# 20903

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

**LONDON TRIBUNAL CENTRE**

**OUR COMMUNICATIONS LIMITED** **Appellant**

**- and -**

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

**Tribunal: ADRIAN SHIPWRIGHT (Chairman)**
**JOHN BROWN CBE FCA CTA**
**SANDI O'NEILL**

**Sitting in public in London on 1- 5, 8-12 October and 6-7 December 2007 and 22-23 January 2008**

**Michael Patchett Joyce and Saba Naqshbandi instructed by Hassan Kahn & Co for the Appellant**

**Philippa Whipple and Robert Wastell instructed by the General Counsel and Solicitor for HM Revenue and Customs, for the Respondents**

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## DECISION

### Introduction

5 1 This decision concerns the appeals by the Appellant, Our Communications Limited ("OCL"), against four decisions by the Respondents ("HMRC") refusing OCL's claims for repayment of input tax totalling some £9.7m.

2 The four appeals are:

(a) Appeal LON/2006/0830 which is against HMRC's decision dated 28 July 2006 refusing OCL's claim for input tax of £3,100,690.25 for the period 01/06; 10

(b) Appeal LON/2006/0983 which is against HMRC's decision dated 7 September 2006 refusing OCL's claim for input tax of £105,175 for the period 01/06. This was in respect of three deals not dealt with in the first decision concerning the first period; 15

(c) Appeal LON/2006/1069 which is against HMRC's decision dated 3 October 2006 refusing OCL's claim for input tax of £4,828,250.00 for the periods 02/06 and 03/06;

(d) Appeal LON/2007/0295 which is against HMRC's decision dated 5 January 2007 refusing OCL's claim for input tax of £1,665,125 for the period 02/06. 20

3 Counsel for HMRC confirmed that there is no allegation of actual fraud against OCL or Mr Dar. She confirmed that HMRC are "not saying that [Mr Dar] is the one who defaulted, who failed to pay the tax over to the Commissioners, who was fraudulent in a domestic law sense". It was not argued that the transactions involving OCL were shams. 25

4 It was accepted that the four Decision Letters concerned four groups of chains of transactions. In each of them OCL was the exporter or as HMRC described it, the "Broker". OCL claimed input tax in respect of the last export transaction in each chain but was refused repayment of the related input tax. 30

5 It was accepted by Mr Smallbone in respect of each of these chains that the paperwork between OCL and its immediate UK counterparty and the person to whom the goods were exported was complete and proper i.e. was in good order. Ms Barker was also of this view.

35 6 Mr Smallbone asserted that there was a tax loss in respect of each chain and that these tax losses were due to fraud.

7 This case is solely concerned with the denial of repayment of input tax to OCL. We have no jurisdiction to consider the VAT treatment of other traders as they are not the subject of the appeal before us. The Appellant has raised issues as to apparent differences in treatment between different traders. These are interesting but are not a matter for us. Accordingly, we do not deal with them. 40

### Structure of this decision

8 The structure of this decision is as follows:

| | | |
|---|---|---|
| (1) | Introduction | Paragraphs 1-7 |
| (2) | Structure of this decision | Paragraph 8 |
| (3) | Abbreviations, Definitions and Dramatis Personae | Paragraphs 9-10 |
| (4) | The Issues | Paragraph 11-13 |
| (5) | Procedural Matters | Paragraphs 14-23 |
| (6) | The Law | Paragraphs 24-30 |
| (7) | The Evidence | Paragraphs 31-36 |
| (8) | Findings of Fact | Paragraphs 37-356 |
| (9) | Submissions of the Parties | Paragraphs 357-385 |
| (10) | Discussion | Paragraphs 386-481 |
| (11) | Conclusion | Paragraphs 482-484 |
| | Appendix 1 Direction with Reasons | |
| | Appendix 2 Table of Transactions and Information | |
| | Appendix 3 List of Alleged Defaulters | |


**Abbreviations, Definitions and Dramatis Personae**

9 The following describes the abbreviations and phrases used and persons concerned in this decision:

| | |
|---|---|
| 21st Century Trading | 21st Century Trading Limited, a company incorporated in the UK |
| Activmind [sic] | Activmind Limited, a company incorporated in the UK |
| Alpha Trade Zone | Alpha Trade Zone Limited, a company incorporated in the UK |
| the Appeals | the appeals listed in paragraph 2 |
| Assurance Officer | an HMRC Officer particularly concerned with assuring that a particular taxpayer fulfils their VAT obligations |
| Ms Barker | Sarah Jane Barker, Higher Officer, HMRC who at the relevant time had recently joined the MTIC team and who carried out the task of trying to trace the chains. She produced three witness statements which were admitted in evidence. She was cross examined. She dealt principally with the February 2006 deals. |
| Blue Star Trading | Blue Star Trading Limited, a company incorporated in the UK |
| Broker | the word used by HMRC to described the UK trader who makes the export at the end of a chain |
| Buffer | the word used by HMRC to described a UK trader who receives and makes a supply to other UK traders within the chain |
| Butt | Butt Limited, a company |

| | |
|---|---|
| | incorporated in the UK |
| Callender/TCG | The Callender Group Limited, a company incorporated in the UK |
| CCT | HMRC's Central Coordination Team which deals (inter alia) with MTIC enquiries |
| Chain | a particular series of transactions involving the same goods (in whole or in part) |
| CHP Distributors | CHP Distributors Limited, a company incorporated in the UK |
| CK Communications | CK Communications Limited, a company incorporated in the UK |
| Com4U | Com4U Limited, a company incorporated in the UK |
| Deal Log | A log of deals produced (usually) by a trader |
| Deal Sheet | Summary sheet in respect of the information collected produced by HMRC |
| Deal Summary | A summary of the transactions in question |
| Decision Letters | the HMC Letters setting out the Decisions |
| The Decisions | the decisions appealed against described in the Introduction and all or any of them as appropriate |
| Defaulter | a person who has defaulted on payment of VAT, usually fraudulently |
| Destonia | Destonia General Trading Limited, a Cypriot company |
| Diarolla | Sia Diarolla, a Latvian company |
| Directive | The Sixth Directive or Directive 2006/112/EC as appropriate. |
| Due Diligence/DD | the checks made on customers, suppliers and others particularly as regards the chains in question |
| Electronic Folder | the computer based way HMRC records information that it has collected which allows information to be shared within HMRC |
| Emmen Communications | Emmen Communications Limited, a company incorporated in the UK |
| Essential Trading SARL | a European customer of OCL |
| Evolution Trading | Evolution Trading Limited, a company incorporated in the UK |
| Extra Letter | An extra letter produced in respect of third party payments on occasions giving further payment instructions |

| | | |
|---|---|---|
| | | usually for part which often reflects the VAT element |
| | Financial Alpha Computer International /FACI | An Italian incorporated company with a French telephone number |
| 5 | First Call / Steven Philips | a trader, alleged to be a defaulter |
| | First Curacao | First Curacao International Bank, a bank in Curacao used in many of the transactions |
| | Faroukh & Suhail | a Dubai customer |
| 10 | HMRC | Her Majesty's Revenue and Customs, the Respondents |
| | IMEI No | International Mobile Equipment Identity Number - unique electronic designation for a mobile phone that can |
| 15 | | be scanned |
| | Interken | the freight forwarder used in most of the transactions |
| | K&S | K&S Limited, a company incorporated in the UK |
| 20 | Kingfisher Traders | Kingfisher Traders Limited, a company incorporated in the UK |
| | Lauriel Reid | Lauriel Reid Limited, a company incorporated in the UK |
| | Maura Enterprises | Maura Enterprises Limited, a company |
| 25 | | incorporated in the UK |
| | Maximila Solutions | a trader |
| | Means of Knowledge | includes knew, ought to have known and had the means of knowledge, as the context requires |
| 30 | Menard Consulting SIA | a Latvian company |
| | Midcom | a Dubai company |
| | MTIC | Missing Trader Intra Community Fraud |
| | Myco | Myco Telecoms Limited, a company |
| 35 | | incorporated in the UK |
| | NAST | National Assets [&} Security Team |
| | NEMESIS | a database of IMEI Nos maintained by HMRC. We were told it is not an acronym |
| 40 | Notice 726 | HM C&E Notice concerning joint and several liability which is not in issue here. It contains an Appendix setting out suggestions as to what traders might do to avoid joint and several |
| 45 | | liability (which is not in point here). It does not have the force of law |
| | OCL | Our Communications Limited, the Appellant. |
| | Olympus | Olympus BV Europe, a European |
| 50 | | customer |

| | |
|---|---|
| Oracle | Oracle (UK) Limited, a company incorporated in the UK |
| Orange and Green | Orange and Green Limited, a company incorporated in the UK. |
| Oxhey | Oxhey Construction Services Limited, a company incorporated in the UK. |
| Pale | Pale Limited, a company incorporated in the UK. |
| Parkacre | Parkacre Contractors Limited, a company incorporated in the UK. |
| Phone City | Phone City Leytonstone UK Limited, a company incorporated in the UK |
| Rakha SARL | a European customer of OCL |
| Rajesh [Kumar] | supplier of jeans who introduced Mr Dar to the mobile phones market. Mr Dar could not easily recall his surname or address in cross examination but it seems his surname was Kumar |
| Mr Ratoo | a sole trader |
| Redhill | a part of HMRC which can be contacted to check VAT registrations etc. |
| Red Rose Consultancy | Red Rose Consultancy Limited, a company incorporated in the UK. |
| Regulation 25 | a regulation allowing notice to be given shortening an accounting period for VAT |
| Rezaco Trading Limited | a Cypriot company |
| Retro Jeans | A company involved in Third Party Payment requests |
| Right of Deduction | the right of a trader to set input tax against his output tax liability or to receive a repayment if the input tax credit due to him exceeds that liability |
| Mr Smallbone | James Smallbone, Higher Officer, HMRC who carried out the task of trying to trace the chains. He produced five witness statements all bar the fourth were admitted in evidence. He was cross examined. He dealt principally with the January and March deals |
| St Aimie | St Aimie Limited, a company incorporated in the UK |
| Steven Phillips | a sole trader trading as First Call, an alleged defaulter |
| Storm 90 | Storm 90 Limited, a company incorporated in the UK |
| TEC | The Export Company Limited, a company incorporated in the UK |

| | |
|---|---|
| Third Party Payment | a payment requested by one party to a deal to be made to a person other than to the counterparty said by HMRC to be an indication of fraud in the context of MTIC |
| Transworld | Transworld Brokerage, OCL's agent in Dubai |
| Umbria Equitazione | an Italian entity |
| Unibrand | a trader |
| VATA | Value Added Tax Act 1994 |
| Mr Vaufrouard | Mark Vaufrouard, OCL's Assurance Officer till mid February 2006 who told us he "specialised in looking at only traders who had a possible interest or were trading in high value goods electrical goods, missing trader intra-community goods; in other words MTIC goods, mobile phones, and the whole idea of it was to identify possible fraud and just to receive information, as much as information as [he] possibly could from the brokers or the traders" |
| Veracis | Veracis Limited, a consultancy involved in advice on and the carrying out of DD |
| Vibetec Solutions | Vibetec Solutions Limited, a company incorporated in the UK |
| Vision | An HMRC electronic Database |
| V2(UK) | V2(UK) Limited, a company incorporated in the UK |

(Not all these persons are referred to in the Decision but they are included for the sake of completeness particularly when considering the Deal Summaries in the Core Bundle).

10 Reference should be made to the Core Bundle for the Deal Sheets. They are too bulky to include here. Appendix 2 provides some of the relevant information as to the relevant issues in tabular form and Appendix 3 sets out a list of Deals and Defaulters. The Appendices form part of this decision.

**The Issues**

11 In simple terms, the principal issue is whether HMRC's decision to refuse the input claims in issue was correct in law.

12 This raises a number of questions including the following:

a. Has the particular chain of transactions in question been established?

b. Were the transactions in question part of a chain in which there was a tax loss?

c. Was that tax loss attributable to fraud?

d. Did OCL/Mr Dar have the Means of Knowledge of their participation in transactions connected with fraudulent evasion of VAT. In particular were all available proportionate steps taken to ensure on the balance of

probabilities that there was no connection with persons or transactions involved in VAT fraud?

13 The Appellant suggested that an extra component should be added, effectively: whether the relevant tax loss has been suffered at the time when OCL entered into its transactions (see para 13 Appellant's Skeleton Argument). The Commissioners did not accept that there was this extra component. They considered the *Kittel* test is in essence a factual one, namely, whether the Appellant's transactions were connected with the fraudulent evasion of VAT in the chain relating to the goods, and the timing of the fraud has no relevance to it.

14 These matters will be considered further below.

**Procedural Matters**

15 Notices of Appeal were lodged by OCL against the Decisions on 7 August 2006, 19 September 2006, 13 October 2006 and 2 February 2007, respectively.

16 By Directions of the Tribunal made on 17 November 2006 and 12 March 2007, it was ordered (inter alia) that all of those Appeals be heard together.

17 Directions as to various other procedural matters relating to documents, skeleton arguments etc. had been given in this case but unfortunately these were not complied with on time. We are grateful for the assistance of Counsel and those instructing them for allowing this matter to proceed by ensuring copies of documents etc. were produced and read.

18 A hearing took place on 26 September 2007 before the Chairman at which the availability of documents, exchange of skeleton arguments and the admissibility of certain evidence were dealt with.

19 Consideration was given to adjourning the hearing but the parties considered it desirable that the hearing should go ahead starting on 1 October 2007. It did.

20 The September hearing also considered the order in which matters should proceed. It was agreed that there should be some time set aside for reading after short introductions.

21 The running order proposed and agreed by Counsel was adopted. It was as follows:

| | |
|---|---|
| Openings: | |
| | Respondent's opening |
| | Appellant's opening |
| | Reading time |
| Respondent's case: | |
| | James Smallbone |
| | Sarah Jane Barker |
| | Christopher Williams |
| | Matthew Bycroft |
| | Susan Okolo |
| | Daniel Outram |
| | Peter Cameron-Watson Oracle UK |
| | Julian Cook |
| | Stewart Yule |
| | Guy Craddock |
| | Mark Vaufrouard |
| | Barry Johnson |
| | Jill Evans |
| Appellant's case: | |
| | Riswan Dar |
| | Stephen Ploughman |
| | Mohammed Iqbal |
| Submissions: | |
| | Appellant's closing submissions |
| | Respondent's closing submissions |
| | Appellant's reply |

5 22 This running order recognised that (as the parties agreed) it was for HMRC to establish the integrity of the chains, the tax loss in them and that it was attributable to fraud in the chain and for OCL to show if that had been established that OCL fell outside the area of "Means of Knowledge".

23 On the ninth day of a hearing originally listed for ten days the Respondent 10 sought again to introduce some 48 UK to UK further chains not the subject of the Appeals. This was again refused. The Direction with Reasons dealing with this is set out in Appendix 1[1].

**The Law**

24 There is much law on this area. The relevant law includes the following.

15 ***The legislation***

25 The principal relevant legislative provision in force at the time at which the transactions in question took place was Article 17(1) of the Sixth VAT Directive (77/388/EC) since replaced by Article 167 of Council Directive 2006/112/EC.

[1] For the avoidance of doubt the Appendices form part of this decision and, where appropriate, are to be treated as finings of fact.

26 As part of the fiscal neutrality of VAT taxable persons may set against the output tax for which they must account the input tax they have incurred on the cost components of their taxable supplies. Article 17(1) provided that:

"The right to deduct shall arise at the time when the deductible tax becomes chargeable."

27 Sections 24 to 26 VATA seeks to implement this in domestic law. So far as relevant, those provisions are as follows:

"**24 Input tax and output tax**

(1) Subject to the following provisions of this section, 'input tax', in relation to a taxable person, means the following tax, that is to say—

(a) VAT on the supply to him of any goods or services;

(b) VAT on the acquisition by him from another member State of any goods;

(c) VAT paid or payable by him on the importation of any goods from a place outside the member States,

being (in each case) goods or services used or to be used for the purpose of any business carried on or to be carried on by him.

(2) Subject to the following provisions of this section, 'output tax', in relation to a taxable person, means VAT on supplies which he makes or on the acquisition by him from another member State of goods (including VAT which is also to be counted as input tax by virtue of subsection (1)(b) above) …"

"**25 Payment by reference to accounting periods and credit for input tax against output tax**

(1) A taxable person shall—

(a) in respect of supplies made by him, and

(b) in respect of the acquisition by him from other member States of any goods,

account for and pay VAT by reference to such periods (in this Act referred to as 'prescribed periods') at such time and in such manner as may be determined …

(2) Subject to the provisions of this section, he is entitled at the end of each prescribed accounting period to credit for so much of his input tax as is allowable under section 26, and then to deduct that amount from any output tax that is due from him.

(3) If either no output tax is due at the end of the period, or the amount of the credit exceeds that of the output tax then … the amount of the credit or, as the case may be, the amount of the excess shall be paid to the taxable person by the Commissioners; and an amount which is due under this subsection is referred to in this Act as a 'VAT credit' …"

"**26 Input tax allowable under section 25**

(1) The amount of input tax for which a taxable person is entitled to credit at the end of any period shall be so much of the input tax for the period (that is input tax on supplies, acquisitions and importations for the period) as is … attributable to supplies within subsection (2) below.

(2) The supplies within this subsection are the following supplies made or to be made by the taxable person in the course or furtherance of his business—

(a) taxable supplies;

(b) supplies outside the United Kingdom which would be taxable supplies if made in the United Kingdom …"

28 These provisions are mandatory. If a trader has incurred input tax which is properly allowable, he is entitled to the Right of Deduction. He is required to hold the evidence to support his claim (see article 18 of the Sixth Directive and regulation 29(2) of the Value Added Tax Regulations 1995 (SI 1995/2518) and the observations of Lightman J in *UK Tradecorp*, at [28] to [34]) but, provided he does so, the right to deduct or to a repayment is absolute, and no element of discretion is conferred on the tax authority, save that the authority may accept lesser evidence than that normally required. HMRC has no right to demand more evidence than that prescribed by article 18. The right is also immediate, that is it may be exercised, as article 17 puts it, "when the deductible tax becomes chargeable." The only limitation is the practical one that, although deductibility (at least, in the present context) is determined on a transaction-by-transaction basis, the mechanical process of deduction or repayment is effected by reference to prescribed accounting periods.

29 Accordingly, there must be a good reason for denying input tax recovery to a taxable person. This could be Abuse or fraud.

***Case Law***

30 We were provided with copies of the decisions in a number of cases which we have read. These included the following.

*R (Teleos PLC) v HMRC* C - 409/04
*Gararge Moleneide BVBA v Belgium* C-286/9 4
*CallTell Telecom Limited v HMRC* 20 July 2007
*21st Century Majestic Solutions Limited v Madysen Limited* [2004].Ll R 92
*Optigen Limited, Fulcrum Electronics Limited and Bond House Systems v CCE* [2006) STC 419
*Barclays bank PLC,* Tribunal Decision number 19302
*Axel Kittel v Belgian State; Belgian State v Recolta* C-439/04 and C-440/04
*Dragons Futures Limited v CCE* [2006]. V&DR 348
*Photo Production Limited v Securicor Limited* [1980] AC 827
*Stichting UItvoering Financiele Acties* [1989] ECR 1737
*R (Just Fabulous (UK) Ltd) v HMRC* [2007] EWHC 521
*Webber's Wine World Handels-GmbH* C-147/01
*Intersplay v Ukraine* Application number 803/02
*Tynewydd Labour Working Men's Club v CCE* [1979] STC 570
*Mobile 365 v HMRC* [2007] EWHC 1737
*McGann Services Limited v HMRC* [2006] EWHC 3232
*Synergy (UK) Limited* Decision 19727

**The Evidence**

31 We were provided with some thirty odd Volumes of documents.

32 We heard oral evidence from:

| | | |
|---|---|---|
| a. | James Smallbone | OCL's assurance officer from mid February who tried to trace back the January and March chains |
| b. | Sarah Jane Barker | HMRC officer who tried to trace back the February 2006 chains |
| d. | Christopher Williams | HMRC Assessing Officer for Steven Phillips trading as First Call |
| e. | Matthew Bycroft | HMRC Assurance for Oxhey |

| | | |
|---|---|---|
| f. | Susan Okolo | HMRC Lead Officer for MyCo |
| g. | Daniel Outram | HMRC Assurance Officer for Callender |
| h. | Peter Cameron-Watson | HMRC Assurance Officer for Oracle |
| i. | Julian Cook | HMRC Assurance Officer for Coms4U |
| j. | Stewart Yule | HMRC Assurance Officer for Activmind |
| k. | Guy Craddock | HMRC Assurance Officer for CHP Distributors |
| l. | Mark Vaufrouard | OCL's assurance officer till mid February 2006 |
| m. | Jill Evans, | an HMRC accountant |
| n. | Riswan Dar, | OCL's principal shareholder and director who was mainly responsible for OCL's trading |
| o. | Stephen Ploughman | Principal of Veracis |
| p. | Mohammed Iqbal | a trader |

33 Witness statements were provided for all of them and they were cross examined.

34 Counsel for HMRC did very well in marshalling and presenting the vast amount of documentation collected by HMRC as did Counsel for the Appellant in being completely on top of it. We are grateful to both of them.

35 The approach of HMRC (excluding their Counsel) was very much on the basis of assertion rather than seeking to prove by cogent evidence those matters which they had the onus to prove by evidence. We recognise that HMRC's witnesses tried their best according to their lights and abilities but they were not as focused on what had to be proved as on what they thought was the case. In future, it is to be hoped that they would be clearer in their objectives. This is not to suggest that there would necessarily have been any difference in the outcome of the present case nor to downplay the difficulty of the task for HMRC. Evidence is vital though in a case such as this notwithstanding the difficulties in collecting it.

36 HMRC should also recognise that directions are not there to be complied with at their convenience. They are to be complied with. Whilst the Appellant's compliance may not have been perfect had HMRC complied with directions in a timely and proper manner the case would have been less diffuse and the hearing speedier. HMRC should also learn the lesson that documents needed for a hearing before the Tribunal should be made available to the Tribunal and not retained by them for their own convenience (see below). It is not only discourteous but could potentially inhibit the fairness of the trial.

