TC02859

Appeal number: TC/2010/09084

VALUE ADDED TAX – input tax – denial of right to deduct on grounds that the Appellant knew or should have known that the transaction was part of fraud by others – alleged MTIC – whether shown that the Appellant's transactions connected with fraudulent evasion of VAT – yes – whether Appellant "knew or should have known" of fraud – yes – valid refusal of right to deduct – appeal dismissed

FIRST-TIER TRIBUNAL
TAX CHAMBER

CHURCH LANE DEVELOPMENTS LIMITED **Appellant**

- and -

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

TRIBUNAL: JUDGE J. BLEWITT
MR. P. WHITEHEAD

Sitting in public at Manchester on 10 and 11 April 2013

The Appellant did not attend and was not represented

Miss Linklater, Counsel instructed by the Respondents

DECISION

Introduction

1. This is an appeal against HMRC's decision, contained in a letter to Church Lane Developments Ltd ("Church Lane") dated 25 August 2010 denying it entitlement to the right to deduct input tax in the total sum of £1,344,000 claimed in the VAT quarterly accounting periods 10/06, 11/06 and 12/06. The disputed input tax was incurred in the purchases of Rogue Penguin software. HMRC say, as set out in its Statement of Case that the input tax incurred by the Appellant was done so in a transaction or transactions connected with the fraudulent evasion of VAT and that the Appellant knew or should have known of this fact. The Appellant maintains that it did not know and had no means of knowing that its transactions were connected with such fraud.

2. Miss Linklater of Counsel appeared on behalf of HMRC. The Appellant did not attend and was not represented. In a letter dated 11 March 2013 Mr Belfield informed the Tribunal that he would not be attending the hearing as the Appellant *"is not in a position to financially defend itself. Its director in an attempt to defend himself previously, has lost his home to pay for QC fees and been homeless for a short period of time…he has now been able to gain employment but is unable to take two weeks off for the Tribunal nor is he able to fund representation."* The Tribunal was invited to make a decision in the Appellant's absence. Despite a direction by the Tribunal dated 21 March 2013 requesting evidence in support of the Appellant's assertions regarding financial difficulties, none was forthcoming. HMRC made an application dated 3 April 2013 to strike out the case on the basis of the Appellant's failure to comply with the Tribunal's direction and its general lack of co-operation. The Tribunal refused the application on the basis that although it took a serious view of the Appellant's failure to comply, the interest of justice would not be served by denying the Appellant a hearing where Mr Belfield's financial and employment positions may prevent him from attending or being represented at the hearing and it considered the letter dated 11 March 2013 did not constitute a formal withdrawal of the appeal but rather a request that the hearing proceed in the Appellant's absence.

3. HMRC also applied for the witness statement of Mr Belfield to be excluded from proceedings. The Tribunal was not minded to grant this application; we took the view that it was in the interests of justice for the statement to be admitted given that the hearing was to proceed in the Appellant's absence however the weight to be attached to the evidence is a separate matter to which we will turn to in due course.

4. We heard evidence from Mr Ceris Arfon Jones, the Case Officer of HMRC responsible for issuing HMRC's decision following review of the extended verification of VAT periods 10/06, 11/06 and 12/06.

5. Other witnesses who were not called to give evidence but whose statements stood as their evidence were:

- Mr Rod Stone, HMRC Officer who provides an overview of the general nature and features of MTIC fraud;

- Mr Phillip Sarocka, an operational accountant and officer of HMRC who provided comment on the loan agreement dated 30 January 2007 berween the Appellant and Lorimer Holding & Finance Limited BVI ("Lorimer");

- Mr Jonathan Vogler, a specialist in multi-user computer systems who was instructed by HMRC to provide a report as to the value of Rogue Penguin Software;

- Ms Nuala Harvey who provided a statement regarding Churchill International Trading Limited ("Churchill"), a trader which HMRC describe as acting as a "blocker";

- Ms Vivien Parsons who provided a statement in respect of Step 1 Solutions Limited ("Step 1"), an alleged contra-trader;

- Ms Theresa Launder who provided a statement in respect of James Barclay Limited, a trader which supplied Step 1;

- Mr Stephen Jenner who provided a witness statement in respect of Fairford Group Plc ("Fairford") which acted as a broker and acquirer in the period 12/06 and which supplied Rogue Penguin Software to the Appellant; and

- Ms Verna Gellvear who provided a witness statement in respect of Mobile One Limited ("Mobile One"); an alleged contra trader which supplied goods despatched by Fairford.

Missing Trader Intra-Community Fraud

6. It may assist in understanding the facts of this case to give a brief overview at this point of the description coined by HMRC and which applies to this case; contra-trading. Essentially contra trading is a variation on MTIC trading. In *HMRC and Livewire & HMRC and Olympia Technology Ltd* [2009] EWHC 15 (Ch) *at paragraph 1* Lewison J provided this clarification as to the different forms that MTIC fraud can take:

"i) In its simplest form it is known as an acquisition fraud. A trader imports goods from another Member State. No VAT is payable on the import. He then sells on those goods to a domestic buyer and charges VAT. He dishonestly fails to account for the VAT to HMRC and disappears. The importer is labelled a "missing trader" or "defaulter".

ii) The next level of sophistication involves both an import and an export. A trader once again imports goods from another Member State. No VAT is payable on the import. Typically the goods are high value low volume goods, such as computer chips or mobile phones. He then sells on those goods to a domestic buyer and

charges VAT. He dishonestly fails to account for the VAT to HMRC and disappears. The domestic buyer sells on to an exporter at a price which includes VAT. The exporter exports the goods to another Member State. The export is zero-rated. So the exporter is, in theory, entitled to deduct the VAT that he paid from what would otherwise be his liability to account to HMRC for VAT on his turnover. If he has no output tax to offset against his entitlement to deduct, he is, in theory, entitled to a payment from HMRC. Thus HMRC directly parts with money. Sometimes the exported goods are re-imported and the process begins again. In this variant the fraud is known as a carousel fraud. There may be many intermediaries between the original importer and the ultimate exporter. These intermediaries are known as "buffers". The ultimate exporter is labelled a "broker". A chain of transactions in which one or more of the transactions is dishonest has conveniently been labelled a "dirty chain". Where HMRC investigate and find a dirty chain they refuse to repay the amount reclaimed by the ultimate exporter.

iii) In order to disguise the existence of a dirty chain, fraudsters have become more sophisticated. They have conducted what HMRC call "contra-trading". The trader who would have been the exporter or broker at the end of a dirty chain, with a claim to repayment of input tax, himself imports goods (which may be different kinds of goods) from another Member State. Because this is an import he acquires the goods without having to pay VAT. This is the contra-trade. He sells on the newly acquired goods, charging VAT but this output tax is offset against his input tax, resulting in no payment (or only a small payment) to HMRC. The buyer of the newly acquired goods exports them and reclaims his own input tax from HMRC. Again there may be intermediaries or buffers between the contra-trader and the ultimate exporter. The fraudsters' hope is that if HMRC investigate the chain of transactions culminating in the export, they will find that all VAT has been properly accounted for. This chain of transactions has conveniently been called the "clean chain". Thus the theory is that an investigation of the clean chain will not find out about the dirty chain, with the result that HMRC will pay the reclaim of VAT on the export of the goods which have progressed through the clean chain."

7. In the present case, one which involves "contra-trading" the Appellant was in all transactions supplied by Fairford. HMRC's case is that Fairford was a contra-trader which was in turn supplied by 2 other contra-traders; Mobile One and Step 1 Solutions. We should note that throughout this decision the use of the terms "contra-trading", "clean chain" and "dirty chain" are used for the purposes of convenience and without any inference of pre-judging the issue.

8. It is the case for HMRC that the contra-trade transactions formed part of an overall MTIC fraud scheme involving a network of companies and chains of contrived transactions the sole aim of which was to defraud the Revenue.

The Legislation

9. The legislation governing the right to deduct is contained within Sections 24 – 26 of the Value Added Tax Act 1994 and the VAT Regulations 1995.

