# TC01429

**Appeal number MAN/07/0992**

***VALUE ADDED TAX — alleged MTIC fraud — refusal of input tax credit — whether appellant knew or should have known of fraud — yes — appeal dismissed***

**FIRST-TIER TRIBUNAL**
**TAX CHAMBER**

**IXES (UK) LIMITED** **Appellant**

**- and -**

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

**Tribunal: Judge Colin Bishopp**
**Mrs Beverley Tanner**

**Sitting in public in Manchester on 1 to 5, 8 to 12, 15 to 18 November 2010, with written submissions concluding on 22 July 2011**

**Mark Lucraft QC, instructed by the Khan Partnership LLP, for the Appellant**

**Mark Cunningham QC and Andrew Westwood, counsel, instructed by Howes Percival LLP, for the Respondents**

## DECISION

*Introduction*

1. The issue in this appeal is whether the respondents are right in their view that the appellant, Ixes (UK) Limited ("Ixes"), in reality in the person of its only director, Mr Iajaz Khan, knew or ought to have known that 46 transactions of purchase and sale of electronic goods undertaken by it between 6 March and 31 May 2006 were connected with the fraudulent evasion of VAT. Relying on that view the respondents have refused to repay to Ixes input tax, almost £10 million in all, incurred by it on the purchases. All of the relevant sales were to overseas VAT-registered traders, and therefore zero-rated. This is, in short, what is commonly if not altogether accurately known as an MTIC appeal.

2. Ixes' case, in summary, is that it undertook comprehensive due diligence on its suppliers and customers, and in doing so carried out all of the checks and took all the precautions the respondents recommended, studied their advice and acted on it, and that Mr Khan did not and could not have known of frauds committed by traders several steps removed from it in its supply chains. It maintains it was a serious and careful trader in what it reasonably believed to be a genuine market, and that it had no reason to think that any of its transactions was connected with fraud elsewhere.

3. Before us, Ixes was represented by Mark Lucraft QC and the respondents by Mark Cunningham QC, leading Andrew Westwood. In accordance with the usual practice in cases of this kind, the respondents (upon whom the burden of establishing most of the relevant facts lies) led their evidence first. We had the statements of a large number of witnesses, which (subject to minor corrections and updating) stood as their evidence in chief. Some witnesses had made more than one statement. The witnesses who gave oral evidence were: Dean Foster, the HMRC officer whose decision it was to refuse the repayment, Russell Hall, Phyllis Mee, Ian Webster, Archibald McAllister, Timothy Reardon, Matthew Bycroft, Claire Badminton, Nicola Leak, Smita Parikh, Robert Ross, John McPartlin, Charlotte-Rebecca Jackson, Ann Bushby, Katie Finn, Jane Humphrey, Susan Okolo, Gary Saul, Daniel Outram, Ghazalah Shah, Kyle Martin, Michael Stevens, Stewart Yule, Lee Nevin and Claire Sharkey, all HMRC officers, John Fletcher, a manager employed by KPMG and called by the respondents as an expert witness, and Mr Khan. We had also the unchallenged statements of two further HMRC officers, Kevin Wright and Nigel Humphries. We were presented in addition with a very large volume of documentation.

4. It was common ground that the starting point was the obligation posed on HMRC, if they are to succeed, to show that Ixes' transactions were "connected to the fraudulent evasion of VAT". That requires them to demonstrate three things:

- that there has been a VAT loss;
- that the loss resulted from fraudulent evasion; and
- that the deals which are the subject of the appeal were connected with that evasion.

5. After the hearing was concluded the decision of Lewison J, sitting in the Upper Tribunal, in *Revenue and Customs Commissioners v Brayfal Limited* [2011] STC 1338 ("*Brayfal*") was released, and the appellant requested permission to make further submissions in the light of it. Because of some confusion, it was not until late July 2011 that we received the respondents' response to those submissions. We have taken both parties' submissions into account in what follows, as well as the refusal by the Supreme Court to Mobilx Limited of permission to appeal against the decision of the Court of Appeal to which we refer below.

6. It is now notorious that the grey market in mobile phones is riddled with fraud, a proposition which Mr Lucraft did not seek to challenge. Indeed, after the evidence was complete he did not dispute the respondents' case that, with a possible exception with which we deal in para 9 below, every one of Ixes' purchases could be traced back, directly or indirectly, to a fraud, consisting in most cases of the failure of a trader (a "defaulter") which had sold the goods, within the UK, to another trader, and which had in consequence incurred a liability to account for the VAT due on that sale, to account for and pay that VAT to the respondents. Usually the defaulter had either disappeared, or gone into insolvent liquidation owing a very large amount of VAT. There was evidence that in a large number of those transactions all or most of the purchase price of the goods had been paid by the purchaser, not to the defaulter, but to a third party overseas, making it impossible for the defaulter to discharge its obligation to account for the VAT.

7. In most cases there was a simple sequence of transactions leading back to a defaulter. Others traced back to honest traders whose identities had been "hijacked" by fraudsters. In four, the chains traced back to contra-traders, that is traders setting off the input tax incurred by them, in a chain of transactions including one carried out by a defaulter, against the output tax for which they must account in a defaulter-free chain. It is to these chains that the additional submissions we have mentioned were directed. As Mr Lucraft did not challenge the respondents' case that there was fraud in the chains, at one or more removes from Ixes itself, and that they had succeeded in demonstrating all of the three things described at para 4 above, we do not propose to set out systematically the detail of the chains, though we shall need to describe Ixes' own transactions, and some other features of the chains, later.

8. It is, however, appropriate to make some preliminary observations. There was overwhelming evidence of fraudulent trading, designed to do no more than generate output tax liabilities for which no-one would ever account, as the precursor to input tax repayment claims the respondents would be expected to meet. The evidence showed defaults, not of moderate sums which might be the consequence of business misfortune or poor judgment, but of vast sums, measured in millions of pounds, generated in very short periods of time by traders which existed for the same short period before their directors disappeared. That the goods in which it dealt had previously been traded by defaulters does not, of course, by itself demonstrate that Ixes was a knowing participant in fraudulent chains, even though it was the trader making the input tax repayment claims, but as has been said many times, it is the input tax injected by the taxing authorities

when meeting such claims which fuels the fraud. We add, in case it should be thought otherwise, that we recognise that Ixes' having made the repayment claims is not by itself an indication that it knew or should have known of the frauds.

9. The exception identified by Mr Lucraft and which we mentioned above was a trader by the name of K & S Export, regarded by HMRC as a defaulter but which had rendered a seemingly near-correct VAT return before it, or more accurately its directors, disappeared without paying the amount shown to be due. Although the completion by a defaulter or supposed defaulter of a return is unusual in cases of this kind, and might be taken as an indication of an intention to meet its obligations, one cannot, in our view, disregard the fact that K & S Export was, like all the other defaulters in this case, a company which had traded for a very short time, incurring an enormous (in its case £8.5 million) VAT debt which remains unpaid. It is conspicuous that it undertook as many as 86 transactions in the space of two working days. We cannot, in these circumstances, draw any real distinction between K & S and the other defaulters, despite the completion of a return. It is noteworthy that K & S was making third party payments, that is sending the bulk of the price of the goods to a company other than its own supplier, leaving only a small amount, insufficient to discharge the VAT debt, to be paid to the supplier itself and, it appears, asking its customers to do likewise. The only reasonable inference to be drawn is that K & S put it out of its power to pay the VAT, and never intended to do so. We consider K & S to be as much a fraudulent defaulter as the others.

10. Although he acknowledged that HMRC had correctly traced the chains of transactions, Mr Lucraft took issue with their contention that there was an "overall scheme to defraud", in which Ixes was a knowing participant. While conceding that fraud was clearly established, he argued that HMRC nevertheless could not show any such scheme, still less that Ixes knew anything about any scheme which might have existed. He pointed out that although officers had taken up considerable quantities of paperwork, including documents left behind by traders which had disappeared, they had not found a single document which supported their theory that the transactions were pre-arranged, each trader being told in advance from whom it should buy and to whom it should sell. In furtherance of his argument that Ixes could not have known of any scheme he emphasised the fact that it had at no time dealt directly with any trader which could be shown to have defaulted. Indeed, he went a little further by claiming that Ixes had at no time dealt with a fraudulent trader, but that is not so, as at least one of its suppliers has been found by this tribunal or its predecessor to be a knowing participant in fraudulent chains, albeit not a defaulter. We will, of course, deal with the arguments in rather more detail later.

