



[2009] UKFTT 127 (TC)

**TC00095**

**Appeal number MAN/07/0702**

*VAT – input tax – MTIC – appeal dismissed.*

**FIRST-TIER TRIBUNAL**

**TAX**

**P D CONCEPTS LTD**

**Appellant**

**- and -**

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

**Respondents**

**TRIBUNAL RICHARD BARLOW  
PETER WHITEHEAD**

**Sitting in public in Manchester on 12, 14, 15, 19 and 26 January and 19 February 2009.**

**Mr Nigel Gibbon of Omnis for the Appellant.**

**Mr Jonathan Cannan of counsel instructed by the General Counsel and Solicitor to HM  
Revenue and Customs for the Respondents**

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## DECISION

### Introduction.

- 5 1. This is an appeal against the respondents' decision given by a letter dated 14 May 2007 by which they informed the appellant that they refused to pay or credit £350,323.75 being part of a slightly larger sum claimed by the appellant as input tax for the three month prescribed accounting period ending 31 July 2006. That input tax was claimed in respect of three transactions in which the appellant sold mobile  
10 telephones to buyers established in Member States of the EU though, as will be seen later in this decision, in two cases the respondents dispute that the goods were removed to another Member State. The respondents allege that the right to deduct input tax was lost by the appellant because the transactions were connected with fraud and the appellant either knew or should have known of that fact.
- 15 2. The appellant was established in December 2004 and Mr Siraj Patel (Mr Patel) had become the sole director by the times most relevant to this appeal and it was trading from his home address.
3. The three transactions in question are as follows. On 13 July 2006 the appellant issued an invoice to ATES International ("ATES") - a French company - for £942,400  
20 in respect of 3,200 Nokia N80 telephones which it had purchased from In Touch Communications Retail Ltd ("In Touch") - a UK company - on the same date ("deal one"). On 17 July 2006 the appellant issued an invoice to EC Trading - a Danish company - for £611,250 in respect of 2,500 Nokia 9300i telephones which it had purchased from In Touch on the same date ("deal two"). On 17 July 2006 the  
25 appellant issued an invoice for £568,000 in respect of 2,000 Nokia N91 telephones to ATES which it had purchased from In Touch on the same date ("deal three").
4. In each case the goods were in the physical possession of a company called AFI Logistics in the UK ("AFI") at the time of the transactions and, according to the appellant, they were removed to a French associated company of AFI at about the  
30 same time as the invoices were issued. The respondents dispute whether the goods in deal one and two were removed.
5. The appellant's gross profit for the deals was £52,800 (deal one), £35,000 (deal two) and £32,000 (deal three).
6. In each case the respondents allege that the goods were bought by In Touch from  
35 Optronix Ltd – a UK company - which had acquired them from businesses established in other Member States.
7. It is not alleged that Optronix or In Touch had failed to account for output tax correctly on the sales in the UK in the chain of transactions leading to the purchases by the appellant but rather that Optronix had been involved in other fraudulent  
40 transactions in the relevant period in respect of which the output tax which these transactions generated had been used to disguise or counteract other fraudulent

transactions conducted by or to which Optronix was connected in the same or overlapping period. In other words this case involves what is termed contra-trading.

**The respondents' case.**

5 8. The respondents allege that the transactions in question were connected with the frauds committed in other chains of transactions in which Optronix was concerned because they were undertaken in order to off set and to disguise the input tax claimed in those other chains and/or to give an impression of genuine trading by Optronix which would answer an allegation that its trading was connected with fraud. Optronix allegedly acted as a broker in those other chains by exporting the goods in question and claiming the input tax where there were defaulting traders who had failed to account for output tax. Mr Gibbon on behalf of the appellant accepted that the witness statement of Ms Camm, a customs official, dealing with Optronix could be accepted as unchallenged evidence and that if the Tribunal were to be satisfied that Optronix was involved in fraudulent trading he would not seek to dissuade the Tribunal from that conclusion. In other words he was not putting forward a positive case that Optronix was not involved in fraud. We will deal with the Optronix evidence later. We also acknowledge that the appellant's case is that it was not in a position to challenge the evidence about Optronix because it had no knowledge of that company.

20 9. It follows from the above that the respondents' case essentially consists of two separate strands. First, are the inferences to be drawn from the undisputed facts about Optronix as a matter of argument based on undisputed evidence. Second, is the evidence about the appellant's involvement in the transactions in question and its state of knowledge. We will deal with the second strand in this section of the Decision and with the first when we consider Optronix's role.