10. The provisions are in mandatory terms; if a trader has incurred input tax, which is properly allowable, he is entitled, as of right, to set it against his output tax liability or to receive a repayment if the input tax credit due to him exceeds that liability. A trader is required to hold evidence to support his claim (under article 18 of the Sixth Directive and Regulation 29 (2) of the Value Added Tax Regulations 1995 (SI 1995/2518)). The right to deduct or right to a repayment is absolute and there is no discretion on the tax authority, save that the authority may accept less evidence that normally required.

Burden and Standard of Proof

11. In *Mobilx Ltd and The Commissioners for Her Majesty's Revenue and Customs, The Commissioners for Her Majesty's Revenue and Customs and Blue Sphere Global Ltd, Calltel Telecom Ltd & another and The Commissioners for Her Majesty's Revenue and Customs* [2010] EWCA Civ 517 ("*Mobilx*") the burden and standard of proof to be applied in this type of appeal was clarified by Moses LJ at paragraphs 81 and 82:

"*It is plain that if HMRC wishes to assert that a trader's state of knowledge was such that his purchase is outwith the scope of the right to deduct it must prove that assertion.*

But that is far from saying that the surrounding circumstances cannot establish sufficient knowledge to treat the trader as a participant...Tribunals should not unduly focus on the question whether a trader has acted with due diligence. Even if a trader has asked appropriate questions, he is not entitled to ignore the circumstances in which his transactions take place if the only reasonable explanation for them is that his transactions have been or will be connected to fraud. The danger in focussing on the question of due diligence is that it may deflect a Tribunal from asking the essential question posed in Kittel, namely, whether the trader should have known that by his purchase he was taking part in a transaction connected with fraudulent evasion of VAT. The circumstances may well establish that he was"

12. The standard of proof to be applied is the ordinary civil standard, namely whether, on the balance of probabilities, HMRC have proved either that the Appellant knew or should have known that the transactions in which it was taking part were connected with fraud.

Case Law

13. The European Court of Justice in *Optigen Ltd and Others v HMRC* [C-354/03] ("*Optigen*") made it clear that output tax can be recovered even though the transaction is outside the VAT scheme. It was confirmed in the cases of *Kittel v Belgium, Belgium v Recolta Recycling* [2008] STC 1537*("Kittel")* and *Mobilx Ltd (in administration) v HMRC* [2009] STC 1107 that there is no discretion on the part of the Authorities to withhold any tax repayment where the objective criteria for compliance with the VAT regime are met. However where a trader does not comply with the objective criteria because there is a fraud, that trader cannot recover any tax.

The case of *Kittel* extended the concept of knowledge to include a trader who ought to have known that there was a fraud and the test was further clarified and refined by Moses LJ in *Mobilx* at paragraph 24:

"The scope of VAT is identified in Art. 2 of the Sixth Directive. It applies, in addition to importation, to the supply of goods or services effected for consideration within the territory of the country by a taxable person acting as such. A taxable person is defined in Art. 4.1 as a person who carries out any of the economic activities specified in Art. 4.2. Art. 5 defines the supply of goods and Art. 6 the supply of services. The scope of VAT, the transactions to which it applies and the persons liable to the tax are all defined according to objective criteria of uniform application. The application of those objective criteria are essential to achieve:-

> *"the objectives of the common system of VAT of ensuring legal certainty and facilitating the measures necessary for the application of VAT by having regard, save in exceptional circumstances, to the objective character of the transaction concerned." (Kittel para 42, citing BLP Group* [1995] ECR1/983 para 24.)…

...the Court made clear that the reason why fraud vitiates a transaction is not because it makes the transaction unlawful but rather because where a person commits fraud he will not be able to establish that the objective criteria which determine the scope of VAT and the right to deduct have been met…

…A person who has no intention of undertaking an economic activity but pretends to do so in order to make off with the tax he has received on making a supply, either by disappearing or hijacking a taxable person's VAT identity, does not meet the objective criteria which form the basis of those concepts which limit the scope of VAT and the right to deduct (see Halifax § 59 and Kittel § 53). A taxable person who knows or should have known that the transaction which he is undertaking is connected with fraudulent evasion of VAT is to be regarded as a participant and, equally, fails to meet the objective criteria which determine the scope of the right to deduct."

14. The position was summarised by Lewison J in *Brayfal Ltd v HMRC* [2011] UK UT B6 (TCC) as follows:

"A taxable person who knows or should have known that the transaction which he is undertaking is connected with fraudulent evasion of VAT is to be regarded as a participant and fails to meet the objective criteria which determine the scope of the right to deduct…

The principle does not extend to circumstances in which a taxable person should have known that by his purchase it was more likely than not that his transaction was connected with fraudulent evasion. But a trader may be regarded as a participant where he should have known that the only reasonable explanation for the circumstances in which his purchase took place was that it was a transaction connected with such fraudulent evasion…

The test is simple and should not be over-refined. It embraces not only those who know of the connection but those who "should have known"…

…Tribunals should not unduly focus on the question whether a trader has acted with due diligence. Even if a trader has asked appropriate questions, he is not entitled to ignore the circumstances in which his transactions take place if the only reasonable explanation for them is that his transactions have been or will be connected to fraud. The danger in focusing on the question of due diligence is that it may deflect a Tribunal from asking the essential question posed in Kittel, namely, whether the trader should have known that by his purchase he was taking part in a transaction connected with fraudulent evasion of VAT. The circumstances may well establish that he was."

15. In the case of *Megtian Ltd v HMRC* [2010] STC 840 at 851*("Megtian")* it was said:

"I do not read Lewison J's analysis [in Livewire] 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.

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: see para 112 of the decision. Participation in a transaction which the broker knows is connected with a tax fraud is a dishonest participation in that fraud: see below…

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.'

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.

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."

16. We reminded ourselves of the comments of Judge Bishopp in *Calltel Telecom Ltd v HMRC* [2007] UKVAT V20266 (at 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 at paragraph 51 of the judgment in Kittel*."*

17. We concluded that the Appellant's entitlement to a repayment would be lost if HMRC proved, to the standard set out above, that through its director, the Appellant knew or should have known that its transactions were connected with fraud (our emphasis).

18. We bore in mind the comments of Clarke J in *Red 12 Trading Limited v HMRC* [2009] EWHC 2563 (Ch) at [84]at paragraphs 109 – 111:

"Examining individual transactions on their merits does not, however, require them to be regarded in isolation without regard to their attendant circumstances and context. Nor does it require the tribunal to ignore compelling similarities between one transaction and another or preclude the drawing of inferences, where appropriate, from a pattern of transactions of which the individual transaction in question forms part, as to its true nature e.g. that it is part of a fraudulent scheme. The character of an individual transaction may be discerned from material other than the bare facts of the transaction itself, including circumstantial and 'similar fact' evidence. That is not to alter its character by reference to earlier or later transactions but to discern it.

To look only at the purchase in respect of which input tax was sought to be deducted would be wholly artificial. A sale of 1,000 mobile telephones may be entirely regular, or entirely regular so far as the taxpayer is (or ought to be) aware. If so, the fact that there is fraud somewhere else in the chain cannot disentitle the taxpayer to a return of input tax. The same transaction may be viewed differently if it is the fourth in line of a chain of transactions all of which have identical percentage mark ups, made by a trader who has practically no capital as part of a huge and unexplained turnover with no left over stock, and mirrored by over 40 other similar chains in all of which the

taxpayer has participated and in each of which there has been a defaulting trader. A tribunal could legitimately think it unlikely that the fact that all 46 of the transactions in issue can be traced to tax losses to HMRC is a result of innocent coincidence. Similarly, three suspicious involvements may pale into insignificance if the trader has been obviously honest in thousands.

Further 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. Our approach to the issue was therefore to recognise that, while we must consider the merits of the individual transactions, we should not view each transaction in isolation as, in our view, to do so would be an artificial exercise but rather we decided that the surrounding circumstances of each transaction and the totality of the deals were relevant considerations. We were conscious to ensure that in considering the knowledge of the Appellant we only took account of information known at or during the relevant period.

Issues

20. The issues to be determined in this case can be summarised as follows:

(a) Was there a tax loss;

(b) Did the tax loss occur as a result of fraud;

(c) If yes, were the transactions in this appeal connected to that fraud;

(d) If so, did the Appellant know or should it have known that the transactions in this appeal were connected with fraud.