*The law*

11. The starting point in cases of this kind is the jurisprudence of the Court of Justice of the European Union (to use its present title), in *Optigen Ltd and others v Customs and Excise Commissioners* (Joined cases C-354/03, C-355/03 and C-484/03) [2006] STC 419 ("*Optigen*") and *Axel Kittel v Belgium; Belgium v Recolta Recycling* (Joined Cases C-439/04 and C-440/04) [2008] STC 1537

("*Kittel*"). Those cases show that each transaction must be considered on its own merits: an overall view is not permissible. In *Optigen* the Court said, at [55],

> " … the answer to the first question referred for a preliminary ruling in each case should be that transactions such as those at issue in the main proceedings, which are not themselves vitiated by VAT fraud, constitute supplies of goods or services effected by a taxable person acting as such and an economic activity within the meaning of Articles 2(1), 4 and 5(1) of the Sixth Directive, where they fulfil the objective criteria on which the definitions of those terms are based, regardless 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. The right to deduct input VAT of a taxable person who carries out such transactions cannot 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."

12. As that passage shows, however, there are circumstances in which the right to deduct may be denied, that is where a trader, even though not himself a party to a fraud, nevertheless knew or should have known of it. This theme was developed in *Kittel*. The core of the Court's reasoning appears in paras 56 and 57 of its judgment:

> "56. … 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."

13. The consequence of such participation was spelt out at para 61 of the judgment:

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

14. How that observation should be applied in practice was considered by the Court of Appeal in the only United Kingdom case, so far, to reach that court, *Mobilx (in administration) v Revenue and Customs Commissioners and related appeals* [2010] STC 1436 ("*Mobilx*"). Moses LJ gave the only judgment, with which the other two Lords Justices agreed. At [52] he said:

> "If a taxpayer has the means at his disposal of knowing that by his purchase he is participating in a transaction connected with fraudulent evasion of VAT he loses his right to deduct, not as a penalty for negligence, but because the objective criteria for the scope of that right are not met …. A trader who fails to deploy means of knowledge available to him does not satisfy the objective criteria which must be met before his right to deduct arises."

15. Then, at [59] he said:

> "The test in *Kittel* is simple and should not be over-refined. It embraces not only those who know of the connection but those who 'should have known'. Thus it includes those who should have known from the circumstances which surround their transactions that they were connected to fraudulent evasion. If a trader should have known that the only reasonable explanation for the transaction in which he was involved was that it was connected with fraud and if it turns out that the transaction was connected with the fraudulent evasion of VAT then he should have known of that fact. He may properly be regarded as a participant for the reasons explained in *Kittel*."

16. At [75] he added that:

> "The ultimate question is not whether the trader exercised due diligence but rather whether he should have known that the only reasonable explanation for the circumstances in which his transaction took place was that it was connected to the fraudulent evasion of VAT."

17. Moses LJ concluded at [85] by saying that:

> "A trader who chooses to ignore circumstances which can only reasonably be explained by virtue of the connection between his transactions and fraudulent evasion of VAT, participates in that fraud and, by his own choice, deprives himself of the right to deduct input tax."

18. It is also worth mentioning the observations of Christopher Clarke J in *Red 12 v Revenue and Customs Commissioners* [2009] EWHC 2563, adopted by Moses LJ at [83] in his judgment in *Mobilx*. Christopher Clarke J said:

> "[109] Examining individual transactions on their merits does not, however, require them to be regarded in isolation without regard to their attendant circumstances and context. …
>
> [110] To look only at the purchase in respect of which input tax was sought to be deducted would be wholly artificial …
>
> [111] … in determining what it was that the taxpayer knew or ought to have known the tribunal is entitled to look at the totality of the deals effected by the taxpayer (and their characteristics), and at what the taxpayer did or omitted to do, and what it could have done, together with the surrounding circumstances in respect of all of them."

19. It is convenient to mention at this point a further comment made by Moses LJ in *Mobilx* , at [61]:

> "If he [the trader] chooses to ignore obvious inferences from the facts and circumstances in which he has been trading, he will not be entitled to deduct."

20. The principles we draw from those observations are, first, that although the focus must always be on the transaction in question, one must nevertheless keep in mind all of the surrounding circumstances. The fact that a trader has undertaken due diligence enquiries will almost always be a factor, but not a determinative factor. In particular, a trader cannot protect himself merely by making enquiries; the enquiries, and the answers he receives (or the fact that does not receive an answer), merely form part of the body of information which he must consider

before deciding whether or not to enter into any individual transaction. It is not necessary for the Commissioners to demonstrate that the trader had knowledge of the detail of the antecedent dealings in the goods, the identities of the traders, the precise nature of the fraud and other matters of that kind; they do not feature in the simple test adumbrated by Moses LJ in the extract from para [59] of his judgment set out above. It is sufficient that there is no plausible honest explanation of the transactions.

21. While not disputing those propositions—indeed, there was nothing of substance between the parties on the law—Mr Lucraft argued that the hurdle HMRC must surmount if they are to show knowing or "blind eye" participation is high, and that it is plain from what was said in *Mobilx* that the Court of Appeal deliberately put it in a high position. First, it was clearly stated, at [60] and [77], that HMRC cannot succeed by merely showing that a trader knew or ought to have known that the transactions into which he entered were more likely than not to be connected with the fraudulent evasion of VAT. They are required to show, even if only on the balance of probabilities, that the trader knew or ought to have known that the transactions *were* so connected. Negligence or carelessness are plainly insufficient. He emphasised two further observations in the judgment of Moses LJ. At [55] he said:

> "A trader who knows or could have known no more than that there was a risk of fraud will find it difficult to gauge the extent of the risk; nor will he be able to foresee whether the circumstances are such that it will be asserted against him that the risk of fraud was so great that he should not have entered into the transaction. In short, he will not be in a position to know before he enters into the transaction that, if he does so, he will not be entitled to deduct input VAT. The principle of legal certainty will be infringed."

22. From that background there emerged the paradigm trader who has forfeited the right to deduct, described by Moses LJ at [61], a description which, Mr Lucraft was to argue, was far removed from Ixes. The description is:

> "A trader who decides to participate in a transaction connected to fraudulent evasion, despite knowledge of that connection, is making an informed choice; he knows where he stands and knows before he enters into the transaction that, if found out, he will not be entitled to deduct input tax".

23. We acknowledge that the test is an objective one, and that hindsight has no part to play: the trader must be shown to have known of the connection with fraud or, instead, to have had, before entering into the transaction, all the information necessary to demonstrate such a connection, but to have failed to deploy it. We recognise too the force of Mr Lucraft's submission that it is necessary to be especially careful in respect of the four contra-trading chains in issue in this appeal, as can be seen from the observation made by the Chancellor in *Blue Sphere Global Ltd v Revenue and Customs Commissioners* [2009] EWHC 1150 (Ch), in respect of such trading. At [55] he said:

> "In my view it is an inescapable consequence of contra-trading that for HMRC to refuse a reclaim by E [the trader in Ixes' position] it must be in a position to prove that C [the contra-trader] was party to a conspiracy also involving A [the defaulter]. Although the fact that C is party to both the clean chain with E and the dirty chain with A constitutes a sufficient

> connection it is not enough to show that E ought to have known of the fraudulent evasion of VAT involved in the subsequent dirty chain. At the time he entered into the clean chain there was no such dirty chain of which he could have known, nor was the occurrence of such dirty chain inevitable in the sense of being pre-planned."