30 10. We will examine the facts of the salient points of the respondents' case and make findings of fact where necessary. Much of their case depends upon inferences to be drawn from undisputed facts. We heard evidence from Mr Christopher Williams, a customs official, and read the statements of other witnesses whose evidence was not challenged. Mr Williams was cross-examined concerning conclusions he had drawn about factual matters but the truth of his evidence was not disputed. We also examined the documents in the case which ran to slightly more than 4,000 pages.

35 11. It is not disputed that the appellant borrowed £350,000 from a company called Rhodi, for which Mr Patel had worked and continued to work while running P D Concepts Ltd. The Rhodi directors were distantly related to Mr Patel. Initially the directors of Rhodi were represented on the board of the appellant. The loan was evidenced by a document drawn up by Mr Patel which the respondents say is on wholly uncommercial terms. The loan was for a maximum of two years but there were no specific terms as to repayment. No interest was chargeable but that was because the religious beliefs of the directors of the companies precluded it. Mr Patel said the parties to the loan had agreed that a management fee would be added to the capital but he was unspecific about how much that was to be and he said it was understood it would be related to the profit made by the appellant. When the loan was

repaid Mr Patel claimed it was agreed that the fee would be £80,000. These facts are mainly undisputed save that the respondents do not accept the evidence about the management fee. We find that the facts about the loan are as stated. We agree with the respondents that the loan was on wholly uncommercial terms which may be explained by the relationship between the parties.

12. The respondents rely on the undoubted rapid increase in turnover of the appellant's business. The undisputed facts are as follows. The first period of trading in mobile phones, which was soon after the Rhodi directors and the appellant became involved, was the three month period ending July 2005. In that period the appellant made three sales of mobile phones to two different purchasers in Dubai all of which had been purchased from In Touch (as were all the phones traded by the appellant). The value of the sales was £2,131,500 and they all occurred in the last few days of the period. The gross profit was £121,500 and Mr Patel agreed that the net profit was £103,000. Trading continued in that pattern until the period with which this appeal is concerned.

13. Mr Patel admitted in evidence that he had considered dealing in mobile phones when he had been involved in a company called Cityscope in 2003 but that never materialised. He had begun to make further enquiries about dealing in mobile phones only shortly before he became involved with P D Concepts Ltd. Originally he claimed that it had been intended to sell phones to large UK retailers, with whom Rhodi already had trading arrangements relating to clothes, but that did not prove possible. He put his success in dealing in mobile phones internationally down to good luck. We find that Mr Patel had started to make specific enquiries about buying and selling mobile phones through P D Concepts very shortly before the company started to trade.

14. The respondents rely upon the fact, which Mr Patel admitted, that he was aware that there was extensive fraud in the mobile phone industry and that he should have been suspicious, at least, about his own rapid success as a newcomer to the market.

15. On 19 July 2005 accountants acting for the appellant had written to the respondents in connection with a request to allow it to make enquiries at the respondents' Redhill office about third parties' VAT registrations. In that letter several potential customers were mentioned but they did not include either of those with which the appellant dealt at the end of July, less than two weeks later. It follows that the appellant was able to find those customers, make such enquiries about their credit worthiness and other such matters as was considered necessary by the appellant's directors and supply the goods within that short period.

16. Mr Patel said he had found the customers before he sourced the goods. All the goods traded by the appellant were sourced from In Touch and that company was always able to supply exactly what the customers had ordered in full. That may be partly because the goods were being traded as a commodity but the respondents also contend that the fact that no consignments had to be consolidated or split is a relevant fact.

17. Mr Patel had visited In Touch and found the business was operated as a small retail shop on the ground floor with one sales assistant and the wholesale business was operated on the first floor with one member of staff or director. The respondents contended that the nature of the premises and the apparently small scale of the business should have alerted Mr Patel to suspicions about its ability to deal in the quantities and value of the goods which he then found no difficulty in ordering.

18. The respondents contend and satisfied us that one of the appellant's customers in Dubai had itself bought goods from In Touch shortly before the customer placed an order with the appellant which the appellant then sourced from In Touch and sold to the Dubai customer at a price less favourable than that it might have obtained from a direct purchase from In Touch. There is no evidence that the appellant knew that was the case.

19. Mr Patel gave evidence that the loan to the Rhodi directors was paid off by January 2006 and they ceased to be directors. It is not in dispute that the loan was never the subject of any invoice or other claim for repayment and indeed no evidence was produced that Rhodi have ever sought repayment.