Undisputed Background Facts

21. The information provided on the VAT 1 dated 12 November 2003 showed that the Appellant Company was incorporated on 4 October 2000. It was registered for VAT with effect from 1 October 2003 and the Principal Place of Business was Sandford House, Catteshall Lane, Godalming, Surrey. The VAT 1 showed the Company to be a property development company which would be in regular receipt of VAT repayments. As a result, the Appellant was placed on monthly returns.

22. The Appellant was purchased by Fairfax Gerrard Holdings Limited on or about 17 March 2006 and was sold to Mr Andrew Belfield on 30 May 2006. On or about 20 October 2006 the VAT trade classification was amended to the wholesale of computers, computer peripheral equipment and software.

23. The Company's registered address and PPOB for VAT purposes was 2nd Floor, River Court, Mill Lane, Godalming, Surrey which was the same address as the Company's accountants – River Court Consultants. On 7 July 2008 Mr Belfield, the

director of the Appellant Company, informed HMRC by letter that the PPOB had been changed to 5 Heathlands House, Knutsford, Cheshire however the registered address remained that in Surrey.

24. Mr Belfield was listed as the sole Director and Company Secretary of the Appellant. The partners of River Court Consultants, Mr Stuart Dick and Mr Nicholas Wilde had both previously acted as Company Secretaries. Mr Dick has also acted as a representative for the Appellant since it registered for VAT. On 5 February 2008 Mr Dick was given a Bankruptcy Restrictions Undertaking.

25. In VAT periods 10/06, 11/06 and 12/06 the Appellant sought to reclaim input tax totalling £1,344,000 incurred through the purchase of Rogue Penguin Software from Fairford.

26. The return for 10/06 was received by HMRC on or about 7 November 2006 and a letter issued to the Appellant on 6 December 2006 informing it that the return had been selected for verification.

27. On 14 December 2006 HMRC officers Goulding and Styles visited the Appellant at the PPOB and met with Mr Belfield and Mr Dick. Both indicated to HMRC that they had read and understood the verification letter issued on 6 December 2006.

28. The returns for 11/06 and 12/06 were received on or about 21 December 2006 and 9 January 2007 respectively. The Appellant was informed by letter from HMRC dated 24 January 2007 that the returns for both periods had been selected for verification.

29. By letter dated 29 March 2007 HMRC informed the Appellant that the sales in VAT periods 10/06, 11/06 and 12/06 had been traced to a tax loss. By letter dated 25 August 2010 HMRC informed the Appellant of the decision to deny the input tax reclaimed on the purchase of Rogue Penguin Software in all 3 VAT periods. The Appellant requested a review of HMRC's decision by letter dated 20 September 2010 and on 3 November 2010 HMRC notified the Appellant that the decision had been upheld.

Was there a tax loss and if so, did the tax loss occur as a result of fraud?

30. In the 3 VAT periods with which this appeal is concerned the Appellant made 4 separate purchases of varying quantities of Rogue Penguin Software from Fairford. On each occasion Fairford were invoiced by adMICRO in Hong Kong which indicated that Fairford had been in the position of bringing the goods into the UK. Mr Jones' witness statement set out that his enquiries of departmental databases showed that adMICRO had an agreement with the developer of Rogue Penguin, Sphere Impex in India, to sell the product to Fairford and to use the support services of UKNet1.

31. Internet enquiries at the time of the transactions also revealed that Indian based company Sphere Impex, which owned the trademark for the software, was described on the website ExportersIndia.com as a hand tool and cutting tool manufacturer. On

the website Alibaba.com it was described as a supplier of allopathic and homeopathic remedies.

32. As regards adMICRO in Hong Kong, HMRC's departmental records showed that Hong Kong Customs and Excise visited the company on 6 separate occasions between September 2006 and May 2007 and on each occasion the business premises was closed and no-one was present.

Fairford

33. During the relevant period Fairford also purchased goods from UK traders which were despatched from the UK. In period 12/06 the despatch deals traced back to Mobile One and Step One.

34. Mr Jenner provided an unchallenged witness statement which set out the trading activities of Fairford and the reasons for HMRC's conclusion that Fairford was a contra-trader. The relevant points of the witness statement are set out below.

35. The Fairford Group plc was incorporated on 10 September 2004. The director was Harjinder Chamdal and the company secretary was Balvinder Bassi. The shareholders were shown as Balvinder Bassi, Harjinder Chamdal and Rajinder Bassi.

36. On 2 February 2005 Mr Chamdal completed a VAT1 which stated the intended business activities as *"traders in various goods ranging from general household goods i.e. beauty products, personal hygiene, vitamins, fragrances, batteries, soft drinks to clothing, furniture etc. We mainly trade within the UK but are also intending to import and export." Our trading partners and customers are comprised of regional and transnational wholesaling distributors, retail, chains and trading companies for who we also source products to their specific requirements. We are also developing a promotional merchandise business within this company; this will be targeted at the large conglomerate sector, with a view to supplying such companies with all their promotional needs this could range from personalised "MP3" players, USB memory sticks to coffee mugs, mouse mats, pens etc. We also act as property brokers which is commission based."*

37. The estimated taxable supplies over the following 12 months were £2,000,000 and the estimated purchases from and sales to other EC Member States were $300,000 although no documentation was provided in support of the figures. The requested effective date of registration was 27 January 2005; the date of the first trade.

38. Fairford's turnover as declared on its VAT returns was as follows:

VAT Period	**(£)**
03/05	3,888
06/05	186,000
09/05	451,913

12/05	60,511
03/06	28,808,193
06/06	40,093,050
09/06	998,050
12/07	33,181,110
03/07	3,327,192

39. Fairford's VAT returns for periods 03/06 and 06/06 were subject to extended verification which led to the denial of input tax claims of £10,272,318.75 on the basis that the deals were connected to the fraudulent evasion of VAT and that Fairford either knew or should have known of the connection. The decision is currently subject to appeal.

40. An associated company, Fairford Partnership Ltd had a common director and company secretary. Its return for VAT period 06/06 was also subject to extended verification which resulted in a denial of an input tax claim of £3,030,685 on the basis that the deals were connected to the fraudulent evasion of VAT and that the company either knew or should have known of the connection. The decision is currently subject to appeal.

41. In period 12/06 Fairford conducted 19 deals; in 8 of those deals Fairford acted as the broker trader exporting to an EU customer (either LPC Trading SA of Luxembourg or EU Con Aps of Denmark). The deals were traced back to contra traders Step 1 and Mobile One.

42. The deals involving Step 1 were in turn traced back to a hijacked defaulting trader; a company purporting to be James Barlay Ltd where debts to HMRC in periods overlapping Fairford's 12/06 return are £710,325 in period 1 September 2006 to 30 November 2006 and £2,358,234 in period 1 December 2006 to 28 February 2007.

43. The deals involving Mobile One were traced back to a trader which HMRC concluded was a tactical blocker; Churchill, where the debt due to HMRC in the period overlapping Fairford's 12/06 return is £807,933 in the period 1 December 2006 to 28 February 2007.

44. The remaining 11 deals (in which Fairford bought from a non UK supplier and sold to a UK broker) involved the Appellant in 4 deals, Base Interactive Ltd in 3 deals and Intent 21 Ltd in 4 deals. The total output tax due on these deals was £3,998,320.

45. Mr Jenner explained that by taking into account all of the deals, the VAT liability changes from a £2,756,923.75 repayment claim to a £251,396.25 payment claim; i.e one set of deals is offset by the other and the large VAT claim which at its

starting point is a defaulting trader is masked by the almost equally large VAT payment on deals acquired from outside the UK and sold onto UK traders. The non UK supplier in all of these deals was adMICRO in Hong Kong.

46. The statement of Mr Jenner set out the clear understanding of Fairford in respect of MTIC fraud within its industry, including the issue of Notice 726 to the company and a supplier declaration form issued by Fairford in each deal which makes specific reference to protecting itself against fraudulent activity. Despite this knowledge, Fairford's due diligence was mostly limited to verification of VAT numbers on the Europa website which was undertaken after the deals had taken place.