24. Mr Lucraft's position was that it followed from that comment, which was approved by the Court of Appeal in *Mobilx*, that only exceptionally would HMRC be able to make out their case in respect of a contra-trading chain. This argument was developed further in the additional submission, which relies particularly on observations by Lewison J in *Brayfal*, a case in which there had been a disagreement in the First-tier Tribunal between the judge, who found in favour of the Commissioners, and the two members, who found in favour of the appellant. At [16] he said

> "The members began their detailed reasoning by saying that the clean chain (in which Brayfal found itself) was created before the dirty chain (para [138]). This was a vitally important point. In order for deduction of input VAT to be withheld, HMRC must prove, having regard to objective factors, that the taxable person, *at the time of his transaction*, knew or should have known that his transaction was connected with fraud. Where the impugned transactions are transactions in the clean chain this presents evidential problems for HMRC. As the Chancellor pertinently asked in *Blue Sphere Global* …: how can a trader who is not part of a conspiracy know of a fraud before it happens? If there is a regular course of conduct in which the trader knows that his transactions are connected with subsequent transactions that he knows *ex post facto* are fraudulent, there may come a time at which he can be credited with knowledge of the future. But that is not the case that HMRC advanced in this case. Moreover, in the present case, as the members pointed out all Brayfal's transactions were in the clean chain where every member correctly dealt with its VAT (para [149]). Thus the members' findings in paras [138] and [149] were also relevant to, and supportive of, their rejection of the case based on actual knowledge." [original emphasis]

25. These judgments showed, Mr Lucraft argued, that in order to succeed the Commissioners must prove both the deliberate, dishonest concealment by the contra-trader of the fact of fraud in the dirty chain, and that the trader in Ixes' position knew or had the means of knowing, at the time of entering into each of its transactions, of either the fraud in the relevant dirty chain, or of the contra-trader's dishonest concealment. We observe, parenthetically, that if Mr Lucraft is right these do not seem to be true alternatives: if the trader in Ixes' position knew or should have known of the concealment, he must have (or, if he deployed the information at his disposal, should have) at least an inkling of what it is that has been concealed. In this case, Mr Lucraft said, HMRC failed on the first limb, and the second therefore did not arise. But if it did, HMRC again failed because they could not show that Ixes knew, or should have known, either of the supposed dishonest concealment, or of frauds in the dirty chains. It was impossible for them to do so when, as Mrs Bushby and Ms Finn said when they gave evidence, they had allocated the tax losses in the dirty chains to Ixes' clean chains by an arbitrary, rather than evidence-based, means. How, he asked, could Ixes have known of frauds, or of the concealment of frauds, linked to its own transactions in so tenuous a manner?

26. Mr Cunningham's response relied upon the further observation of Lewison J in *Revenue and Customs Commissioners v Livewire Telecom Ltd* [2009] STC 643 at [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 [*ie* the default or the concealment]. 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."

27. That observation was the subject of comment by Briggs J in *Megtian Ltd (in administration) v Revenue and Customs Commissioners* [2010] STC 840:

> "[34] … I do not read Lewison J's analysis of the issue as to what must be shown that the broker knew or ought to have known in a contra-trading case as amounting to a rigid prescription that, as a matter of law, such an analysis must be performed in every contra-trading case, such that it will be defective unless it identifies one or other of the alternative frauds as being that which the broker knew or ought to have known.
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> [35] In the first place, Lewison J was, as he made very clear, addressing the question, what had to be demonstrated against an honest broker who was not a dishonest co-conspirator in the tax fraud. In the present case, the tribunal's conclusion, after hearing oral evidence from and cross-examination of Mr Andreou, Megtian's shareholder and principal manager, was that Megtian knew that the transactions on which it based its claim were connected with fraud…. Participation in a transaction which the broker knows is connected with a tax fraud is a dishonest participation in that fraud…..
>
> [36] Secondly, Lewison J acknowledged that in many if not most cases of contra-trading, the clean chain and the dirty chain were likely to be part of a single overall scheme to defraud the Revenue. As he put it, at [109]: 'Indeed it seems to me that the whole concept of contra-trading (which is HMRC's own coinage) necessarily assumes that to be so.'
>
> [37] In my judgment, there are likely to be many cases in which a participant in a sophisticated fraud is shown to have actual or blind-eye knowledge that the transaction in which he is participating is connected with that fraud, without knowing, for example, whether his chain is a clean or dirty chain, whether contra-trading is necessarily involved at all, or whether the fraud has at its heart merely a dishonest intention to abscond without paying tax, or that intention plus one or more multifarious means of achieving a cover-up while the absconding takes place.
>
> [38] Similarly, I consider that there are likely to be many cases in which facts about the transaction known to the broker are sufficient to enable it to be said that the broker ought to have known that his transaction was connected with a tax fraud, without it having to be, or even being possible for it to be, demonstrated precisely which aspects of a sophisticated multifaceted fraud he would have discovered, had he made reasonable inquiries. In my judgment, sophisticated frauds in the real world are not invariably susceptible, as a matter of law, to being carved up into self-

> contained boxes even though, on the facts of particular cases, including *Livewire*, that may be an appropriate basis for analysis."

28. We respectfully agree, and we do not think either Lewison J or the Chancellor intended to say anything else. It may well be that the evidential problems facing HMRC in a contra-trading case are greater, as Lewison J indicated, but greater evidential difficulties do not affect the underlying test, which remains that described by Moses LJ in *Mobilx*. All that is required is that the trader knew or should have known that his transaction was connected with fraud. There is nothing in what Moses LJ said which supports the proposition that he must know, or have the means of knowing, any of the detail of the fraud.

*Standard of proof*

29. Mr Lucraft accepted that the standard of proof was the civil standard but, he said, where fraud was alleged, as here, the quality of the evidence which must be adduced if the burden was to be discharged was high, to the extent that, as he put it in his skeleton argument, "These proceedings cross the boundary from civil proceedings to criminal by reason of the identification of a criminal charge". He relied upon what was said by Richards LJ in *R (N) v. Mental Health Review Tribunal (Northern Region)* [2006] QB 468 at [62]:

> "Although there is a single civil *standard* of proof on the balance of probabilities, it is flexible in its *application*. In particular, the more serious the allegation or the more serious the consequences if the allegation is proved, the stronger must be the evidence before a court will find the allegation proved on the balance of probabilities. Thus the flexibility of the standard lies not in any adjustment to the degree of probability required for an allegation to be proved (such that a more serious allegation has to be proved to a higher degree of probability), but in the strength or quality of the evidence that will in practice be required for an allegation to be proved on the balance of probabilities." [original emphasis]

30. That observation was approved by Lord Carswell in his speech in *re D* [2008] 1 WLR 1499 at [27], where he said "In my opinion this paragraph effectively states in concise terms the proper state of the law on this topic."

31. In our view, what Richards LJ and Lord Carswell said, both in the extracts from their respective judgment and speech we have set out and elsewhere—and Mr Lucraft's skeleton contained a good deal more of Lord Carswell's speech—do not make good his contention that the standard to be applied here is, or verges on, the criminal standard of proof beyond reasonable doubt. Both Richards LJ and Lord Carswell undertook a detailed analysis of the recent case-law on the topic, an analysis which we do not need to repeat here. As Lord Carswell said, at [28],

> "It is recognized by these statements [*ie* the authorities to which he had previously referred] that a possible source of confusion is the failure to bear in mind with sufficient clarity the fact that in some contexts a court or tribunal has to look at the facts more critically or more anxiously than in others before it can be satisfied to the requisite standard. The standard itself is, however, finite and unvarying. Situations which make such heightened examination necessary may be the inherent unlikelihood of the occurrence taking place …, the seriousness of the allegation to be proved or, in some

> cases, the consequences which could follow from acceptance of proof of the relevant fact. The seriousness of the allegation requires no elaboration: a tribunal of fact will look closely into the facts grounding an allegation of fraud before accepting that it has been established. The seriousness of consequences is another facet of the same proposition: if it is alleged that a bank manager has committed a minor peculation, that could entail very serious consequences for his career, so making it the less likely that he would risk doing such a thing. These are all matters of ordinary experience, requiring the application of good sense on the part of those who have to decide such issues. They do not require a different standard of proof or a specially cogent standard of evidence, merely appropriately careful consideration by the tribunal before it is satisfied of the matter which has to be established."

32. We proceed, therefore, upon the basis that although the burden of showing that a trader has forfeited the right to deduct rests on the Commissioners (*Mobilx* at [81], a proposition which the Commissioners have accepted for many years) the standard of proof is the ordinary balance of probabilities, albeit we must examine the evidence with great care and take into account such factors as the inherent improbability of an occurrence wherever such a consideration is relevant.

*The relevant decisions*

33. The decisions which are the subject of this appeal were notified by HMRC to Ixes by letters dated 26 July 2007 and 22 November 2007. The first letter rejected a claim for the repayment of input tax of £8,395,302.68 incurred in 43 purchases which took place in the 03/06, 04/06 and 05/06 VAT periods. The second letter rejected a claim for the repayment of input tax of £1,547,875 incurred in three further transactions in the 03/06 and 04/06 VAT periods. The reasons relied upon, as they were set out in the letters, were, first, that the transactions formed part of an overall scheme to defraud HMRC and, second, that Ixes knew or should have known that its transactions were so connected. HMRC's primary case was and is that Ixes was knowingly part of that scheme; that Ixes should have known is put as an alternative or secondary argument.

