March 2006 VAT certificate gives the activity as *ingrossi di elettrodomestici di apparecchi radiotelevisi*.

25 (n) (Sigma (Sixty) BV is dealt with under the heading *Alleged contra-trading* below)

(3) The Appellant usually checked with the freight forwarders that they knew of the companies concerned.

30 (4) Pricing in whole pounds or possibly 50p was normal for the Appellant and for the buffers (although this would not be known to the Appellant). While we find this pricing surprising for such large deals, there was no evidence that the pricing of other traders especially for example authorised distributors to the manufacturers like Nokia was different. We were also  
35 not provided with evidence that the prices at which the Appellant sold phones to its overseas customers were out of line with wholesale and retail prices of the same type of phone in each specific country and that that information would have been available to the Appellant.

40 (5) The Appellant asks for all IMEI numbers to be checked and put on a database. It has not dealt in phones having the same number more than once. Nemesis information showed that phones purchased from Owl had been traded previously; and that Owl later traded in goods that the Appellant had previously purchased from another source.

(6) The Appellant asks for an inspection of the phones. We were taken to one invoice for inspection of 500 phones for £100 plus VAT during the

hearing, but noted a number of other examples of invoices in the documents.

5 (7) The goods are insured in transit for £1m in any one vehicle, £5m in three named freight forwarders premises and £2m in other locations at a premium of £48,000 (we find that the invoice for £12,000 stated to be for the period 11 April 2006 to 11 April 2007 is an error because it conflicts with the policy).

10 (8) The Appellant's business terms and conditions provided that when the Appellant was the buyer "7.1 Risk of damage to or loss of the Goods shall pass to the Seller [Buyer?] upon delivery to the Buyer in accordance with the Contract. 7.2 The property in the Goods shall be of the Seller upon delivery, unless payment for the Goods is made prior to delivery, when it shall pass to the Buyer once payment has been made and the Goods have been appropriated to the Contract....13.3 The Buyer reserves the right to cancel any transaction with the Seller at any time if the above conditions of sale are not fully complied with. In this event, the seller agrees that it has no legal recourse against the Buyer." The last of these may have been added by the Appellant to the document drafted by the solicitors as it is in different spacing from the rest. When the Appellant is the seller risk passes to the buyer at the time of delivery if delivery is made otherwise than at the seller's premises, but title does not pass to the buyer until the seller has received cleared funds for payment in full for the goods.

20 (9) Many of the Appellant's suppliers and customers banked with First Curacao International Bank ("FCIB"). The Appellant had an account there but did not use it. The Appellant was aware that high street banks in the UK were reluctant to allow mobile phone traders to have accounts with them.

25 (10) In respect of four lorries taking goods to Madrid for Dantec, three returned earlier than they could have done if they had been to Madrid. The written explanation given by the transporter's subcontractor (which on balance we accept in the absence of any evidence to the contrary) was that the vehicles had developed an electrical fault affecting the lights and windscreen wipers and the load was continued in a larger vehicle. The CMRs were not altered to reflect this.

30 (11) Verifications of all VAT numbers of suppliers and customers were made by Customs at Redhill before release of the goods, although some of these were after the date of invoice which means that while the Appellant could still stop the goods they would have to be brought back to the UK if confirmation had not been obtained.

35  
40 *Contentions of the parties*

41. Mr Beal contends:

(1) The Appellant knew about the possibility of fraud and took reasonable precautions, such as 100 per cent IMEI scans and physical inspection, and compliance with Notice 726, which Mr Stone considered should be

5 applied by analogy. Customs were satisfied about the steps taken and approved earlier refunds where the trading pattern had been similar and many of the parties the same. In particular, Customs have made reference to transactions in January and February 2006 being traced back to a defaulting trader, but repayments were made to the Appellant. Officers conducting a visit in February 2006 accepted that it was hard for the Appellant not to get caught unwittingly. They confirmed that IMEI numbers supplied by the Appellant were genuine. Officer Watt could not think of any other steps the Appellant should have taken. It was not until 1 August 2006 that Customs suggested that they obtained confirmation from the IMEI scanning company that the Appellant's phones had not been scanned for other customers of the scanning company. Mr Habib is a director of a scanning company that would refuse to give this information on the grounds of confidentiality, as was the case with Customs' information on Nemesis, and he did not consider that any others would do so. The fact that the Appellant knew that there was fraud in this market does not mean that as regards the Appellant's involvement the need for cogent evidence is diminished.