**Findings of Fact**

37 From the evidence we make the following findings and do so as findings of fact.

*OCL*

38 OCL is a company incorporated in England. Mr Dar was the principal[2] shareholder and director of OCL.

39 A reorganisation took place later seemingly to allow profits to be extracted from OCL at a reduced rate of direct tax[3]. We draw no inference either way from this but note it for completeness.

[2] Seemingly the sole shareholder till the reorganisation.

[3] Seemingly an arrangement provided by accountants other than the auditors.

40 Mr Dar purchased OCL in July 2000. It was already an established company. He did so after taking advice from one of his suppliers in Manchester. He told Mr Dar it might be easier if he could buy a company already set up that was for sale. He suggested that Mr Dar speak to an accountant in Manchester. Mr Dar spoke to the accountant. He had a company available for sale and Mr Dar bought it.

41 Mr Dar said the company had had no problems in the past and that the accountant had looked into that. Mr Dar put himself in the hands of the accountant.

42 OCL ceased trading in March 2006.

*Accounts*

43 The first relevant accounts are those for February 2001.

44 Mr Dar accepted OCL made about half a million pounds worth of net profit in the first six months of trading. He said it also paid substantial tax on it as well.

45 He accepted that the Accounts showed that OCL dealt in large quantities of mobile phones. In reply to the suggestion that this was extraordinary Mr Dar said he considered it was but continued "From the start I worked very closely with my insurance [sic] officers and to me, the commodity that I was trading in, this is normal in commodity trading".

*OCL's Principal, Mr Dar*

46 We make the findings in this section mainly from what Mr Dar told us in oral evidence which was not refuted.

47 We found Mr Dar a thoughtful, shrewd and intelligent witness and accepted his evidence. He appeared to us to be a natural trader pursuing profit where and how legally he could. We also remind ourselves that he was dealing in a new business and in a new country and wanted to do what was necessary to allow him to trade peacefully. To that end he put various procedures (including DD) in place so that he would have the right documentation etc.

48 Mr Dar came to the UK from Pakistan in the mid to late 1990's. He had started trading goods in Pakistan in 1987. He traded air coolers, televisions and other electronic goods both wholesale and retail.

49 A second retail outlet was opened in 1995. This sold higher value goods, including air-conditioning units and mobile telephones. Mobile phones were a very new commodity at that time in Pakistan. The trade in mobile phones was not very large. The turnover in Pakistan was a few hundred thousand pounds. No export was involved. Mr Dar had ten years' experience of this before coming to the UK.

50 He set up in the clothing retail business when he came to the UK. He had a shop in West Ealing as well as some market stalls. He would personally supervise the market stalls especially at weekends. The clothing business's turnover was not large nor was the profit. A lot of the time it barely broke even. Mr Dar said he found it difficult to break into a very competitive market in the clothing retail business.

*Mr Dar and the Mobile Phone Business*

51 Mr Dar started to move into the wholesale mobile phone business in October 2002. This was a new area of business in which he only had retail experience in Pakistan.

52 Mr Dar told us he got into the wholesale mobile phone business because he had a contact in the retail clothing business who told him about it. He was

called Rajesh. Mr Dar could not immediately remember his surname or address.

53 He used to supply Mr Dar with jeans. He also traded in mobile phones. He used to come and see Mr Dar about twice a month. Rajesh used to live in Paris. There was usually no prior appointment for him to visit, he would just turn up most of the time.

54 Rajesh told Mr Dar he brought jeans over from Paris and used to buy mobile phones in the UK to take back to France. He supplied mobile phones to some retail shops in Paris. It was not on a big scale.

55 Mr Dar was not doing too well in the clothing business and he wanted to explore other opportunities. He said the mobile phone market seemed an exciting market to get into.

56 Mr Dar decided to look into that market. He became aware of "The buoyant mobile telephone trading sector operating within the UK and elsewhere." He told us if you can find the right suppliers and customers you could make money in any business. His intention was to make more money.

57 Mr Dar discovered that mobile phones were handled by specialist freight forwarders. The phones were kept at a small number of warehouses by the specialist freight forwarders handling phones. Mr Dar started by visiting their premises. Interken and Paul's Freight were the freight forwarders Mr Dar particularly referred to.

58 Mr Dar told them that he was setting up a business and that he wanted to know how the business worked from the freight forwarders' side. He was a potential client.

59 He said he met other traders operating within the sector, often meeting such traders at the premises of freight forwarders with whom he became acquainted. When he went to visit Interken and Paul's Freight, there were other individuals there that he talked to. By talking to those individuals he considered he got a good picture of the potential volume of trade, et cetera, involved. The other traders at the premises of the freight forwarders were potential suppliers as well as potential customers. They were thus mutually valuable contacts.

60 The freight forwarders took Mr Dar around to show him what they did and how they operated their business and what services they provided.

61 Mr Dar said that he rapidly became aware, through his researches, that this was a market in which there was a lot of fraud. More specifically he said "I had been made aware, through my discussions with freight forwarders, that the UK Revenue Authorities required mobile telephone traders to produce more documentation supporting VAT returns than was required of traders in other areas. It was different because it was a high value commodity and there was a certain procedure when it comes to dealing with it, so, as far as I was concerned, there were certain procedures that you have to follow when you deal with this sort of commodity". Mr Dar made sure he followed the procedures and had the requisite documentation so that he could trade to make money.

62 Mr Dar's evidence was that the first supplier was introduced to him by his contact Rajesh and the first customer, Mr Iqbal, was one of Mr Dar's clothing wholesalers who had been introduced to him by Rajesh.

63 Mr Dar took a reference for Mr Iqbal. He was an established businessman and had a good reference. Mr Mir trading as Uniform Networks was the first

supplier. Mr Mir knew that Mr Dar was selling goods back-to-back as was also Mr Mir.

*The initial funding etc. of the business*

64 The initial investment came from Mr Dar's personal funds. It was about £10,000. It was used to pay for the company, some computer equipment and a few other assets.

65 Mr Dar traded from his home to start with. He had an office there. Later he took an office away from home at Cranbrook Road.

66 He did not take out any loans or have any borrowings. He said he was not going to be paying for the goods until he was paid.

67 The first staff member was taken on shortly after the move to Cranbrook Road.

68 The back to back structure also reduced the cost of funds.

*Extent of Research*

69 Mr Dar looked at various magazines such as Mobile News, vMobile Phone, What Cellphone?, and a few others. He later looked at websites mainly IPT (International Phone Traders).

70 The IPT website is essentially for traders in mobile phones. Mr Dar said that it was later that OCL started using the IPT website By becoming a member, one got the right to advertise on that website, a "passport" and the facility to post stock that the member requires or wants to sell.

*Method of Trading*

71 The stock is kept by the owner at the premises of the freight forwarder. Stock may be allocated by the owner to a trader who will try to sell the stock and if he has a customer, he has a deal. If not there is no deal. The stock first gets allocated to someone who is interested in buying the stock. At that point, there is no paper work, there is no commitment to taking the stock. The trader is simply just trying to sell it. Once there is an interested customer the trader thinks he has a deal at that point, the trader goes back to his supplier and says, "Yes, I will take that stock". That is when the parties commit to that deal. Before that the trader has no commitment to the stock**.** The stock is kept at the freight forwarders so there is no security issue. Mr Dar told us "…if the customer does not pay the stock can be taken back or it is just not released to him. There would be no deal and the contact lost".

72 It was a high value commodity business working on very small profit margins. It was totally different from what Mr Dar was doing before. He was expecting to achieve a high turnover as he was expecting to make profits.

73 Mr Dar/OCL started to undertake export trades in January 2003. The trade then became one involving both domestic and export deals.

74 Mr Dar accepted that the turnover in the first two months of such trading using his figures was in excess of £97 million and that it was extraordinary in general terms but added this is normal in commodity trading.

75 From the start of the business Mr Dar worked very closely with the assurance officers.

76 Mr Dar requested Mr Iqbal, his first customer, to make a third party payment to his supplier. At that point Mr Dar explained that OCL did not have a bank account "so there was no other way of doing it". This related to a period some time before those which are the subject of the Appeals**.**

77 Like Mr Dar we do not accept that, on its own, this demonstrates that there was not a real trade at all especially when considering a later time. It was not

argued by the Respondents that any of the transactions involving OCL was a sham. We find as a fact that none of the transactions in question involving OCL was a sham.

78 OCL stopped trading for a period in 2003 because it was concerned that new measures were to be introduced aimed at MTIC fraud.

79 However, the new measures did not make much difference to OCL's business. This was because OCL was already doing Due Diligence. OCL thought its DD was sufficient to comply with the new measures. Mr Vaufrouard, OCL's assurance officer at the time, also seems to have been of the opinion that OCL's DD more than met the new measures.

80 Mr Dar told us that "The freight forwarders basically told OCL what additional paperwork was required".

81 Mr Dar said he became aware that there was fraud in the industry in 2003 or possibly earlier.

82 He said in his witness statement:

"OCL has never knowingly been involved in MTIC fraud or any transaction which to its knowledge was tainted by fraud. OCL has at all times taken reasonable steps to ensure that it doesn't become involved in such fraud…".

83 He also said "OCL has at all times taken reasonable steps to ensure it does not become involved in such fraud".

84 Mr Vaufrouard, OCL's assurance officer, had told OCL that it needed to verify the supplier before it commenced a deal. OCL was already doing so. OCL did get to know the supplier, it did inspect the stock, etc. All the elements were in place at that point as Mr Vaufrouard acknowledged.

85 OCL accordingly provided the requisite paperwork. OCL and Mr Dar, we consider, wished to trade to make money and would do what was necessary to continue to trade legally. They would provide the authorities with the requisite documentation and do what was necessary to be able to trade. This is not surprising when the person in question started his career outside the UK and was now dealing in a market place and an area of business which was new to him. HMRC accepted that the paperwork with OCL's counterparties etc. was all in good order. It was accepted by Mr Smallbone in respect of each of these chains that the paperwork between OCL and its immediate UK counterparty and the person to whom the goods were exported was complete and proper i.e. was in good order. Ms Barker was also of this view.

86 OCL had an agent in Dubai called Transworld Brokerage. Transworld found OCL customers in Dubai. There was a contract to pay commission (£91,000 in the first relevant accounts).

87 Transworld would find the customers, Transworld would carry out due diligence and once they were satisfied with those customers they would recommend those customers to OCL. On the sales to those customers OCL would pay a commission to Transworld. Transworld recommended companies. OCL took their recommendation as well as doing its own due diligence. Mr Dar went to see those companies personally and met with them and assessed how to go forward. More than half the trade went to the Middle East according to the analysis by geographical market in OCL's accounts.

88 Transworld's director was Mr Atik Ahmed, whom Mr Dar knew from Pakistan. Mr Ahmed was based then in Dubai.

*Payment and Title*

89 Mr Dar agreed that most of the time OCL paid its supplier when OCL received the money. He rejected (as do we) the suggestion that the supplier was extending OCL very substantial amounts of credit to enable OCL to complete the export deal. The supplier was not extending credit because although the stock was allocated to OCL, OCL's supplier kept control of that stock[4]. The freight forwarder would keep that stock in OCL's supplier's name and normally it would not be released until payment[5]. It would be available to the customer overseas to inspect but it would not normally leave the freight forwarder's premises until the supplier has released the stock on receiving the payment. This was so notwithstanding that it may take a few days for the stock to be transported abroad, inspected, etc.

90 Mr Dar understood this to mean that title did not pass until payment (cf the Sale of Goods Act position). There was a retention of title till payment. The documents provided "All goods remain the property of OCL until paid in full." We find that there was retention of title till payment and in these circumstances no extension of credit by the seller. Title passed on payment.

91 In other words, it was made it quite clear that the goods were OCL's/the supplier's property until the customer had paid in full.

92 If the customer was not happy with the stock and terminated the contract OCL would not be paid.

93 The stock could then be abroad but OCL would not be in funds to pay its supplier. Mr Dar told us that would only happen if the stock was not as described or it was damaged. The stock would be inspected before it was shipped so it would be as described and the customer would know what language, what manual, what chargers, what software, what colour the stock was. Upon arrival the customer would inspect it. Once the customer was happy with the stock, the customer would make payment and the stock would be released to the customer at the destination. OCL's agent in Dubai recommended people who were established businesses in Dubai so they were considered good for the money.

94 Mr Dar accepted that the risk varies from local to export deals. When OCL exported stock to Dubai, it was at risk but there was insurance in place. If there was something wrong with the stock, OCL was at risk and would have had to call the stock back or try to sell it to somebody else. If the stock for some reason had to be called back OCL would end up paying for the return freight charges. OCL would return the stock to the supplier if it could not be sold to somebody else where the stock was at that point. That was how the trades were conducted.

95 Mr Dar said in his witness statement:

> "I was OCL's main sales negotiator and negotiated the majority of its transactions. There were some occasions when transactions were negotiated by other members of staff, such as the business development officer. However, on such occasions, I was fully informed of all aspects of the transactions and retained final approval."

96 That was true in relation to all of the trades January, February, and March 2006 and we so find.

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[4] This, as the case law shows, is common in trade hence *Romalpa* clauses etc cf also The Sale of Goods Act.

[5] There were exceptions such as "Ship on Hold".

97 Mr Dar accepted that :

(a) OCL tried not to maintain stock because of the risk that the stock would depreciate and go down in value- hence OCL wanting to do back-to-back trades;

(b) OCL did not release its stock until it had been paid by the customer.

98 These deals would come about through "calls from suppliers or customers offering or wanting stock. It could start either way. OCL had trading partners who would buy and sell phones. There could be a day when OCL had the stock they were looking for or there could be a time it is the other way around". Sometimes the customer would ask for stock and OCL would source it and sometimes the supplier would offer stock and OCL would try to sell it.

99 There could be many contacts a day. Somebody in OCL's office would answer the telephone. Usually the receptionist would take and direct the call. OCL had staff assisting Mr Dar with sales and purchases so there would be someone sitting on the sales desk. There were also administrative staff at the purchase desk. Contact would be by faxes and telephone not by e-mail.

100 It did not mean all the calls were from people OCL was interested in trading with. A lot of the customers or suppliers were not on OCL's database. If someone not on the database called their details would then be noted down as would information such as who is offering what. This was done to assess the market price of the goods etc...

101 The OCL team used to make notes of all goods offered or required. Each member of the OCL team would have a notepad to write down the details of each offer or request. OCL would have a staff meeting at least once or twice a day. OCL would have a good idea of what the stock price was from its records. If a company called that was not one of OCL's accredited customers or suppliers Mr Dar would say "Yes, we will look into it" and exchange details of that company and get them approved and put them on OCL's database".

102 The next step if the trader or company was on the database would be to see what position OCL was in and if it had enough funds to undertake an export. OCL would obviously prefer to export stock and so it would check with its overseas customers whether they were interested. In the periods in question there were about ten such customers. OCL added a margin to the offer price of the stock to OCL.

103 OCL would have a shrewd idea of the market price from the previous day's notes and the website. If the stock was offered at what seemed a reasonable price, OCL would take that price and offer the stock to their customers. If OCL's customers wanted that stock but at a price where OCL's margin was not covered OCL would ask the supplier to reduce the price.

104 Procedures were in place intended to make sure the prices were right and OCL's margin was preserved. This included the notes of all offers and requests not just exports.

105 Prices did fluctuate. This depended on the handset in question, its availability and the demand for it. The price on the day obviously reflects this.

106 Sometimes OCL would intentionally split the invoice because it knew the whole shipment was not going on the same aeroplane. For example, this might be done if the freight forwarder could not put all of those shipments on one flight.

107 There would be a telephone call log of this.

108 OCL's supplier and customer would very often use First Curacao as the bank for the transaction. All the parties would then be using the same bank.

*"Ship on hold"*

109 If OCL were exporting the goods, it might ask Shelford, or whoever the supplier was at that time, to allow it to ship the goods on hold. If the supplier agreed to that then OCL would ship those goods to its customer. If OCL had funds available and was able to pay early, OCL would do so.

110 Mr Dar agreed "ship on hold" means that the buyer (e.g. OCL) is entitled to ship the goods even though title has not passed. The original contractual terms remained that the purchaser had undertaken to pay 100 per cent of the price after inspection. However, the parties later agreed to those goods being shipped on hold notwithstanding that payment had not been made.

111 Practical control as to whether these goods could be taken for shipment abroad, notwithstanding title in them had not passed as payment had not been made, would rest with the freight forwarder. The freight forwarder controlled the stock and it would not release goods without agreement from the supplier for the buyer to ship the goods abroad.

112 Thus goods were always under the control of the freight forwarder and the freight forwarder would take instructions from the supplier. The supplier if it was comfortable with the freight forwarder controlling those goods on their behalf until payment in full would agree.

113 Mr Dar said "It is a very normal practice in this industry and we have been operating in this industry for over four years with assistance of the insurance [sic] officer and commissioners and everybody was aware of the trading practice and there was no issues raised before that and I can't see why is it not commercial? They had their peace of mind. The stock was in the freight forwarder's possession and he will not release it until they are paid on their instruction".

114 Other suppliers were not so keen on this procedure and other suppliers on occasion declined to let OCL ship goods out of the jurisdiction before they had been paid. It depended on the relationship with the supplier and if the supplier trusted the customer.

115 Deals did go wrong. Mr Dar gave an example of a case the other way round i.e. where OCL was the supplier and was not paid., Mr Dar said if deals went wrong "basically OCL did honour its commitment [to its supplier] and took the loss".

*NEMESIS*

116 Mr Smallbone told us that the NEMESIS database was not actually up and running until mid February 2006 or later. Any scans that had taken place prior to the NEMESIS database being up and running and made available were retained, either on the electronic gun that carried out the scan or on a disk, until such time as they could be uploaded on to the database.

117 The batch date, we understand, is generated electronically by the computer system itself when the information is "inputted". The rest of the information is inputted on to the NEMESIS system manually. We were told it is taken from an officer's notebook which is completed at the time of the scan.

118 Mr Smallbone said "if the information is put in manually then, obviously I can only assume that the occasional human error may occur, yes".

119 Mr Smallbone did not know where the scan date came from. He did not know how the technical aspects worked. His understanding was that there are two

separate dates that are entered. One is the date when the phones are scanned, and the second is the batch date although this seems to be computer generated.

120Mr Smallbone accepted that Invoice 1384 is in respect of the export of 1,500 phones, yet over 2,000 were scanned and that there was something very wrong with the system. On the evidence we are not convinced as to the reliability of NEMESIS at the time in question. Accordingly, we do not consider that great reliance can be put on it in respect of the transactions in question nor as to how useful scanning was at any rate. We find this as a primary fact there being no evidence before us to the contrary.

121Ms Barker accepted that the "…some phones appear to have been scanned in both batches as the details in both batches are exactly the same.". This is further support that NEMESIS is not always reliable.

122She also said in cross examination:

"Q. So, therefore, if someone else other than Our Communications has been exporting goods, there is no practical way that Our Communications can find that out because they don't have access to the NEMESIS database or any other database which records exports by other traders, do they?

A. That's true. When we do identify instances of double exports, for want of a better way of putting it, we will always inform the traders concerned so they're aware of that information.

Q. After the event?

A. When the information comes to our attention because it's on the same day and within minutes of each other. Yes, that's right".

*Assurance Visits - Mr Vaufrouard's visits etc.*

123Mr Vaufrouard made nine assurance visits to OCL. He was the assurance officer for OCL and OCL's main contact with HMRC till mid February 2006. Various conversations took place during those visits some of which were recorded.

124He said in evidence "The purpose of the visits—I was … [the] assurance officer but actually specialised in looking at only traders who had a possible interest or were trading in high value goods electrical goods, missing trader intra-community goods; in other words MTIC goods, mobile phones, and the whole idea of it was to identify possible fraud and just to receive information, as much as information as I possibly could from the brokers or the traders, whether they were at the bottom end of the chain or the top end of the chain, and glean as much information to get it back to make a bigger picture".

125He also said "it was my job to advise and direct people and not just Our Communications but any MTIC trader upon what we required as a department as a bare minimum and what we required and what we were looking for in prevention of any civil fraud".

126He also said "… there is no criticism of the documents that Mr Dar has produced to the Commissioners in support of his purchases for those periods or in support of his sales".

127He said to Mr Dar about OCL's DD "You always get it spot on, so, so just make sure, make sure that it's all there." He also said "You're a good person to do business with, you see, you've got a good established business". He confirmed that "there were other people you dealt with who weren't nearly as nice to deal with".

128At every visit he was able to "uplift" the documents. Mr Dar provided Mr Vaufrouard with a deal log and every document that he required in its original

format. He confirmed that there is no criticism of the documents that Mr Dar has produced to HMRC in support of his purchases for those periods or in support of his sales.

129 He confirmed that Mr Dar told him that Mr Dar did not keep IMEI numbers and he requested him to keep them in future but that there was no follow-up in relation to IMEI numbers. He did not request OCL to nor did he follow the issue up at any subsequent visits.

130 He confirmed that in relation to OCL"… you have got to go three, four, five steps down the line before you find the questionable due diligence".

131 He also confirmed that Mr Dar did not deal with a defaulting trader.

132 He said of Mr Dar "I actually advised him that his checks were good. However, he needed to ensure that his supplier was carrying out those checks and his supplier's supplier was carrying out those checks".

133 For completeness we record that Mr Dar did do this (see below). Mr Vaufrouard confirmed " insofar as he raised any particular points with Mr Dar, it was actioned appropriately, and as far as he were concerned, if he raised a point he [Mr Dar] dealt with it"

134 In response to the Chairman's question "what do you think they ought to have done more than they did do?" Mr Vaufrouard replied:

"A. There wasn't really much that they could do which I think is why you are seeing the referrals, that I did say that his due diligence was fine. However, I think for the amount of money that the deals were worth and the threat to the loss of that money dependant upon joint and several liability, NEA [Non Economic Activity], or whatever type of action that the Revenue could have taken at the time, probably would be more robust if his supplier—to ensure that his supplier was carrying out the checks. Obviously his supplier is not going to want to divulge his supplier's name because obviously it is going to be economically unsound".

135 In response to the Chairman's question "how could OCL have forced it down the chain?" He replied "To be honest, I couldn't see much more that they could physically do at that stage".

136 We understood this to mean that was there nothing more that Mr Dar/OCL could reasonably or proportionately do and we so find as a primary fact.