34. All but two of the 46 transactions consisted in the purchase by Ixes of phones from one of six suppliers in the UK, and its immediate sale of the same goods, with one exception in intact consignments, to one of four customers in continental Europe. The exception was one case in which Ixes bought two consignments, and combined them in a single sale. In the remaining two cases, the goods were iPods, but the remaining features of the transactions were the same. As we have indicated, four of the deals (two in April and two in May 2006) were in "contra" chains, that is, in chains going back to "contra-traders" and thereafter, via off-sets, to defaulting traders, while the remaining 42 were in "straight" chains, that is, chains of sales and purchases leading directly back from Ixes to parties that HMRC allege (and, by the end of the hearing, Ixes conceded) were defaulters. Of those, 21 took place in March, 8 in April and 13 in May 2006.

35. Although Ixes did not at first accept that this was so, by the end of the hearing Mr Lucraft had acknowledged on its behalf that the Commissioners had made out this part of their case, that is (as we have recorded above), they had shown that all three of the limbs of the test of "connected with the fraudulent

evasion of VAT" were satisfied. For these reasons it is unnecessary for us to set out much of the considerable volume of evidence we heard about the defaulting traders, with none of which, as Mr Cunningham agreed, had Ixes ever dealt directly. But as we have mentioned, Mr Lucraft did not go so far as to concede that the Commissioners had demonstrated the "overall scheme to defraud" referred to in each of the decision letters. The Commissioners modified that description in the statement of case, in which the phrase "a contrived scheme to defraud the revenue" is used. In our view there is no material difference between the two terms. It is not necessary for HMRC to demonstrate such a scheme—as the extracts from the judgment of Moses LJ in *Mobilx* we have set out show, no more than knowledge or the means of knowledge of a connection with fraud is required—but we shall nevertheless return to the topic later.

*Ixes and Mr Khan's background*

36. Mr Khan's evidence was that he had some experience in electronic goods before he acquired Ixes and began trading in mobile phones. After he left school he had studied electrical and electronic engineering, and had then taken up employment with the well-known retailer Comet, where he remained for about 15 years, starting as a sales assistant and ending as the senior general manager of a large store. He acquired, he said, experience of retail sales of mobile phones, which Comet began to sell in about 2000, and he also met Mr Andy Jennings, at the time a fellow-employee, who later joined him at Ixes. By late 2003, Mr Khan said, he was ready for a new challenge in his own business. After a short period assisting his brother in the latter's business, he acquired Ixes or, as it was then called, Revs (UK) Limited.

37. Revs (UK) Limited was incorporated on 4 November 2003. Mr Ayaz Ashraf (a friend of Mr Khan) was a director from incorporation until 3 February 2004, but from that date on the sole director, and beneficial owner of the shares, of Ixes has at all times been Mr Khan. The company changed its name to Ixes (UK) Limited on 6 October 2004.

38. Despite his experience in retailing domestic electrical goods, Mr Khan's evidence was that his initial intention had been to export electricity generators. In May 2003, Mr Khan said, he had visited a customer of his brother's company in the United Arab Emirates, hoping to sell it generators manufactured in the UK, by-passing and under-cutting the locally based authorised agents. The customer's director asked whether he could also supply mobile phones and this request, Mr Khan said, led him to investigate the feasibility of entering that market, though it was not altogether clear to us what research he undertook, beyond attending a trade fair in Germany in March 2004, shortly after he had acquired Ixes.

39. Against that background it is in our view rather odd that in Ixes' application for VAT registration, made almost immediately after Mr Khan acquired it, its current and intended business activities were (truthfully) described as "retail general motor factors". The value of its taxable supplies in the following twelve months was estimated to be £260,000, and the value of its EC trade was estimated as "none". The application was accepted and Ixes became registered for VAT with effect from 1 March 2004.

40. The oddity of Ixes' choice of trade at that time is emphasised by Mr Khan's further evidence that he had no experience in what the company was doing, that is making bulk purchases and retail sales of spare parts for cars. It is perhaps unsurprising in those circumstances that between its registration for VAT on 1 March 2004 and 31 March 2005, Ixes' turnover amounted to only £17,680. Mr Khan told us that in late 2004, realising he was in the wrong business, he decided to start afresh, by re-naming the company, moving to other premises, abandoning, or at least supplementing, trade in car parts and embarking instead on exports of generators and other goods. He made further contact with the customer of his brother's business—which, if Mr Khan's evidence is right, was engaged in precisely the same trade—with a view to arranging sales of generators.

41. On 7 March 2005 Ixes' accountants wrote to HMRC requesting a change from quarterly to monthly VAT returns on the basis that, it was said, the business of the company was "to change dramatically from just retail motor spares to include that together with exports of different types of goods". The letter said that Ixes had export orders to Dubai, worth in the region of £200,000, for chemical toilets, petrol generators and spare parts for pick-up trucks and that such export orders would continue "into the foreseeable future". The request was granted with effect from 18 March 2005. However, the claim was untrue: Ixes did not have any export orders, and indeed never traded in any of the items referred to by the accountants. Instead, in April 2005 (and, as it accepts, without any prior indication to HMRC), Ixes started trading in mobile phones. Since, as we shall explain, Mr Khan by then knew a good deal about HMRC's attitude to wholesale dealers in mobile phones, it is an inevitable conclusion that what was said about Ixes' intentions was a deliberate deceit, designed to secure the advantage of making monthly returns which would probably have been refused had HMRC known the truth.

42. At about the same time Mr Jennings joined the company as an employee, and he and Mr Khan undertook all of its trades; there were no other employees. The intention, Mr Khan said, was to deal in different types of electrical goods but it appears that all of its trade, from April 2005 on, was in mobile phones, with the exception of the two transactions in iPods we have mentioned. We observe in passing, since Mr Cunningham made an adverse comment about it, that although Mr Jennings attended the hearing he did not give evidence. We do not ourselves read much into this fact.

43. Mr Khan's evidence was that Ixes had become a member of an internet trading organisation, specifically devoted to wholesalers of mobile phones dealing in the grey market, and that its doing so had enabled him and Mr Jennings to establish contacts and build up the business rapidly. He mentioned its first two deals, in April 2005, both exports, and described them as "small". As the first was worth almost £200,000 and the second over £400,000, and the value of those two deals alone over 30 times Ixes' turnover for the entirety of the previous 13 months, that seems a rather strange description. In fact, Ixes' turnover increased very rapidly: in the five-month period to 31 August 2005, it amounted to £20,727,072, and for the whole of the year ending 31 March 2006 it was £84,347,895.

*The grey market*

44. The principal topic of Mr Fletcher's evidence was the so-called grey market in mobile phones, in which Ixes claimed it was trading—"grey" because it does not, at least directly, include manufacturers and authorised distributors. Mr Fletcher has, he told us, 15 years' experience in the telecommunications industry, in various capacities, and he is well acquainted with the different means by which mobile phones find their way from the manufacturer to the end user. He produced a clear and helpful report, on which he enlarged as he gave oral evidence. We accept Mr Fletcher as a well-informed expert on the topic although, as he acknowledged himself, the very nature of the market makes it necessary to treat the statistics and source material on which he relied with some caution. We also recognise that he has focussed on the European, rather than the global market, and that his doing so makes it necessary to treat his estimates of volumes with particular caution.

45. Mr Fletcher agreed that there is a genuine grey market, by which smaller retailers acquire handsets, since the manufacturers and network operators will not deal directly with them. Instead, authorised distributors aggregate smaller retailers' requirements and place with the manufacturers orders of a size they will entertain. Additionally, even large retailers and air-time providers sometimes make up for shortages of stock by buying in the grey market. Manufacturers have considerable control over the pricing of their products, so much so that Nokia sets uniform prices throughout the world. Other manufacturers do not, indeed they may deliberately set low prices in certain areas in order to build up market share. As prices for phones other than those manufactured by Nokia are not uniform in different countries, there is some scope for the making of profits by cross-border trade, although there are risks because the price of a particular model falls over time. Advance notice of price reductions is given by the manufacturers to authorised distributors, but is not disseminated further; thus dealers further removed from the manufacturer risk buying stock only to discover that its price has fallen, without warning, before a purchaser has been found.

46. Mr Fletcher explained in some detail that there are two main ways of profiting in the grey market: box-breaking, by acquiring handsets which are heavily subsidised in one country, modifying them for a different country, and selling them in that country at the higher price prevailing there; and arbitrage, by which authorised distributors, prevented by their agreements with manufacturers from buying and selling directly from and to each other in order to take advantage of price differentials, instead do so (with the "blind eye" acquiescence of the manufacturers) through intermediaries. In the case of Nokia handsets, the wholesale price of which is set once a month, throughout Europe, in euros, profit from arbitrage is possible in the United Kingdom only when there are significant movements of the euro against sterling in the period between one price setting and the next.