20 (2) Back-to-back transactions are the normal way of conducting business in the grey market. Goods are delivered to the neutral territory of the freight forwarder as required by the insurers and as security for non-payment. No deals were completed in the sense of the goods being released until Customs at Redhill had verified the VAT registrations of the parties. The variation in mark-ups between 2.96 and 6.97 per cent is an indication of genuine trading. Credit checks were not important to the Appellant since it was not granting any credit; it was Notice 726 that required them. It is not alleged that any of the customers failed to pay VAT in their own countries. The overseas customer is of little relevance to the question whether the Appellant ought to have known about the fraud by the UK importer at the start of the chain.

42. Mr Moser contends (any statements of fact as opposed to contentions included therein are facts that we find):

35 (1) Mr Habib's evidence was not credible. In particular, his company literature described him as having previous experience as a "legal consultant at Erskene (sic) Chambers and Holborn Chambers, and as a strategic consultant to Price Waterhouse Coopers." The former was work experience as a student and the latter was a two-month job in Tanzania at the age of 17. Secondly, he was asked about dividend payments by the Appellant in 2006 and replied that they were £5,000 or £6,000 which he revised to £10,000 to £20,000. When the accounts were produced (which were not in the papers but we agreed to admit them) they showed dividends of £636,159.

45 (2) The Appellant regarded its due diligence as assisting in protecting it against the risk of loss rather than against the risk of being involved in a fraudulent transaction. No notice was taken of Graydon reports showing

poor credit risk because the Appellant was not giving credit to anyone. No action was taken on the basis of any of the odd features identified by the Graydon reports.

5 (3) The Appellant knew of fraud in the market and the workings of MTIC fraud; it knew that the goods were imported; all the deals were quick, for exact quantities (usually of exact thousands); no stock was held; mark-ups were in whole pounds; same-day back to back deals where no loss was made; most of the suppliers and customers banked with FCIB; some purchasers wanted delivery to warehouses in different cities or countries  
10 from their place of establishment; there were frequent matches of the same and suppliers with the same customers (Owl to URTB 5 times); it knew it was in chains of transactions; Mr Habib and Mr Jivraj who were at the time two men in their 20s running their first company were able to have a turnover of £80m a year without financial risk. It was too good to be true.

15 (4) The 100 per cent inspection of phones was not possible in the time frame involved, particularly in relation to deals 1565 and 1566 in which 3,800 phones were shipped on the same day.

(5) The CMRs relating to the lorries that were alleged to have broken down were false in not recording the change of lorry.

20 *Reasons for our decision in relation to “ought to have known”*

43. We have set out the test that we consider should be applied in paragraph 16 above. In considering what a reasonable trader in the Appellant’s position would have done we are heavily influenced by Notice 726, which Mr Stone agreed should be applied by analogy, and also the Code of Conduct, as something that the Appellant has  
25 voluntarily agreed to carry out. We do not pay any attention to the Appellant’s evidence to the House of Lords Committee since it was primarily a suggestion of what Customs should be doing in the future.

44. We consider that some of the indicators relied on by Mr Moser relate to the trade in general and are not relevant in assessing whether the Appellant ought to have  
30 known of the fraud in the deal chains in which we have found fraud. If something is normal in the trade then it is not likely to excite suspicion. Mr Stone would no doubt say that it is only normal because 95 per cent of the trade is fraudulent but we have already stated that we start from the view that something that appears to be commercial is commercial, and if Customs say it is fraudulent, that is something that  
35 needs to be proved by evidence. We include the following: quick back-to-back same-day deals with any stock being held to order until payments are made; dealings usually in the same quantities of goods in the chain; mark-ups in whole pounds (in one case 50p); many of the companies banking with FCIB when UK high street banks would not allow mobile phone traders to have accounts.

40 45. Next we consider the credit ratings bearing in mind that the Appellant was not giving any credit. The Appellant was dealing in significant amounts; the deals have an average selling value of £587,000 and a median of £466,000. Should it have wondered how persons with such low credit ratings could find the money with which to deal? The problem with placing too much reliance on this, as Mr Beal pointed out,

is that there was fraud in the chain in cases where the credit rating was above average or showed the lowest possible risk, as in the case of Navigo.