20. Mr Patel continued as the sole director. He initially said in evidence that the loan was repaid from profits but Mr Cannan was able to show by cross examination that some working capital had been used to pay it off as well as profits and that there was then still a shortfall. Mr Patel then recalled that he had been allowed credit (he thought about £19,000) from In Touch. He did not claim that the credit was subject to any interest or other additional payment to In Touch or produce any evidence about the actual amount or date of it. The respondents rely upon the fact that In Touch made gross profits on the transactions very much less than £19,000 in that three month period and so allowing such credit was uncommercial. We find that credit was given to the appellant by In Touch which contributed to the repayment of Rhodi though we do not make any finding as to its amount or terms other than that it was at least a sum that made the transactions uncommercial from In Touch's point of view and was on uncommercial terms.

21. The respondents rely upon allegations that the appellant conducted too few due diligence enquiries about its customers and supplier and such other traders as an inspections service and freight forwarders. We regard the level of due diligence that can be expected where the trader is not at risk of loss, as here, as being somewhat debatable and so we are not able to form a positive view about whether what was done might be termed sufficient as a matter of fact so far as the solvency of the counterparties to the appellant's deals are concerned. However, in view of the large amounts of money involved it is surprising that Mr Patel never though it necessary to visit the freight forwarders and the inspection service providers to make sure they could comply with the appellant's business needs.

22. The transactions directly in question in this case (ie those that gave rise to the input tax claims that have been refused) were sales to ATES and EC Trading which are a French company and a Danish company respectively and it is the case, as Mr Patel did not deny when he was cross examined, that the phones sold to those

companies were sold without detailed specifications and terms. The phones had a variety of languages in which they could be operated which mostly included at least some of the major European languages but which were apparently sold on the basis they were “Central European Specification” which was undefined and varied as to precisely which languages were available. The same applied to the guarantees and instruction manuals. Some phones were sold with language settings that appeared to have no relevance at all to the markets in which the purchasers were based and it might have been expected that Mr Patel should have made further enquiries about such matters, particularly bearing in mind the fact that he knew fraud was rife in the market in which he was trading.

23. No terms were agreed as to return of faulty goods either by the appellant to In Touch or from the customers to the appellant and, although that might be because the transfer of title only occurred after inspection by the buyer, it was the case that no contractual terms were agreed about what the consequence would be if the goods were rejected as a result of the inspection or in what circumstances they could be rejected. The same lack of particularity occurred when the phones were purchased by the appellant from In Touch.

24. A company called A1 inspections inspected the phones on behalf of the appellant (though in one case that was done through AFI who undertook to inspect but delegated the task to A1). The appellant paid for a 10% IMEI inspection which means an inspection of the supposedly unique numbers allocated to mobile phones. It also paid for a 100% open box inspection of the phones which involved, so Mr Patel told us, each box being opened and the contents being confirmed as to phone, guarantee, manual, charger, battery and anything else included with that phone and a power test to make sure the phone was working and, Mr Patel assumed though he did not know, to ensure the correct keyboard language was set. Mr Patel agreed that the appellant paid 10 pence per phone for IMEI inspection and 10 pence per phone for open box inspection.

25. Mr Patel made no enquiries to satisfy himself that such inspections could properly be carried out for those prices. The only direct evidence about that is that he said he was told by A1 that it would take two to three hours to check 2,000 phones. That would be at best therefore one phone checked every 5.5 seconds approximately assuming three hours were taken. The total payment would be £200 or £66.66 for each of the three hours. Even assuming staff were employed at the then minimum wage of £5.05 per hour no more than 13 staff could be employed and each phone would at most have 71 seconds spent on it for the box inspection. However, that would leave A1 with no payment for overheads, staff supervision and profit and would not take account of the time taken to unload pallets and open packing cases before actual inspection could begin or repacking and re-palletting after inspection. We find that for the price paid and for the work involved it is so unlikely that the inspection could be carried out properly that the very least that can be concluded is that Mr Patel should have realised that further enquiry was needed to confirm what the situation was.

26. One consignment was reported with what turned out to be entirely wrong IMEI numbers and A1 was never able to explain to Mr Patel why that had occurred.

27. In respect of the transactions in question in this appeal a small number of the IMEI numbers supposedly relating to phones sent to France were reported to have  
5 been recorded at Manchester Airport at a time when the phones were still en route to France via lorry.

28. The respondents produced evidence of weighbridge details for the lorries said to be carrying the goods in question in deals one and two which they contend show that the lorries had travelled empty with the consequence that the goods had not been  
10 removed from the UK. The evidence was that of Mr John Morrissey of Sea France, Dover, the ferry operator. He said that the procedure was for the company's staff to enter a standard weight for a normal lorry and then when it was weighed the difference between that weight and the total weight shown on the weighbridge would be assumed to be goods unless something alerted the staff to a discrepancy. He also  
15 said that the staff were required to ask the driver whether he was carrying goods and to make sure that, if he was, they also asked for assurance that the goods were non-hazardous. In fact the actual weight, within certain parameters, was not significant to Sea France as they charged the same price for a wide range of weights and the length of the vehicle was more significant than its weight, within those parameters. In our  
20 view, although the records do suggest, taken at face value, that there were no goods on the lorry on those two occasions the evidence falls short of what would be required to prove that. The entering of an arbitrary weight for the lorry raises sufficient doubt and to reach the opposite conclusion would require us to assume or be satisfied that the operator had carried out his instructions correctly.