47. He thought it unlikely that Ixes was engaged in box-breaking, since (with the exception of Nokia handsets) the UK has the highest subsidies in Europe, while the phones dealt in by Ixes were to a continental specification, indicating that they had not been manufactured in order to be sold here. In addition, Ixes did

not have sufficient staff to undertake the work of re-configuring phones, and the brevity of the interval between their acquisition and sale made re-configuration impossible in any event. As Mr Khan did not claim that Ixes undertook any re-configuration we do not deal with this topic further. Mr Fletcher thought it unlikely too that it was engaged in arbitrage, since over 75% of the phones in which it traded in the relevant period were of Nokia manufacture, while the movements at that time between sterling and the euro were too small to make profits possible. In addition, he thought, the description of the specification of the phones traded which appeared on Ixes' and its customers' and suppliers' documentation was insufficiently detailed to be consistent with trade in such a market, where a high level of detail was the norm. It was also a characteristic of the arbitrage market that the chains of deals were very short, because of the low level of available profit, yet Ixes' deal chains were long.

48. Mr Khan was asked at some length about his own knowledge of the grey market in mobile phones. He said, in his statements, that he had undertaken research and had made extensive enquiries and, to take only one example, he gave us some statistics of the volume of trading in the grey market, and in the primary, or white, market in which authorised distributors and large retailers engage. We recognise, as Mr Lucraft emphasised, that Mr Fletcher, with the resources of a large firm of accountants behind him, was able to access material which was beyond the reach of a small trader, for reasons of price or because circulation was restricted, and that Mr Khan's knowledge and understanding of the market is not to be judged by the same standard. However, after initially seeking to justify them he eventually conceded that the statistics he gave of the volumes traded were based on nothing more than guesswork. In those circumstances, and despite the reservations we have mentioned, we prefer Mr Fletcher's evidence; no reliance can be placed on what Mr Khan said on this topic.

*The relevant transactions*

49. The 46 transactions we have briefly described above constituted the entirety of Ixes' trading during the months of March, April and May 2006; in other words, all of its transactions in that period led back, directly or indirectly, to defaulting traders. HMRC rely also on their tracing back of all of Ixes' deals in January and February 2006. There were 20 purchases followed by immediate sales of the same goods, and again all led to defaulting traders. Repayment of the input tax claimed by Ixes for those two months was made by HMRC, but on a "without prejudice" basis. Ixes accepts, now, that these transactions, too, were connected to fraud, as the Commissioners maintain.

50. The first of the deals in issue in this appeal took place on 6 March 2006, the last on 31 May. The Commissioners' enquiries show that in most cases the goods had already changed hands several times on the same day. Occasionally the earlier trades had occurred over two or, in one case, five days including a weekend. Those time-scales assume that all the relevant documents are correctly dated. There was some controversy about whether they were, but as we have no other evidence about dates we can find no more than that (as Mr Khan accepted) the deals in each chain took place in very quick succession. That conclusion is consistent with Mr Fletcher's evidence about the risk of sudden drops in price.

Ixes' policy was always to buy only when it had a purchaser—that is, it invariably exactly matched its purchases to its sales, and did not carry stock. Thus buying and selling on the same day was, for it, the norm.

51. We should add at this point that Mr Cunningham drew our attention to a number of cases in which goods appeared to have been shipped before they were sold and, in one case, were purportedly inspected at a warehouse in the United Kingdom after they had already left for the continent (we shall deal with inspections in more detail shortly). Mr Khan suggested that the timing on some of the documents might have been inaccurate, or the documents might have been incorrectly matched to Ixes' deals, and Mr Lucraft pointed out that the timings assumed by HMRC were dependent on the accurate setting of the fax machines used to transmit them. If the documents can be taken at face value they do lend support to Mr Cunningham's argument that they were generated for the purpose of preparing an audit trail, and were not documents coming into existence in the course of legitimate trading, but we recognise the force of Ixes' arguments, and treat the timing evidence with caution. All we feel able to find with confidence is that the goods entered the UK, changed hands several times and then left the UK within a very short period. In most cases that period probably did not exceed a single day.

52. The traders preceding Ixes in the chains all made gross profits measured in pence per unit; Ixes' gross profit varied, but was consistently much greater. With the one exception we have mentioned every trader, including Ixes, sold exactly what it bought: save for that one example there is no pattern of splitting or combining of consignments. Most consignments were of round numbers, the smallest 1,000 and the largest 15,000, but in some cases the quantity traded was not of a round number of items. There were no consignments of more than one model of phone. In every case Ixes bought from a UK supplier and sold to a continental customer; there is not a single instance of its having bought and sold within the UK, nor of its having bought from a continental supplier.

53. Since Mr Lucraft accepted on Ixes' behalf that every one of its purchases was of goods which had been dealt in by a fraudulent trader or a contra-trader, there is nothing to be gained by our describing each chain, or even Ixes' own purchases and sales, since nothing depends on their detail, and although they were fully documented in the written material produced for the hearing, we heard comparatively little oral evidence about them as individual transactions. It is, however, worth mentioning Mr Khan's evidence about how he and Mr Jennings managed to identify suppliers and customers, and how they negotiated deals.

54. He told us that Ixes relied to a significant extent on the website we have already mentioned for both purposes, that is in finding suppliers and customers with which, he said, Ixes traded over the longer term, and in identifying which traders wanted goods and which had them for sale. Although, as relationships with suppliers and customers became established, the identification of demand and availability was increasingly undertaken by telephone, Ixes continued to "post" its requirements on the website. As it happens, the length of Ixes' relationships with its suppliers and customers could be measured in months, but we recognise that it had been in business for only a short period and we read little into this fact. What

is puzzling, and Mr Khan could offer no explanation of it, is that so many traders were involved in chains of deals in goods when availability and demand were published on a website which could be accessed by any subscriber. Against that background it is difficult to understand why each of the relevant chains featured so many dealers, each of whom, by simple interrogation of the website, could as easily have found a supplier as Ixes.

*Inspections*

55. Ixes produced documentary evidence that it had arranged for the phones it bought to be inspected by a specialist inspection company at the premises of the freight forwarders in whose warehouse the phones were held while they were in the United Kingdom. In his first statement Mr Khan said, without qualification, that the inspection was performed to "confirm they were physically present and in good condition. This was done by opening the boxes. Our request was for one hundred percent of the phones to be inspected to ensure they contained the correct telephones and manuals." There are four features of the evidence about inspections with which we must deal.

56. First, the inspections were undertaken not, as one might perhaps expect, before Ixes handed over payment and accepted delivery, but immediately before the goods were shipped to its customer. Mr Khan was quite unable to explain to us why that was so. He suggested that Ixes' customer would want to be sure that the goods were in good condition, and that is no doubt true, but by the same token Ixes would want to satisfy itself before it handed over the price that it had received what it ordered, that the right quantity had been delivered, and that the goods were undamaged. We had no explanation of its practice of accepting goods without prior inspection.

57. Second, the documentary evidence did not support Mr Khan's claim of 100% open box inspections. The inspection reports provided to Ixes showed that some of the consignments had not been inspected, as it had requested, by opening each individual box and inspecting the contents but (as Mr Khan said as he gave oral evidence) by scanning the bar codes on the boxes, and subjecting them to x-ray examination to verify that the contents were as they should be. He explained that one inspection company used by Ixes did not offer open box inspections, and it had been compelled to accept something else. He was unable to explain why the assertion in his statement was nevertheless so unequivocal.

58. Third, Mr Khan was asked about the time required to open a box, inspect the contents, replace them and close the box, which he estimated at 10 to 15 seconds (Mr Foster told us he had done the exercise himself, and found it took about 90 seconds). In our view 10 seconds is impossibly short, and self-evidently so, but if we assume Mr Khan's higher figure of 15 seconds, itself difficult to believe even for a practised inspector, a consignment of 1,000 phones (the smallest of those in issue) would take 15,000 seconds or a little more than four hours, while the largest of Ixes' consignments, consisting of 15,000 phones, would take over 60 hours—or more than 15 hours if undertaken by a team of four. Since Ixes took delivery of goods which had already passed through several hands on the same day, then shipped them, again on the same day, to an overseas

customer, it is clear to us that there was not enough time for them to be inspected as Mr Khan claimed.