47. HMRC also relied on the following as indicators that Fairford knew or should have known that its transactions were connected to the fraudulent evasion of VAT: back to back deals with many traders in the chains banking with FCIB, the lack of any written contracts or agreements with suppliers and customers and the absence of insurance. Mr Jenner also concluded that the 2 distinct patterns of trading, i.e. acting as acquirer in one set of deals and broker in the other, allowed the claims for repayments of VAT to be offset.

48. Fairford went into voluntary liquidation on 3 October 2008 and was subsequently de-registered for VAT with effect from 1 July 2010.

Step 1

49. HMRC officer Ms Parsons provided the unchallenged evidence in respect of Step 1.

50. Step 1 was incorporated at Companies House on 15 July 2005. The director of the company from 15 July 2005 until his resignation on 22 September 2007 was Balal Ahmed. On 2 June 2007 Azim Nadeem was appointed as a director. Both Mr Ahmed and Mr Nadeem are shown as shareholders on an Experian Gold report exhibited by Ms Parsons. Mr Nadeem was appointed as company secretary on 15 July 2005 and Mr Nasim Akhtar was appointed as company secretary on 22 September 2007.

51. Step 1 applied for voluntary VAT registration on 8 August 2005. The VAT1 was signed by Balal Ahmed. The main business activity was specified as "electronic products" and the estimated taxable turnover for the following 12 months was £150,000. Further information was requested by HMRC to support the application and the document provided in response showed an intention to trade in toys in addition to electronic items.

52. At a visit prior to registration for VAT, HMRC officer Shah was informed that the main business activity would be the import of car alarms from Taiwan and a subsidiary business activity of selling cameras was also intended.

53. Step 1 was registered for VAT with effect from 18 September 2005. A request was made to amend the trade classification of "electrical wiring and fittings" to "wholesalers of electronic products (mainly car alarms)" on 27 January 2006. Ms

Parsons noted that the documents received by HMRC in support of the VAT application and thereafter did not show any sales of car alarms or any retail sales.

54. From period 10/06 onwards the company's trading activity involved wholesale back to back transactions in clothing, perfumes, toiletries and electrical items either by purchasing stock from EU suppliers and selling in the UK or purchasing stock from UK suppliers and selling to EU based customers. Ms Parsons inferred that this type of activity, together with other features of the company, established that Step 1 was involved in contra-trading.

55. Step 1 was compulsorily de-registered as a missing trader on 13 August 2008 as mail was returned from its PPOB and a visit to the premises by HMRC officers on 13 August 2008 revealed that the company had vacated the premises 6 months earlier owing rent of £1,200.

56. The VAT declarations showed the company's turnover as follows:

VAT Period	Turnover (£)
07/07	0.00
10/06	18,092,485
01/07	9,281,425
04/07	0.00
07/07	248,400
10/07	203,472
01/08	0.00

57. Ms Parsons noted that there was a rapid growth in turnover from a standing start despite the fact that neither Mr Ahmed nor Mr Nadeem had any previous trading history or business experience and the company had no employees.

58. In VAT period 10/06 Step 1 completed 17 transactions. In 13 of those deals Step 1 acted as the acquiring trader and no documentation was provided by the company to evidence the arrival or movement of the goods into the UK. In the remaining 4 transactions Step 1 acted as a broker. In each of the broker transactions the supplier was Naurung Trading Limited which acquired the goods from Danish Company, EU.Com APS but failed to account for the resulting output tax liability. Naurung was assessed in respect of these transactions in the sum of £1,575,857. The assessment remains unpaid and has not been appealed. Naurung was de-registered as a missing trader with effect from 6 March 2007.

59. In VAT period 01/07 Step 1 completed 6 transactions. In 5 deals Step 1 acted as the acquirer. Again, no documentation was provided by the company to evidence the

arrival or movement of the goods into the UK. In each of the acquisition deals Step 1 sold to either Apna Bazaar TV Ltd or Fairford.

60. In the remaining transaction Step 1 acted as broker. No evidence was provided to demonstrate the removal of the goods from the UK. The supplier was purported to be James Barclay Ltd ("JBL"). JBL subsequently denied any knowledge of this transaction. In the absence of evidence to the contrary, HMRC accepted that the VAT registration number of JBL had been hijacked and an assessment was subsequently raised in respect of the output tax liability in the sum of £807,933 against the "Taxable person purporting to be James Barclay Limited". The assessment has not been appealed and remains unpaid.

61. HMRC established that in each of the transactions in the acquisition chain there was a hijacked or defaulting trader in the chains resulting in tax losses in the 2 periods totalling £2,383,790.50; £1,575,857.50 in 10/06 and £807,933 in 01/07. HMRC submitted that the similarity between the tax lost in each period and the amount of output tax charged by Step 1 in relation to the onward sale of goods in the acquisition chains cannot be coincidental and demonstrates that the transactions were contrived. In its 13 acquisitions deals in 10/06 output tax of £1,577,391.29 was charged and in the 5 acquisitions deals in 01/07 output tax of £810,350.63 was charged.

62. In summary, Ms Parsons outlined that the value of supplies to other Member States in 10/06 was £9,078,750 and the value of purchases from other Member States was £8,959,976. In 01/07 the value of supplies to other Member States in was £4,650,850 and the value of purchases from other Member States was £4,604,180. By off-setting its despatches against acquisitions Step 1 reduced its payment claim thus avoiding any verification activity by HMRC. In the broker chains each of the transactions were traced back to a hijacked or defaulting trader. Step 1 was aware of MTIC trading which was discussed during a visit by HMRC. Despite this, Step 1 either failed to carry out any due diligence on its trading partners or failed to have regard to negative indicators raised by checks. There were no formal written contracts between trading partners and no evidence was provided to show shipping costs or that the goods were insured. Step 1 also reached a gross turnover in 10/06 and 01/07 of £29,761,581.42 without financial backing and little working capital. HMRC concluded that the factors set out above demonstrated significant evidence that Step 1 was acting as a contra-trader during the relevant period.

Mobile One

63. HMRC officer Ms Gellvear provided a witness statement detailing the trading activities of Mobile One, a contra-trader which supplied goods despatched by Fairford.

64. Mobile One was incorporated on 4 June 2004. The business activities were shown at Companies House as "other software consultancy and supply". A VAT1 was received on 3 September 2003. It was signed by Mr Akil Desai and stated that Mobile One was a partnership of Mr Desai and Mr Anis Patel. The business activities were stated as "mobile phone and accessories retail." The Company personal were:

- Imran Kathrada, director appointed on 16 May 2005 to current date;
- Imran Patel, director appointed on 16 May 2005 and resigned on 16 May 2005;
- Mohammed Aijaz, director appointed on 21 February 2005 and resigned on 16 May 2005;
- Zuber Desai, director appointed on 4 June 2004 and resigned on 21 February 2005;
- Mohebour Rehman, company secretary appointed on 1 October 2006 to current date;
- Westco Nominees, company secretary appointed on 21 February 2005;
- Shabina Fakir, company secretary appointed on 4 June 2004 and resigned on 21 February 2005;
- Swift Incorporations Nominee, company secretary appointed on 4 June 2004 and resigned on the same date.

65. The shareholder was Zuber Desai who transferred his 100% shareholding to Imran Kathrada on 16 May 2005.

66. Mobile One was registered for VAT with effect from 7 November 2003. On 2 February 2004 HMRC were notified that Akil Desai was no longer involved with the company and that a new partner, Zuber Desai was joining Anis Patel. On or about 15 April 2004 HMRC was notified that Mobile One was trading as a sole proprietorship. The new proprietor was Zuber Desai and on 26 April 2004 HMRC informed Zuber Desai that the company's VAT registration had been reallocated to him. On 29 September 2004 HMRC was notified that the company had changed from a sole proprietorship to a Limited Company. The VAT registration number was reallocated to Mobile One Limited.

67. At a visit by HMRC on 5 April 2005 it was established that Mr Aijaz, the director, could speak little English. A friend of Mr Aijaz assisted during the interview and confirmed that Mobile One had been given to Mr Aijaz without any money having been exchanged. Despite having no experience in wholesaling mobile phones, Mr Aijaz stated that there was "big money" to be made.