29. Mr Patel was very specific, when giving evidence, that he always negotiated the prices at which he bought and sold goods. During his evidence in chief he said the following:

Q. The £294.50 [selling price to ATES in deal one] could you just remind the tribunal how that price came about, how that was agreed with ATES?

30 A. Through negotiation.

Q. You mentioned previously that they gave a –

A. Target price.

Q. – target price. Would that have been the target price or was there negotiation around the target price.

35 A. If I remember right I think it is about £1.50 [under] what we asked for.

And when being cross examined he said:

Q. So your target price was 293.

A. No, their target price.

Q. Sorry, yes, their target price was 293, but you did the deal at 294.50.

A. Correct.

5 Q. I think all the deals that you have done throughout your trading have always been in round figures in the sense of round pounds or to a 50 pence.

A. Yes.

Q. In your negotiations with any of your customers ... did the negotiations never settle on a price that went down to the nearest 10 pence, or even the nearest penny because it makes a big difference doesn't it.

10 A. It never has done, no.

Q. But you say that there were full negotiations on both sides with ATEES and In Touch and that the price that was settled on happened to be these round sums.

A. Yes.

15 30. The mark up achieved by the appellant hovered around 6% for all the deals except those in one period to a Dubai based customer when they were close to 3%. Mr Patel explained that difference by the fact that there had been a delay in shipping the goods to Dubai on that occasion and the price was re-negotiated. In fact on examination the mark ups achieved are even more remarkably consistent than that. There were a total  
20 of 15 deals and every one except one was priced at the nearest round 50 pence to a 3% or 6% mark up. The one exception was a deal where the actual price to achieve 6% would have ended in 30 pence but instead of its being rounded up to end in the nearest 50 pence above 6% it was rounded down to end in the nearest pound below 6%. Had Mr Patel said that he dictated his prices and set them in that way that would have been  
25 one thing but to have achieved that remarkable consistency by "full negotiations" is quite another or so the respondents contend.

31. The respondents rely on the above facts as indicating, as they contend, the contrived nature of the appellant's transactions as well as the extent to which Mr Patel, as the only directing mind in the company must have realised that his  
30 transactions were connected with fraud or at least that he ought to have realised that.

32. They do not contend that any individual fact proves their case but rather that the facts as a whole, which we have summarised above, produce a compelling case that Mr Patel and therefore the appellant knew or should have known that the deals were connected with fraud in the relevant sense.

35

### **The appellant's case.**

33. The appellant's case is very straightforward. It contends that it dealt with its supplier and customer and had no knowledge of suppliers up the chain of transactions from its supplier or what the customers did with the goods after sale. It contends that it could not have obtained knowledge of the other traders in the chain.

34. It contends that as far as due diligence is concerned Mr Patel made such enquiries as he could and such as he thought necessary bearing in mind that, as the goods were supplied on terms that they would only be released to the purchaser after P D Concepts received payment and P D Concepts would only buy the goods from In Touch when the purchaser paid (so called back to back transactions on ship on hold terms), there was little commercial risk and so any questions about the creditworthiness of the other traders was largely irrelevant.

35. Mr Patel said he trusted In Touch and that he had found the appellant's purchasers through legitimate enquiries.

36. Mr Gibbon pointed out that there is no evidence that would even suggest that the appellant knew about the existence of Optronix let alone that that company was involved in the chain of transactions leading to In Touch and so even perfect due diligence, sufficient to satisfy any criticism HMRC might want to put forward in respect of In Touch and the purchasers, would not have revealed anything about Optronix. We agree with that and note that the only thing HMRC have been able to suggest a legitimate trader in the position of the appellant might do to discover the identity of any trader further up the chain would be to ask In Touch but we regard that as somewhat unrealistic.

37. Mr Gibbon pointed out that by the time the transactions in question in this appeal occurred the appellant had been paid input tax after verification by the respondents in respect of a number of transactions with In Touch and so there was no basis on which to suggest that the appellant should have had any concerns about dealing with In Touch.

38. Mr Gibbon mentioned the case of *Our Communications Ltd* (Tribunal reference V20903). He pointed out that in that case the Tribunal (differently constituted) had said that back to back trading was not in itself indicative of fraud and that it is a legitimate way of trading so that something other than the nature of the transactions themselves is needed to prove that transactions are related to fraud.