46. So far as the suppliers are concerned there is little unusual about them. Although London Mobile Communications Limited had an amended VAT certificate on 18  
5 January 2006 we do not think that Mr Moser is correct in saying that it had changed hands then as the director who signed the contractual conditions had been appointed on 19 September 2003 and was listed in the Graydon report as the holder of all the shares. The amendment to the VAT certificate could have been a change in the bank details. We do not regard the fact that it was dormant over 18 months before the deal  
10 as particularly relevant. The fact that its trade classification is that of retail of mobile phones is not so far removed to be indicative of fraud.

47. The customers are less straightforward. Although most of the trading activities could include wholesale trading in mobile phones, doubtful cases include (1) World Communications' activity being electrical household goods, (2) URTB's activity of  
15 *Autres commerces de gross de biens de consommation*, which may not have been understood by the Appellant, as Mr Habib does not speak French, but which we believe means wholesaler of consumer goods (in the French VAT registration), and "import export telecommunication" (in the Graydon report) and the reference to mobiles in the NACE code, in spite of the other references to restaurants, and (3)  
20 Paris 2000 Sarl's activity in the Graydon report of "wholesale of clothing and footwear" but the Belgian VAT Registration Certificate dated 17 March 2006 clearly shows import and export of mobile phones, implying a recent change of activity. It is noticeable that the Code of Conduct with the industry does not mention the classification of trading activities as something to look out for, except possibly under  
25 the very general heading "What knowledge do credit search companies used by you have of the supplier [customer]?".

48. There are also some very out-of-date accounts for the customers: URTB 31 December 2002; Paris 2000 and World Communications both 31 December 2003, and no accounts at all in the case of Polska Telefonía, World Cellular, or Dantec but we  
30 put this information in a similar category as credit risk; the Appellant was not relying on their credit worthiness or their net worth.

49. One of the questions relating to the customer in the Code of Conduct is "How long have they been trading and do they have any history in the trade?" Polska Telefonía had been registered only in August 2005, and Dantec in January 2005.  
35 Paris 2000 was previously a clothing company, had changed hands in January 2006 and was VAT registered for mobile phone trading in March 2006. The Code of Conduct lists items to be considered and this is something that the Appellant clearly did not take into account. However, this factor does not give any indication about possible fraud, as would have been the case, for example, if Paris 2000 had still been  
40 registered as a clothing company.

50. So far as we are aware all the goods were delivered to the same country as the customer's establishment, except for the deals with Polska Telefonía which were shipped to Paris as the Appellant explained that the freight forwarder had no secure

warehousing facilities in Poland. Mr Moser pointed to the delivery of Dantec's phones to Madrid, where the warehouse was, rather than Barcelona, where Dantec was, but we see nothing unusual in this, particularly as the Code of Conduct refers to the country ("Are the goods to be delivered to the country where the customer is  
5 resident or are they to be delivered to another country?"). We are also not aware of any other factors relating to the customers in the Code of Conduct that were not satisfied.

51. A more prudent or cautious trader might have tried to obtain further references and/or information about the trading activities of especially those companies like  
10 URTB, Dantec, Paris 2000 and World Communications where the first contact appears to have been in 2006 and the Appellant had not met the customer. However, we are mindful of the fact that Mr Habib did not speak French, Spanish or Polish and consider that it would not have been easy for him to discover facts that might have made him more cautious. It is also the case that the emphasis in Notice 726 is on the  
15 supplier and the supply chain, for example the reference to the purchase price in para 2.5, the supplier in para 4.5 ("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") and the questions relating to the supplier in para 8.1; the customer is mentioned only at para 8.2.

20 52. Based on Mr Stone's information from Nemesis that 70 per cent of phones go round more than once, the fact that the Appellant has never dealt in the same phones suggests that it is trading better in this respect than other traders. Customs have information through Nemesis about which the Appellant could not know, that its phones have been dealt in by others. We do not consider this is relevant to deciding  
25 what the Appellant ought to have known.