*Patterns of Trade*

137 HMRC sought to rely on what they called artificial patterns of trade which they claimed to be revealed in the chains of transactions as showing the transactions were connected with fraud. There was no evidence that OCL and/or Mr Dar knew of these patterns at the relevant time. Indeed, HMRC did not seem to know either at the relevant times notwithstanding their greater knowledge, resources and powers.

138 HMRC also wished to rely on UK to UK transactions in this context. It is not clear how UK to UK transactions could show fraud in a particular UK to foreign transaction which is what this case is about. A Schedule to Mr Dar's Witness Statement set out all the trades undertaken by OCL in the periods in question (see below). We were taken to this and so HMRC was able to put forward its arguments in this respect.

139 If the Respondents wished to rely on UK to UK trade they should have provided the evidence on a timely basis in accordance with the Tribunal's Directions and not sought to have it admitted two normal working days before the hearing or on day nine of a hearing listed originally for ten days.

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140 As regards the UK to Offshore chains whilst there may have been fraud in some specific links we do not accept HMRC's contention that the patterns of trade of themselves here generally show fraud. Mr Dar had produced a Schedule as an exhibit to his Witness Statement. This showed the trading pattern over a considerable period and showed the mark ups, gains and losses over the period. We find as a fact that this was not a pattern of trade which of itself shows a fraudulent trade or connection with a fraudulent trade in the particular chain in question. That is not to say that there could not be fraud in the chains merely that the patterns of trade of themselves did not show fraud. We consider this below and make findings as to each chain in question.

141 No evidence, expert or otherwise, was led to show that it was such a pattern (i.e. connected with fraud). Two of HMRC's witnesses asserted[6] that it was but it was accepted that they did not have the necessary experience to give expert evidence and they had not been called as such. Their experience of investigating MTIC fraud was concerned with collecting and collating documents[7]. They were not concerned with investigating fraud as Mr Smallbone repeatedly told us. Accordingly, their experience, such as it was, does not allow us to give any particular weight to their assertions[8].

142 The fact that a trader may appear in a different position in various chains of transactions is not of itself suspicious or of itself indicative of fraud or a connection to fraud. It is not necessarily indicative of "a cartel organized amongst those traders to reap the benefit of the arrangements" as was suggested by HMRC. Evidence is needed. The evidence led in this case we find did not substantiate this directly or in a way that would allow inferences to drawn in respect of other chains.

143 Evidence as to UK to UK trades would not have been evidence as to the position as regards the particular chains before us which were UK to offshore. At most it could have gone to background but there were already over seventy more relevant UK to offshore transactions before us which gave considerable background as to the relevant factors in UK to offshore transactions.

144 HMRC led no evidence to show that the prices at which OCL bought or sold were not the market or legitimate prices for the particular phones at the time of the transactions.

145 We do not find it suspicious that the trades to persons outside the UK which were completed carried a higher mark up than UK to UK trades. On the contrary because of the higher costs it is what one would expect and Mr Dar had said in evidence this was what he did which we accept. There was no evidence as to what offshore trades were offered at a lower mark up and

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[6] Eg Ms Barker someone without direct experience of this business by her own admission said "Well, it's a little bit strange, bearing in mind that Our Communications was clearly in touch with The Export Company, why they didn't buy their phones directly from The Export Company, clearly at a cheaper price than putting in the middleman, Elite Mobile". And "Q. And did the chains, as you had established them and as they are shown here, appear to you to represent a genuine trade?
A. No, not really."

[7] Eg as noted above Ms Barker said in evidence ". I don't really feel I could comment on the way that traders conduct their business, not being directly involved in it.". Comments were made though.

[8] Eg Ms Barker said ". I don't really feel I could comment on the way that traders conduct their business, not being directly involved in it". She also confirmed that she had only recently joined the MTIC Team at the time.

declined by OCL. It would seem a sensible policy for a trader to adopt to seek a higher mark up if he could particularly where there were higher costs. We find this as a fact. We do not accept that the mark ups to continental Europe should necessarily on that basis be lower than to the Middle East as the costs may be assumed to be higher. No evidence was led by HMRC as to the relevant costs. It also ignores the fact that a trader will seek to maximize his profit on a particular deal but not normally to the extent it would stop others wanting to trade with him. Accordingly, if the trader can successfully get the same profit margin on a Middle Eastern and a European deal he would obviously take that profit margin. This is a function of the counterparty's position. We reject HMRC's contention and find that there was no cogent evidence before us to support it.

146 Mr Dar said it was correct that OCL would not export goods unless it was able to achieve the sort of percentage mark-up needed to cover additional costs etc.

147 Export percentage mark-ups were generally at the higher level say around about the 5 per cent mark, some higher, some lower.

148 Margins on domestic trades were generally lower than export trades although some were higher and some were lower. In February 2006 for some of the export trades 8 and 9 per cent was achieved. It was a fluctuating market. The prices did go up and down on a daily basis and, simply, OCL got the best price that it could get on the day. OCL was able to bargain the best possible price that it could. It was a busy time in the industry, there were certain desirable handsets and OCL **was** able to secure the stock.

149 This was suggested to be an indication of an uncommercial market. We do not accept that. It reflects what one would expect from Mr Dar's policy of seeking to export first and then sell domestically if OCL could not export at the desired price. The domestic costs were less as were the margins so a profit could still be made.

150 In reply to the suggestion that multiple deals on the same day were uncommercial Mr Dar said "If we had a deal one day and we didn't have another day, we obviously were in a money-making business and we tried to do the deals as best we can. Everybody can have a quiet day". He said later "It is not necessary that the deals happened on the same day. The deals could have started on a day and the date you see on the deal is the date that paperwork was done. It doesn't mean the deal was done on that day".

151 We do not find it strange of itself that the deals were back to back and all took place on the same day. This seems a commercially sensible way of proceeding to minimize risk and reduce financing costs. It was the way The London Stock Exchange operated before "Big Bang" with settlement taking place at the last day of the Contango Period. It was never suggested that this was indicative of fraud. It is still the way many markets operate. We do not consider the back–to-back trading arrangements of themselves to be uncommercial and indicative of fraud in the circumstances of this case and we so find.

152 We find as a fact that from the perspective of a business person in the position of Mr Dar, at the relevant times, the arrangements and patterns of trade were not uncommercial and would not would not of themselves have given rise without more to a suspicion of fraud.

153 What more would be needed would be something such as a third party payment request relating to the goods in question. Mr Dar and OCL received and requested no such third party payments in the three months in question. No

evidence was led to show otherwise nor that OCL and/or Mr Dar knew or had the Means of Knowledge of any third party payments elsewhere in the chain and we so find as a primary fact. We find that there was no evidence from which we could infer such Means of Knowledge.

154 HMRC did not show anything more to suggest that the trading patterns were indicative of fraud as far as OCL was concerned or that OCL could have known of it. We reject the assertion that it did and find that it did not and to the extent possible we do so as a finding of primary fact.

*The Grey Market*

155 HMRC led no evidence concerning the grey market. Their only evidence related to listed companies who were network providers and (inter alia) retail sellers of phones[9]. Accordingly, we have to rely on what relevant evidence is available to us in this case.

156 Mr Dar said that:

> "Such a market typically emerges where there is a significant price differential for goods in different countries, or where an authorised distributor of the goods releases its surplus stock at a reduced price thereby enabling purchasers of the surplus stock to on sell goods outside of the normal authorised distribution channels. So the first source of the grey market, if I can call it that, is the notion of a price differential for the goods in different countries so what you will be saying is that in country A, a particular telephone is more expensive than in country B…"

157 He was asked:

> "Q. It doesn't take a very clever person to realise that if a particular phone is more expensive in country A than country B, there is obviously a potential of arbitrage, a potential of trade, in importing that phone from country B into country A, isn't there?
>
> A. Yes, there are distributors who buy directly from the manufacturers. Sometimes they over commit to the stock and they have a surplus stock to clear. If someone is aware of someone having that stock in a certain country and the price suits them, yes".

158 Mr Ploughman gave the following unchallenged evidence:

> "Q. But you know very well that MTIC fraud often has more links in the chain and there may well be other UK parties involved higher up the supply chain.
>
> A. That is, of course, as most people who know the industry, is how it is perceived.
>
> Q. Exactly, so the point that I put to you is this, if a party, an exporter, does due diligence on its counterparties, that is never going to be a guarantee of not getting involved in MTIC fraud?
>
> A. We have discussed this many times with Customs officers who we have met all over the country, and we have tried to ascertain to be helpful to our clients what is the extent of this MTIC fraud; what are we dealing with? We have never been given a definitive answer as to what the extent is, but we got some

[9] Ms Evans was asked " You recognise in the body of your witness statement, or at least in your report and we will come back to this, that there is, you are not comparing like with like and that Vodafone, BT, O2, Cable and Wireless and Virgin Mobile are not wholesalers in the grey market for mobile telephones. A. They are not".

indication last year—or earlier this year anyway—from the House of Lords committee when an officer from Customs said 10 per cent of the trade was bent. Now, if that is true—but we have never seen any statistics to substantiate the alleged amounts of losses that have been notified, like 1.9 billion, we have never seen the evidence. But if only 10 per cent of the trade is bent, then it was my view—and perhaps I was being over generous, but it was my view that 90 per cent of the trade was not bent, and that was from a senior Customs officer".

159 This is helpful as indicating that not every trade in this market is fraudulent. However, it does emphasise that this was a market in which there was fraud which had to be guarded against as Mr Dar accepted.

160 Neither the grey market aspect nor the alleged patterns of trade of themselves or in combination of themselves indicate fraud in the transactions in question.

161 We make our specific findings as to fraud in the chains further on in this decision.

***DD - Suppliers and Customers***

*Overview*

162 OCL carried out considerable due diligence on both its suppliers and customers. It visited them. It had continuous checks made by Veracis[10], Transworld and others. Stephen Ploughman said "Yes, I think with Mr Dar, he wanted to keep checking up on his suppliers, and redoing the due diligence reports to bring them up to date". OCL had Dunn & Bradstreet monitoring on the suppliers and customers. It took supplier declarations. It made Redhill checks. It did what was suggested by Notice 726. However, it should be noted that Notice 726 was directed to something else i.e. Joint and Several Liability and so is of limited relevance. Even that only said that HMRC expected rather than required the trader to consider the integrity of the chain. It was whether there was fraud in the chain that the due diligence was aimed at. We find as a primary fact that OCL did all that could reasonable be expected of it in considering the integrity of the supply chains and fraud at the time of entering into a deal. We find that to require more would be disproportionate and unreasonable.

163 It was suggested that this was just a paper gathering exercise and that there was a lot of irrelevant information. The same could be said of HMRC's "verification exercise". However, that does not mean that OCL has not taken all reasonable and proportionate steps as to the integrity of the chain. OCL is not HMRC's insurer as to the payment of VAT by someone far away in the chain. Otherwise why would joint and several liability provisions be needed? OCL only needs to act reasonably and proportionately in considering the integrity of the chain. It has done so and we so find.

164 Mr Vaufrouard was satisfied with the due diligence. Mr Smallbone and Ms Barker were happy with OCL's paperwork with its immediate counterparties Like Mr Vaufrouard we do not see what else OCL could reasonable do[11]. OCL has provided satisfactory responses showing why it was reasonable for OCL not to do things suggested by HMRC Officers with the benefit of hindsight and based on an overview of the chain who by their own admission

[10] Who had even done two reports on OCL for others. Veracis obviously had a large amount of data and information on a lot of those involved in this market.

[11] See para 123 et seq Assurance Visits

have not been involved in the mobile phone business and were not acting as expert witnesses[12].

165 We have born in mind Ms Whipple's suggestion that there was a cavalier attitude towards regulation and compliance in considering the evidence. She referred (inter alia) to the approach to obtaining or not obtaining the consent of visitors to OCL to be filmed in accordance with the relevant provisions.

166 At the start of proceedings the Chairman raised the impact of the Data Protection Act in respect of the filming of three of the visits by Mr Vaufrouard. The parties were of the view that the Data Protection Act does not go to admissibility in this Tribunal. Rule 28 of the Tribunal Rules specifically provides that evidence shall not be excluded on the grounds it would be excluded in a court of law. Accordingly, the evidence was admitted. We make no findings as to signature or not of the Visitors' book by Mr Vaufrouard and/or his awareness of the notice or filming.

*Specifics*

167 Mr Dar accepted that the point of the due diligence was (inter alia) for OCL to be able to check out and verify its suppliers and customers. The reason for doing that was good commercial sense to ensure that OCL was trading with bona fide companies that are of substance and creditworthy, and so on. There was a particular need in the context of mobile phone trading because OCL knew from Notice 726, from budget statements, from the joint and several liability provisions that the Commissioners expected it to check out its counterparties. He added that he "did more than what they expected me to do".

168 Stephen Ploughman of Veracis who carried out much of the DD reporting said "… the objective of due diligence is to establish if [the trader is a] bona fide company, and that entails quite a few checks … like the security of tenure and their business premises, their company registration and the VAT details, bank details, et cetera, et cetera. It includes the ID of the directors, their personal details, and initially this was done to make sure they were not actually going to be a missing trader, that they were established"

169 Mr Dar said he could only do due diligence on his immediate counterparties. We agree as do seemingly the authors of Notice 726. Mr Dar accepted that all due diligence achieves is checking out your suppliers, your customers and if the fraud is at a remove, such due diligence is not really going to help.

170 HMRC's advice is set out in Notice 726 at paragraph 4.5 which reads:

"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 judgment on the integrity of your supply chain**." (emphasis supplied)

171 We note that this refers to checking the legitimacy of your supplier. A later part of the notice deals with checks on customers. The notice does not advise but merely expects a judgment on the integrity of the trader's supply chain. This is

[12] See para 141 et seq and footnotes 6,7 and 8

also in the context of a provision not in point here. This is not a joint and several liability case.

172As Mr Dar said (and we accept) OCL worked very closely with its assurance officers and always took guidance from them and there was no criticism ever made by them of the way it traded.

173He also said "We have tried to speak to Redhill and ask them if they can assist us and if we tell them the deal we are doing and if they can then go on because they would have access to the information and check the supply chain. We were refused that service and there was nothing else we could do". OCL did Redhill checks.

174It was put to him that OCL needed to be very careful to pick up signs that perhaps it was being swept up in an unlawful and fraudulent sequence of transactions.

175We have sympathy with his reply given what OCL did "How could I have done that? I can't see how I could have". We find as a primary fact that to require more would be unreasonable and disproportionate.

*Defaulters much further down the chain in 2005 and later*

176Ms Barker accepted that in all the deals "The fraudster was well removed up the supply chain" from OCL.

177Much was made in cross examination that in 2005 (not the periods in questions) OCL had been told that chains had been traced back to defaulters many deals back along the chain. Mr Dar replied that "… we asked our assurance officer what steps we can take and we were told, "There is nothing more you can do but to go back to your supplier and ask them, they will do similar checks on their supplier and they should ask their supplier to do the same on theirs." Which he did. "You should speak to your supplier and make sure who he is dealing with is correct and he does the fraud checks". He did.

178The transcript of the meeting with Mr Vaufrouard (see above) when this occurred continued

"Question: Okay, so you need to be forcing it down the chain."

179Mr Dar said "Again, I did everything that I thought was expected of me and more. If I knew I was going to end up in this position, things might have been different, but at the time, the information I had and the decisions I took, I thought I was doing all I can". We have found he and OCL had.

180It was suggested to him in cross examination "what you ought to have done, is to stop trading with those companies. You reassessed your business with those companies, perhaps you should have specifically gone to each of those companies and said to them, "Do you realise that all the stuff I bought off you in August 2005 in fact was infected with fraud". This arose from something which did not relate to the periods with which the Appeals are concerned nor the transactions in question.

181Mr Dar told us he did that. He said OCL spoke to every single one of its suppliers. Mr Dar met them regularly. He raised those concerns and they assured him that they did all the checks that OCL was doing. There was no evidence to the contrary.

*Supplier Declarations*

182These were standard form documents sent out by OCL to its suppliers for the suppliers to complete. They read:

"We confirm we have carried out reasonable due diligence checks on our supplier of these goods including a review of [various listed matters]" and they

were signed on behalf of the supplier. It was one of a number of measures undertaken by OCL. It was reasonable to do so. OCL would doubtless have been criticised if it had not done so.

183 OCL could not be sure that the supplier was telling the truth but OCL had raised the question with its counterparty, the one person with whom it could raise the question with any relevance and without jeopardising commercial relationships. OCL did not have information powers similar to those of HMRC. Even when they did HMRC do not seem to have known of fraud at the time the deals in question were entered into.

184 We were not taken to any deals where there was not a supplier declaration for the relevant deals OCL undertook It instructed another independent company to carry out further due diligence. Veracis did an ongoing due diligence on OCL's suppliers as well. Due diligence was an evolving procedure and OCL took whatever steps it could.

185 Mr Dar was asked "Why didn't you get Security Unlimited to ask specifically Globcom about the August [2005] deals?" He replied that "I had spoken to the director of Globcom myself. If you see that when the visit was carried out, Mr Iqbal was not present at that visit but I had spoken to Mr Iqbal about concerns raised by the Commissioners". This was not seriously challenged and we accept it and find it was reasonable and proportionate. The matters arose before the periods with which the Appeals are concerned.

186 Mr Dar said of Elite "I had visited them, I have seen the warehouse, I have met the directors, I have done credit searches on them. I have done Veracis searches and I knew it was a long established company. Let me make clear on that Veracis point. We did not rely on Veracis to assist us carrying out trade. That was just an additional step we took in due diligence. We were carrying trades with our established suppliers before we started using Veracis so that was just an additional measure. You look at the positive, you look at negatives and you make your decisions. We had a monitoring with Dunn & Bradstreet we had visited the company, we constantly met the directors and we did whatever we could and Elite is still a long established company and is still trading. Veracis was not a sort of green light for us to carry out trade. That was just an additional measure we took to carry out due diligence on—and existing due diligence enhanced it by doing that. We were already doing business with this company for a couple of years with the directors of this company". We accept this and find it was reasonable and proportionate. Mr Dar could only go to his counterparties.

*The Manchester Incident*

187 Certain boxes of phones which were to fulfill an export order were detained by HMRC at Manchester Airport but then returned. OCL used these phones to fulfill the order. HMRC suggests that this was another indication of the artificial nature of the arrangements and their connection with fraud.

188 We disagree with HMRC's suggestion. OCL's action seems to be the natural reaction of a trader at minimum cost and delay. HMRC's suggestion that they should not have completed the order but cancelled it and returned the phones seems unrealistic and uncommercial. It would also be unreasonable and disproportionate.

189 We find as a fact that:

a. OCL's action seems to be the natural reaction of a trader at minimum cost and delay;

b. is not an indication of the artificial nature of the arrangements and their connection with fraud. We find as a fact this was not the case as regards these transactions; and

c. when the phones were returned and not kept by HMRC after seizure it was perfectly natural, reasonable and proportionate for OCL to assume that they had been cleared.

190 There had been a dispute as to what had been removed from the outside of the cartons and what this showed. However, this was not pursued. We do not think it could have assisted us.

191 Mr Dar accepted that the goods in question were eventually traced back to fraudulent traders although this was unknown to OCL at the time and seemingly to HMRC.

192 He made the point that when the shipment was cleared by Customs, he was under the impression that those concerns were not there anymore. He said he could have pulled out of the deal but that could have jeopardised the relationship with the supplier. He chose to carry on with the deals after the Commissioners were satisfied with their checks. We accept this evidence and find it reasonable and proportionate to have continued with the deal. He did cancel deals in the period with suppliers. This incident concerned customers not suppliers as in the cases of cancellation.

*Switzerland*

193 In the period after the Manchester inspection OCL started to ship Dubai consignments not by air but by road to Switzerland. That was partly based on requests from Dubai customers. OCL's trading partners in Dubai said they were using an alternative route and it was more effective and there was less delay. OCL spoke to their freight forwarder and the freight forwarder confirmed he was using that route as well and it worked out better for OCL insurance-wise and freight-wise as it was cheaper. We accept this unrefuted evidence and so find.

194 The whole point of changing the route, taking the goods out via Switzerland was not to lessen the likelihood that Customs were going to inspect the goods as was suggested to Mr Dar. OCL had no problem with Customs inspecting the goods. Sometimes it just took too long. Customs still inspected the goods when they travelled by road but the delays were not as long as at the airports. It was also cheaper by road.

195 OCL gave deliveries in Switzerland (i.e. the freight responsibility ended there). Mr Dar told us that the Dubai customers bore the cost of taking the goods by air to Dubai. They had an additional cost and when the price was agreed the customers bargained OCL down. There was no evidence to refute this and we accept it.

196 It was suggested to Mr Dar that this was a completely uncommercial way of transporting goods designed to minimise Customs interference with goods going abroad and that OCL ought to have known that. He disagreed. We accept his unrefuted evidence.

*Other Jurisdictions*

197 In reply to the question "If you knew that your Dubai customers were on-selling to other jurisdictions and plainly making money in so doing, why didn't you investigate direct sales to those other jurisdictions?" He replied "We did… wherever we could find business, we explored those opportunities and wherever we were satisfied selling, we did explore other jurisdictions".

198 He accepted that there were not any onward trades in OCL's business profile to places such as China, India and Africa.

199 Mr Dar said India was "something" OCL was not comfortable dealing with and it did not have the connections or the means to go out there. We note here that Mr Dar is a Pakistani by origin. OCL were happy selling to Dubai but it also sold to Hong Kong and Singapore. We accept Mr Dar's unrefuted evidence.

*The Issue of Insurance and Exports*

200 OCL had an insurance arrangement with Norwich Union. It also had insurance arrangements through the freight forwarders, Interken. The Interken policy was effective from 1 February 2006.

201 Mr Dar accepted that the Manchester shipments exceeded OCL's own insurance cover limit of £2.5 million because of their value. Their sale value was something in excess of £8 million.

202 They were due to all go on the same aircraft. OCL was not aware of that. OCL did take it up with Interken at that time and that is when the possibility of using their insurance was discussed.

203 The freight forwarders had instructions to stay within OCL's cover. The freight forwarders sometimes did go out of the cover. When the freight forwarders did go outside the cover OCL were unhappy. OCL did take it up with them.