68. HMRC interviewed Imran Kathrada in 13 September 2005. He stated that he was the current director and had purchased the business from Mr Aijaz on 16 May 2005 for £8,000. Mr Kathrada appeared to officers to have little knowledge about the mobile phone industry. He had previously worked at Dewhurst Jam factory in Manchester and had run a farming and transport business in India. HMRC officers queried a transaction in which a supplier had supplied goods on credit to Mobile One amounting to over £3,000,000. Mr Kathrada appeared flustered and informed officers that a deposit had been paid to the supplier. Mr Kathrada could not explain why the

deposit had been paid on 8 July 2005 despite the fact that the company had been trading with the supplier since 15 May 2005. A letter subsequently provided to HMRC from Mobile One to its supplier described the deposit as "an advance payment/deposit towards future deals".

69. On 22 January 2007 HMRC issued a letter to Mobile One informing it that tax losses had been traced in 8 deals declared in April 2006. The tax loss exceeded £3,000,000. HMRC visited the company on 8 February 2007 to obtain information about its supplier and customer declared on the June 2006 return. HMRC spoke to Mr Kathrada, director, and Mr Rama, company secretary. It was established that the company had opened a new bank account with Pacific Financial Centre as FCIB had closed, however neither Mr Kathrada nor Mr Rama were able to access the account despite numerous attempts. As neither appeared to be aware of the password, HMRC officers concluded that they were not in control of the company's bank accounts.

70. At a subsequent visit on 26 March 2007 Mr Kathrada was unable to produce CMRs requested by HMRC. He had previously agreed to provide itemised telephone bills but recalled after searching for them that the relevant telephone calls to a freight forwarder were made via charge card and therefore would not appear on the bills. Mr Kathrada could not provide documentary evidence of insurance for the goods but stated that they would have been insured by the freight forwarder.

71. HMRC issued a letter to Mobile One dated 29 June 2007 in which its concerns regarding the day to day running of the company were outlined. The letter stated that neither the director or company secretary appeared to have knowledge of deals undertaken by the company. Furthermore the company did not have a telephone line that accepted incoming calls and only had £390 in its bank account. In those circumstances HMRC concluded that there was no firm evidence of an intention to trade.

72. On 30 November 2007 HMRC wrote to Mobile One giving details of tax losses exceeding £2,000,000 relating to its December 2006 deals.

73. On 28 February 2009 Mobile One was assessed for £2,011,490 having failed to provide evidence to support its zero rating of goods in period 12/06. On 26 August 2009 the company was declared insolvent with a debt due to HMRC of £2,166,612.61.

74. Ms Gellvear's statement outlined that Mobile One conducted 5 deals in November 2006 in which it acted as an acquirer. 31 deals were carried out in December 2006 in which Mobile One acted as a broker trader. A further 26 deals were undertaken in December 2006 in which Mobile One acted as the acquiring trader.

75. The overall value of the goods acquired from the EU in December 2006 was £13,505,735 which almost equals the overall value of its despatches to the EU of £13,181,883. This resulted in a net repayment claim of £41,843.49 in comparison with a turnover of £26,744,697 and a total output tax liability of £6,943,816.20. In

December 2006 all of the 5 deals in which Mobile One purchased from Churchill HMRC established that a tax loss totalling £2,358,234 has occurred at the start of the UK supply chains.

76. Ms Gellvear noted that from June 2006 Mobile One appeared to act as a contra-trader as the value of its acquisitions and despatches, as well as its net input and output figures, were very similar. The membership of the supply chains also showed a remarkable degree of consistency; the acquisition deals contain precisely the same members in the same order and the despatch chains contain the same number of members with only one or two different members when compared. The company's turnover increased from nil to £53,000,000 in less than 3 years despite the company being a new business with no technical knowledge or experience in the trade sector. No meaningful due diligence was carried out by the company on its trading partners and no contracts were entered into. In those circumstances, HMRC concluded that Mobile One was a contra-trader within a contrived trading scheme designed to defraud the Revenue.

Churchill

77. HMRC officer Harvey provided a summary of the trading activities of Churchill which was incorporated on 9 February 2004 and dissolved on 20 November 2008. Churchill was registered for VAT with effect from 1 June 2004. The undated VAT1 was signed by Mr Abdul Majid who was director of Churchill from 9 February 2004 to 6 September 2004. The main business activity was cited *as "intend to buy/sell Formica sheets/raw wood materials/railway sleepers"*. Mr Sajad Rehman Khan, a director of Churchill between 9 February 2004 and 15 November 2006 was a solicitor practising from premises rented from Charles Khan, Solicitors and Commissioners of Oaths at the time of an HMRC visit on 20 September 2004.

78. Churchill was de-registered for VAT on 26 April 2007.

According to an Experian Limited Company Gold Report dated 22 March 2011 there have been 6 County Court Judgments with a total value of £54,451 against the company. At a hearing in The Official Receiver's Office on 14 March 2008 Mr Sajad Khan stated that he had settled one judgment for £35,585 owed to a finance company by payment of £20,000.

During the period for which the company was registered for VAT the company officials were:

- Aftab Ahmed, director from 1 November 2006;
- Sajad Rehman Khan, director from 9 February 2004 until 15 November 2006. Mr Khan also held one of the two Ordinary £1 shares issued by the company;
- Abdul Majid, director from 9 February 2004 until 6 September 2004 and company secretary from 9 February 2004 until 16 September 2004. Mr Majid held the remaining £1 Ordinary share issued by the company;

- Zulfiqar Mahmood, director from 6 September 2004 until 19 October 2006 and company secretary from 16 April 2004 until 19 October 2006.

79. A Director and Secretary Report on Experian indicates that Mr Mahmood was also a director of Surgiden Instruments Limited and Harjay Management Services Limited. At a visit by HMRC to Churchill's PPOB on 20 September 2004 revealed that Mr Mahmood had also previously been a director of Universal Technologies Limited and Esbae Limited; the former was dissolved on 3 December 2002 with VAT arrears outstanding to HMRC as at 9 April 2003 of £4,233,969.58 and the latter was de-registered on 1 October 2002 and recorded on HMRC's data systems as a missing trader.

80. According to a Director and Secretary Report on Experian Sajad Khan was also a director of Five Pillars, Sports International Management Limited, Surgiden Instruments Limited, Chicks Rule OK Limited, Intec Direct Limited, Myda Foods Limited and 78 Goldhurst Terrace Limited. HMRC's records indicate that Intec Direct Ltd was a missing trader. A bankruptcy order was made against Mr Khan on 23 October 2009. On 20 October 2008 there was a hearing held by the Solicitors Regulation Authority at which Mr Khan was reprimanded.

81. HMRC conducted enquiries into a number of Churchill's VAT returns. In respect of the 02/05 return HMRC wrote to Churchill on 14 April 2005 advising that the reclaimable VAT amount for the period 1 December 2004 to 28 February 2005 should be amended to £92,097.25 and the amount repayable reduced to £30,821 as a number of purchases shown on invoices did not in fact take place. The amounts of VAT disallowed were £28,962.50 and £21,564.55.

82. In respect of the 05/05 return a central assessment was issued for £6,036 as the return was not received by HMRC. An additional assessment was raised in the sum of £13,432 on 4 May 2007. An assessment in the sum of £10,237 was issued on 31 May 2006 in respect of the 11/05 return. A central assessment for £249 was issued as the 11/06 return was outstanding. On 23 May 2007 HMRC issued an assessment to Churchill in the sum of £235,843 in addition to an earlier central assessment in the sum of £264. Subsequently a further assessment was issued on 5 October 2007 in the sum of £2,358,234 in respect of 5 deals with Mobile One in December 2006. A central assessment in the sum of £115,172 was issued for the period 05/07 as a return for the final period of trading was not received by HMRC.