39. Mr Gibbon also said that the Tribunal's findings in that case corroborated the appellant's case that European Specification phones were usable widely throughout Europe because they were found to be usable in the UK in that case.

40. Mr Gibbon adopted the argument accepted in that case by the Tribunal that, when considering whether the appellant had taken on any commercial risk, it is necessary to remember that there may be fruitless negotiations leading nowhere that remain unknown to HMRC. We agree that may be the case though we would point out that although such negotiations may take up time and effort the commercial risk in a case

like this, where all the work of the company is done by a single director, is very limited as the expenses of conducting fruitless negotiations will be minimal.

### **Optronix.**

5 41. In December 2005 Optronix was taken over by a company based in the British Virgin Islands. Its turnover in the twelve months ending November 2004 had been £2,340,141. Its turnover in the twelve months ending November 2005 was £137,620,074. On 15 December 2006 officers of the respondents uplifted its business records in connection with a criminal investigation and by 12 January 2007 mail was being returned from its address and on enquiry it was found to have vacated the  
10 address.

42. July 2006, the month in which the transactions in question in this case took place, fell within Optronix's prescribed accounting period ending in August. During that month Optronix acquired mobile phones in 36 deals from EU suppliers at a total cost of £16,413,562.50 and sold them, also in 36 deals, to UK customers for a tax  
15 exclusive price of £16,464,800.00 thus making a very small margin of profit. Three of the sales were to In Touch and were the goods sold by In Touch to the appellant.

43. In July 2006 Optronix was involved in 48 deals in which it purchased goods from UK based suppliers which were not mobile phones but which were high value low volume goods to a total VAT exclusive value of £24,720,900.00 which it dispatched  
20 to EU customers for a total of £25,043,926.00 making a significantly larger profit margin.

44. All 48 "broker" deals were in chains commencing with defaulting traders.

45. The respondents were also able to produce evidence from the records of the First Curacao International Bank which ultimately Mr Gibbon accepted showed that, in  
25 respect of deal 1 and deal 3, the money paid for the goods sold by the appellant had been circulated so as to pay for earlier transactions involving the same goods flowing through Optronix's possession and its account. Such circulatory payment is at least suggestive of fraud because it would appear to lie outside normal commercial arrangements.

30 46. The transactions in June 2006 conducted by Optronix in the same VAT accounting period were of a similar nature to those in July 2006 though they did not involve chains in which the appellant was involved.

47. We find that Optronix was involved in fraudulent transactions and that the three in which it made supplies to In Touch, which In Touch supplied to the appellant, were  
35 connected with fraud.

48. In general we find it significant that Optronix went missing so soon after a criminal investigation started. We regard that as cogent evidence of fraud. In addition the extreme rapidity with which the company increased its level of trade is indicative of fraud. The apparently unusual pattern of trade consisting of acquiring  
40 one type of goods in the EU and selling them in the UK while purchasing another type

of goods in the UK and despatching them to the EU without any cross over of goods between the markets is also easily explicable in terms of contra-trading but difficult to explain in terms of normal business and commercial practice especially bearing in mind the very small margin achieved in respect of the sales of mobile phones.

- 5 49. Given the above, we also find specifically that the three transactions in question in this appeal were part of Optronix's contra-trading and fraudulent activities.

**The applicable law.**

50. The law applicable to contra-trading MTIC cases has been clarified and summarised in the judgment of Lewison J in the case of *Revenue and Customs Commissioners –v- Livewire Telecom* [2009] STC 643. the most relevant passages are as follows:

89. As I have noted the ECJ has used various phrases to describe the link between the fraud and the impugned transaction. In *Optigen* the phrase was "a chain of supply of which those transactions form part"; in *Kittel* the phrase was "connected with fraud". In *Teleos* and in *Netto* it was "participation in tax evasion". Both *Teleos* and *Netto* are, in my judgment, a narrowing of the test.

90. The *Kittel* test, even in its original form, requires that the taxable person "knew or should have known" something. It is therefore necessary to identify what it is that he knew or should have known.