204 Mr Dar said the freight forwarders assured OCL, if anything were to go wrong, their policy would cover any discrepancies. We accept this evidence which was not refuted.

205 Mr Dar told us that the goods were only exposed to risk when they were on the road. When the goods got to the airport, on the aircraft OCL's insurance was £2.5 million and the rest was covered by Interken's insurance if anything were to go wrong.

206 The Norwich Union policy did not expire. The consignments that were covered by Interken were not covered by Norwich Union. We accept this unrefuted evidence and so find.

*Europe February 2006*

207 Things changed quite substantially in February 2006 because, whereas before OCL had previously exported mainly outside the EC, it now started quite a considerable EU export trade. OCL were closely in touch with the EU market. It had done some deals, Mr Dar thought two or three months prior to that, but mainly OCL dealt with Dubai.

208 Essential Trading, Olympic and Rakha, all relatively recently formed European companies**,** approached OCL for stock in early 2006. OCL were in contact with them for a couple of months and having checked them out decided to trade with them. The reason for the change of policy was what was said in the *Bondhouse* decision of 12 January 2006. OCL traded in Europe because there was a demand in Europe for the commodity. OCL took references and visited them. They were buying at that time from other companies and there was potential business for OCL there.

209 Mr Dar visited all three of these European companies just before doing business with them. Copies of hotel bills and the ferry ticket (Dover-Calais) were produced as corroborative evidence. Mr Dar wrote a note for the file on each of these companies. The note follows the Veracis report paragraph headings. There is no evidence in the bundles that Mr Dar obtained independent verification of the limited financial information he gleaned at these meetings though some DD enquiries were made through references from freight

forwarding agents and customers and suppliers etc. References were seemingly also obtained as were confirmation of VAT registrations.

210 As far as Olympic Europe was concerned OCL took references and sold goods, controlled by the freight forwarder so that they had control and title till payment. At the time of the trade with them, they were verified by Redhill. OCL got paid for those goods. Olympic BV in fact ended up being the subject of a veto letter but that was many months later.

211 Similar visits and DD were made in respect of Essential Trading SARL and Rakha SARL

212 It should be noted that in all the deals with Essential Trading, Rakha and all but the last two deals with Olympic Europe BV**,** OCL were paid by these customers before the goods were shipped overseas. OCL, therefore, took no financial risk (save the cost of freighting goods back). This differs from the normal pattern.

*Alleged Deficiencies*

213 Mr Smallbone and Mr Burchfield wrote letters after the periods in question in the Appeals suggesting alleged deficiencies in the Due Diligence for those periods. These suggestions were not made out and/or were dealt with at the Hearing. We find this as a primary fact.

214 These letters were written four or five months after the periods in question here and notwithstanding that Mr Vaufrouard, OCL's assurance officer, checked OCL's due diligence virtually on a monthly basis. Mr Vaufrouard was satisfied with the due diligence on every single one of OCL's suppliers and customers. Mr Vaufrouard was OCL's only real contact with HMRC. OCL took everything he said very seriously and relied on his comments. We find this as a fact.

215 Mr Birchfield, for example, asserted that there were no copy Redhill checks for Shelford Trading Limited. This was wrong as can be seen from the documents annexed to Mr Dar's witness statement. There were numerous checks on that company. We find this as a fact. There were also the Veracis reports in the bundles.

216 Various comments on the due diligence were also made by Ms Barker. She suggested OCL should have been keeping a database of IMEI numbers. Mr Dar accepted it was possible to keep such numbers.

217 He said in cross examination "…If it assists us and makes us any better position or give us any comfort and security, we would do that but there was no way we could—we used to keep IMEI numbers, we used a keep on a record of IMEI numbers and there was no system for us to check those IMEI numbers with. The only thing we can do is just to see if we have had that stock before. It didn't give us any comfort that stock is not seen by other traders in the UK. There was no database available to us to refer. Nokia didn't assist and the NEMESIS, I don't know when it came in, and there was no availability of that to the traders so they can take those IMEI numbers, give it to the Commissioners and make sure the stock they were buying hasn't been in circularity before. …When we used to scan IMEI numbers there are bound to be errors and there were errors at the time of scanning of IMEI numbers. There was inspection teams, all my own staff scanning IMEI numbers. There were occasions when they mix up the consignments from one to another. Sometimes they will double scan the numbers and we took advice from our lawyers and our VAT consultants about IMEI numbers. There was no legal

requirement. Even though we still used to take IMEI numbers, they were never taken away by the Commissioners from us and we thought that exercise to be not in any help at all".

218 We accept this unrefuted evidence. We find this was reasonable and proportionate.

219 Stephen Ploughman said in cross examination "…it has proved to be the case that there are a lot of flaws in recording IMEI numbers". This accords with Mr Smallbone's evidence on NEMESIS.

220 Mr Dar also said "When he requested us to keep those IMEI numbers, we did keep the numbers but Mr Vaufrouard never took the numbers with him….We assisted, and very helpfully assisted, in any single way we could and we did the best we could. The numbers, like I said, we had no way of checking those numbers. What should we check them against? We could only offer to give them to the Commissioners so they can check in the database, if they had NEMESIS, they could check from their database. We were willing to give them shipment-to-shipment, consignment-to-consignment, deal-to-deal, they could have checked it for us and told us, "This stock has been in circulation" or not, but they didn't offer those services to us".

221 We also accept this evidence. We reject the suggestion that OCL missed an obvious opportunity and a step that could have been taken to extend its due diligence procedures. We find OCL's action was reasonable and proportionate.

*The Issue of Inspections.*

222 Mr Dar said that:

"OCL instructs an independent inspection team to conduct 100 per cent external box checks and 10 per cent internal box checks on delivery."

223 He said in his witness statement:

"The independent inspections team ensure that the correct number of boxes are delivered and also check the model number and condition of the boxes to ensure there is no damage to the boxes. The seals haven't been broken and that the model numbers accord with the delivery notes."

224 There was a conflict of evidence as to what was meant by this. Mr Vaufrouard understood OCL carried out a close inspection, an internal inspection of 100 per cent of its goods. This was not what Mr Dar said he said. If Mr Vaufrouard understood it in any other way he never mentioned it to OCL or Mr Dar. We do not consider this to be of great significance but we prefer Mr Dar's version and so find.

*Suitability and source of phones etc*

225 The issue was raised at the hearing as to the suitability of the phones as to language, accessories, chargers etc. and that the phones came from abroad. It was suggested to Mr Dar in cross examination "that many of these phones were not suitable, were they, for those sorts of places [ie where they were going]".

226 He replied "They are suitable European spec. The phones are GSM phones, they can be used worldwide so there is no problem with the specification, European specification being used anywhere in the world. The only thing that some people take into account is what languages it has so if they are happy with that language mostly English is an acceptable language worldwide, then there is no problem". We accept his unrefuted evidence.

227 Mr Dar was aware the phones are not made in the UK so they would have to come into the UK.

228 It was suggested to him that there was "… no reason for those phones to be in the UK, is there? He replied "There is. I know for a fact there are a lot of distributors who are actually Nokia distributors and they source stock from the grey market and it is consumed in the UK".

229 Not all the deals OCL did in January, February and March 2006 were exports. There were some UK to UK deals. Mr Dar said that the phones they dealt in could be exported and continued "…those phones could be consumed here in the UK. We used to supply to customers who supplied to distributors". We find the phones were suitable for both UK and export trades.

230 The question also arose as to why OCL did not buy the phones in the country of manufacture. Mr Dar was asked:

"Q … Why didn't you just buy the phones from wherever they were manufactured …? Why not cut out these intermediate chains? Why not go straight to where they were coming from?

A. We did try that a bit later on when we were established. The manufacturers do not supply to everybody that approaches them. There is a lot of red tape and they are fussy and selective as to who they give distributors' dealerships to".

231 We find OCL did try to buy direct but was generally unable to. Mr Dar told us that most of the time the only source of phones for OCL, in practice, was suppliers in the UK. We accept this and so find.

232 Ms Barker was asked in cross examination:

"Q. What is the point that you are making by the fact that the phones originated from outside the UK?

A. The point I am making is they originated from outside the UK. Our Communications knew that they were exporting the phones, so the phones were not actually designed for the UK market".

233 She accepted English was included as a phone language on the phone but did not think this was an indication that they were designed for the UK market. She accepted English was an international language and that there was a global market in mobile phones.

234 She considered that someone who is buying in bulk and selling on to someone in another member state or outside the EU was not necessarily an indication of the global market operating. She accepted there is no reason why it should not be.

235 We find that the phones themselves were suitable for use in the UK (even if not designed[13] for the UK market) as the phone languages included English. We do not consider that there is anything necessarily untoward in mobile phones manufactured abroad being imported into the UK even if subsequently exported. We have also already found that OCL could generally only source phones from within the UK. Accordingly, if OCL were exporting the phones they might well have to come into and go out of the UK especially if OCL could only source them from the UK.

236 Much was made of two-pin chargers and three-pin chargers and the time and cost of changing them. However, Mr Dar's unrefuted evidence was that it was the retailer who would do this. He said it was normal in this industry for the

[13] We are not sure that any phone is designed solely for the UK market when there is a much bigger global market. We have considered their suitability rather than design.

retailer to do that if it was considered necessary. OCL offered the stock to customers as it was as to language, colour, model, charger etc. Any modifications were for the customer to do. We accept this and so find.

***The Deals***

*Chains Methodology*

237 HMRC sought to piece together the chains of transactions and to show the integrity of the chains.

238 Mr Smallbone described the methodology as follows:

"Basically, we look to trace back the transactions in the UK, back to either perhaps a manufacturer of the goods or a trader that has failed to pay the output tax and gone missing. It simply involves looking at the supplier, which is information provided to us by the company requesting the repayment claim. We would then go to the electronic folder which is a database we have on our systems for that supplier to find out, in turn, where they purchased the goods from. If that information is not available electronically we would then turn to the officer responsible for that company and ask them for that information. So and so down the chain until we eventually come to a stopping point".

239 This information was put on a Deal Sheet.

240 Ms Barker was also involved in this "verification" particularly in respect of the February 2006 deals. She was relatively new to this[14].

241 A vast amount of paper work was produced. From that the following relevant information has been extracted. We consider that all the chains in the deal sheets have 'integrity' in that sale invoices and generally purchase orders were exhibited which ultimately led to the OCL transaction in question. Had HMRC complied with Directions they could have been agreed with the Appellant prior to the hearing – a year is not too short a period to do this. This would have saved much time, expense and effort.

242 We find that in general the chains have been established. There are some that cannot be traced back to the source of the phones from outside the UK. We consider that the Northwest and Storm 90 chains (as detailed below) have not been established. The integrity of the chains and tax loss in them caused by fraud are matters considered in detail below.

*Illustrative Transactions*

243 It may help to illustrate how these transactions worked if three consignments of phones are considered. We have chosen Deal Chains 1366 -**1370**, 1412.and 1437 – 1441.

*Transactions 1366 -1370*

*Introductory*

244 The phones in this chain come from single batch of 23,000 units. The source was (seemingly) FACI although no sales, purchase or payment documents were available. The original batch of 23,000 was broken down into four consignments of 5,000 units and one of 3,000. We were not told why this was done.

245 The transactions all took place on 23 January 2006.

*Transaction 1366*

246 The chain consists of a number of deals.

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[14] Ms O'Neill: "Miss Barker, a similar question to what I put to Mr Smallbone. When you did this tracing exercise for the 02/06 OCL chains, how many others—tracing exercises had you actually done? A. I hadn't completed any at that stage, because I'd recently joined the MTIC team".

It involved:

i. Sale by FACI to Oxhey;
ii. Sale by Oxhey to Pale;
iii. Sale by Pale to TCG;
iv. Sale by TCG to TEC;
v. Sale by TEC to Globcom;
vi. Sale by Globcom to OCL;
vii. Sale by OCL to Midcom.

247 The documentation is not perfect. For example:

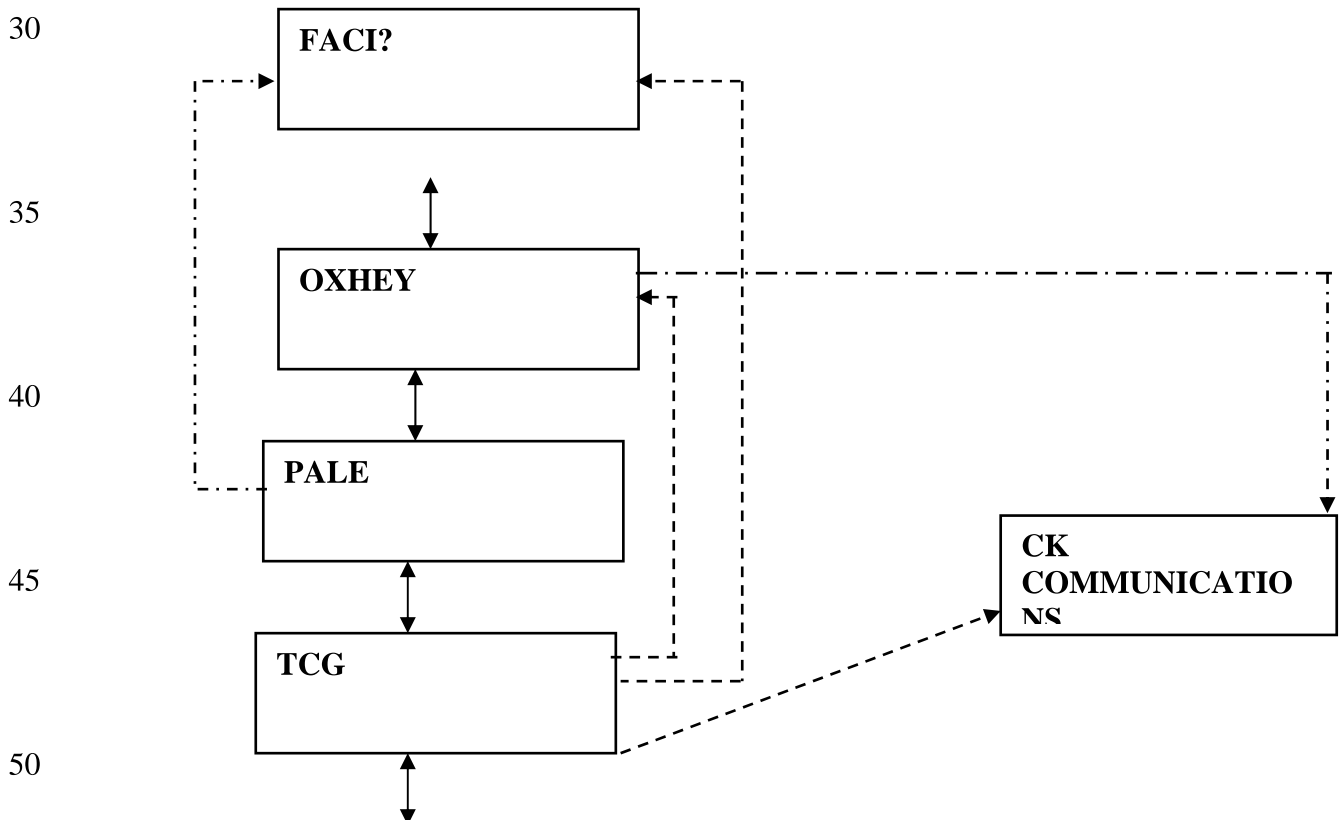
i. In the Oxhey – Pale limb the payment instructions dated 23 January only mentions 3000 phones, We presume this is a typing error as the amount tallies with the invoice value for 23,000 phones.
ii. In the TCG to TEC limb there is only a pro forma invoice and no VAT invoice.
iii. In the TEC to Globcom limb the invoice date is 30 January 2006 and not 23 January 2006. The invoice is marked as paid but no date of payment is given.
iv. No payment instructions were produced.
v. The **p**ayment **i**nstructions further along the chain are dated 30 January 2006 rather than 23 January.

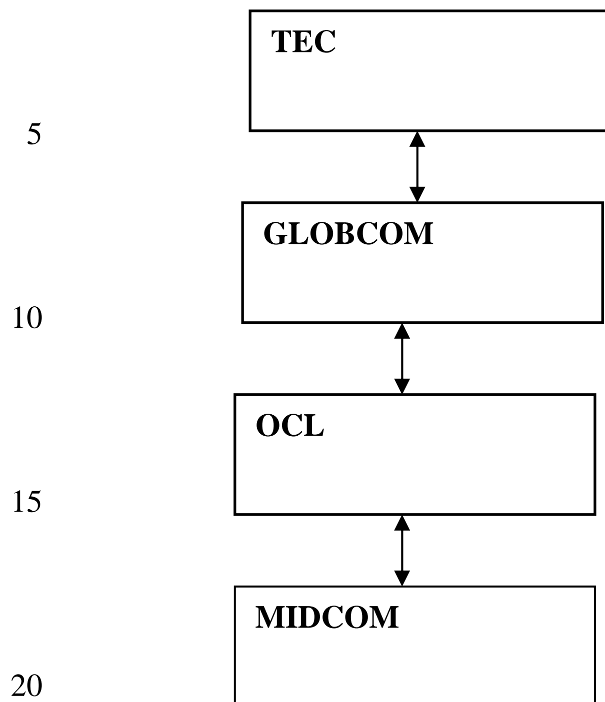
248 There were third party instructions in the chain. They included:

a. Oxhey – Pale (total value £,3,771,339)
There were Third Party Payment instructions of £3,197,000 to CK Communication, and £3,450 to FACI.
b. Pale to TCG (total value £3,755,393)
There were Third Party Payment instructions of £3,766,478 to CK Communication**s**, £3,450 to FACI, and £1,410 to Oxhey Construction

249 None of the third party payments involved OCL and all were some way away from OCL. However, it shows that there were indicia of fraud in the chain.

250 This may be shown diagrammatically as follows.






*Transaction 1367*

251 Essentially the same sales along the chain took place as in transaction 1366. It also concerned 5000 units.

252 For this deal the payment dates TEC to Globcom and Globcom – OCL were 31 January 2006 while the payment date by OCL to Midcom was 30 January 2006.

*Transaction 1368*

253 Essentially the same sales along the chain took place as in transaction 1366. It also concerned 5000 units.

254 The TEC – Globcom sales invoice is dated 30 January 2006 not 23 January.2006 and stamped as “paid 31.1.06”although there no payment details. The Globcom – OCL payment was made 31 January 2006 while the payment date OCL – Midcom was 30 January 2006.

*Transaction 1369*

255 Essentially the same sales along the chain took place as in transaction 1366. It also concerned 5000 units.

256 The TEC – Globcom sales invoice is dated 30 January 2006 not 23 January 2006 and stamped as “paid 31.1.06” . The pro forma invoice is dated 23.1.06. There are no payment details. The Globcom – OCL payment date is 31 January 2006 while the payment date OCL – Midcom was 30.January 2006.The Inspection is stamped by Midcom as 28 January 2006

*Transaction 1370*

257 Essentially the same sales along the chain took place as in transaction 1366. However, it only concerned 3000 units.

*Transaction 1412*[15]

258 The chain consists of a number of deals. It involved:

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[15] Note this invoice number is out of date sequence of the deals

i. Sale by a third party to Storm 90;
ii. Sale by Storm 90 to Wildtower;
iii. Sale by Wildtower to Elecron Global;
iv. Sale by Elecron Global to Mena;
5 v. Sale by Mena to Shelford;
vi. Sale by Shelford to OCL;
vii. Sale by OCL to Essential Trading.

259 Again the documentation is incomplete. Shipment was allowed before full payment. No evidence was led as to third party payments.

10 *Transactions1437 – 1441*

260 The chain consists of a sale by OCL to Midcom which was split into five separate invoices from a single purchase from 21st Century Traders initially originating from FACI.

261 The chain involved a number of deals. The documentation shows Third Party 15 Payments and Extra Letter payment instructions within the chain.