83. HMRC noted that the company's turnover increased dramatically from £538,694 during the quarter ended 28 February 2005 to £2,615, 200 during the quarter ended 31 May 2005 and then £40,601,647 for the quarter ended 31 August 2005. Churchill expressed conflicting statements regarding its due diligence; despite telling HMRC that the company wished to protect itself and was "well on top of" due diligence, it failed to carry out any meaningful checks. Redhill checks were carried out on only 2 traders and after the dates of the transactions. HMRC have had no contact from Churchill since 11 January 2007 and the company has not appealed against the decision to de-register it with effect from 23 April 2007. Churchill has not

appealed against the assessments raised against it, which remain unpaid. The total insolvency debt is £2,739,467 plus interest, surcharges and penalties of £440,426.85.

84. Ms Harvey concluded that it was unclear whether or not Churchill purchased goods from the EU. Invoices held indicate that it mainly purchased from and sold to UK traders and acted as a "blocker"; a trader inserted into a deal chain which will go missing or fail to provide evidence of its purchase invoices in an attempt to prevent tax losses and fraud being established by HMRC. However Ms Harvey found 5 invoices which show that Churchill sold to companies with addresses outside of the UK and therefore may have acted as a broker in some instances. Churchill's sales to Mobile One in December 2006 were included in the assessment issued to the company in respect of its 02/07 VAT period. The documents relating to the sales were provided by Mobile One. HMRC concluded that Churchill's activities were a deliberate attempt to defraud HMRC of large amounts of VAT.

James Barclay Limited

85. HMRC officer Launder provided a statement in respect of James Barclay Limited.

86. By way of background a company called Nations Club Express Ltd applied for VAT registration on 3 September 1998 in a VAT1 signed by Shafia Rehman. Registration was granted with effect from 1 September 1998. HMRC requested further information in support of the application by letter dated 2 October 1998 and a response was received from Mr Raaj Van Heldon. The information also stated that Mr Shafia Rehman had changed his name to Mr Van Heldon.

87. Information at Companies House differed from that given by Mr Van Heldon as the dates of birth given for himself and Mr Rehman differ.

88. On 10 April 2003 a request was made to amend the entity registered for VAT to R Van Heldon t/a Nations Club Express. During a visit by HMRC on 3 July 2003 Mr VanHledon advised that he had changed his name for a second time to Sabur Rafi and that Nations Club Express Ltd had been wound up and he was continuing as a sole proprietor using the name Nations Club Express. An application to transfer the registration number from the limited company to sole proprietor was received from Mr Van Heldon on 22 December 2003 and the transfer was stated as having taken place on 1 February 2003. Approval for the transfer of the VAT registration number to Raaj Van Heldon was notified to Nations Club Express Ltd on 12 January 2004.

89. An application was received dated 15 November 2005 to change the name of the entity to that of James Barclay Limited. The change was said to have taken effect on 4 November 2005 and the relevant forms had been signed by Mr Sabur Rafi. During a visit to the accountant on 12 June 2006 HMRC officer Cook was informed that the only share in the company had been sold to Mr Nicholas Vaz. Mr Rafi had retained the assets and contracts of the company and Mr Rafi had set up another company called James Barclay (Derby) Ltd.

90. HMRC visited James Barclay Ltd due to information received by HMRC that it had purchased from a defaulting trader. The visiting officer was also requested to investigate a sales invoice issued by James Barclay Ltd to a company called Step 1 Solutions Ltd.

91. There was no answer at the PPOB which was also the home address of Mr Vaz. The HMRC officers went to the offices of Johnson Tidsall (accountants to the previous legal entity) who stated that Mr Vaz had been assaulted the previous year and to their knowledge had not traded with the registration.

92. A number of attempts were made to contact and meet with Mr Vaz. On 19 June 2007 a meeting was eventually held. Mr Vaz explained that he had been assaulted at a local gym in Manchester in October 2006. In December he had met a male called "Mo", who he thought was called Mohammed but could not be sure. Mo had suggested that Mr Vaz contact a Mr Nadeem Tariq, which he did and a meeting was arranged in Birmingham. Mr Vaz informed Mr Tariq that he had a dormant company and was looking to make money from it. Mr Tariq had stated that he could help in terms of using the business for general trading. Mr Tariq provided Mr Vaz with his company's introduction pack (Euro Beverage Ltd) and a number for Step 1. Mr Vaz stated that he was given another number by Mr Tariq for Mobile One. However he stated that he had not been involved in any transactions with the companies although he had provided them both with an introduction pack which included a letter of introduction, copy of Certificate of Incorporation, copy of VAT registration Certificate, Letter from Companies House, copy of Mr Vaz's passport, details of the company's Lloyds bank account and possibly a blank copy of company headed paper.

93. Mr Vaz stated that he was told by Mr Tariq to open a Worldwide Currency account. He noticed money transferring in and out but as it was not his he did nothing about it. HMRC informed Mr Vaz that as the director of the business he was accountable. He stated that he assumed the people to whom he had given introduction packs were responsible for moving the money but he had no evidence of this and as it was not his money he did not panic.

94. Mr Vaz denied all knowledge of transactions undertaken by James Barclay Limited. HMRC decided that the company details had been hijacked and on 10 July 2007 an assessment for £807,933 was raised and notified to the Taxable Person purporting to be James Barclay Limited. The assessment was based on an invoice from James Barclay dated 11 January 2007 provided by Step 1 Solutions for the supply of Sony media projectors which generated VAT of £807,933. HMRC concluded that although the tax loss identified in the sum of £807,933 arising from the transaction with Step 1 was the result of fraudulent activity, it was not possible to say with any certainty that Mr Vaz had been involved in any trading with the company

95. The company was de-registered with effect from 30 April 2007.

Findings on whether there was a tax loss, whether the tax loss was fraudulent and whether the Appellant's transactions in periods 10/06, 11/06 and 12/06 were connected with fraudulent VAT losses?

96. We accepted the evidence of HMRC and we were satisfied that the chains of supply had been accurately traced. In each of the deals which are the subject of this appeal the Appellant was supplied by Fairford which was in turn supplied by Mobile One and Step 1 Solutions.

97. We found as a fact that the trading activities of Fairford, Mobile One and Step 1 as outlined in the witness statements of HMRC officers demonstrated that they were contra-traders.

98. The defaulting trader in the deal chains of Mobile One was Churchill and the defaulting trader in within Step 1 Solutions' deals chains was James Barclay.

99. We were satisfied from the evidence of Ms Harvey that the features of Churchill's trading were indicative of a deliberate attempt to defraud the Revenue of VAT; we reached this conclusion taking into account the phenomenal increase in turnover over a short period of time, the lack of any meaningful due diligence carried out by the company on its trading partners, its failure to contact HMRC regarding its unpaid debt and outstanding VAT returns and the fact it vacated its premises and disappeared.

100. We accepted Ms Launder's evidence that James Barclay's details were hijacked and that the trading activities purportedly undertaken by James Barclay were part of a contrived scheme designed to dishonestly evade VAT.

101. We accepted that assessments for unpaid output tax were raised against the taxable person purporting to be James Barclay and Churchill and that the tax losses, which remain unpaid, are the result of fraud.

102. We found the evidence compiled HMRC compelling and we concluded that the contra traders' role in both the clean and dirty chains was designed to deliberately and fraudulently offset some or all of the input tax repayment claims it would otherwise have had to make by conducting acquirer deals as well and that in acting so each contra-trader was aware of the connection of its broker deals to fraud. We were satisfied that the connection via the contra-traders was established by the fact of the offsetting of the input and output tax by the contra-traders and that it must follow that the transactions conducted by the Appellant in which it was supplied by Fairford which in turn was supplied by Mobile One and Step 1, were connected to the fraudulent evasion of VAT and tax losses.

Did the Appellant know, or should he have known that the transactions in this appeal were connected to fraud?

103. The evidence on behalf of HMRC came from the officer who was allocated the Appellant's case in November 2009 and issued the decision letter by which the Appellant's claim was refused, Mr Jones, who gave oral evidence and provided a witness statement setting out the reasons for HMRC's decision to deny the Appellant's repayment claim in a statement dated 29 June 2011. Mr Belfield provided a witness statement dated 6 January 2012 together with a number of exhibits which we considered carefully.