91. In cases (such as the present) where the taxable person is not a co-conspirator in an overall scheme to defraud the revenue by the fraudulent evasion of VAT it is, I think, necessary to identify the fraud with which the taxable person's transaction is alleged to be connected, and of which he should have known. Mr Anderson asserted several times that the fraud in question was a fraud to defraud the revenue through a series of transactions designed to extract money from the Exchequer by means of defaulting chains and contra-trading. The contra-trading deals, he said, were designed to displace claims for repayment of input tax. The ultimate intra-community export of goods was critical in order to extract money from the Exchequer, which was the purpose of the whole scheme. That, he said was the fraud. Assuming, for the moment, that the trader who makes his claim for repayment of input tax is not himself a dishonest co-conspirator, I had difficulty in understanding how this differed from saying that the fraud was the fraud of the missing trader in the dirty chain. The honest trader knows that he has bought goods on which he has paid VAT. He knows that he will export those goods and reclaim the VAT from HMRC. Unless there is a missing trader somewhere further down the chain (or in a parallel chain) there is no fraud. I accept that the honest trader need not know the identity of the missing trader but unless he knows or should have known that that there was (or was likely to be) a missing trader somewhere in the dirty chain, I do not see how it can be said that he knew or should have known that his transaction was connected with fraud. ...

98. Likewise in *Just Fabulous* Burton J said of an MTIC carousel fraud (§ 7):

"The fraud is plainly committed, if the participants in such chain are dishonest, at the stage of the *missing trader*, although the loss may not crystallise until the Revenue has to pay out in full in respect of the return filed by the exporter." (Emphasis in original)

5 99. All these observations were directed to "straight" MTIC frauds rather than a  
contra-trading fraud. In the case of a "straight" MTIC fraud it seems to me that  
a taxable person who is not himself a dishonest co-conspirator will not be  
deprived of his right to reclaim payment of input tax unless he knew or should  
10 have known of a connection between his own transaction and the fraud of the  
missing trader.

100. Burton J considered a contra-trading fraud later in his judgment. He  
said (§ 52):

15 "... on the assumed facts ... Evolution is 'a taxable person who knew  
... that by his purchase, he was taking part in a transaction connected  
with fraudulent evasion of VAT'. In those circumstances, I am satisfied  
that the Revenue would have the right to refuse to pay the input  
claimed, and my concluded view is the same as was the untutored  
response of Charles J in *Megantic*: and the same as the provisional  
view of Mr Bishopp in *Calltell* (see [\[2007\] UKVAT V20266](#), para 18)  
20 that:

'18. ... if the Respondents can show that the transactions were what  
they claim them to be ... they have at least an arguable case that a  
trader who, knowingly or with means of knowledge, engages in  
conduct designed to conceal, or avoid the consequences of discovery  
25 of, a fraud should be in no better position than the perpetrator of the  
fraud.'

101. In the case of contra-trading, therefore, the fraudulent conduct extends  
to conduct "designed" to conceal or avoid the discovery of a fraud. In other  
words the cover up is part of an overarching scheme, and is part of an overall  
30 fraud. But whether this is a correct description of the overall fraud depends on  
the facts. Underlying Mr Anderson's description of the fraud is the *assumption*  
that there is an overarching scheme. But whether there is such a scheme is for  
the Tribunal to decide. Mr Anderson's formulation assumes that which it is  
necessary for HMRC to prove.

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

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

40 ii) The dishonest cover-up of that fraud by the contra-trader.

103. Thus it must be established that the taxable person knew or should  
have known of a connection between his own transaction and at least one of  
those frauds. I do not consider that it is necessary that he knew or should have

known of a connection between his own transaction and both of these frauds. If he knows or should have known that the contra-trader is engaging in fraudulent conduct and deals with him, he takes the risk of participating in a fraud, the precise details of which he does not and cannot know. As Millett J put it in *Agip (Africa) Ltd v Jackson* [1990] Ch. 265, 295 (in the context of dishonest assistance in a breach of trust):

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

104. This conclusion is, I think, consistent with what Burton J said in *Just Fabulous* (§ 24):

"whether or not Evolution knew of the precise nature of the defaulter chain or of the goods purportedly dealt with in that chain or the identities of the participants in that chain, Evolution *knew of the fraudulent aim of Blackstar* in acquiring, through the off-set on the contra-trading transaction, the opportunity to receive, by such off-set, VAT which it would not be able to recover direct from the Revenue." (Emphasis added)

105. In other words, if the taxable person knew of the fraudulent purpose of the contra-trader, whether he had knowledge of the dirty chain does not matter.

106. However, if the contra-trader is not himself dishonest, then there will only have been one fraud, namely the dishonest failure to account for VAT by the defaulter in the dirty chain. In that situation, the taxable person will not, in my judgment, be deprived of his right to reclaim input tax unless he knew or should have known of that fraud. But if the taxable person knew or ought to have known of that fraud, then he will be deprived of his right to reclaim input tax, even if the contra-trader is wholly innocent (as, for instance, where the missing trader and the taxable person between them dishonestly orchestrate a sale to and purchase from an innocent intermediary, which appears to have happened in *Recolta*).