262 The transactions in the chain were as follows:

i. Sale by FACI to Red Rose – the payment instruction was to pay Evolution Trading SIA;

ii. Sale by Red Rose to Lauriel Reid – the payment instructions were to pay 20 £1,500, 500 to Evolution Trading SIA and £268,462.50 to Red Rose Consultancy. There was an additional payment instruction called an Extra Letter which instructed that £262,587.50 should be paid to Evolution Trading and £5,875.00 should be paid to Red Rose Consulting;

iii. Sale by Lauriel Reid to Phone City Leytonstone – the payment instruction 25 was to pay £1,763,087.50 to Evolution Trading SIA and £8,225.00 to Lauriel Reid. There was a letter from Lauriel Reid to Phone City Leytonstone which said "the above stock will be releast *(sic)* to you by CK Communications Ltd";

iv. Sale by Phone City Leytonstone to Euroquest Traders – no payee was noted 30 on the payment instructions but payments were made in two tranches by Retro Jeans;

v. Sale by Euroquest Traders to Globcom – payment was made to Retro Jeans

vi. Sale by Globcom to 21st Century Traders – there were no payment instructions or details evidenced;

35 vii. Sale by 21st Century Traders to OCL;

viii. Sale by OCL to Midcom International

263 This may be shown diagrammatically as follows.

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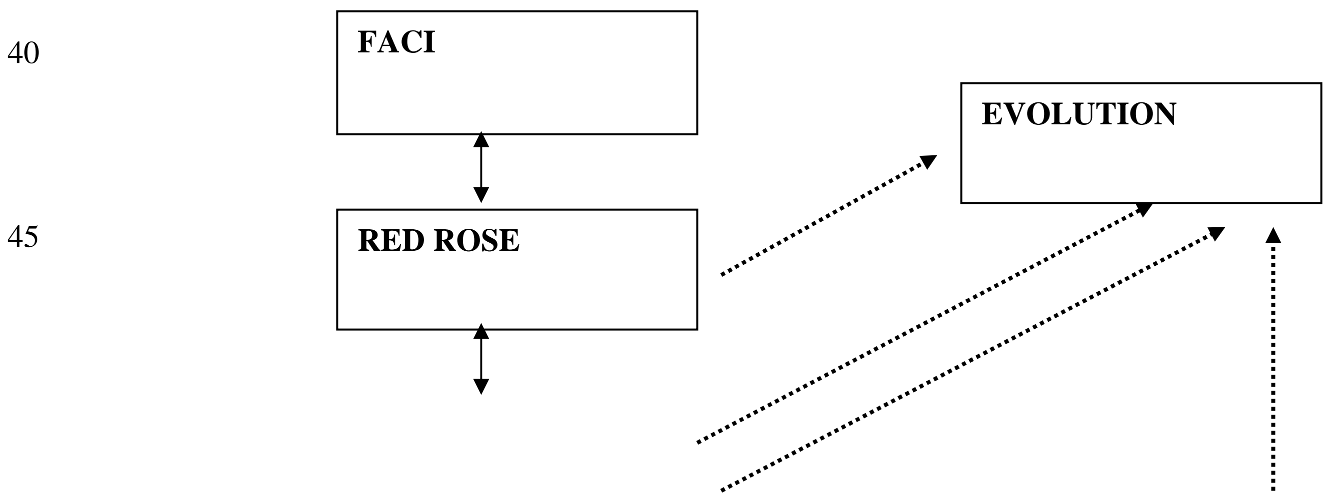

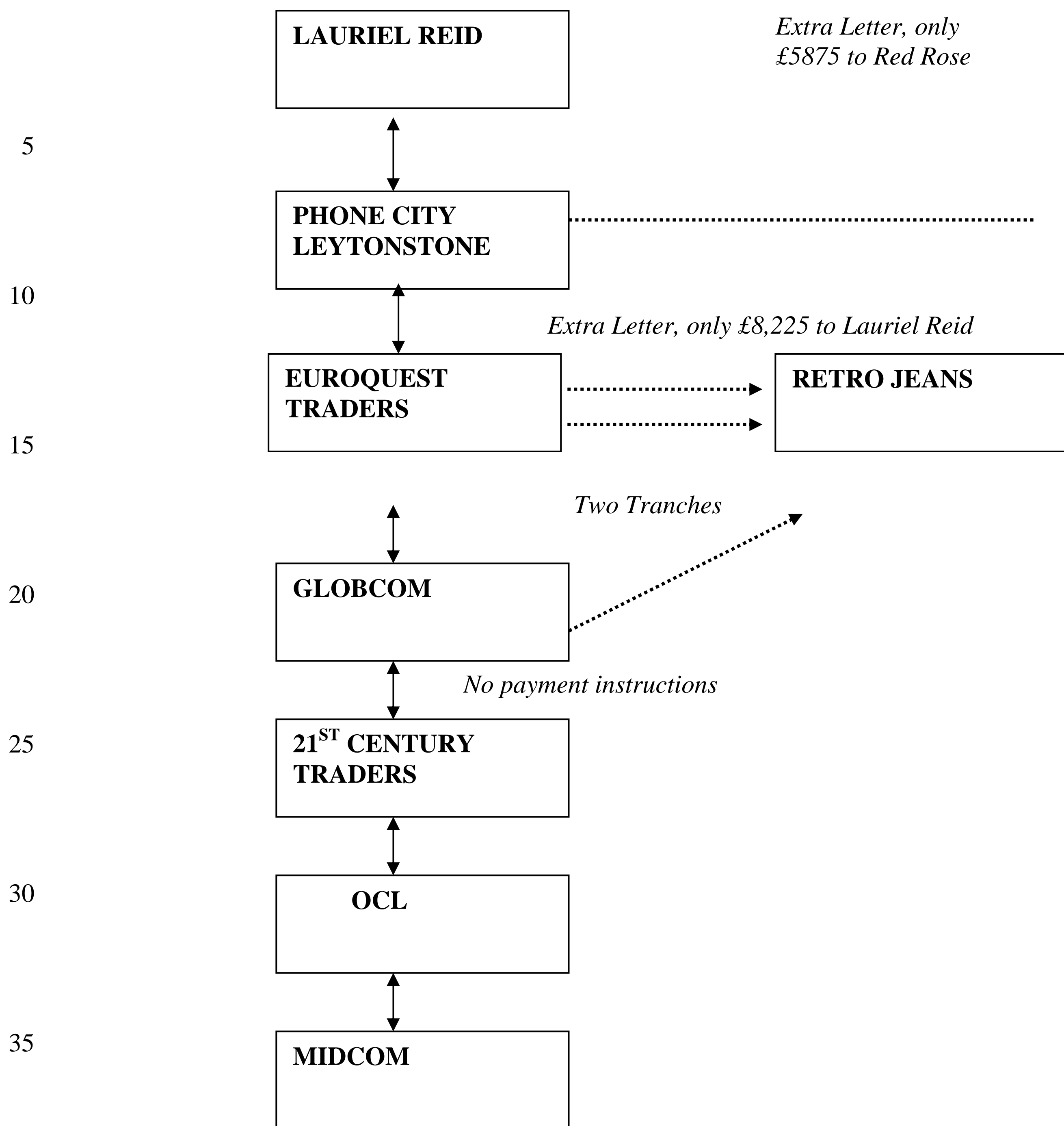


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40 *Summary Table*

264 A summary of some relevant information is set out in Appendix 2.

265 We note that we did not always have full paperwork for the earlier stages of the chains but the sales invoices and most of the purchase orders had been produced.

45 *Chains Established?*

266 The purpose of this section is to consider what chains of transactions have been established by HMRC.

267 We take OCL's acceptance that the substantial majority of defaulters were parties acting fraudulently to means that OCL accepts that there were tax

losses in those chains and the chains in question had been established[16] other than those dispute such as Storm 90 and Northwest.

268 We consider each of the chains by reference to the trader HMRC allege is the defaulter.

5 269 We note (as we have seen above) that some of these chains have limited information at their early stages.

**(a) Steven Phillips t/a First Call**

*Deals 1375, 1377, 1378,1379,1380,1381,1382,1383,1391*

270 On the evidence produced we consider that HMRC has done enough for us to
10 conclude that these chains have been established and we so find as a matter of fact.

**(b) Oxhey Construction Services Ltd**

*Deals 1364,1365,1366,1367,1368,1369,1370,1372,1373,1374*

271 On the evidence produced we consider that HMRC has done enough for us to
15 conclude that these chains have been established and we so find as a matter of fact.

**(c) Myco Telecom Ltd**

*Deals 1376, 1385*

272 On the evidence produced we consider that HMRC has done enough for us to
20 conclude that these chains have been established and we so find as a matter of fact.

**(d) The Callender Group**

*Deals 1470, 1471*

273 On the evidence produced we consider that HMRC has done enough for us to
25 conclude that these chains have been established and we so find as a matter of fact.

**(e) Oracle UK Ltd**

*Deal 1472*

274 On the evidence produced we consider that HMRC has done enough for us to
30 conclude that these chains have been established and we so find as a matter of fact.

**(f) Com4U Ltd**

*Deals 1414, 1415*

275On the evidence produced we consider that HMRC has done enough for us to
35 conclude that these chains have been established and we so find as a matter of fact.

**(g) Red Rose Consultancy Ltd**

*Deals 1416, 1417, 1418, 1419, 1420, 1431-35, 1437 -41, 1453-57, 1458 –68*

276 On the evidence produced we consider that HMRC has done enough for us to
40 conclude that these chains have been established and we so find as a matter of fact.

**(h) Activmind Ltd;**

*Deals 1444-1445,1446-1447, 1451-52*

277On the evidence produced we consider that HMRC has done enough for us to
45 conclude that these chains have been established and we so find as a matter of fact.

**(i) CHP Distribution**

*Deals 1448, 1449, 1450*

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[16] see paragraph [268]

278 On the evidence produced we consider that HMRC has done enough for us to conclude that these chains have been established and we so find as a matter of fact.

**(j) St Aimie Ltd**

*Deals 1350, 1351,1361,1362,1363*

279 On the evidence produced we consider that, on the balance of probabilities, HMRC has done enough for us to conclude that these chains have been established and we so find as a matter of fact.

**(k) Others**

280 As regards Northwest Deal 1384 we find that the chain below Northwest has been established. However, the supplier to Northwest has not been established nor any chain above it. We note that this is a short chain.

281 As regards Storm 90 Deals 1412, 1413, 1423-1430 we find that the chains below Storm have been established. However, the supplier(s) to Storm has not been established nor any chains above it.

282 There is no evidence to establish the higher parts of the chain and no evidence of sufficient cogency to allow us to make inferences as to who the parties (if any) were in the higher parts of the chain yet alone tax loss and fraud.

*Summary*

283 We consider that the integrity of all the chains has been established with the exception of the Northwest and Storm 90 chains

***Tax Loss and Defaulters***

*General*

284 The purpose of this section is to consider what tax loss has been established by HMRC.

285 We take OCL's acceptance that the substantial majority of defaulters were parties acting fraudulently to mean that OCL accepts that there were tax losses in those chains and the chains in question had been established[17].

*Tax Loss - Specific*

286 We consider each of the chains by reference to the trader HMRC allege is the defaulter.

**(a) Steven Phillips t/a First Call**

*Deals 1375, 1377, 1378,1379,1380,1381,1382,1383,1391*

287. The trader was on monthly VAT periods. Before the period 08/05 very little trading was undertaken. The Returns for the periods 08/05, 09/05 and 10/05 show large input tax claims. These claims were disallowed as they related to trading with deregistered traders. No further VAT Returns seem to have been made. A Bankruptcy order was made against the trader.

288. The input tax claim was in respect of the purported export of calling cards to the EU bought in UK. The purported purchase was from deregistered traders. The trader continued to trade in 'vast quantities' of mobile phones

289. Christopher Williams evidence dealt with an assessment that was made against Steven Phillips, trading as First Call concerning five sales invoice issued by Steven Phillips. Mr Williams simply raised an assessment. He did not ever visit Steven Phillips, the trader. He had nothing to do with verifying the deal chains.

290. The letter to the trader said

"2. The £37.875 million input tax claimed in relation to the purchase of international calling cards from Stephen Wayne Ali trading as SWA Systems

[17] see paragraph 378

has failed verification. [Mr Ali's] VAT registration was cancelled with effect from 1st March 2004. The supplies in question took place, on or about 1st September 2005 to 30th September 2005."

291 Mr Williams accepted that it seemed not only did Mr Phillips procure supplies from a deregistered trader in August 2005, Mr Phillips then procured a further £37.875 million worth of supplies from the same deregistered trader the following month.

292 The input tax was disallowed. The letter to Mr Philips also said

"A net amount of £37.607 million is thus considered to be properly payable by you in respect of this period and this amount is hereby assessed as tax due. I must point out that the return in question is still the subject of an ongoing verification exercise. As such, further adjustments may be made if appropriate.

293 Mr Williams was not aware whether Mr Phillips did pay £37.607 million he was being invited to do on 8th November 2005, which was a clear two months before the first of the trades in question in this case.

294 Mr Williams was not able to shed any light at all on what happened, so far as HMRC are concerned in response to that letter.

295 Mr Williams could not assist us with the visits. Unfortunately, HMRC decided not to call Ms Wride who attended them and made notes.

296 On the evidence produced we find HMRC has not established a tax loss in these deals because the tax loss (if any) was caused by the disallowance of input tax[18]. Further the input tax disallowed appears to relate to periods other than those with which we are concerned.

**(b) Oxhey Construction Services Ltd**

*Deals 1364,1365,1366,1367,1368,1369,1370,1372,1373,1374*

297 Oxhey was registered as a supplier of construction services and was on quarterly VAT returns. The relevant return period here is period 01/06.

298 A VAT liability of about. £2.8m remains unpaid. The Company deregistered and shut down. The evidence shows that supplies by Oxhey to Pale Ltd gave rise to an output tax liability that is still outstanding.

299 There were third party payments in the chains. Those payments did not involve OCL.

300 On the evidence produced we find HMRC has established that there was a tax loss in the chains relating to these specific trades.

**(c) Myco Telecom Ltd**

*Deals 1376, 1385*

301. On the evidence produced we find HMRC has sufficiently established that there was a tax loss in the chains relating to these specific trades particularly n the light of there being third party payments. The evidence included that from Officer Okolo as to the £20m assessment and its disposition.

**(d) The Callender Group**

*Deals 1470, 1471*

302. Daniel Outram gave evidence as to The Callender Group to this to the best of his ability given that another part of HMRC had taken away the relevant documents and had not and did not provide copies. This did not accord with the directions that the Chairman had made over a year before as to documents. It was extremely

[18] HMRC had accepted it was for HMRC to prove "… there been a loss of revenue in terms of output tax unaccounted for at an earlier stage on the particular goods which are now included in OCL's deals".

inconvenient and could have caused great difficulty. We do not mention the discourtesy to the Tribunal.

303. It is to be hoped that the HMRC's Internal Instructions will be amended to deal with this type of situation where evidence is required for a hearing. It was not satisfactory.

304. Mr Outram told us that initially, the assessment on The Callender Group was for about £52 million, but when further information came in the assessment was increased, and he "believed at the moment … now stands at around £79 million".

305. Mr Yule told us part of the earlier assessment was based on best judgment because there was a number of missing invoices. The assessment was subsequently updated when further information was to hand.

306. On the evidence produced we find HMRC has established that there was a tax loss in the chains relating to these specific trades.

**(e) Oracle UK Ltd**

*Deal 1472*

296 Mr Cameron-Watson gave evidence from the updated Vision printout dated 9 October 2007 that this trader was deregistered on 7 April 2006 and that it is in compulsory winding up. He told us that there is tax due and outstanding. The current ledger balance was £28,861,738.05. on 5 October 2007. That was the sum used for the winding up.

297 On the evidence produced we find HMRC has established that there was a tax loss in the chains relating to these specific trades.

**(f) Com4U Ltd**

*Deals 1414, 1415*

298. On the evidence produced we find HMRC has established that there was a tax loss in the chains relating to these specific trades. Tis included the Officer's oral evidence and that of Mr James Smallbone.

**(g) Red Rose Consultancy Ltd**

*Deals 1416, 1417, 1418, 1419, 1420, 1431-35, 1437 -41, 1453-57, 1458 -68*

299. This trader was on quarterly return periods. It was deregistered as of 3 March 2006.

300 An assessment was made for a three day period for about £3.7m. All Red Rose's trades after 17 February 2006 were acquisitions from the EU. It failed to provide returns.

301 We find on the evidence before us that there was a tax loss in the chains relating to relating to these specific trades.

**(h) Activmind Ltd;**

*Deals 1444-1445, 1446-1447, 1451-52*

302 IRC say it does not know the source of the phones here but maintains it must have been from the EU. It was also accepted in evidence by HMRC's witness that there was no loss in the chains. Accordingly, we find that there is no tax loss established in these chains. This follows from HMRC's own evidence.

303 Mr Yule, the HMRC Officer responsible for Activmind gave evidence that the Commissioners repaid the sum of £204 and a few odd pence to Activmind. He agreed that payment, small though it is, must have been made after 26 April 2006, because that is the date on the return that the return was received. He accepted Activmind is put forward as a defaulting trader by the Commissioners and defaulting in relation to OCL's accounting periods 01, 02 and 03/06. He agreed that it was correct that the payment was made some three months after the deals in question.

304 He said Activmind been deregistered for VAT on 9 March 2006.

305 He specifically agreed during cross examination:

i. Activmind had declared to the Commissioners the supplies purporting to be from Maximila Solutions in the total sum of £18.425 million ;

ii. Activmind had declared to the Commissioners outputs in total of some £14.542 million;

iii. "So therefore Activmind had declared to the Commissioners input tax derived from Maximila Solutions and output tax in relation to the invoices scheduled in the following pages in the sum of £14.542 million";

iv. Then the Commissioners disallowed the Maximila Solutions inputs and said Maximila Solutions was deregistered well before these purported supplies. This input tax would not be allowed;

v. "So that the default or the assessment was raised on the basis of disallowance of input tax, not a failure to declare output tax";

vi. "So, therefore, the fraud which caused the loss was the fraudulent declaration of supplies from Maximila, or at least the fraudulent claim for VAT from supplies from Maximila, because Maximila had been deregistered so it could not possibly be charging VAT";

vii. "That is the source of [HMRC's] loss in this regard…".The source of HMRC's loss was the disallowance of the input tax which Activmind was saying that it had paid to Maximila.

306 We find as a fact that the loss has not been established by HMRC to be connected with the goods OCL exported. That would require a failure in respect of output tax on those goods which has not been established.

307 We find as a primary fact that no tax connected to the chain has been established in respect of these deals.

**(i) CHP Distribution**

*Deals 1448, 1449, 1450*

308 The trader was on monthly returns.

309 The trader failed to pay VAT for relevant period. There is an outstanding assessment for about £14m which has not been paid.

310 We find on the evidence before us that there was a tax loss in the chains relating to relating to these specific trades.

**(j) St Aimie Ltd**

*Deals 1350, 1351,1361,1362,1363*

311 St. Aimie failed to render VAT returns. There is an Output tax liability still outstanding.

312 St. Aimie purchasing 'vast quantities' of goods from a Cypriot company and selling them in the UK.

313 There is a lack of documentation but the relevant supplies to St. Aimie were from EU so there is no input tax offset.

314In the circumstances we consider that on the balance of probabilities there was a tax loss in the chains relating to relating to these specific trades.

**(k) Others**

315 As regards the Northwest Deal 1384 we find that the chain below Northwest has been established. However, the supplier to Northwest has not been established nor any chain above it. We note that this is a short chain.

316 As regards the Storm 90 Deals 1412, 1413, 1423-1430 we find that the chains below Storm have been established. However, the supplier(s) to Storm has not been established nor any chains above it.

317 There is no evidence to establish the higher parts of the chain and no evidence of sufficient cogency to allow us to make inferences as to who the parties (if any) were in the higher parts of the chain yet alone tax loss and fraud. On the evidence produced we find that tax loss has not been established in these chains.

5 *Summary*

318 We consider that tax loss in the chain has been established in all the chains except Stephen Phillips t/a First Call and Activmind chains.

319 We have also found that the chains above Northwest and Storm 90 have not been established and so there cannot be tax loss established above Northwest and 10 Storm 90.

**Fraud in the chain**

320 The purpose of this section is to consider what tax loss caused by fraud has been established by HMRC.

321 We consider each of the chains by reference to the trader HMRC allege is the 15 defaulter.

**(a) Steven Phillips t/a First Call**

*Deals 1375, 1377, 1378,1379,1380,1381,1382,1383,1391*

322. We have already found no evidence of tax loss in these chains.

323. For the sake of completeness we record that no conclusive evidence was 20 produced to show that First Call was likely to have been involved in fraud.

324. However, we note the following matters:

a. The growth of turnover between 07/05 and 10/05 (3 months) from £0 to £427m;
b. There was a consistent pattern of trading with deregistered traders;
25 c. There was a consistent failure to render returns;
d. There was no apparent intention to pay the assessments;
e. It declared purchases of calling cards from a company that denied supplying them.

**(b) Oxhey Construction Services Ltd**

30 *Deals1364, 1365, 1366, 1367,1368,1369,1370,1372,1373,1374*

325. Oxhey's trade classification was as a building contractor. Its turnover growth was formidable (from £8,105 to in excess of £37.5m between October 2005 and January 2006 (a six months' period)

326. The deals were back to back deals. Third party payments instructions from 35 suppliers were accepted by Oxhey. For example, in Deals 1364/1365 Third Party Payment was made between CK Communications and Oxhey Construction. In Deals 1372-1374 there were third party payments in the Pale to K&S limb of the deal chain and in the Oxhey to K&S limb. Similar payments were made in Deals 1366-70 and1372-1374

40 327. It seems Oxhey was never in a position to pay its VAT liability.

328. This indicates fraud in the chain and we find that there was fraud in the chain in relation to these specific deals.

**(c) Myco Telecom Ltd**

*Deals 1376, 1385*

45 329. On the evidence before us we consider that there is fraud in the chains here and we so find.

330. There are Third Party Payment to FACI by Lauriel Reid. We consider this is an important hallmark of fraud here. There are third party payments in the sale from Lauriel Reid to The Callender Group (99.5% payment to Evolution Trading SIA 50 and small amounts paid to The Callender Group and to FACI).

**(d) The Callender Group**

*Deals 1470, 1471*

331. There were third party payments in both these chains which in the circumstances were indicative of fraud.
332. We consider that there is fraud in the chains here and we so find. The third payments in the chains we consider are an important hallmark of fraud here.

**(e) Oracle UK Ltd**

*Deal 1472*

333. We consider that there is fraud in the chain here and we so find. The Third Party Payments in the chains we consider are an important hallmark of fraud here. The Third Party Payments can be linked directly to the defaulter.
334. The Third Party Payments include the following.
    (a) In the Sia Diarolla – Oracle UK limb there was a third party payment to CK Communications
    (b) In the Oracle UK – Woodworks UK limb there were third party payments as to 85% to CK Communications and 15% to Oracle UK. There were also additional instructions to pay the majority of 15% to CK Communications leaving Oracle with a payment of just £763.75 on deal of £1.87mn.
    (c) In the Woodworks UK – UKGCT limb there were third party payments as to 99.9% to CK Communications and a small amount to Woodworks UK.

**(f) Com4U Ltd**

*Deals 1414, 1415*

335 We consider that fraud in chain has not been established by the evidence produced to us in respect of these deals. There is again a lack of information here.

336 Third Party Payments were not shown to have been made here on the evidence produced to us.

**(g) Red Rose Consultancy Ltd**

*Deals 1416, 1417, 1418, 1419, 1420, 1431-35, 1437 -41, 1453-57, 1458 -68*

337 These chains are some of the most comprehensively documented from the defaulter position onwards and show evidence of fraud which can be directly linked to the defaulter. Accordingly, we find this as a fact.

338 There is prolific evidence of third payment instructions. The Extra Letters strengthen this and show a clear connection to fraud. An example of this is founding the illustrative transaction (Deals 1437-41) at 260 et seq above (see also Deals 1416 -1420, 1431 -35, 1453-1457 and 1458-1468).

**(h) Activmind Ltd;**

*Deals 1444-1445, 1446-1447, 1451-52*

339 We consider that fraud in chain has not been established by the evidence produced to us in respect of these deals.

340 We have already found as a fact that no tax loss connected to the chain has been established in respect of these deals so whilst there may have been fraud involved it is not a relevant loss here. There is no tax loss to be caused by fraud. In these specific chains.