The Deals

104. In the 3 VAT periods under appeal the Appellant made 4 purchases of Rogue Penguin Software at £3,200 per unit from Fairford as follows:

- Two supplies of 300 Rogue Penguin Software on 31 October 2006;
- One supply of 1200 Rogue Penguin Software on 30 November 2006; and
- One supply of 600 Rogue Penguin Software on 30 November20 December 2006 2006.

105. The onward sales took place in October 2006, January 2007 and February 2007 at a sale price of £3,408 when the Appellant's customer was Canair Telecom or ZZ Telecommunications and £3,410 when the customer was Nordic Trade/Commerce Nortique.

106. The mark up achieved by the Appellant was 6.5% when the selling price was £3,408 and 6.56% when sold for £3,410 as compared to Fairford which purportedly had worldwide distribution rights for the software and only achieved a mark-up of 2.24%.

107. The Appellant was a sub-distributor of the software and had negotiated exclusive rights to distribute Rogue Penguin to North America (Mexico, Belize, Guatemala, Honduras, El Salvador, Nicaragua, Costa Rica and Panama) and Canada. All of its customers were based in Canada. The Appellant produced a distribution agreement with Fairford which Mr Jones noted was, in the main, identical to an agreement used by Fairford in an earlier VAT period when it dealt in a software package called Archemedes with Sabina Ltd. The agreement bears the name of Laytons Solicitors which acted on behalf of Fairford. Mr Jones noted that the Appellant had essentially the same document, save for the duration of the agreement, with its customers. HMRC submitted that the Appellant had simply used Fairford's document as its own in respect of its customers.

108. At a visit by HMRC on 14 December 2006 Mr Belfield stated that the Canadian customers responded to advertisements on the websites "alibaba.com" or "exporters.sg". Mr Belfield stated that he had not previously dealt with Fairford but had "met whilst out and made an agreement". He added that he had seen Fairford on the IPT website and contacted Bill Bassi.

109. In respect of the purchase price, the Appellant informed HMRC in a letter dated 5 February 2007 that it was dictated by the supplier and that there was an RRP for the product of £4,150. Mr Jones noted that he had seen no evidence to support the Appellant's assertion regarding the RRP and that a printout from a Canadian classified site dated 12 October 2009 showed a retail price of $5.25.

110. The Appellant produced a business plan to HMRC which showed that once an order was placed the Appellant's customers would pay 25%, a further 50% when the product was ready to ship and the final 25% when the product was inspected upon

delivery. Mr Jones noted that the business plan did not resemble the reality of how payments were made as the Appellant's customers paid in one full payment and on all but 2 occasions the payment was immediately transferred to Fairford. Mr Jones also noted anomalies in the payments made, for example in one deal £1,023,000 is paid to the Appellant by its customer and £1,022,400 is paid by the Appellant to Fairford. It would appear that the Appellant's customer overpaid and no explanation has been given by the Appellant regarding this discrepancy.

111. Mr Jones' witness statement highlighted a number if anomalies in the deal documentation, for example the 2 deals (numbers 2005 and 2006) in 10/06 both took place on 31 October 2006 however the sales invoice for one of the deals (2005) was dated 30 October 2006 thereby predating the purchase. The payments for these deals followed 80 days later on 19 January 2007 for deal 2006 and 113 days later on 21 February 2007 for deal 2005. Once payment was received, the Appellant immediately paid Fairford the amounts received save for £600 in respect of deal 2006.

112. The Appellant's bank statements showed that payment was always received from its customer before payment was made to its supplier and the payments made to Fairford were never for the full purchase value; from the information provided by the Appellant to HMRC Fairford was owed £843,200. Despite the fact that the distribution agreement mandated payment to Fairford within 60 days, the Appellant failed to adhere to that condition.

113. On 14 May 2007 the Appellant wrote to HMRC informing it that as it had been made aware that Fairford had not paid tax due to HMRC it had cancelled the distribution agreement and demanded a refund for stock that had not been shipped. On 28 May 2007 a credit note from Fairford was provided by the Appellant to HMRC together with a letter confirming that goods purchased in 01/07 had been cancelled. Mr Jones noted that Mr Belfield's witness statement contradicts this information as he stated that Fairford refused to refund the Appellant and that despite the fact that the Appellant received payment from its customers for the goods which had not been shipped, there is no evidence that the customers attempted to recoup the money or obtain the goods.

114. HMRC contended that the Appellant's invoices contain the words *"goods remain the property of Church Lane Developments until paid for in full"* and *"subject to our standard terms and conditions available on request"*. Mr Jones was unaware of the details of those terms and conditions and queried whether the assertion by the Appellant was accurate given that it had already sold the product to its customer prior to making payment to its supplier.

Due Diligence

115. The Appellant's due diligence was discussed at a visit by HMRC on 14 December 2006 at which Mr Belfield stated that he requested Equifax checks, Companies House documentation, trade applications and 3rd party references.

116. A document dated September 2006 was provided to HMRC by the Appellant entitled "New Market, New Products, New Opportunities." The document states:

"We operate a comprehensive due diligence process BEFORE we commence any trading activities with any potential customers. More specifically we…meet the directors of the company, at their premises…complete a visit report and take photographs. Only when ALL the criteria have been satisfied, will we approve the company as being acceptable to trade with."

117. Despite the Appellant's assertions, the only due diligence provided to HMRC in respect of its supplier and customers was an Equifax business report. HMRC noted the following negative indicators raised in the reports which appeared not to have been queried by the Appellant:

Canair Telecom:

- Under "Identification" the report reads *"the subject is not registered as a phone/fax user locally. We have tried to obtain numbers for Subjects directors, but proved unsuccessful as they are apparently also not registered as telephone users locally"*.

- Under "Credit Risk Rating" the report states that there is insufficient data to make any meaningful assessment of the company's financial or operation condition and *"Advisable to conduct further due diligence before making any credit or business decisions"*.

- Under "Operations and History" the report states that *"The Subjects operation could not be determined as we were unable to contact the company"*.

ZZ Telecommunications Ltd

- Under "Credit Risk Rating" the report states that financial information was not available and caution was advised when considering granting credit.

- Under "Financial Accounts" the report stated that the financial statements were not available and members of the company contacted were "not prepared to release such documents."

Commerce Nortique Inc

- Under "Credit Risk Rating" the report states that there was insufficient data to make *"any meaningful assessment of financial or operational condition"*. Further due diligence checks were advised before any credit or business decisions were made.

- The financial statements were not available due to the recent date of the company's establishment.

- Mr Jones noted that in respect of Nortic Trade all correspondence was with Mr Mark Young who is not listed as either a director or shareholder. The report also gives an address for Mr Young in America rather than Canada where the company was purportedly based.

Fairford

- The report shows a "Client Code/Name" of Fairfax Gerrard Holdings Limited which HMRC contended showed that the Appellant did not request the report but rather it was obtained via a 3rd party.

- The "Analyst report" states that there was insufficient information upon which to base a credit rating and that *"we suggest that you seek suitable assurances from the Directors…For contracts, we suggest obtaining performance/indemnity bonding…for credit insurance purposes the credit limit is nil."*

- Under the heading "protect information" the report states "*…caution. Current/previous Director(s) and/or current/previous Secretary have been recorded as directors of a company and/or companies which have been struck off the Register of Companies as a result of either a subject company voluntary application or due to non-compliance…Current/previous Director(s) and/or current/previous Secretary have been recorded as being directors of a company or companies which have been dissolved."*

- The report indicates that the latest account had not been filed.

118. Mr Jones noted that the Appellant had provided no evidence to demonstrate that any further enquiries were made in respect of the negative indicators set out above or that it acted upon the information provided within the report.

119. The "New Market, New Products, New Opportunities" document provided by the Appellant also referred to "non-circumvent, non-disclosure" binding contractual agreements however no such documents have ever been provided to HMRC.

120. Further due diligence files were exhibited by Mr Belfield with his witness statement and included photographs of meetings with customers. Mr Jones noted that the receipts provided with the photographs indicate that the meetings were during the working week (24 and 25 October 2006) with Canair however although work booths can be seen in the photographs there are no employees visible.