108. Similarly in *Calltell Telecom Ltd v HMRC* [2007] UKVAT V20266, discussing the question of knowledge, the Tribunal (Chairman Colin Bishopp) said (§ 52):

"It is difficult to see how a trader, entering into a chain of transactions in which every trader accounts correctly for VAT (and which is not tainted for some other reason) could have the means of knowing that it

is a device for concealing, or avoiding the consequences of discovery of, another, fraudulent, chain of transactions. Nevertheless it is, we think, possible that a trader could have the means of knowing that, by his participation, he is assisting a fraud. Much will depend on the facts, but an obvious example might be the offer of an easy purchase and sale generating a conspicuously generous profit for no evident reason. A trader receiving such an offer would be well advised to ask why it had been made; if he did not he would be likely to fail the test set out in paragraph 51 of the judgment in *Kittel*."

51. In light of the above we identify the questions we have to address as follows:

- 1) Was the appellant a co-conspirator in an overall scheme to defraud the revenue by evasion of VAT?
- 2) If not, the appellant will only be denied its input tax recovery if it either knew or should have known about an identified fraud.
- 3) That identified fraud may be either the fraud committed by the missing trader in the dirty chain or the "cover-up" by the contra-trader, which means conduct designed to conceal or avoid discovery of the missing trader fraud.
- 4) What the appellant (if it was not an actual co-conspirator) knew or should have known is set out in paragraphs 103 to 105 which require further discussion.

52. The first three sentences of paragraph 103 appear to say that the taxable person in question must have known precisely about the contra-trading (and the identity of the contra-trader) and to have dealt with the contra-trader knowing or being in a position where he should have known that the contra-trader was involved in at least one of the frauds identified in paragraph 102. However it should not be overlooked that the contra-trader was held not to have been proved to have been dishonest in that case.

53. The reference in the third sentence in paragraph 103 to the taxpayer "dealing with" the contra-trader cannot be taken to mean that he must have dealt directly with the contra-trader because, as is clear from paragraph 16 of the agreed statement of facts recorded by the Tribunal in the *Livewire* appeal (decision number V20533), the taxpayer did not deal directly with the contra-trader in that case and if a direct deal had been a necessary condition for refusal of input tax Lewison J would have decided the case on that basis.

54. We hold that transactions at one or more removes from the contra-trader can be transactions relevant to a decision to disallow input tax. The citation from *Agip Africa Ltd -v- Jackson* [1992] All ER 406 in which there is no suggestion, albeit in a different type of case, that a fraud can only be assisted by direct assistance to the person at the heart of the fraud suggests that indirect assistance is enough. In particular, the citation with approval in paragraph 108 of the judgement in *Livewire*, of the decision of the Tribunal in *Calltell*, in which the relevance of evidence about

means of knowledge of participation in fraud quite clearly extending beyond actual knowledge of the contra-chain was cited as an example of how the trader's involvement in the clean chain might be tainted for a reason not directly connected with actual knowledge of the dirty chain as such, shows that Lewison J agreed that the taxpayer might be deprived of a claim for input tax for a transaction not directly between him and the contra-trader. We would draw special attention to the fact that Mr Bishopp refers to "assisting a fraud" in that paragraph not to assisting a particular fraud. In addition there is nothing about the formulation of the test in *Kittel*, even as modified by *Teleos* and *Netto*, that would suggest that where, in fact, the transaction is connected with a VAT fraud the ECJ meant it to be any pre-determined type of connection that had to be proved other than that there should, as a matter of fact, be a connection which assisted the fraud and which the taxpayer either knew about or should have known about, again his knowledge being a question of fact. Finally we regard it as analogous to or at least consistent with the law relating to criminal fraud to interpret the authorities in this way because it is sufficient to found criminal liability for a defendant to be proved to have known that he was involving himself in a fraud without necessarily knowing the identities of the other participants or the full extent or details of the fraud.

#### **Discussion and conclusions.**

55. We have already found Optronix to have been proved to have acted dishonestly as a contra-trader in respect of these transactions.

56. We have no doubt and find that Mr Patel acted dishonestly in engaging in the three transactions in question in this appeal. As the only directing mind of the company that also proves that the appellant acted dishonestly.

57. Our reasons for that include the fact that from the outset the appellant company had traded very profitably with minimal effort by Mr Patel. He told us that he worked for the Rhodi group, as he had done before the appellant started to trade, as well as running P D Concepts. His part time working was sufficient to run the company.