**(i) CHP Distribution**

*Deals 1448, 1449, 1450*

341 The supplier in Deals 1448-50 was Destonia General Trading, a Cypriot company. HMRC evidenced the purchase order, sales invoice and payment made in the bundle – see deal sheet. Umbria Equitazone was alleged to be the supplier to Com4U.

342 The trade classification of the trader is publishing and installing computer networks. Again there is a formidable growth of turnover to about £80m in a short time there is no evidence of supplies in relation to Umbria Equitazione.

343 The payments made by CHP in Deals 1448-1450 is 17.5 % above invoice value. No other goods or services are noted on the invoice to justify this discrepancy.

344 We find on the evidence before us, that there was fraud in the chains in relation to these specific deals.

**(j) St Aimie Ltd**

*Deals 1350, 1351,1361,1362,1363*

345 We find on the evidence before us that these trades were connected with fraud.

346 We note the following matters:

(a) The business category was graphic design;
(b) The trader's turnover increased in a month from nil to in excess of £290m;
(c) There were third party payments in the chain. For example in Deals 1350 /1351 Third Party payments were made between Blue Star Trading and Euroquest seemingly 3 and 2 deals away from the OCL transaction.
(d) In Deal 1361 OCL paid supplier before receiving the customer's monies;
(e) St. Aimie failed to render VAT returns;
(f) The trader's Output tax liability is still outstanding
(g) St. Aimie purchasing 'vast quantities' of goods from a Cypriot company and selling them to Steven Phillips
(h) There was a lack of documentation.

**(k) Others**

346 As regards Northwest Deal 1384 we find that the chain below Northwest has been established. However, the supplier to Northwest has not been established nor any chain above it. We note that this is a short chain.

347 As regards Storm 90 Deals 1412, 1413, 1423-1430 we find that the chains below Storm have been established. However, the supplier(s) to Storm has not been established nor any chains above it.

348 There is no evidence to establish the higher parts of the chain and no evidence of sufficient cogency to allow us to make inferences as to who the parties (if any) were in the higher parts of the chain yet alone tax loss and fraud.

*Summary*

349 We find that there was tax loss caused by fraud in all the chains where tax loss was established with the exception of Com4U.

350 We have found that tax loss in the chain has been established in all the chains except Stephen Phillips t/a First Call and Activmind chains.

351 We have also found that the chains above Northwest and Storm 90 have not been established and so there cannot be tax loss established above Northwest and Storm 90.

**Means of Knowledge?**

352 This section is concerned with the Means of Knowledge. We discuss the test to be applied below. We confirm that our findings (see paras 123 et seq) would remain the same whatever of the tests discussed was applied.

353 We have already made findings of fact in relation to DD and other matters related to Means of Knowledge.

354 We make the following finding as to Means of Knowledge. On the evidence before us we find that OCL/Mr Dar did not know or ought to have known or have the means of knowing of their participation in transactions connected with fraudulent evasion of VAT. In particular they had taken all available proportionate steps taken to ensure on the balance of probabilities that there was no connection with persons or transactions involved in VAT fraud. This is the case in respect of all the chains concerned in this appeal.

355 In this connection we note (inter alia) :

(a) Mr Vaufrouard was satisfied with the due diligence.

(b) Mr Smallbone and Ms Barker were happy with OCL's paperwork with its immediate counterparties Like Mr Vaufrouard we do not see what else OCL could reasonably do[19].

(c) The amount of DD undertaken on customers and its detail was considerable.

(d) OCL provided the requisite paperwork to HMRC.

(e) Mr Vaufrouard said "… there is no criticism of the documents that Mr Dar has produced to the Commissioners in support of his purchases for those periods or in support of his sales".

(f) He also said to Mr Dar about OCL's DD "You always get it spot on, so, so just make sure, and make sure that it's all there." He also said "You're a good person to do business with, you see, you've got a good established business". He confirmed that "there were other people you dealt with who weren't nearly as nice to deal with".

(g) At every visit he was able to "uplift" the documents. Mr Dar provided Mr Vaufrouard with a deal log and every document that he required in its original format. He confirmed that there is no criticism of the documents that Mr Dar has produced to HMRC in support of his purchases for those periods or in support of his sales.

(h) He confirmed that Mr Dar told him that Mr Dar did not keep IMEI numbers and he requested him to keep them in future but that there was no follow-up in relation to IMEI numbers. He did not request OCL to nor did he follow the issue up at any subsequent visits.

(i) He confirmed that in relation to OCL"… you have got to go three, four, five steps down the line before you find the questionable due diligence".

(j) He also confirmed that Mr Dar did not deal with a defaulting trader.

(k) He said of Mr Dar "I actually advised him that his checks were good. However, he needed to ensure that his supplier was carrying out those checks and his supplier's supplier was carrying out those checks".

(l) For completeness we record that Mr Dar did do this.

(m) Mr Vaufrouard confirmed " insofar as he raised any particular points with Mr Dar, it was actioned appropriately, and as far as he were concerned, if he raised a point he [Mr Dar] dealt with it"

(n) We understood Mr Vaufrouard replies to mean that was there nothing more that Mr Dar could reasonably or proportionately have done.

**Summary of findings of fact**

[19] See para 123 et seq Assurance Visits

356 In summary, we have found (and to the extent we have not already done so we now so find) the following facts. To the extent we can we find these facts as primary facts.

a. OCL did not have the Means of Knowledge so that the other findings are included for completeness.

b. The integrity of the chains seems to have been established on the balance of probabilities by evidence seemingly of sufficient cogency with the exception of the following chains which we find have not been fully established by such evidence as has been produced by the HMRC officers, namely the Northwest (Deal 1384)and Storm 90 (Deals 1412,1413 and 1423-30) chains.

c. As these are eleven chains out of 82 we do not consider that we can treat such a number of the chains as established by inference there being no reason such as cogent evidence to do so nor a clear enough pattern of trade. It is for HMRC to establish these chains and they have failed to do so.

d. A tax loss has been established on the balance of probabilities at the start of all the chains except the Stephen Phillips t/a First Call and Activmind chains and the Northwest and Storm 90 chains where the chains cannot be traced above Northwest and Storm 90.

e. A connection with fraud has been established in all the chains in which tax loss has been established with the exception of Com4U.

f. OCL has shown that it did not have the Means of Knowledge. This is the case whatever test is applied.

   i. The documentation maintained by OCL was accepted by HMRC as complete and in good order.

   ii. There was nothing more that OCL could have reasonable done. In particular, there was nothing more they could have done to force due diligence down the chain[20].

   iii. This is not diminished by OCL not keeping IMEI numbers[21]. Mr Vaufrouard only mentioned it once in nine visits. He was provided with everything he asked for by this trader that was pleasant to deal with.

g. We find that OCL has taken all proportionate steps available to it to ensure that, on the balance of probabilities, no aspect of the transaction is connected with any other party involved in, or any other transaction involving, fraud on the public revenue through the value added tax system.

## Submissions of the Parties

*Appellant's Submissions in outline*

357 In essence, Mr Patchett Joyce argued on behalf of the Appellant that :

   a. HMRC had not shown (subject to what he had said in his Closing) that the transactions in question were part of a chain in which there was a loss attributable to fraud;

   b. Even if they had (which is not admitted) the Appellant had taken all reasonable steps to ensure that on the balance of probabilities there was no connection with fraud:

   c. Accordingly, there were no grounds for denying the Right to Deduction and the Appeals should be allowed.

358 He contended on fraud that "Quite simply, the conclusion does not follow from the premise: a trader might be in default through misfortune or oversight, not fraud.

[20] See paras 123 et seq

[21] See paras 116 et seq

The Commissioners must prove, in relation to each of the traders whom they claim to be in default, not only the default, but also that the reason or cause of that default was fraud. Fraud cannot, as the Commissioners contend, simply be assumed from default[22].

359 The Appellant is a 'taxable person' within the meaning of that expression in the Directive.

360 Articles 167 et seq. of the Directive establishes the Right of Deduction. It "is an integral part of the VAT scheme and, in principle may not be limited. It must be given effect to immediately in respect of all the taxes charged on transactions relating to inputs (*Optigen*).

361 The domestic legislation must be read purposively so as to give effect to the intention of the provisions of the Directive[23].

362 He also complained that the Commissioners did not appear to have taken any, or any effective, steps against the parties said to be a fraudulent defaulter and/or the immediate counterparty;

363 He continued:

(a) The party refused repayment has paid money by way of VAT to its suppliers ie the Appellant has incurred input tax;

(b) those suppliers have, all, properly accounted for VAT to the Commissioners; and

(c) neither the party refused repayment, nor the suppliers to that party, are alleged to have acted fraudulently.

364 Even if the suppliers had (which is not admitted) the Appellant had taken all reasonable steps to ensure that on the balance of probabilities there was no connection with fraud.

365 He further submitted that the Commissioners' case:

(a) offends against fundamental EC principles of proportionality, effectiveness, legal certainty, fiscal neutrality, peaceful enjoyment of property, the right to pursue a lawful trade and the free movement of goods;

(b) has failed to establish any "exemption to entitlement" as concerns the OCL's right of deduction, and involves the wrongful infringement of that right;

(c) has failed to establish the existence of any relevant tax loss in any of the supply chains in question, at the relevant time;

(d) has failed to establish that OCL knew of had the means to know, at the time of entering into any of its transactions, that an identified fraud resulting in a relevant tax loss had occurred earlier in any of the chain of supply in question;

(e) is inimical to the common system of VAT;

(f) relies on discriminatory practices and/or amounts to an unlawful penalty;

(g) has failed to satisfy the requirements of the proper, and strict, legal test;

(h) Accordingly, the Tribunal is invited to allow these Appeals.

366 This is subject to what Mr Patchett Joyce said on behalf of the Appellants in his written closing submissions (see below).

*HMRC's Submissions in outline*

[22] *cf.*, the observation in *Dragon Futures* at para. 67: "Entitlement to input tax ... cannot be taken away simply by reference to the fact that the contract was one of a chain of transactions affected by fraud elsewhere."

[23] see, for example, *Barclays Bank PLC*, Tribunal Decision No. 19302, released on 24 October 2005 at paras. 25 *et seq.*

367 In essence, Ms Whipple, on behalf of the Respondents, argued on behalf that :

(a) The evidence established that there was fraud in the chains all of whose integrity had been established;

(b) The Appellant had the Means of Knowledge in the relevant sense;

(c) The burden of proof is the civil standard which had been discharged as far as the Respondent's case is concerned;

(d) Accordingly, the appeal should be dismissed.

368 HMRC accepted that it was for HMRC to establish fraud in the chain on the balance of probabilities by cogent evidence and the seriousness of the allegation of fraud has to be taken into account when applying the civil test[24]

369 It was accepted that this requires HMRC to show that:

(a) the deals in question took place as part of a chain of transactions which can be traced back to a defaulting trader.

(b) there been a loss of revenue in terms of output tax unaccounted for at an earlier stage on the particular goods which are now included in OCL's deals. This is a question of primary fact.

370 It was also accepted, at least in principle, that the mere fact that there has been a default at an earlier stage is insufficient in and of itself to demonstrate fraud

371 If HMRC establishes loss in the chains caused by fraud then the Means of Knowledge has to be considered.

372 The test for "knowledge or means of knowledge in the UK context is that given by the Tribunal in *Dragon Futures* at paragraph 75 as follows:

> "Has the taxable person, at the time of entering into a transaction involving payment of value added tax by or to that person, and taking into account the actual knowledge of the taxable person at that time (including knowledge acquired from any enquiry or investigation), taken all proportionate steps available to it to ensure that, on the balance of probabilities, no aspect of the transaction is connected with any other party involved in, or any other transaction involving, fraud on the public revenue through the value added tax system?"

373 This is for the Appellant to prove[25] on the ordinary civil standard of the balance of probabilities

374 HMRC argued that the evidence shows that in respect of every one of the transactions which were the subject of the first and third decisions, the chain of transactions leads back to a tax loss due to a defaulting trader.

375 Each deal can be traced back to one of:

(a) Steven Phillips t/a First Call;

(b) Oxhey Construction Services Ltd;

(c) Myco Telecom Ltd;

(d) The Callender Group;

(e) Oracle UK Ltd;

(f) Com4U Ltd;

(g) Red Rose Consultancy Ltd;

(h) Activmind Ltd;

(i) CHP Distribution

(j) St Aimie Ltd;

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[24] *Megantic Services Ltd v HMRC* [2006] EWHC 3232 (Admin) para 33.

[25] See *Dragon* paras 85-86 and Lightman J in *Mobile 365 v HMRC* [2007] EWHC [1737] (Ch), para 7,

who were defaulters. It should be inferred for the Northwest and Storm 90 deals that in the circumstances they also led back to defaulters and fraud.

376 Mr Dar for OCL admits awareness and understanding of the risks of MTIC fraud both within the mobile phone industry generally and in relation to its business specifically. The Commissioners have drawn to its attention those risks on a number of occasions by letter and otherwise and OCL has shown itself to be aware of them.

377 It was further submitted that quite apart from the obvious pointers towards particular deals being infected with fraud, there are numerous indications that OCL's whole trade during the periods in question was wholly artificial, for example:

(i) The frequency and extent of OCL's involvement in chains leading to a tax loss and the same handful of defaulting traders.

(ii) OCL has used consistent mark-ups which vary according to whether the goods are supplied as a UK sale as opposed to an export sale, although suppliers remain the same. The only inference can be that when selling to UK customers OCL is acting as a buffer higher up the fraudulent chain.

(iii) OCL claimed that the purchase price of phones constantly fluctuated. OCL's own evidence demonstrates markedly similar prices and margins.

(iv) There is a lack of commercial risk in OCL's trading pattern. Goods are not released to the customer until fully paid and there is no requirement to pay the supplier until payment is received from the customer. This is consistent with artificially contrived transactions.

(v) All of OCL's transactions are part of similar length chains of back to back transactions on the same day involving the same phones and usually in the same quantity. This is not consistent with normal commercial practice and is consistent with artificially contrived transactions.

(vi) OCL appears to be able to acquire goods immediately in order to satisfy orders received. That is not consistent with normal commercial reality and is consistent with artificially contrived transactions.

(vii) Some purchase orders post-date corresponding sales invoices, which shows that the paperwork was sometimes put in place after the event to provide evidence to the authorities and not as part of a bona fide trade.

(viii) OCL expected over £5million profit last year when on Mr Dar's evidence OCL employed eight staff (including its director) two of whom were admin staff, two inspectors and one accountant. These figures are not consistent with a competitive industry with low barriers to entry.

(ix) Results of IMEI scans are not retained and there is no evidence to suggest that positive matches are acted upon.

(x) There is evidence that the same mobile phones have been scanned at export more than once and that OCL has exported the same phones more than once.

(xi) OCL did not hold sufficient insurance for the level of goods traded. OCL has asserted that it increased the level of cover on the policy in September 2005, but the documentation is dated May 2006; and it is claimed that no additional premium was required, despite increasing the level of cover from £1,000,000 to £2,500,000 per consignment.

(xii) OCL was notified by the Commissioner's Redhill office that traders in the chain had trade classes incompatible with trading in mobile phones. OCL has made no substantial response to this information.

(xiii) OCL has a previous history of involvement of a carousel fraud chain passing through Switzerland involving a trader known as Digi Trading GMBH. Goods in this chain were found to return to the UK within 48 hours of export. This was to be mentioned but not necessarily relied on.

(xiv) After the examination of goods at Manchester Airport, OCL began to export goods to Dubai via Switzerland.

(xv) OCL was able to buy large quantities of goods imported into the UK from foreign countries which were not suitable specification for use on the UK market. Most of OCL's export trades have been traced back to an import trade by a defaulting trader from outside of the UK. That is consistent with MTIC fraud trading patterns and artificially contrived transactions.

(xvi) On several occasions OCL traded phones with British plugs despite being described as Central European specification. Not only did OCL not react to the inspection report findings, but it did not hinder it from selling the phones abroad nor did its customers complain.

*Appellant's Closing Submissions and Defaulters*

378 Mr Patchett Joyce said in his written closing submissions on behalf of the Appellant (at paragraph 10):

> "Having seen (albeit at a very late stage and in the face of considerable resistance on the part of the Commissioners) the notebooks, the visit reports and the Commissioners' relevant internal documents (ledger details and Vision reports) on the alleged defaulters, OCL is minded, as concerns the substantial majority of defaulters, not only to agree with the Commissioners that those parties were indeed acting fraudulently, but have gone further and pointed out additional, obvious, lines of inquiry which, if pursued, might have led to the much earlier prevention of fraud. The Commissioners' witnesses gave clear evidence that those additional lines of inquiry were not pursued, although obvious, because their responsibility was limited to a paper-retrieval exercise. The witnesses themselves did not pass on, internally, any relevant information to their "Law Enforcement" division, and could shed no light on whether that information had been otherwise passed to "Law Enforcement".
>
> In some instances where, for example, the defaulter had been placed in creditors' voluntary liquidation, or the date of insolvency substantially post-dated the accounting periods relevant to this appeal, or the insolvency was identified internally as "insolvency cancelled"[26], the Tribunal is invited to consider whether there is evidence of sufficient cogency to conclude that the fraudulent nature of the tax losses in question has been proved[27]".

379 He footnoted that "… the Commissioners have asserted that "in truth, the Appellant does not seriously challenge the fraudulent nature of the default". That is not accurate: leaving aside the instances covered by the express reservations articulated in para. 10 of these submissions, the Appellant does not seriously challenge the fraudulent *character* of the *defaulter*. The Appellant *does* challenge

[26] see, *e.g.*, 4/84/20 – 4/88/13; 6/143/8 – 6/144/12.
[27] see, *e.g.*, 4/67/4-10; 4/67/19 – 4/69/22; 4/71/11-14.

the fraudulent nature of the default in instances covered by para. 11 of these submissions".

380 Paragraph 11 provided "In other instances, it became apparent (again through the persistent pursuit, and late provision of, disclosure) that the "defaulter" had accounted for the output VAT on the transactions in question on its VAT Return. However, in those instances, the Commissioners had "corrected" the defaulter's VAT Return, by disallowing input VAT claimed on quite separate transactions where there was no evidence that the goods had been purchased. OCL would agree that a party that claims input VAT on non-existent goods is acting fraudulently, but the fraud lies in the wrongful claim to input VAT, and the tax loss to the Commissioners arises from the disallowance of that input VAT (the output VAT on the sales that led to OCL having been declared by the defaulter on its original VAT Return, and remaining unaffected by the Commissioners' "correction" of that Return). [(See, re Oxhey Construction Limited, 4/80/3 – 4/83/11; and re Callender Group, 4/90/18-21]

381 We take this to mean that OCL accepts that the substantial majority of defaulters were parties acting fraudulently. This presumably means that OCL accepts that there were tax losses in those chains which have been established.

382 We take the reference to certain matters to refer to matters such as:

(a) Cases where the "defaulter" had accounted for the output VAT on the transactions in question on its VAT Return but there has been a disallowance of input VAT claimed on quite separate transactions where there was no evidence that the goods had been purchased. such as Oxhey Construction Limited, 3 and Callender Group,

(b) Cases where the invoices, relied on by a buffer (often the immediate counterparty to the defaulter) were defective on their face, either because

(i) they did not state the VAT number of the invoicing party, or

(ii) the VAT number stated was obviously wrong,

(iii) the invoice was a "*pro forma invoice*", and stated on its face that it was not a VAT invoice

(iv) the date of insolvency substantially post-dated periods in question

(v) it was one where marked "insolvency cancelled",

383 Those transactions included are not clearly specified. However, we have already made our findings on the integrity of the chains, tax loss and fraud above. It is those where we have found that HMRC has not shown the integrity of the chains, tax loss and fraud we consider to fall within this.

384 These are

| | |
|---|---|
| i. Northwest | Deal 1384 |
| ii. Storm 90 | Deals 1412, 1413, 1423-30 |
| iii. Stephen Phillips t/a First Call | Deals1375,1377, 1378, 1379, 1380, 1381, 1382, 1383, 1391 |
| iv. Activmind | Deals 1444-1445, 1446-1447, 1451-52 |
| v. Com4U | Deals 1414, 1415 |

385 This is a total of 28 transactions out of 82 in issue.

**Discussion**

*Introduction*

386 When setting out the issues we said there were four questions in particular that needed to be considered in deciding this case. We now turn to consider them.

387 They are:

(a) Has the chain of transactions in question been established?

(b) Were the transactions in question part of a chain in which there was a tax loss?
(c) Was that tax loss attributable to fraud?
(d) Did OCL/Mr Dar know or ought to have known or have the means of knowing of their participation in transactions connected with fraudulent evasion of VAT. In particular were all available proportionate steps taken to ensure on the balance of probabilities that there was no connection with persons or transactions involved in VAT fraud? (cf *Dragon Futures* particularly paragraph 75 and paragraph [377] above).

388 The arguments of the parties also raise certain questions and issues we need to deal with before dealing with the questions relating to the main issue. We deal with the matters raised by the arguments first. They are:

(a) Effect of closing submissions
(b) Standard of proof
(c) Establishing the chains
(d) Possibility of confusion of goods within chains
(e) Trades Which Could Not Be Traced Back and Inference of fraudulent defaulter
(f) Established Tax Loss (including timing)
(g) Connected with fraud
(h) Imply specific from General?
(i) Back to back deals shows fraud
(j) Multiple Deals on a single day
(k) Consistency of mark up etc.
(l) Purported Independence
(m) Hindsight
(n) Combination
(o) "Typical attributes"

*Effect of closing submissions*

389 We agree with Mr Patchett-Joyce's sensible acceptance that the defaulters with the exception of the deals he specified were fraudsters.

390 We consider and find that in respect of all the deals other than the specified deals listed in the following paragraph:

(a) The chains have been established;
(b) There is tax loss in the chain;
(c) This was caused by fraud; but
(d) It has not been shown that the Appellant knew or ought to have known of this. We consider below whether the Appellant had means of knowledge.

391 The specified deals mentioned above are:

| | |
|---|---|
| i. Northwest | Deal 1384 |
| ii. Storm 90 | Deals 1412, 1413, 1423-30 |
| iii. Stephen Phillips t/a First Call | Deals1375,1377, 1378, 1379, 1380, 1381, 1382, 1383, 1391 |
| iv. Activmind | Deals 1444-1445, 1446-1447, 1451-52 |
| v. Com4U | Deals 1414, 1415 |

392 We now turn to discuss the arguments raised during the case subject to these findings.

*Standard of proof*

393 We accept that it is for the Appellant to establish its case so that the onus of showing entitlement to the Right of Deduction is on the Appellant. However, if, as here, input tax recovery is denied on the grounds of fraud in the chain it is for HMRC to establish the chain, the tax loss and that it was caused by fraud in the chain as HMRC accepts[28].