53. The evidence on the 100 per cent inspection of the phones is largely untested but we have one invoice which seems credible (500 phones inspected for £100 plus VAT). Mr Habib was unaware of how inspections were carried out. While we share Mr Moser's doubts whether such inspection was possible in the time involved in  
30 relation to deals 1565 and 1566, we are not prepared to find as a fact on the basis of supposition rather than evidence of how long an inspection might take, that it was impossible in the time involved, or that inspections did not take place merely because we were not taken to the invoices in the hearing.

54. We have on balance accepted the explanation of the lorries breaking down on the  
35 way to Spain in the absence of any evidence to the contrary. If the CMRs should have been altered but were not that may indicate breach of some regulation, but we find it irrelevant to this issue. If Customs consider that the phones did not reach Spain they can (subject to *Teleos*) reverse the zero-rating of the deal.

55. Lastly, we stand back and ask ourselves whether as a whole the Appellant ought  
40 to have known about the particular frauds. We start with Mr Habib's credibility. We agree with Mr Moser that the description of his previous business experience was "over the top," and his evidence about not knowing the amount of the dividend in 2006 was not credible. We are slightly more sympathetic to his changes of mind

about how long he knew the directors of London Mobile Communications and Topnotch (see below) because the question related to how long he had known them in April 2006, nearly two years before the hearing. He seemed to us to be naïve in business matters, for example merely asking the freight forwarders orally if they knew the person they were dealing with, not examining the Graydon reports more critically, not knowing how inspections of phones were in fact carried out, not realising how the customer (as opposed to the supplier) could be involved in VAT fraud and hence not being alerted when all the customers he dealt with in May 2006 were new to him (although one should point out that Notice 726 concentrates on the supplier), and still at the time of the hearing seeming to believe that sending details of deals to Customs in Redhill was protection against fraud when all Customs were doing was checking that the parties were registered for VAT. However, we bear in mind that he was aged 24 with no previous business experience when the Appellant started in 2000 and about 30 at the time of the deals in question. The question we have to ask is whether the deals should have seemed too good to be true to a reasonable trader with his attributes, particularly his business experience. He managed to deal with almost no financial risk buying on credit and selling for cash without the danger of being left with any stock if the price went down. The margins are not so large as to excite suspicion (2.4 per cent of turnover after distribution costs for 2004-05 according to the accounts). He had cooperated fully with Customs who had repaid input tax in the past and nothing about the pattern of trading was particularly different in the two periods concerned.

56. Weighing up all these factors, we consider that Mr Habib was, on account of his inexperience, naïve and gullible. Had we decided that the test of “ought to have known” should be based on an ordinarily competent director we might well have decided that such a person ought at least to have made further enquiries, but we have based the test on the experience of the particular director, Mr Habib. He was the ideal person for a “puppet master” to involve in fraud without his knowing. On balance, we believe that a person with his experience would not have known that there was fraud in the deal chains. Accordingly we conclude that it cannot be said that he, and accordingly the Appellant, ought to have known about the fraud in the deal chains.

### **Alleged contra-trading**

57. We find the following facts in relation to the alleged contra-trading (see the table above for particulars of the deals):

- (1) The Appellant knew Topnotch, the importer and their supplier (and alleged contra-trader) for a period stated in Mr Habib’s witness statement as “a long time” and given variously as between six months and a year.
- (2) In these deals the Appellant was approached by Sigma Sixty, their customer, through the website in the morning and by Topnotch in the afternoon of 20 April 2006.
- (3) All three deals consisted of phones supplied by Senbettel (Spain) to Topnotch, except that in deal 1563 1,600 out of the 3,600 phones were sold by Senbettel first to Executive Leisure Limited and then to Topnotch,

5 while the other 1,600 were sold directly by Senbettel to Topnotch. The  
CMRs for these deals all show all the goods (whether from Senbettel or  
Executive Leisure) being consigned by Bell Trask (Luxembourg) and  
arriving together. Topnotch passed the CMRs to the Appellant blanking  
out the name of Bell Trask. The director of Executive Leisure Limited  
told officers that he had previously provided security for and chauffeured  
the director of Topnotch (although the evidence of this is in a visit report  
of officer Speight that is not mentioned in his witness statement, but we  
accept it). The director of Topnotch is also the director of Cashcourt  
10 Limited. A Cashcourt document dated 10 April 2006 (not relating to any  
of the deals with which we are concerned) was produced requesting the  
allocation of certain goods to Executive Leisure, and ended “best regards,  
Executive Leisure.” The brother of the director of Topnotch is the major  
shareholder of Owl Limited (but not a director), although Mr Habib said  
15 (and we accept) that the two brothers did not get on well together.