58. The fact that all the P D Concepts transactions (and this applies throughout the trading period not just to the three transactions directly concerned in the appeal) were generally clustered at the end of the VAT periods shows that he was able to enter into deals at times to suit the company's cash flow. There was an incentive for entering into them at the ends of the tax periods in order to decrease the length of time for which the appellant's funds were tied up. Those funds were only needed to finance the VAT paid on the purchases from In Touch until it was claimed back from HMRC because the back to back nature of the transactions meant that no capital was committed for the purchase and sale of the goods themselves. By entering into deals at the end of the three monthly tax periods that commitment was reduced as far as possible. If transactions had been hard to come by that clustering would have been unlikely to be achievable.

59. We were presented with no direct evidence about failed attempts to find purchasers and Mr Patel was not even able to say much about what efforts he had

made. For example, he visited Dubai on holiday while the Dubai based customers were his only customers but he did not even take the opportunity to visit them. He had met only one person connected with any of his customers and most of the work was done by telephone or other electronic means.

5 60. The appellant consistently managed to trade up to a level which made virtually maximum use of its working capital from the outset. Again, this indicated that the deals were easily come by.

10 61. Our conclusion is that that evidence proves that the deals were presented to Mr Patel and the appellant “on a plate” so to speak and we approach the relevance of that in much the same way as Mr Bishopp approached the analogous situation in *Calltell* in the passage quoted in paragraph 108 of *Livewire*. We ask ourselves the question how was Mr Patel, as a novice in the mobile phone industry and as he admitted, within only a couple of weeks of deciding that the company would not be able to obtain purchase orders from big UK retailers, able to go into a totally different market and to obtain large orders from overseas purchasers with whom neither he nor the  
15 appellant had any previous relationship and at the same time to find a source for exactly those phones in the UK also from a company with which neither he nor the appellant had any previous dealings. The appellant started to deal with those traders on highly advantageous terms namely back to back deals on ship on hold terms  
20 involving virtually no financial risk. It was able to trade on those terms from the outset and so was not being given such advantageous terms because of a trading history with its counter parties which might have explained why the terms were advantageous had it been the case. In addition the contractual terms for the sales were so lacking in details that the goods supplied were easily sourced in the UK.  
25 Surprisingly the goods sourced in the UK were readily available even though such detail as was demanded by the overseas buyers related to sales of goods more likely to be available in those markets than the UK (ie Central European specification goods). The only answer that presents itself is that the deals were contrived.

30 62. Given that Mr Patel admitted he knew there was much fraud in the trade generally (certainly he knew that by the time of the deals under appeal) and given that he is clearly an intelligent man, as we observed and as Mr Gibbon agreed was the case, we can rule out any possibility that he was used as a dupe and we have no hesitation in saying that, on that evidence, he should have known that something fraudulent was involved in these deals.

35 63. But the evidence does not end there. We remind ourselves of what we have already said about the A1 inspections. This is evidence that Mr Patel must have known that his deals were connected with fraud because he showed himself to have turned a blind eye to facts so obviously not reliable, when seeking to rely on those inspections, as to make it clear he knew rather than that he should have known the  
40 deals were related to fraud.

64. The most compelling evidence that Mr Patel was knowingly acting in pursuance of a fraud is the evidence about the mark ups achieved by the appellant. Mr Patel repeatedly said that he had negotiated the purchase and sale prices of the goods the

appellant sold in the three transactions in question and indeed in every transaction the appellant was involved with. That evidence was undoubtedly untrue and we find that he deliberately lied about negotiating the prices. The reason we are so certain about that is that, whilst a trader might aim for a 6% mark up and might achieve close to it reasonably consistently in some circumstances, it became obvious that a formula had been used to calculate rather than to negotiate the prices as we have explained in paragraph 30 above. Only two possible explanations present themselves. One is that Mr Patel was told what price to charge his customers by someone who knew the price the appellant had paid In Touch and who knew the formula or he was himself aware of the formula and applied it.

65. The fact that Mr Patel lied about this question of negotiations when he gave evidence demonstrates to us and we find it to be the case, that he was at least aware that the transactions were part of an overall conspiracy in which he became a co-conspirator in the relevant sense. He may not have known the full ramifications of the conspiracy or the identities of all the conspirators, of which there may have been many, but none the less he was a conspirator. We also find that he knew the conspiracy was a conspiracy to defraud the revenue in respect of VAT. He admitted he knew about VAT MTIC fraud and his intelligence is such that we find he must have realised that was the nature of the conspiracy in which he involved himself even if no-one spelt it out to him when he first became involved.

66. The appeal is dismissed. The respondents are entitled to refuse to credit or pay the input tax in question.

67. We direct that any application for an award of costs should be made within three months to a Judge of the Tribunal sitting alone, that is to say an application in principle, we are not directing that any such application should be quantified at the time any such application for an award in principle is applied for.

**RICHARD BARLOW**

**TRIBUNAL JUDGE  
RELEASE DATE:**