59. The fourth point, relied on by Mr Cunningham as a demonstration of Mr Khan's casual attitude to the inspections, was illustrated by one case in which Ixes bought what were described in its purchase order and in the supplier's invoice as central European specification phones, and sold the phones using the same description, yet the inspection report showed them to have 3-pin, UK-style plugs to their chargers. There was no evidence that Ixes, or its supplier or customer, had even noticed that the plugs did not match the specification. There was certainly no evidence that the difference between the specification and the goods was the subject of discussion or re-negotiation. Mr Khan's explanation was that it was unimportant as the chargers could be changed at minimal cost. We add, parenthetically, that it is a cause for wonder why, in that case, any of the traders troubled to include the specification on their documentation, and why, if it was so unimportant, the freight forwarders undertaking the inspections were asked to check and report on that aspect of the specification. Moreover, this claim is inconsistent with the assertion in Mr Khan's statement that the open box inspections were intended to ascertain whether the correct (that is, correct language) version of the manual was included in the box.

60. Mr Cunningham's cross-examination of Mr Khan about the inspections was designed to show that they were carried out for the sake of appearance, rather than because they afforded Ixes genuine protection against risk. In our view he succeeded: here as elsewhere we found Mr Khan's evidence evasive and unconvincing. The essential question, in our view, is whether inspections were carried out thoroughly, as a genuine means of obtaining assurance for Ixes that it had received what it had contracted to buy and that the phones were in good condition; or inspection reports were obtained for no more substantial purpose than to complete the paper trail, the bundle of deal documentation sent to HMRC with each VAT return. In our view Mr Khan's purpose was revealed by the nature of his evidence to be the latter.

*Ixes' relations with HMRC*

61. Mr Khan's evidence, throughout, was that he actively sought HMRC's guidance, did what was suggested or recommended, both by visiting officers and in HMRC publications, particularly Notice 726 (the Public Notice dealing with the possible imposition of joint and several liability for unpaid VAT, in accordance with s 77A of the Value Added Tax Act 1994), ceased trading with anyone about whom he had received any form of adverse information, and did his best to take every possible practical precaution. He also provided comprehensive documentation, supporting the repayments claimed, with each of Ixes' VAT returns. Conduct of that kind was indicative, Mr Lucraft argued, of an honest compliant trader. Moreover it was unfair of the Commissioners, having made no adverse criticisms, and having hitherto met Ixes' repayment claims without demur, suddenly and without warning to penalise it by refusing repayment of input tax incurred in purchases of goods from the same suppliers as Ixes had used before, and when those same goods were sold to established customers.

62. The Commissioners do not take issue with the underlying factual basis of that argument; they accept that Mr Khan was indeed cooperative, that he or Mr Jennings was always present when they called, that documentation was produced readily when requested and that Ixes' VAT returns were correctly prepared and supported by the transaction records. They also acknowledge that its repayment claims, before those with which we are concerned, had been met without adverse comment (save for the "without prejudice" reservation to which we have referred), that, as Notice 726 recommended, Ixes checked with their Redhill office on the VAT registrations of its suppliers and customers, that it did not deal directly with a defaulter, that it did not make and did not ask its customers to make third party payments, and that it not been warned by HMRC of concerns about any of its suppliers or customers. They accept that when Ixes was warned of a "hijack" in a chain leading to an intended purchase, it withdrew from that purchase. They acknowledge too that Ixes had not been told that the facility of making monthly returns, thus accelerating its repayments, might be withdrawn. Their case nevertheless is that Ixes' conduct in this respect was no more than a façade, designed to give the impression of a respectable trader. We shall return to this point.

*Due diligence and record keeping.*

63. Although a number of (in our view rather minor) criticisms of detail were made, it was accepted by HMRC that Ixes' due diligence documentation was complete and in good order. The Commissioners therefore do not criticise the due diligence undertaken by Ixes on its suppliers and customers in the sense that it was not done, or adverse results disregarded, but in the sense that it too was no more than window-dressing, something done for the purpose of showing that the checks suggested by Notice 726 had been carried out, and in order to collect pieces of paper designed to impress but with no real purpose to them. It is, we think, sufficient for us to comment that the due diligence seemed to us to be somewhat superficial and formulaic, consisting as it did of the collection of copies of certificates of incorporation and of VAT registration, together with the completion of some rather rudimentary questionnaires. There was no evidence that Ixes carried out credit checks on its suppliers or customers—Mr Khan said that they were unnecessary as Ixes did not extend credit. Perhaps more importantly, as we shall explain, there was no evidence that any of its suppliers carried out credit checks on Ixes.

64. Mr Lucraft made a number of observations about the due diligence and other records taken up by HMRC officers from traders which preceded Ixes in the chains. In many cases they were incomplete and in very poor order, sometimes being left scattered on the floor of abandoned premises. In other cases records or partial records had been handed over, or shown to the officers, only with reluctance. Despite clear indications that traders were not complying properly with their obligations, in many cases clearly undertaking no due diligence at all, Mr Lucraft complained, HMRC did not de-register them or did so without any apparent sense of urgency and, in one case, re-registered a trader which had been de-registered, even though it was perfectly clear from the evidence in HMRC's hands that it was non-compliant.

65. These complaints were accepted to be factually correct. The explanation we were offered was that as the traders were making, or appeared to be making, taxable supplies of goods, HMRC had no choice but to register them, or continue their existing registrations. As a proposition of law that may be right, and we accept that HMRC have finite resources, but we nevertheless agree with the thrust of Mr Lucraft's argument that more effective policing of the traders might have helped innocent businesses becoming embroiled in it. Whether, as he argued, Ixes was an innocent trader is of course the issue we must decide.

*Mr Khan's evidence about Ixes' trading*

66. Mr Khan accepted that he was well aware, before Ixes embarked on trade in mobile phones, that such trade was commonly used as a vehicle of fraud, and that he was correspondingly anxious to ensure that Ixes engaged only in legitimate trade. He informed himself of HMRC's guidance and requirements, followed them, and also actively sought further advice and guidance from visiting officers. It was apparent as he gave his oral evidence that Mr Khan was very familiar with the contents of Notice 726, though it also became clear, as Mr Cunningham pointed out, that he was rather more familiar with those parts of it from which traders might derive comfort than with the warnings. We add in passing that while the Notice deals with trade in mobile phones, it does so from the perspective of s 77A, and not by reference to the *Mobilx* test: the Notice predates the Court of Appeal's judgment by several years. It is not argued that Ixes failed to undertake the checks recommended in Notice 726; the argument is that they were undertaken for the sake of appearances.

67. We have already recorded our reservations about the statistical parts of Mr Fletcher's evidence, and we attach little weight to the differences, large though they were, between his estimates of the volumes of goods traded and the much higher estimates or, as they turned out to be, guesses advanced by Mr Khan. Though he put those guesses forward by way of explanation of Ixes' ability to find and deal in very large quantities of goods, in our view that feature of the case has greater importance from a different perspective, to which we shall come. What was conspicuous about the evidence relating to the grey market was that whereas Mr Fletcher gave a clear, reasoned account of the ways in which profits could be made by dealing in mobile phones, Mr Khan's answers to Mr Cunningham's questions, even though he had had the benefit of reading Mr Fletcher's statements and hearing his oral evidence, revealed that he had almost no understanding of the market and how Ixes' transactions fitted, or supposedly fitted, into it.

68. His evidence of his having undertaken research was at best vague and superficial, and we consider it implausible that he made any real effort to understand the market in which Ixes claimed to be engaged—indeed, we are quite sure Mr Cunningham was right to argue that not only his estimates of the volumes of goods traded but the remainder of what he said about the market was little more than guesswork. It was clear from his demeanour that, despite Mr Fletcher's explanation of them, he barely understood the concepts of box-breaking and arbitrage, and he plainly was not familiar with manufacturers' pricing policies. It

is conspicuous too that in none of the chains is there to be found a manufacturer, authorised distributor, substantial retailer or air-time provider.

69. Mr Khan was asked why, almost without exception, the phones in which Ixes dealt had a continental specification. We have already mentioned his casual attitude to the inspection report which revealed that supposedly continental specification phones were in fact accompanied by chargers with UK plugs. We formed the distinct impression that this was a factor which he had not really considered before, since the explanation he gave did not fully address the point. As before, he said—and this we can accept, since it accords with Mr Fletcher' evidence—that the cost to a dealer of chargers bought in large quantities would be small. Thus (as Mr Fletcher also agreed) phones manufactured for retail sale on the continent could be brought to the UK and, given adequate manpower resources, have their chargers replaced, and become acceptable for retail sale within the UK. We add parenthetically that it was not only Ixes which had no staff or facilities for undertaking the replacements; none of Ixes' suppliers were capable of doing so either. What is more important is that the phones had plainly not been brought to the UK for the purpose of conversion. Typically, they entered the country early in the day, passed rapidly through the hands of several dealers before reaching Ixes which sold them, unchanged, to a continental customer. Mr Khan agreed that he realised that the goods in which Ixes was dealing had been manufactured for use on the continent and then brought to the UK before Ixes exported them again.