(4) In the three-month period to June 2006 Topnotch paid net VAT of  
£919.79. In April 2006, the same month as the deals with the Appellant, it  
entered into 13 deals, 6 as exporter (all of which were in a tax-loss chain)  
purchase value £2,278,500 (we assume VAT-exclusive), 4 as a buffer  
20 (three of which were in tax-loss chains) and the three deals with the  
Appellant where it was the importer and the Appellant was the exporter  
(none of which was in a tax-loss chain), sales value £657,100. In the  
export deals the defaulter was Worldwide Enterprises Limited in one and  
Computec Solutions Limited in five. Topnotch is about to be assessed in  
25 relation to the export deals (but not the buffer deals) on the basis that it  
knew or ought to have known that it was engaged in fraudulent chains;  
officer Harris would have done this immediately had she not been in the  
Tribunal in this appeal.

(5) At the end of the June 2006 period Topnotch bought 2,000 Nokia N70  
30 phones from Kavico Aps (Denmark) for £197 per unit equals £394,000,  
and sold them to Executive Leisure (see paragraph 57(3) above for the  
connection between the two companies) at £200 per unit equals £400,000  
plus VAT of £70,000. Kavico telephoned to say that they could not supply  
the phones and the deals were cancelled on 3 July 2006 in the next VAT  
35 period. The director of Topnotch agreed that the normal procedure had not  
been followed for these deals. Topnotch told the officer that they had dealt  
with Kavico some months before but the officer could not find this.  
Officer Harris described these as three deals (or possibly four in her  
evidence) but we have details only for the one just described, which  
40 suggests that there were others.

(6) Officer Harris said that there was a further import by Topnotch in May  
2006.

(7) Information obtained by the Appellant about both companies was:  
45 (a) Topnotch Corporation Limited (UK). Information was  
received from them on the day of the deals, at 16.44 hours on the

5 fax header. Credit rating high risk; activity according to the Graydon report was retailer of mobile phones; VAT trade classification telecommunications; the trading application form states that they heard about the Appellant from the internet; last filed accounts to 31 December 2002 showed an increase in shareholders' funds (suggesting a post-tax profit) of £93,000, and net worth £167,000.

10 (b) Sigma (Sixty) BV (Netherlands). Name change on 29 December 2005; credit risk 5 (out of 5) guide Eur 6,000 per month; managing director in Dubai; registered activity wholesale trade in vehicles and vehicle parts and accessories, wholesale trade in electro engines, wholesale trade in office machinery and equipment; Graydon report 2 May 2006 (deals were on 20 April 2006); number of employees 1 on trade register (22 February 2006) (also in Graydon report), 3 on trading application form sent 20 April 2006.

20 (8) Officer Harris, the officer responsible for Topnotch, stated that she was about to assess Topnotch as exporter on the basis of a means of knowledge case, not actual knowledge, of the dirty chains. In her witness statement officer Harris did not state that she considered that Topnotch knew that they were deliberately cancelling their net input tax claim by the deals with the Appellant (and the three cancelled deals with Executive Leisure), but she stated that these were contrived deals. In evidence during cross-examination she considered that there was some evidence to support this. She said in answer to the tribunal that she thought that Topnotch knew that this was what they were doing, and thought it unlikely that they were being manipulated by someone without knowing it. We were impressed by the way officer Harris gave evidence. She was unwilling to say anything for which she did not have good evidence, and was therefore reluctant to give her own impressions.

*Contentions of the parties*

58. On this aspect the issues are:

- 35 (1) Whether there was a relevant tax loss in the dirty chain, which is not in dispute.
- (2) Whether that tax loss was caused by fraud, which is disputed.
- (3) Whether that fraud was connected to Topnotch, which is not in dispute.
- (4) Whether Topnotch knew (not ought to have known) that VAT was likely to be withheld and contrived to offset that input tax with an ostensibly clean chain including the Appellant, which is in dispute.
- 40 (5) Whether the Appellant ought to have known that the three deals were connected with fraud, which is in dispute.