*Establishing the chains*

394 Aside from the number of chains which could not be traced back to a defaulter (which are addressed separately below), we consider that the Commissioners have proved to the required standard the integrity of the chains. This also flows from the Appellant's closing submissions.

395 Those chains that could not be traced back to a defaulter are mainly those in February 2006 and are the chains from Northwest (Deal 1384) and Storm 90 (Deals 1412, 1413, 1423-1430).

*Possibility of confusion of goods within chains*

396 It was argued on behalf of the Appellant that there was confusion within the chains and that the Commissioners had failed to prove that the tax which had gone unpaid at the head of the chain related to the very same goods on which OCL reclaimed the input tax. For example, if a trader undertook multiple deals of the same volume or the same phone on the same day, then it would not be possible to know which deal was part of the chain involving the Appellant.

397 HMRC made three responses to this argument. These were:

(a) as a matter of fact, there are few instances where the same phones are traded in the same quantities on the same day;

(b) each individual company in the chain provides transaction paperwork regarding both the sale and purchase of the particular goods. As Mr Smallbone said "The reality is that we tend to know, or each officer will tend to know, which purchase relates to which sale for each individual company within the chain. …." The information goes into the Electronic Folder, The Tribunal can therefore be confident that the chains of transactions are accurate;

(c) The deal documentation itself often provides the link by purchase order and sales invoice numbers.

398 We find that the Appellant's suggestion that different goods may have been traced back is not substantiated in the chains where we have found the integrity of the chains to have been established. We reject it and so find.

399 In doing so we are conscious of what the Appellant said in this context. The Appellant argued:

> "the point, here, was that without full and proper disclosure of the trading records of the parties intervening between the defaulter and OCL (i.e., the "buffers") in all deals, it was impossible to effectively to trace the deal chain. No such full and proper disclosure had been made and, hence, the inability effectively to trace the deal chain remained. Given the multiplicity of deals undertaken by some of the [traders] on any single working day, the possibility for confusion within the chains must, in the absence of full and proper disclosure, remain live. Moreover, it is to be noticed that, in seeking to rebut that possibility, the Commissioners have relied on the fact that "each individual company in the chain provides transaction paperwork". However, as the sequences of deals were traced back, the quality and reliability of the

[28] See paragraph 369 et seq

paperwork became increasingly questionable, as the Commissioners acknowledged both in evidence and submissions. It is ironic that the Commissioners should seek to rely on the provision of transaction paperwork by each individual company whilst acknowledging the "poor record keeping and compliance by traders [other than OCL]" in their closing submissions".

*Trades which could not be traced back and inference of fraudulent defaulter*

400 HMRC invited the Tribunal, in respect of the deals which could not be traced back to a defaulter, to infer that, on the balance of probabilities, the transactions took place as part of a chain which did lead back to a defaulter.

401 In support of this HMRC relied on *CallTell Telecom Ltd v HMRC* where HMRC say there was a similar "gap" in the evidence of the full deal chains (a "gap" that is hardly surprising in the context of poor record keeping and compliance by traders who, plainly, do not intend to assist the Commissioners in the detection of the fraud). In that appeal HMRC say the Tribunal readily drew such an inference, stating that it was "not merely reasonable, but compelling. It would be remarkable if the illicit deals could be traced, while the legitimate deals could not".

402 The Appellant submitted that inference cannot be a substitute for cogent evidence, and that *CallTell* was wrong to decide otherwise.

403 We find that in the circumstances of this case there was insufficient cogent evidence in respect of the chains not traced back to a defaulter for us to infer that, on the balance of probabilities:

a. transactions took place as part of a chain;
b. which did lead back to a defaulter.

We consider fraud further below.

*Established Tax Loss* (including timing)

404 Mr James Smallbone confirmed that there was a debt on file for all three defaulting traders covering all of the deals for export in January 2006 which had been traced back, namely Stephen Philips t/a First Call, Oxhey Construction Services Ltd, and Myco Telecoms.

405 Subsequently, HMRC considered St Aimie has been identified as a further defaulter in this period replacing some of the deals earlier attributed to Stephen Philips t/a First Call.

406 For the period February 2006, HMRC said each of the deals has been traced back to one of Com4U Ltd, Red Rose Consultancy Ltd, Activmind Ltd, and CHP Distribution Ltd

407 For the period March 2006, HMRC said each of the deals has been traced back to one of The Callender Group Ltd and Oracle UK Ltd.

408 HMRC say that the tax losses have been established. Officers were cross-examined on the basis of the detail of the assessment, such as how the figures were calculated, why they were updated, and why the vision prints showed that the insolvency had been "cancelled". They were also asked questions about details of possible input tax offset from domestic purchases. But in each case, HMRC say there can be no doubt that the defaulting trader had an output tax liability in the relevant period, which included supplies of goods which devolved to OCL, which liability remains outstanding – in most cases in very considerable sums. As the Appellant said, the existence of a tax loss per se is not sufficient for the Commissioners' purposes because an unparticularised tax loss is not a relevant tax loss.

409 The Appellant submitted that the evidence in respect of Com4U Limited established that the tax loss sustained by the Commissioners was not a relevant tax

loss because it arose from the disallowance of input VAT, not failure to declare output VAT. We agree with this.

410 We consider the position here varies with the chain in question. We have made findings above in respect of the chains. These may be summarised as follows:

a. In all the relevant chains except those specified in b tax loss has been established;
b. No tax loss caused by fraud has been established in the chains from

| | | |
|---|---|---|
| i. | Northwest | Deal 1384 |
| ii. | Storm 90 | Deals 1412, 1413, 1423-30 |
| iii. | Stephen Phillips t/a First Call | Deals1375, 1377, 1378, 1379, 1380, 1381, 1382, 1383, 1391 |
| iv. | Activmind | Deals 1444-1445, 1446-1447, 1451-52 |
| v. | Com4U | Deals 1414, 1415 |

411 This is a total of 28 transactions out of 82 in issue.

412 We have also considered the Appellant's argument that, in effect, the tax loss must exist (ie have crystallised rather than being latent) at the time the Appellant entered into the transaction in question. We consider that this is too restrictive an approach as to whether the tax loss has crystallised would depend on issues such as return periods, payment dates etc. and cannot depend on whether the loss has been perfected by the exact time "the Broker" entered into the deal.

413 We consider the better approach is to consider whether there was a tax loss in the particular chain when viewed realistically taking all the circumstances into account. HMRC must establish this which is one protection for the Appellant, another is the Means of Knowledge test.

*Connected with fraud*

*General*

414 We have found a connection with fraud in all the chains except:

a. Northwest
b. Storm 90
c. Stephen Phillips
d. Activmind
e. Com4U

415 That said the first general point to note is that where fraud has been established in a chain it is generally at least three deals removed from OCL

416 We remind ourselves of paragraphs 10 and 11 of the Appellant's written closing. We take this to mean that OCL accepts that the substantial majority of defaulters were parties acting fraudulently. This presumably means that OCL accepts that there were tax losses in those chains which have been established.

417 We consider that each chain has to be considered individually to see if there is tax loss in the chain caused by fraud.

418 HMRC says the evidence discloses that in the case of each defaulter, the failure to account for the VAT due on the goods which subsequently devolved down the chain to the Appellant was fraudulent and that such evidence should be assessed against the background of Mr Smallbone's and Ms Barker's evidence of the general characteristics and indicators of MTIC fraud, as well as the specific application to individual defaulting traders.

*Imply specific from General?*

419 HMRC asked us to infer that all the transactions should be treated as established chains traceable back to a defaulting trader where this had not actually

been established as it was the only real possibility. We remind ourselves that as accepted by HMRC the onus of establishing this is on HMRC and that this should be done by cogent evidence.

420 Both Mr Smallbone and Ms Barker were said by HMRC to have experience in dealing with MTIC fraud. Both were said to be qualified to talk with some authority on what are the typical attributes of MTIC fraud. That, it was **omit** \ said, does not, obviously, supplant the Tribunal's decision making role; nor does it result in these witnesses in a litigation sense being "experts". But their experience in dealing with MTIC traders, HMRC agued, is undoubtedly of relevance in assessing the merits of the Commissioners' case.

421 We are not entirely clear what we are invited to do on the basis of what is said by Mr Smallbone and Ms Barker. We presume this goes to inference. However, we have preferred to proceed on the basis of considering all the evidence and information before us and giving it due weight. We do see how more weight can be given to what Mr Smallbone and Ms Barker say is a matter of opinion if they are not giving evidence as experts. We have proceeded on that basis.

422 The Respondent said "In truth, the Appellant does not seriously challenge the fraudulent nature of the default". However, the Appellant says "That is not accurate: leaving aside the instances covered by the express reservations articulated in paragraph 10 of its written closing submissions, the Appellant does not seriously challenge the fraudulent character of the defaulter. The Appellant does challenge the fraudulent nature of the default in instances covered by para.graph11 of these submissions".

423 The Respondents submit that the Tribunal should not only consider the factors pointing to fraud in relation to each individual defaulter and chain, but should also take into account the features of all the chains looked at as a whole, in particular the patterns of trade, both UK and export, which indicate artificiality in all chains. They then set out a number of factors which allow they say the inference of fraud in an established chain causing tax loss to be inferred where not specifically shown which we now turn to consider.

*Unlikely link to innocent trader*

424 HMRC invited us to consider the inherent unlikelihood that OCL trades can be linked back to a succession of non-fraudulent disappearances and defaults at the end of each complete chain associated with an export transaction.

425 The Appellant replied that the flaw in the Commissioners' argument is laid bare by some purposive consideration of the infelicitous use of the verb "linked back". OCL is "linked" by its trade to the immediate counterparty from whom it has purchased. There is no more extensive, or distant, link; certainly not to an unknown party at n-removed. Yet, it is just such false proximity that the Commissioners seek to convey by their use of the verb "linked back". The only party which is "linked back" to "disappearances and defaults at the end of each complete chain" (whether those disappearances and defaults are fraudulent or otherwise) is the immediate counterparty to the disappearing or defaulting counterparty**.** Yet, as has already been seen, the Commissioners have processed the VAT Returns of those parties as a matter of course, and not followed up obvious lines of further inquiry that might have led them to the actual fraudster. The plain fact is that all such direct and questionable links (and, having seen the evidence, OCL accepts that there are many) have remained unpursued by the Commissioners, while the Commissioners have refused to repay the input VAT claims of OCL, a party removed from the fraud,

426 We do not consider that HMRC have substantiated their general contention in the circumstances of this case on the evidence presented to us. We have made specific findings in respect of each chain.

*Infer patterns show contrived fraud*

427 HMRC invited us to consider the similarity of the chains to each other, and that the inference should be drawn that the chains were contrived for the sole purpose of tax fraud;

428 However, as the Appellant pointed out it was accepted that OCL traded with suppliers that were well-known to it, in which it had confidence and on which it had carried out continuing "due diligence". It may also raise similarity points.

429 We note the Appellant's submission that in those circumstances, it is quite impermissible to invite any "inference" to be drawn.

430 We prefer to proceed on the basis that considering the evidence in relation to each particular chain of transactions as the ECJ suggests rather than, without more, rely on generalisations. Whilst the circumstances could show fraud, however, this is not the case here on the evidence led and does not lead us to infer generally for that reason there was fraud in the chains where we have not found fraud established and we so find.

431 We have set out our findings as to fraud in any particular chain above. We do not consider that looking to the general to infer the specific fraud in a particular chain where it is not proved amounts to cogent evidence in the particular circumstances of this case. Different circumstances might lead to a different result.

*Multiple Deals on a single day*

432 HMRC invited us to consider the fact that all the export trades were transacted on just a handful of days in the period 01/06 to 03/06, sometimes with multiple deals on single days, but with an uneven distribution across those months showed that the deals were contrived.

433 The Appellant said of this "the deals that have given rise to the appeal do not constitute the whole of OCL's business. In particular:

(i) the input VAT credit claim arose from deals in which OCL exported goods to customers abroad; domestic deals undertaken by OCL in the same period formed no part of the appeal;

(ii) deals that proceed on one day might have taken several preceding days to organise, and any coincidence of dates on which deals take place are just that, coincidental (unless a large consignment has been deliberately split into a number of smaller consignments, for insurance cover purposes). Coincidence is antithetical to contrivance; deliberate splitting might be 'contrived' but if, as here, it is done for an obviously sensible commercial reason, it is also wholly innocent".

434 We note the Respondent's "expert" Ms Barker said in answer to Mr Patchett Joyce's question in cross examination:

"Q. You were asked about deals being conducted on the same day. Do you see anything untoward in deals being conducted on the same day, Miss Barker?

A No".

435 We also note our comments elsewhere about Contango Days.

436 We find that it has not been established that multiple deals taking place on a single day in the particular circumstances of this case establishes generally that, on its own or in combination with other elements, the deals were contrived. On the

evidence presented to us we find that it has not been established that these were in general contrived deals. We have already set out our specific findings above.

*Back to back deals show fraud*

437 HMRC invited us to consider that there was fraud in all the deals as they were all back-to-back transactions, involving a small pool of suppliers and customers.

438 The Appellant replied that back-to-back deals are a quite ordinary incident of a business that involves matching demand and supply (or vice versa) (see the argument advanced by the Commissioners in *Senergy (UK) Limited*, Decision No. 19727, released on 23/08/06 at para. 105).

439 We do not consider that as a generalisation back to back deals necessarily constitute or indicate fraud. A number of financial and commodity transactions would then have to be considered fraudulent.

440 The evidence does not lead to the conclusion that merely because there were back to back transactions in the present circumstances there was fraud in the particular chain and we so find. Back to back deals are not illegal and can be used for perfectly commercial reasons. Why do they of themselves require an inference of fraud? In this case they do not.

441 On the evidence presented to us we find that in the particular circumstances of this case it has not been established that back to back deals were here as a matter on its own or in combination with other elements, contrived in an uncommercial way and necessarily show fraud. We have set out our findings as to fraud in any particular chain above.

*Consistency of mark up etc.*

442 HMRC invited us to consider the characteristics of those chains identified e.g. the consistency of mark-ups in trades, lack of commercial risk, the use of the same freight forwarder, by all parties to the same transaction, and the fact that the goods all originated outside of the UK, were brought to the UK despite, in most cases, not having appropriate specifications for the UK market, were traded through a succession of traders in the UK and then re-exported usually on the same day, as indicating fraud.

443 The Appellant replied:

i. it is denied, as a matter of fact, that there was any consistency of mark-ups. An elimination of commercial risk is an ordinary incident of any (profitable) back-to-back deal. That is not to say that there is no commercial risk in the business: there is plenty. The commercial risk lies in the unrewarded expenditure of time and expense on pursuing deals that do not come to fruition. The Commissioners have ignored that aspect of OCL's business because fruitless negotiations that lead nowhere are not visible to them.

ii. The use of the same freight forwarder is a simple expedient: if the goods are located at freight forwarder "A", it makes no sense to transport the goods to freight forwarder "B" for inspection and onward carriage, if freight forwarder "A" is capable of undertaking those tasks.

iii. None of the makers might manufacture mobile phones in the UK. Consequently, mobile phone would be bound to have originated from outside of the UK. That is an ordinary incident of global manufacture.

iv. There was no evidence that any of the phones did not have "appropriate specifications" for the UK. The only evidence was that many had 2-pin chargers. The evidence (uncontroverted by the Commissioners) was that chargers could be, if need be, easily changed.

444 We note the points made by the Appellant. The general characteristics of those chains identified do not of themselves indicate fraud. The deals done could be done legally. They could also be done fraudulently. It is for the Respondents to prove fraud by cogent evidence.

445 Without more we do not consider that the characteristics of those chains identified in the circumstances of this case themselves on their own or in combination indicate fraud. Of themselves they are neutral. Even if they did indicate that there might be fraud (which is not admitted) more would be needed to establish fraud in a particular chain. As HMRC themselves say cogent evidence on the civil standard is needed to establish fraud in the particular chain.

*Purported Independence*

446 HMRC invited us to consider the links between different purportedly independent traders: the common use of First Curaçao National Bank; supply by FACI to Oxhey, Myco and Red Rose; third party payments to CK Communications Ltd in chains involving Oracle, Oxhey, The Callender Group and Red Rose Consultancy; supply to both Stephen Phillips and Com4U by Maktrim in Poland; Com4U and Activmind both purportedly supplied large volumes of phone cards to Umbria Equitazione for which no export evidence was ever provided; trading links between Oxhey, Myco and The Callender Group; and similar buffers appearing within the chains e.g. Lauriel Reid Ltd buys from both Red Rose Consultancy (e.g.1416) and Myco (e.g.1385) and sells to The Callender Group (e.g.1385). All of these factors are suggestive of contrived transactions.

447 The Appellant replied that the use by a number of traders of the same bank (a state of affairs which facilitates prompt transfer of funds) formed no part of the Commissioners' case and is, in any event, unexceptionable. The remaining "links" relied on by the Commissioners tend strongly to prove the Appellant's case, not the Commissioners'. It is to be noted that the "links" are links, now revealed, between a number of the defaulters all of which were at n-removed from OCL. Those "links" were not known to OCL until the Commissioners adduced their evidence in this appeal, months after OCL's claims to repayment of their input VAT. Credits had, first, been subjected to extended verification by the Commissioners, and had, secondly, been refused by the Decision Letters that have prompted the Appeals.

448 We do not see that on its own such a generalisation is an indication one way or the other as to whether a particular deal is fraudulent. It is neutral. A lawyer may have a small group of clients (both Government Departments and businesses) who instruct the lawyer regularly. That may indicate the skill of the lawyer but without more substance is neutral as to fraud.

449 Putting all these together may allow one to go further but without more do not assist in showing fraud in a particular transaction chain. Third party payments may in the particular circumstances show fraud if it stops the payer being able to pay the VAT due. In such a case the details of the payment and whether tax has been paid or not would need to be considered. The question then is whether the payment on the evidence relating to the particular transactions shows fraud. On the evidence before us that is not the case as a general matter.

450 Again the generalisation does not assist us. We have set out our findings as to fraud in any particular chain above.

*Hindsight*

451 HMRC argued that when looked at as a whole, in addition to the specific indicators against each individual defaulting trader, it is clear that the chains of transactions were contrived in order to defraud HMRC. Indeed, even Mr Dar

accepted that they were artificial, when viewed by standing back from them and knowing the full extent of each of the chains.

452 Mr Dar said in cross examination HMRC noted:

Q: "Looking at this schedule, we are just looking at February 2006 at the moment, but as you look at it now and as you see the various deal chains set out in the table like this, it just looks completely uncommercial, doesn't it?"

A: "When you look at this, of course it does, yes."

Q: "You accept that, as you see it now, it is not commercial, is it?"

A: "Looking at this, of course it is not commercial."

453 The Appellant replied it is true that the picture as between the defaulting fraudsters could be said to be one of contrivance. Mr Dar would not suggest otherwise. Moreover, the extract of evidence set out by the Commissioners must be read in its context: Mr Dar was being asked to look at schedules, completed by the Commissioners months after the event. Those schedules contained information which could not possibly have been known to OCL at the time that it entered into the deals in question, and Mr Dar was being asked to consider, with the benefit of hindsight, the picture then (and only then) revealed to him. The irrelevance of hindsight was made clear in Dragon Futures Limited.

454 This seems to elide two general points, namely artificiality and contrivance to defraud the Revenue to show fraud causing loss in the specific chains. It is also looking not at the time of the transaction in question but the whole chain of deals/transactions and payments set out. The transactions even if artificial could have been carried out in a legal way and do not in the particular circumstances allow us as a general matter to infer fraud in a particular transaction and that it was known to OCL at the time of the deal.

455 We have set out our findings as to fraud in any particular chain above.

*Combination*

456 We do not consider that the various general factors, on their own or in combination referred to by HMRC are in the particular circumstances, of themselves, indicative of fraud. They are the set of circumstances in which a fraud may or may not be committed. They are not something as a generalisation that would in the circumstances of this case allow us to infer as a general matter that there was fraud in a particular transaction on the balance of probabilities as a matter of cogent evidence

457 The Appellant said in its closing submissions

"the Commissioners have asserted that "in truth, the Appellant does not seriously challenge the fraudulent nature of the default". That is not accurate: leaving aside the instances covered by the express reservations articulated in para. 10 of these submissions, the Appellant does not seriously challenge the fraudulent character of the defaulter. The Appellant does challenge the fraudulent nature of the default in instances covered by para. 11 of these submissions. See, in this regard, HMRC opening submissions …

"[10]Having seen (albeit at a very late stage and in the face of considerable resistance on the part of the Commissioners) the notebooks, the visit reports and the Commissioners' relevant internal documents (ledger details and VISION reports) on the alleged defaulters, OCL is minded, as concerns the substantial majority of defaulters, not only to agree with the Commissioners that those parties were indeed acting fraudulently, but have gone further and pointed out additional, obvious, lines of inquiry which, if pursued, might have led to the much earlier prevention of fraud.

The Commissioners' witnesses gave clear evidence that those additional lines of inquiry were not pursued, although obvious, because their responsibility was limited to a paper-retrieval exercise. The witnesses themselves did not pass on, internally, any relevant information to their "Law Enforcement" division, and could shed no light on whether that information had been otherwise passed to "Law Enforcement".

In some instances where, for example, the defaulter had been placed in creditors' voluntary liquidation, or the date of insolvency substantially post-dated the accounting periods relevant to this appeal, or the insolvency was identified internally as "insolvency cancelled", the Tribunal was invited to consider whether there is evidence of sufficient cogency to conclude that the fraudulent nature of the tax losses in question has been proved.