70. It is a complete mystery to us why traders in a genuine market should incur the transport and insurance costs of transferring such consignments to and then immediately from the UK, even if the costs were split between two traders. As the documents secured by the HMRC officers showed, it was commonplace for the goods to remain in the premises of a single UK freight forwarder while (assuming the trade was genuine) various dealers negotiated sales and purchases by telephone and email before the chain of deals was concluded, the prices were paid, and the goods were released successively from one trader to the next in the sequence. Since, it seems, none of the traders personally inspected the goods, and it is perfectly plain that none were ever converted to a UK specification, it is not clear to us why such phones were ever brought to the UK, at least until it was known they would find a final purchaser here; they could as easily have been stored, inspected and released in their country of origin, travelling to the UK only if an end user was found here. The only evident explanation of the transfers is that goods need to cross national borders in order that sales of them can be zero-rated.

71. Mr Khan was asked to explain how it was that Ixes could enter into transactions worth millions of pounds, although it had negligible capital—only two £1 shares had been issued. It is in this context that we consider the size of Ixes' deals to be important. He answered that he ploughed back its profits, and relied on loans. We accept that this is a partial explanation, though it is a far from adequate answer, even allowing for Mr Khan's clearly very rudimentary understanding of capital. His evidence was also that Ixes did not release goods to its customer until the price was paid in full, and that it did not have to pay its supplier until it had itself been paid. That practice, if applied rigorously, would certainly reduce the amount of capital Ixes needed to finance its trade, but the

capital required was still formidable. A single example will suffice. On 24 April 2006 Ixes bought 15,000 phones (this was, in fact, its largest transaction) for an aggregate price of £7,920,000 plus VAT of £1,386,000 and sold them for £8,396,250. As the sale was to an overseas customer, it charged no VAT. The difference between the gross purchase price and the proceeds of the sale was £909,750. Ixes expected, of course, to recover this sum from HMRC but it would not be able to do so until its April 2006 return had been submitted and processed. It had also to bear the costs of inspecting, insuring and transporting the goods. And this was not an isolated deal: there were nine others in the month. Although they were smaller the input tax Ixes incurred was in every case measured in hundreds of thousands of pounds. Thus the amount of capital needed to fund the payments to its suppliers while Ixes waited for repayment of its input tax claims was very substantial.

72. There was very little evidence of terms and conditions of trade between the various participants in the chains: the stipulation that the agreed price must be paid before the goods would be released (that is, an instruction given to the freight forwarder to hand the goods over to the customer), which appeared on every invoice, was the only condition we saw. This requirement, which Ixes did seem, as a general rule, to enforce, protected it from the risk of non-payment in that Ixes would not have parted with the goods if it was not paid, but did not protect it from the risk that the customer would be unable to pay for goods Ixes had committed itself to buy. There was nothing before us, and nothing in Mr Khan's evidence, to show that Ixes took any steps to protect itself against this eventuality. It is perhaps a minor point, but we also cannot help wondering how each trader in a chain which might extend to five or six was able to release goods to its own customer, which had paid the price and expected immediate release, before it had paid its own supplier and the goods had been released to it. It is conspicuous too, though again perhaps a minor point, that there is no evidence that any consignment of goods in which Ixes dealt was ever shown on inspection to be short, damaged or, with the one exception we have mentioned, of the wrong specification (although the model of phone in that instance was correct).

73. It appears to be true that Ixes ploughed back most of its profits—and Mr Khan's evidence on this point was not challenged—and there was some, though limited, evidence of loans. There was also evidence that on occasion Ixes had paid its suppliers only partially, making up the balance of the price later. This practice—despite the stipulation on the supplier's invoice that goods would not be released until the price had been paid in full—clearly did make it easier for Ixes to finance its transactions. However, one can only wonder what trader in a genuine market would be willing to extend credit in this way to a purchaser which was selling goods on (as the supplier must have known) to another trader—in the event an overseas trader—about whom the supplier knew nothing. There was no evidence of any agreements between Ixes and its suppliers by which credit was provided for, and the consequences of default spelt out. There was similarly no evidence that any supplier made credit checks of Ixes or took security, even in the shape of a director's personal guarantee. It was all done, so Mr Khan said, on the basis of trust.

74. We make it clear at once that we do not accept Mr Khan's evidence about the willingness of Ixes' suppliers to extend credit to it. However much trust there might have been between Ixes and its suppliers (with which it had been dealing for, at most, a year), no rational trader in a legitimate market would extend credit of hundreds of thousands, if not millions, of pounds to another without a written agreement recording the arrangement and setting out its terms. It is conspicuous that, despite the claimed relationships of trust, Ixes did not seek to introduce any evidence from its suppliers about the topic. The only reasonable conclusion is that its suppliers were casual about payment because they knew that the trading was nothing more than a contrivance, that these were not genuine arm's-length deals, and that the payments, like the deals themselves, were pre-arranged between traders who all knew what was to happen. A similar conclusion follows from Ixes' failure to protect itself against the risk that its customer would be unable to pay: that Mr Khan knew there was no risk that would happen.

*Discussion*

75. We begin with the core of Mr Lucraft's argument, which breaks down into two components: was there any scheme to defraud?; and, if there was, was Ixes a knowing participant in that scheme (taking "knowing" to include should have known)? We have already made the point that the demonstration of a scheme is not necessary for the Commissioners to succeed, but it is a pleaded element of their case and it should be dealt with. Of course, the demonstration of a scheme does not of itself mean that the Commissioners are bound to succeed; they must in addition show that a trader knew or had the means of knowing some at least of the relevant facts. Thus the second of the two components is the central issue in the appeal, with which we shall deal at greater length below.

76. Mr Lucraft emphasised that Mr Khan was a man of good character, and he placed particular reliance on his experience in the electronics business, particularly in his career with Comet. We accept that he had some knowledge of electronic goods, while making the observation that retail sales by a high-street trader are some way removed from the wholesale deals in which Ixes was engaged. We have already accepted that Ixes undertook the checks recommended by HMRC in Notice 726, carried out some (even if, as we have indicated, rather superficial) due diligence into its suppliers and customers, maintained comprehensive records of its deals and its checks, and was cooperative whenever officers visited it. One can, as Mr Lucraft urged us to do, regard that evidence as indicative of Mr Khan's honesty. Ixes' conduct could, instead, be seen as precisely what one would expect of a trader hoping to recover large sums of input tax from HMRC—any deficiency, in record keeping or in cooperation, would be likely to lead HMRC to refuse, or at least to be difficult about, the claimed repayments. Mr Khan's demeanour was such that we are satisfied that the second of those alternatives is much the more likely.

77. One feature of the case is that Ixes had a small number of suppliers and a smaller number of customers. Mr Khan told us that this was a matter of choice. It dealt with a limited circle of apparently reliable traders, with whom it had traded for some time before the relevant period, because it believed that by doing so it was reducing its exposure to risk. Despite numerous visits by HMRC officers, it

had not been warned that any of its suppliers or customers was suspected of involvement in fraud, and it was not told until after the relevant transactions had been concluded that any of the goods in which it had dealt could be traced back to an earlier fraud. Indeed, its claims for repayment of input tax incurred in transactions with the same suppliers and customers in earlier months had been met without demur. Mr Lucraft argued that any trader in that position was entitled to take the view that he was acting in a responsible manner, and that if he carried on trading in the same way his repayment claims would continue to be met.

78. There is at first sight some merit in that argument and we accept, as Mr Lucraft pointed out, that Ixes was in a different position from Mobilx, which had been told several times that its deals traced back to defaulters before HMRC decided to refuse its claims for repayment of input tax. Mr Lucraft made also the, similarly at first sight forceful, point that HMRC had spent two years tracing the relevant chains (and had not completely succeeded even after all that time). How, he asked rhetorically, could Mr Khan, who did not have the Commissioners' resources at his disposal, and did not have the benefit of hindsight, possibly have discovered who had dealt in the goods before Ixes acquired them, and that those traders, or some of them, had fraudulent intentions? Whatever might be our view of the quality and depth of Ixes' due diligence, we accept Mr Lucraft's point that it was successful in as much as Ixes did not itself deal with a defaulter. The fact that there was fraud elsewhere was not inconsistent with Mr Khan's argument that he was trying to make a legitimate profit in what he believed to be a genuine market; it was not possible to undertake due diligence into a supplier's supplier, whose identity was unknown.