59. Mr Moser contends:

(1) Point (2) in the previous paragraph relies on the same evidence as in relation to the Appellant,

5 (2) On point (4) officer Harris considered these to be contrived deals. The cancelled deals with Executive Leisure Limited, which had a connection with Topnotch through the ex chauffeur of the director of Topnotch, are suspicious.

10 (3) On (5) the deals were unusual for the Appellant being purchases directly from the importer; the due diligence was absent or poor for both Topnotch and Sigma Sixty; it is suspicious that both companies contacted the Appellant on the same day and were able to conclude matching deals totalling over £919,000 that day. The Appellant should have suspected that it was being used and that such a deal was too good to be true.

60. Mr Beal contends:

15 (1) Officer Harris said nothing in her witness statement about Topnotch's participation in any fraud. Officer Speight did not give evidence about the connection between Topnotch (and Cashcourt) and Executive Leisure. The evidence about the Cashcourt document referring to Executive Leisure is based on supposition as it could be a typing error since Executive Leisure was previously named in the document. If there was any fraud in  
20 the cancellation of the three deals at the end of June 2006 this is wholly unconnected with the deals between Topnotch and the Appellant on 20 April 2006.

25 (2) According to officer Harris's evidence Customs are alleging only means of knowledge against Topnotch, which is not sufficient for their purposes.

*Reasons for our decision in relation to alleged contra-trading*

61. On point (2) in paragraph 58 we have already found fraud proved in relation to Worldwide Enterprises and Computec Solutions in relation to the Appellant's deals.

30 62. We consider that there is a logical flaw in Mr Moser's case on this aspect of the appeal. If, as officer Harris considered, Topnotch ought to have known about the frauds in the dirty chains, but did not know, we do not understand how it can be argued that Topnotch knew it was covering up the fraud by entering into the alleged contra-trading transactions with the Appellant, if they did not know of the fraud.

35 63. Making any findings of fact about the involvement of Topnotch in fraud in their absence is something for which we would need cogent evidence. We agree with officer Harris that on the evidence the highest she could put it was that Topnotch ought to have known of the frauds.

40 64. In any event, we do not consider that we have full information about Topnotch's deals in the 06/06 and subsequent period. Given the figures for April 2006 in officer Harris's witness statement and assuming that the net VAT payable on the buffer deals is negligible there were outputs of £657,100 for the sales to the Appellant and inputs

of £2,278,500, suggesting a repayment of the order of £283,000. That was cancelled by the three deals at the end of June 2006 on which the VAT on the only deal we have information about was £70,000 plus an unknown deal in May 2006. It may be that we have information about only one of the three deals mentioned by officer Harris. This  
5 lack of evidence is particularly unsatisfactory. If it is said that the deals with the Appellant on 20 April 2006 deliberately cancelled a repayment, there must have been another deal in May with the same purpose, about which we have no information, and the same for the deals at the end of June that were subsequently cancelled, about which it seems that we have incomplete information. We would expect that if the  
10 deals with the Appellant were deliberately entered into to offset the input tax claim, it would have cancelled more of it. Although cancellation was complete by the end of the period the cancelled deals, while containing some odd features, are not so obviously fraudulent that we can conclude that all the imports were fraudulent.

65. Since we have not found that Topnotch knew that VAT was likely to be withheld and contrived to offset that input tax with an ostensibly clean chain including the  
15 Appellant, whether the Appellant ought to have known does not arise. While, again, there are odd features of these transactions they are not obviously fraudulent.

66. Accordingly, the Appellant succeeds in relation to the alleged contra-trading deals.

20 67. Our decision is that:

(1) in relation to the straight deals it cannot be said that the Appellant ought to have known of fraud in the transaction chains; and

(2) we find for the Appellant in relation to the alleged contra-trading deals;

and we allow the appeal.

25 68. We direct the Respondent to pay the Appellant's costs of, incidental to, and consequent upon, the appeal on the standard basis to be determined in default of agreement by a Taxing Master of the Supreme Court.

69. We direct that any application by the Appellant relating to interest on the repayment of input tax due to the Appellant be made to the Tribunal with a copy to  
30 Customs within 21 days of the date of release of this decision.

**JOHN F AVERY JONES**

35

**CHAIRMAN**  
**RELEASE DATE: 15 February 2008**

LON/07/104

40