[11] In other instances, it became apparent (again through the persistent pursuit, and late provision of, disclosure) that the "defaulter" had accounted for the output VAT on the transactions in question on its VAT Return. However, in those instances, the Commissioners had "corrected" the defaulter's VAT Return, by disallowing input VAT claimed on quite separate transactions where there was no evidence that the goods had been purchased. OCL would agree that a party that claims input VAT on non-existent goods is acting fraudulently, but the fraud lies in the wrongful claim to input VAT, and the tax loss to the Commissioners arises from the disallowance of that input VAT (the output VAT on the sales that led to OCL having been declared by the defaulter on its original VAT Return, and remaining unaffected by the Commissioners' "correction" of that Return). …

458 For the reasons already explained, it is not sufficient for the Commissioners to demonstrate that the mere failure on the part of any particular defaulter to account means there was a tax loss in the chain caused by fraud. HMRC accepted that it was for HMRC to show, inter alia, that "there been a loss of revenue in terms of output tax unaccounted for at an earlier stage on the particular goods which are now included in OCL's deals. This is a question of primary fact".

459 We agree and have taken this approach in relation to each specific chain of transactions.

460 We have set out our findings as to fraud in any particular chain above.

*"Typical attributes"*

461 The Appellant submitted that the Tribunal will not be materially assisted by what are said to be "typical attributes" of MTIC fraud. We agree that generalisations are not useful in the circumstances of this case in deciding on fraud in a specific chain. Each chain has to be considered individually on its facts and in the light of the evidence led.

462 We also agree that what the Commissioners must (in broad terms) prove, as a first step, is fraud in at least one of the transactions comprised in the chain of supply that led ultimately to OCL and each of the OCL's transactions in issue in the Appeals and, as a second step, is knowledge or means of knowledge of that particular fraudulent transaction on the part of OCL at the time when OCL entered into its own purchase and sale transactions. Nothing else will do.

463 HMRC have invited the Tribunal to have regard to "the features of the chains looked at as a whole". OCL is unsurprised that the Commissioners have extended such an invitation as such an argument appeared to underpin much of the Commissioners' case. The so-called "patterns of trade" on which the

Commissioners have relied are, in reality, nothing other than the ordinary incidents of carrying on business in bulk commercial arbitrage.

464 We have not found the general typical attributes of MTIC fraud particularly helpful in deciding on fraud in a particular chain. We have preferred to consider the specific chains and all the relevant evidence and circumstances (cf *Optigen* below)

**Overview**

465 We have preferred to proceed on the basis of considering each particular chain of transactions in the light of the specific evidence relating to the chain in question. This includes the context in which the transactions took place but more than generalisations is needed to establish fraud. As HMRC said cogent evidence on the balance of probabilities is needed. The general approaches argued for by HMRC are not sufficient here for us to infer fraud without more cogent evidence.

466 We have set out our findings as to fraud in any particular chain above.

**Means of Knowledge**

467 As the Advocate -General noted in *Optigen* (see below) "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"[29].

468 Accordingly, each transaction in question entered into by OCL must be considered on its own merits to see if there were grounds for disallowing input tax recovery at that because OCL had the Means of Knowledge that there was fraud in the chain.

469 It was not established that OCL knew who other than its immediate counterparties were involved in the chain. Accordingly as one gets away from the immediate counterparty it generally becomes harder for OCL to have "constructive" knowledge rather than actual knowledge of fraud. There is no allegation of actual knowledge of fraud here (see above).

470 As we have already found OCL took supplier declarations and carried out other checks and other matters suggested in Notice 726 as regards Joint and Several Liability. At the time the Respondent's approach had been based on Non-Economic Activity which the ECJ decided was not the right approach. Hence Joint and Several Liability, Notice 726 etc. was introduced. The evidence showed that OCL complied with this.

471 The first issue here to consider is what Means of Knowledge means and what test is to be applied. That test then needs to be applied to the facts of the case. We proceed to do this.

472 The Court in *Optigen*, Cases 354/03, 355/03 said:

> "[46] An obligation on the tax authorities to take account, in order to determine whether a given transaction constitutes a supply by a taxable person acting as such and an economic activity, of the intention of a trader other than the taxable person concerned involved in the same chain of supply and/or the possible fraudulent nature of another transaction in the chain, prior or subsequent to the transaction carried out by that taxable person, of which that taxable person had no knowledge and no means of knowledge, would a fortiori be contrary to those objectives.
>
> [47] As the Advocate General observed in point 27 of his Opinion, each transaction must therefore be regarded on its own merits and the character of a particular transaction in the chain cannot be altered by earlier or subsequent events.…

[29] Para 27

[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."

473 In *Kittel*, Cases C-439/04, 440/04 the taxpayer contracted with a fraudster. Such a contract under Belgian law was void. In Rocolta Recycling SPRL, heard at the same time as Kittel the domestic court made a finding that there was nothing to suggest that the directors of the company knew or had any suspicion that they were involved in a fraud. The question put to the ECJ was on the effect of such a contract where the other party to the contract did not know and could not know that the transaction was part of a fraud.

474 The ECJ said :

"[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).

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

[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 evidence, that that right is being relied on for fraudulent ends (see Fini H, paragraph 34).

[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."

475 *Optigen/Bond House* talks of the means of knowledge. *Kittel* talks of "knew or ought to know". These are not necessarily the same thing. Does one have to consider (actual knowledge is not involved) all or any of the following:

(a) whether the taxpayer with his actual attributes and knowledge ought subjectively to have known ( " the Subjective Approach");

(b) whether the taxpayer with his subjective attributes and knowledge ought

objectively to have known ("the Subjective/ Objective Approach");

(c)whether a business person in the taxpayer's position objectively to have known ("The Objective Approach"). This could also be a Reasonable Business Person test;

(d)whether an officious bystander would say it ought to have been known that there was fraud;

(e)whether it is sufficient that there was information available to the taxpayer whether the taxpayer looked at it or not ( “the Pure Means of Knowledge Approach"). This could be important if a Nelsonian blind eye was turned.

476 These approaches are not exhaustive. Further questions also rise such as knowledge of what and from what perspective. It is one to consider what knowledge ought to be known from the perspective of a taxpayer in the broker's position or of an officious bystander with a view of the whole chain.

477 We consider the proper approach is to ask what the reasonable business person in the position of the broker ought objectively to have known (" the Reasonable Businessperson Test" in (c) above). This minimises the difference between "ought to have known" and having "the means of knowledge". It does not require one to seek to make a window into men's minds as a subjective approach does which can only be resolved by making objective assumptions. This does not preclude special circumstances being taken into account where appropriate (e.g. youth, lack of capacity etc.).

478 We do not consider in the case before us that the test applied would lead to a different result. We are to be taken as making such findings of fact (in addition to those actually made) as may be necessary or reasonable for this position to be achieved.

479 We find as a fact that the Appellant did not have the Means of Knowledge.

*The four questions*

480 We now turn to consider the four questions raised at the start of this discussion.

*(a) Has the chain of transactions in question been established?*

We consider that the integrity of the chains has been established with the exception of the Northwest and Storm 90 chains...

*(b) Were the transactions in question part of a chain in which there was a tax loss?*

We consider as set out above that a tax loss has not been established in respect of the chains from:

| | | |
|---|---|---|
| i. | Northwest | Deal 1384 |
| ii. | Storm 90 | Deals 1412, 1413, 1423-30 |
| iii. | Stephen Phillips t/a First Call | Deals1375, 1377, 1378, 1379, 1380, 1381, 1382, 1383, 1391 |
| iv. | Activmind | Deals 1444-1445, 1446-1447, 1451-52 |

*(c) Was that tax loss attributable to fraud?*

We consider that those tax losses in the chains have been established and shown to have sufficient connection with the Appellant’s transactions with the exception of those referred to in the paragraph above and Com4U (Deals 1414, 1415).

*(d) Did OCL/Mr Dar know or ought to have known or have the means of knowing of their participation in transactions connected with fraudulent evasion of VAT. In particular were all available proportionate steps taken*

*to ensure on the balance of probabilities that there was no connection with persons or transactions involved in VAT fraud?*

We consider that the Appellant has established that OCL and its Principal Mr Dar did not have the Means of Knowledge.

5 481 To the extent that we have not specifically found a matter or related or necessary inferences above we do so here.

**Conclusion**

482 To reiterate we have found:

(a) The particular chains of transactions in question have been established with
10 the exception of the chains noted above;

(b) The transactions in question form part of a chain in which there was a tax loss with the exception of the chains noted above;

(c) That tax loss attributable to fraud in the chain in question has been established with the exception of the chains noted above;

15 (d) OCL/Mr Dar did not know or ought to have known or have the means of knowing of their participation in transactions connected with fraudulent evasion of VAT. In particular **OCL** had taken all available proportionate steps taken to ensure on the balance of probabilities that there was no connection with persons or transactions involved in VAT fraud. This is the
20 case in respect of all the chains concerned in this appeal...

483 Accordingly, insofar as is necessary the Appellant has discharged the burden of proof in respect of Means of Knowledge.

484 Consequently, the Appeals are allowed with costs.

25 Adrian Shipwright

CHAIRMAN
RELEASE DATE:

(1) LON/2006/0830
30 (2) LON/2006/0983
(3) LON/2006/1069
(4) LON/2007/0295

## APPENDIX 1

**LONDON TRIBUNAL CENTRE**
**(1) LON/2006/0830**
**(2) LON/2006/0983**
**(3) LON/2006/1069**
**(4) LON/2007/0295**

**OUR COMMUNICATIONS LIMITED**

**Appellant**

**- and -**

**COMMISSIONERS OF HM REVENUE AND CUSTOMS**

**Respondents**

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**DIRECTION**

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**Tribunal: Adrian Shipwright (Chairman)**
**John N. Brown CBE, FCA, CTA**
**Sandi O'Neill**

Sitting in public in London on 12 October 2007

**UPON APPLICATION** being made by the Respondent on the ninth day of the hearing of these appeals for the admission in evidence of the Witness Statement made by James Stephen Smallbone dated 13 September 2007 and referred to as "Smallbone 4"

AND UPON HEARING on the tenth day of the hearing listed for ten days Philippa Whipple, Counsel, for the Respondents and Michael Patchett-Joyce, Counsel, for the Appellant

**IT IS DIRECTED** that Smallbone 4 is not admitted in evidence in these appeals.

**REASONS FOR THE DIRECTION**

1. Smallbone 4 was served on 18 September 2007 for a hearing starting on 1 October 2007 with a ten day time estimate which had been listed some considerable time before.

2. Service of Smallbone 4 was not made in time under Rule 21 of the VAT Tribunal Rules ("the Rules"). Rule 21(6)(c) provides that the time within which witness statements in these circumstances may be served under Rule 21 is 21 days after notification of the Commissioners' statement of case. This was not the case in respect of Smallbone 4 as the Respondents acknowledged. Four other Witness Statements were served at the same time by the Respondents.

3. Smallbone 4 with its enclosures fills two lever arch files. It relates to 45 or so UK to UK deal chains usually involving 5 or so links in the chain. More than 220 transactions would need consideration in addition to the 300 or so UK to Abroad transactions considered over the preceding eight days. The appeals relate solely to transactions where the Appellant was an exporter seeking repayment of input tax and not to UK to UK transaction where the Appellant was not an exporter claiming repayment of input tax. The Schedule of Documents exhibited to Smallbone 4 was itself more than 38 pages long.

4. None of the documents exhibited to Smallbone 4 were on the Respondent's list of documents required to be served under Rule 20 of the Rules setting out a list of documents in the Respondents' possession, custody or power which the Respondents proposed to produce at the hearing of the appeals. This is to be served within 30 days of the notification of the notice of appeal if the Rule is to be complied with in the circumstances under consideration.

5. A hearing concerning all 5 Witness Statements referred to above and the lack of paginated and indexed bundles and skeleton arguments and related matters was held on 26 September 2007 before the Chairman sitting alone. A further hearing was held before the Chairman on 27 September 2007.

6. The appeals (as noted above) were listed to be heard over ten days starting on 1 October 2007. The appeals concern the refusal by the Respondents to repay input tax relating to exports by the Appellant. The appeals are not concerned with UK to UK transactions by the Appellants which is what Smallbone 4 is concerned with. There is no suggestion that the Appellants were fraudsters in the transactions which are the subject of the Appeals. The Respondents confirmed that

this was the case at the beginning of the hearing. It is not alleged that the Appellants were fraudsters in the UK to UK transactions.

7. At the hearing on 26 September 2007 the Chairman admitted the four Witness Statements other than Smallbone 4 referred to above. He reluctantly excluded Smallbone 4. His reluctance was because at that stage there were no paginated and indexed bundles and skeletons before him and so a lack of background and context within which to place Smallbone 4. However, as Smallbone 4 involved some 45 deal chains each of 5 or 6 links, there would have been insufficient time before the hearing started for Mr Patchett-Joyce to have considered them properly given that there were some 52 deal chains to consider in the UK to Abroad transactions with which the appeals are concerned. The Chairman reserved his reasons at the September hearing (from which the parties did not dissent) and directed that the costs for that hearing be costs in the case. The Chairman also noted the President's statement of practice on adjournments and the difficulty of rescheduling. He was also conscious that the Appellant had been waiting for some time for the matter to be determined and wished the hearing to continue.

8. The reasons for the exclusion of Smallbone 4 at the hearing by the Chairman five or so days before the hearing of the full appeal were not just lack of time for preparation but included non-compliance with the Rules of the Tribunal and Directions made some considerable time before and a lack of context within which to judge relevance and context at that time. Had the relevant Rules and Directions been complied with the task would have been much easier. The Rules and Directions are not there for the parties to comply with only if they found them convenient particularly in a large case when detailed directions have been given.

9. The Chairman had made an order in two of the appeals in November 2006 that UNLESS the Respondents serve Statements of Case by a specified date the appeals be allowed. There were then set out directions to apply if the Respondents had complied in time. These related to matters such as documents, witness statements, time estimates, issues and similar matters. If the Respondents, in particular, had complied with the Directions issued to both parties and with the Rules the difficulty under consideration would not have arisen.

10. The Appeals came on for hearing on 1 October 2007 with a ten day time estimate. This was on the basis that Smallbone 4 was excluded. By agreement the

Respondents went first. Cross examination of the Respondents' witnesses was conducted on the basis that Smallbone 4 had been excluded. On 11 October 2007, the ninth day of the hearing, Counsel for the Respondents again applied for Smallbone 4 to be admitted before she closed her case on the evidence.

5 11. A Skeleton Argument for the Respondent in support of the application was produced on the morning of the tenth day (12 October 2007) when the application was to be heard.

12. The Chairman referred the parties to Foulser [2007] STC 973 and in particular paragraph 18 of Chadwick LJ's speech on case management.

10 13. The Respondent argued (in outline):

(a) The Tribunal had wide procedural discretion (see Rule 19 of the Rules and Jackson [2004] STC 164 at paragraph 22).

(b) The Overriding Objective of the CPR and the need to deal with cases justly by active management had to be borne in mind.

15 (c) Lightman J had said in ME 365 "the presumption must be that all relevant evidence should be admitted unless there is a compelling reason to the contrary".

(d) Foulser is not relevant as it relates to new points of law not to factual matters.

(e) Excluding Smallbone 4 is prejudicial to the Respondent's case. Admitting it would not prejudice the Appellant. It was all foreshadowed in the Statement of

20 Case and Smallbone 1.

14. Mr Patchett-Joyce, for the Appellant, contended (in outline):

(a) Smallbone 4 had been excluded and the Respondent could not renew (as her Skeleton said) an application which had been disposed of. The Tribunal was "functus" (if Latin was still allowed) as regards the renewed application. This

25 would be a simple way to dispose of the matter.

(b) If a new application were involved it should not be acceded to as there were compelling reasons of relevance and proportionality to exclude it. Further it would require more than Mr Smallbone's further evidence to substantiate it.

(c) Smallbone 4 was at best "a halfway house". Mr Smallbone could not give

30 evidence, for example, as to default which could be properly tested where Mr Smallbone was not the Assurance Officer. The Appellant would not be able to test the evidence properly particularly as to allegations of fraud if the appropriate officers did not also give evidence. Smallbone 4 was not sufficient to do this.

(d) It was not proportionate to introduce another 45 or so deal chains in two lever arch files on day 9 of a hearing listed for 10 days.

15. The application to admit Smallbone 4 in evidence made in the course of the Appeal was heard by the full Tribunal and not just the Chairman.

5 16. The Tribunal (ie the Chairman and both members) decided not to admit Smallbone 4. This was announced to the parties after the short adjournment on the tenth day. It was agreed that the Tribunal should produce a direction with reasons. This it has done.

17. The reasons for excluding Smallbone 4 included the following:

10 (a) We considered that it was too late in the hearing (day 9 of 10) to seek to introduce almost as much evidence again as had occupied the previous eight days of the ten allotted. The hearing had been conducted till then on the basis that Smallbone 4 would not be admitted. The primary object for the Respondent was to prove on the balance of probabilities:

15 i. the integrity of the chains concerned in the appeals;

ii. that there was a loss of tax in the chains; and

iii. that such loss was because of fraud.

This new evidence related to different types of transactions as they were all UK to UK rather than involving exports. The evidential burden was on the Respondents as
20 regards this aspect of the case relating to the chains in respect of which repayment of input tax was claimed. This was why the Respondents had agreed to go first.

(b) Smallbone 4 was out of time on the Rules as the Respondent accepted. Rule 21 required Witness Statements to be served within 21 days from the notification of the Commissioners' statement of case.

25 (c) Smallbone 4 was concerned with documents not on the Respondent's list of documents. That list referred to deal numbers; none of them were on the list Rule 20 requires.

(d) Smallbone 4 was apparently to be used to show that the Appellant had traded with UK traders as well as exporting and at different points in the chain and that
30 the margins were different between export chains and others. Smallbone 1 introduced this and Mr Dar's Witness Statement also dealt with this. Smallbone 4 may provide more information but does not go to the heart of what the Respondents have to prove in respect of the deal chains actually concerned in the

appeal. At most it goes to assist with matters of inference and analogy. The decision is to be made on the balance of probabilities and cogent evidence.

(e) If it is sought to establish fraud at the end of the chains not concerned in the appeal then we agree with Mr Patchett-Joyce that it is "a halfway house". As such
5 it would be unsatisfactory.

(f) It would be necessary for the relevant Assurance Officers (where they were not Mr Smallbone) to give evidence to establish the loss and more importantly the fraud in the chains not concerned with the appeal. It would not be a fair trial within Article 6 of the Human Rights Act to allow allegations of fraud by another
10 not to be tested properly and fully by the Appellant when in excess £9 million was at stake.

(g) We consider the "halfway house" aspect to be a compelling reason of itself to refuse to admit Smallbone 4 in evidence. We are concerned with specific transactions in respect of which input tax has been withheld. We consider we
15 should concentrate most on the transactions in question ie those on which the input tax repayment had been refused. A strong basis would be needed in the evidence relating to export transactions for inferences to be drawn in respect of other export transactions. Even greater cogency would be needed to draw inferences from a different type of transaction (ie UK to UK) where fraud is
20 alleged but not against the Appellant. This raises the question of relevance (and see (d) above).

(h) Even if relevance were made out (which we do not consider it has) the question of proportionality then arises. We do not consider that Smallbone 4 with its 38 page plus list of enclosures is proportionate here. It is introducing almost as many
25 deal chains not of the same type (ie involving no export and no claim to repayment of input tax by the Appellants) as the transactions actually concerned in the appeal. We consider this is the context of a part heard case to be disproportionate particularly when raised on the penultimate day of the period for which the hearing had originally been fixed.

30 18. We find (and to the extent possible we find as fact):

(a) Smallbone 4 was out of time (see Rule 21)

(b) Smallbone 4 is concerned with documents not on the Respondent's list required under Rule 20 of the documents the Respondent intend to produce at the hearing.

(c) Smallbone 4 is at best a halfway house and further evidence from others would be needed to establish particularly fraud in those chains. This brings Smallbone 4's relevance into question.

(d) It would be unfair on the Appellant to allow in evidence which the Appellant could not challenge by cross examination especially where fraud was alleged particularly if interferences were to be drawn which could potentially deprive the Appellant of in excess of £9 million. The Overriding Objective of dealing with cases justly and the Human Rights Act requirement of a fair trial would not be met if Smallbone 4 were admitted at this stage.

(e) The size of documentation and consequent effort required would be disproportionate.

(f) As a matter of case management it is too late to introduce on day 9 of 10, new evidence which could have affected how prior cross examination proceeded. It could not then be a fair trial.

19. Accordingly, we decide that there are compelling reasons of fairness, relevance, proportionality and case management (amongst others) to exclude Smallbone 4. Lightman J's presumption is thus rebutted within its own terms. Smallbone 4 is therefore excluded.

ADRIAN SHIPWRIGHT
Chairman
Release Date 19 December 2008

LON/2006/0830
LON/2006/0983
LON/2006/1069
LON/2006/0295

**APPENDIX 2**

5

10

## APPENDIX 3

## ALLEGED DEFAULTERS ACCORDING TO HMRC

5 (k) Steven Phillips t/a First Call;
(l) Oxhey Construction Services Ltd;
(m) Myco Telecom Ltd;
(n) The Callender Group;
(o) Oracle UK Ltd;
10 (p) Com4U Ltd;
(q) Red Rose Consultancy Ltd;
(r) Activmind Ltd;
(s) CHP Distribution
(t) St Aimie Ltd
15

Two set of chains have not been traced back to an importer. These are the chains involving Northwest and Storm 90.

## CHAINS BY RFERENCE TO OCL INVOICE NUMBER

20
(a) *Steven Phillips t/a First Call,*
1375
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25 1379
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1381
1382
1383
30 1391
*(b) Oxhey Construction Services Ltd*
1364
1365
1366
35 1367
1368
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1370
1372
40 1373
1374

(c) *Myco Telecom Ltd;*
1376
45 1385

(d) *The Callender Group*
1470
1471
50

(e) *Oracle UK Ltd*
1472

(f) *Com4U Ltd*
5 1414
1415

(g) *Red Rose Consultancy Ltd*
1416a&b
10 1417a&b
1418
1419a-c
1420
1431-35
15 1437 -41
1453-57
1458 -68

(h) *Activmind Ltd;*
20 1444-1445
1446-1447
1451-52d
(i) *CHP Distribution*
1448
25 1449
1450

(j) *St Aimie Ltd;,*
1350
30 1351
1361
1362
1363

35 **Others**

*Northwest*
1384 Short Chain

40 *Storm 90*
1412
1413
1423-1430

45