79. However, those arguments beg the question, since they assume for their validity Mr Lucraft's intended result, namely that Mr Khan embarked on trade in mobile phones believing it to be a legitimate business. Were that the case, we would accept that nothing was said to him by HMRC officers that should have made him realise that his deals led back to defaulters, or that there were concerns about his suppliers or customers (although, as he himself accepted, there were many warnings about the trade as a whole). If, however, Mr Khan was a knowing participant in fraudulent chains, the absence of warnings and the difficulty, or apparent difficulty, of finding out for himself that there was a connection between Ixes' transactions and frauds elsewhere are irrelevant.

80. As will be readily apparent from what we have already said, we found Mr Khan to be a wholly unsatisfactory witness who dealt with what he obviously perceived to be difficult questions by prevarication and, when pressed, by evasion. There was very little about what he told us which we considered to be reliable, not least because his written statements, even though prepared by Ixes' solicitors, were internally inconsistent and often inconsistent with his oral evidence. Several times in cross-examination he changed his evidence when, as was quite clear, he realised that an earlier answer did not give the impression he desired, or did not match the documentation, as in the case of his evidence about inspections, with which we have already dealt. Where his evidence conflicted with that of another witness, we prefer that of the other witness. We were left with no impression of a man doing his honest best to steer away from suspicious transactions; Mr Khan's whole demeanour was that of someone who knew very well that the trade in

which Ixes engaged was profitable because, and only because, it was rife with fraud, who knew very well how the fraud worked, and who set out with the intention of profiting from what, until HMRC began to refuse traders' repayment claims, seemed to be a very easy way of making money. The greatest difficulty which Ixes faces in this appeal is, in a nutshell, Mr Khan himself.

81. It is also difficult if not impossible to understand why Mr Khan ever embarked on wholesale dealing in mobile phones if his own evidence is right. He has some experience in dealing in phones, but as the manager of a high-street retail store, dealing in many types of electrical goods, and no experience of wholesale trade. He had some, but limited, experience of exporting, though not of mobile phones. Yet he began to make large exports of mobile phones, knowing that he was entering a market in which fraud was endemic. No honest person would do such a thing. If he should happen to blunder into such a market, he would soon ask himself how it was that he, a newcomer, could identify suppliers and customers with such ease; as we have mentioned, in the space of five months and from a standing start, Ixes had turned over £20 million. It defies belief that anyone could consider that a normal phenomenon.

82. It is true, as Mr Lucraft said, that the trade was in high value goods, but his and Mr Khan's claim that mark-ups were low is true only of the buffer traders (*ie* those buying from and selling to other UK dealers). As our description of Ixes' deals mentions, it was constantly making gross profits of a few pounds on each item. We accept that Ixes had to bear the cost of transporting the goods to its continental customer, but its ability, as a newcomer to the trade, to find customers not occasionally, but consistently, willing to pay a price which left Ixes with a good profit is remarkable. One can ask rhetorically why it was that Ixes was able to identify its suppliers and customers without apparent difficulty, while others (as we most assume was the case, if the trade was genuine) were not, despite the website advertising of stocks about which Mr Khan told us, and instead were able to make only a few pence per unit on each deal. The obvious and inevitable conclusion is that Mr Khan's claims cannot be true.

83. Mr Lucraft drew our attention, as we have said (see para 22 above), to Moses LJ's description of the paradigm trader who has lost the right to deduct. We think however it is necessary to consider also the proposition which immediately followed that description:

> "The extension of that principle [of forfeiture of the right to deduct] to a taxable person who has the means of knowledge but chooses not to deploy it, similarly, does not infringe that principle [of legal certainty]. If he has the means of knowledge available and chooses not to deploy it he knows that, if found out, he will not be entitled to deduct. If he chooses to ignore obvious inferences from the facts and circumstances in which he has been trading, he will not be entitled to deduct."

84. The overall difficulty with Ixes' arguments, as we see it, is that they do not address the *Mobilx* test. The question is not whether the trader concerned set out with the best of intentions (which we do not accept Ixes did) nor, as we have said, whether he knew or should have known the detail of any frauds tainting the goods in which he dealt, but whether there was any plausible explanation for the transactions into which he entered other than that they were connected with fraud.

It does not require the deployment of large resources, but merely the application of thought, to recognise that easy sales and purchases, rapidly generating a huge turnover for a novice in the market, of goods available within the UK but, apart from the one exception we have mentioned, with a continental specification, and with no or negligible risk, are not consistent with the workings of a legitimate market.

85. When one stands back and views the larger picture, as both Moses LJ and Christopher Clarke J indicated was the appropriate course, it is in our view plain that trade of the kind in which Ixes engaged is compatible only with there being an overall scheme to defraud. There were too many transactions, with too many similarities, with too many participants dealing in goods worth millions of pounds but without any contractual protection, for it to be otherwise. But although that conclusion helps HMRC, it does not, as we have said, satisfy the *Mobilx* test. We must ask ourselves whether, when it entered into each of its transactions Ixes knew that it was connected with fraud. We recognise that some of the evidence available to us would not have been available to Ixes at the time it entered into the transactions, and we repeat that Ixes is not to be judged with the benefit of hindsight.

86. Mr Khan was, to summarise what we have already said, an evasive witness who contradicted himself several times and who plainly knew little about the legitimate grey wholesale market in mobile phones. We are quite satisfied, by contrast, that he understood perfectly the market in which Ixes was engaged, and that he knew very well, and intended, when deciding to embark on transactions in mobile phones, that Ixes would be sharing in the proceeds of fraud. His demeanour was not that of a man who had unwittingly, and despite his best efforts, been drawn into frauds committed by others, but of one who deliberately and knowingly set out to benefit from what appeared at the time to be an easy way of making a lot of money. It does not matter whether there was "an overall scheme" or merely a constant repetition of an arrangement which seemed to succeed in its purpose, and it does not matter whether Mr Khan knew the details of the other transactions and traders in the chains; it is sufficient that he knew, as we find he did, that Ixes' transactions were connected with fraud.

87. In reaching that conclusion we have not disregarded Mr Lucraft's argument that there was no evidence before us, in the form of emails or other written communications between the participants, that the transaction chains were orchestrated, nor have we overlooked his point that it required only one trader to break ranks for the scheme, if there was a scheme, to collapse. Although, as we have said, it is not necessary to decide whether was a scheme, we are satisfied there was, and that Ixes and all the other participants in the chains almost certainly undertook a pre-arranged sequence of deals. It is quite possible there is no document detailing the sequences, but one would not normally expect fraudsters to document their intentions, and then make that document available to a policing authority; they would do their best to conceal it. And there would be little incentive for any participant to break ranks since, as examination of the chains immediately reveals, as long as the scheme worked there were ample rewards for little work. Even the buffers, who made the least profit, could earn £1000 or more for simply generating a purchase order and an invoice, and arranging the transfer

of funds: the evidence showed that they rarely, if ever, handled the goods or even inspected them, arranged for their transfer or indeed did anything which required more than nominal effort.

*Conclusions*

88. There is no doubt in our minds that Mr Khan knew perfectly well, when Ixes embarked on transactions in mobile phones, that it was involving itself in a dishonest trade. We reject the claim that Ixes was a serious trader in a genuine market; we have concluded, instead, that it was the paradigm trader described by Moses LJ in *Mobilx*. Mr Lucraft did not suggest any basis on which we might reach a different conclusion in respect of the two transactions in iPods, and we see none ourselves.

89. It follows that the appeal must be dismissed, in respect of all of the 46 transactions. Applying the provisions of para 7 of Sch 3 to the Transfer of Tribunal Functions and Revenue and Customs Appeals Order 2009, we direct that Ixes pay the Commissioners' costs of and incidental to the appeal, to be the subject of detailed assessment on the standard basis by a costs judge of the High Court if they cannot be agreed.

90. This document contains full findings of fact and reasons for the decision. Any party dissatisfied with this decision has a right to apply for permission to appeal against it pursuant to Rule 39 of the Tribunal Procedure (First-tier Tribunal) (Tax Chamber) Rules 2009. The application must be received by this Tribunal not later than 56 days after this decision is sent to that party. The parties are referred to "Guidance to accompany a Decision from the First-tier Tribunal (Tax Chamber)" which accompanies and forms part of this decision notice.

91.

**Colin Bishopp**

**Tribunal Judge**

**Release Date: 8 September 2011**