Customers' associations

121. Mr Jones noted that there is evidence of links to the UK for 2 of the Appellant's Canadian customers in the periods under appeal:

- Zeeshan Khan, the director of Canair Telecom was also the director of UK registered companies Lonair Telecom Ltd (dissolved), Canair Telecom Ltd (dissolved) and Ivydale Consultants Ltd (dissolved);

- The company secretary of Ivydale Consultants Ltd was Amir Kaleem Saddiqui;

- Zeeshan Saeed, the director of ZZ Telecommunications was also the director of UK based companies Linkside Solutions Ltd (dissolved), ZZ Telecom Ltd (dissolved) and Cosmoseis PLC (dissolved);

- The company secretary of Linkside Solutions was Amir Kaleem Saddiqui, thus linking the company to Canair Telecom;

- Of the 6 companies set out above, all but Cosmoseis shared the same registered address in Middlesex;

122. Ivydale Consultants and Linkside Solutions were both registered by Harold Wayne and Yvonne Wayne.

Product

123. HMRC submitted that the product itself, Rogue Penguin Software, lacked credibility. The Appellant did not appear to pay Fairford any additional payments for the distribution rights to "exclusive territory" or support services yet the agreement states that Fairford would provide a support facility. Mr Jones noted that this was at odds with information obtained by HMRC at a visit to the support company for Rogue Penguin, UKNet1 Limited on 30 April 2007. HMRC was informed that the support for the software was only provided to Fairford and that UK sub-distributors (such as the Appellant) and resellers (such as the Appellant's customers) would have to provide their own support to end users. HMRC was also informed that if the software disks was not activated within 12 or 24 months of manufacture then the activation keys would not work.

124. Mr Jones also noted that in a telephone call on 20 October 2006 Mr Dick stated that onward sales would take place within the UK, however the Appellant was clearly not going to make UK sales at that time and the software distribution agreement does not list the UK as part of the Appellant's exclusive territory.

125. It was HMRC's contention that the potential difficulties regarding software support and activation exposed a retailer to the risk of being left with worthless stock if not sold within a certain timeframe.

126. Mr Jones noted that the software is made up of several different elements, most of which are freely available on the internet. Furthermore, the Appellant's document "New Market, New Products, New Opportunities" makes reference to activation keys being sent to customers after final payment was made to guard against theft, however no evidence was ever produced by the Appellant to demonstrate such a practice.

127. Mr Vogler, a Chartered Engineer, Fellow of the Academy of Experts and Fellow of the British Computer Society provided a detailed report on the Rogue Penguin Software. Mr Vogler concluded that Rogue Penguin is a standard version of Kubuntu, a free software system and as an obsolete version its value is nil. The modern equivalent can be downloaded for free of purchased on CD or DVD at a cost

of under £5.00. MrVogler concluded that the programming is amateurish, inefficient and of low worth.

128. A search on the internet returned a number of hits; analyses of the most relevant hits were found to be announcements of agency deals with a number of firms: Base Interactive Ltd, Intent21 Ltd, UK Net1 Ltd, Fairford Group PLC and Azure International Trading. None of the companies' websites provided on-line purchasing of the product.

129. Mr Vogler's report examines the value of the software. He used two methods: the first was a market comparison which revealed that the value of Rogue Penguin is less than £10 – the cost of a DVD or CDs containing large amounts of free software. The cost plus approach allowed Mr Vogler to aggregate the costs involved in producing and selling Rogue Penguin in order to calculate the overall investment needed to launch the product and estmate the price which would need to be charged to achieve a profit. Mr Vogler exolained that the difficulty with the cost plus approach was the lack of data available and lack of evidence of costs from the Appellant as a vendor. Mr Vogler concluded that the costs of packaging must be 30% of the eventual retail cost, to make the business worthwhile and his highest estimate was £8.00 per item with a probability that it would be substantially lower. Even taking into account the errors contained in the cost plus method of valuation, Mr Vogler noted that a selling price of £3200 would represent a mark-up of anything between 5000 and 25000%.

130. In addition to the product's poor quality packaging, Mr Vogler noted that in the Rogue Penguin License Agreement and Limited Product Warranty Sphere Impex Pvt Ltd grants the user a license to use Rogue Penguin but that the word Rogue is written as "Rouge" not "Rogue" throughout the document.

131. Rogue Penguin is not listed as providing support for Kubuntu *"so no sane customer would buy it"* and its *"obsolescence makes Rogue Penguin unsaleable except to ignorant or gullible customers."* Mr Vogler found no evidence that the product was publicised or advertised and he was unable to purchase it online.

Turnover, Loans and Banking

132. HMRC contended that the significant increase in the Appellant's turnover over such a short period of time did not resemble that of a legitimate business with a limited trading history. In the year ending 07/05 Appellant's turnover was £1,208,142, in the year ending 07/06 it was £352,152 and following the change of business activity it was £8,657,920.

133. The Appellant, its supplier and customers all used banking services provided by Pacific Savings and Loan ("PS&L") which was registered as a New Zealand company on 6 March 2006 and struck off on 10 July 2007.. Mr Jones noted that PS&L used the website www.pacificfinancialcenter.net which was registered by NET 4 INDIA LIMITED by Syed Khalid. Mr Khalid also registered the domain name

SOFTECHCOMPANY.COM which appears as a customer of intent making onward sales of Rogue Penguin.

134. HMRC's enquiries revealed that no trader, to its knowledge, has ever successfully withdrawn funds from PS&L.

135. Mr Jones examined the PS&L statements in respect of the relevant transactions and noted that the narratives from all of the Appellant's customers incorrectly show the software name as "Rouge Penguin".

136. Other anomalies include references made by the Appellant in making payment to Fairford to "500 units of version 2.7" when in fact the Appellant never invoiced for 500 units or version 2.7.

137. On 12 April 2007 the Appellant informed HMRC by letter that it had obtained finance from Lorimer Holding and Finance ("Lorimer"). A copy of the agreement was provided to HMRC on 14 May 2007. Mr Jones noted that Mr Belfield had previously received financing from Lorimer for another of his companies; Regent Commodities Limited ("Regent").

138. The agreements between Lorimer and the Appellant and Lorimer and Regent were examined and were found to be identical save for the names, addresses and dates. The agreement with the Appellant is dated 30 January 2007 and signed only by Mr Belfield; no one from Lorimer has signed the agreement. The nominated account for the Appellant is stated as "TBC" which indicates that at the time of the agreement Lorimer did not have the information as to where the loan should be sent. The transfer of the loan for £865,000 has never been evidenced and Mr Jones noted that at the time of the transactions in the periods relevant to this appeal the Appellant did not have the loan in place with which to purchase goods from Fairford. That the purchases took place indicates that the Appellant was aware that financial backing would be found.

139. Mr Jones noted that in April 2009 when the appeal of Regent was heard by a differently constituted panel of the First-tier Tribunal (Tax Chamber) the loan remained outstanding:

"In interview on 20 December 2006, Mr Belfield confirmed that the whole of the Lorimer loan remained outstanding. Mr Belfield maintained that he had endeavoured to contact Lorimer in order to clarify Regent's position with it, but with no success; its website had "gone down", so that he was unable to contact it by email."

140. A FAME report for the Appellant indicate that the accounts show a liability of £865,000 which indicates that the loan to Lorimer remains unpaid yet no action appears to have been taken by Lorimer to recoup either the loan to the Appellant or that to Regent.

141. Mr Jones noted that that all of the sub-distributors (the Appellant, Base and Intent) of Rogue Penguin Software have obtained loans from companies based in Road Town, Tortola, BVI and the 3 companies which provided finance (Lorimer,

Levinson Invest and Finance and Jamanota Holding and Finance) all had domain names which were registered on 2 February 2007 by the same person; Howard Nicholson of Southport, Lancashire.

142. Mr Jones' statement referred to the Tribunal decision of Judge Demack in Regent in which it was stated that Regent had the facility to borrow £500,000 from Marldon Corporation, of which Mr Nicholson is a director:

"There was then a disagreement between Mr Belfield and messrs Nicholson and Howarth as a result of what Mr Belfield claimed to be the failure of Regent's former directors to discharge an outstanding corporation tax liability. Consequently, Mr Belfield said he resolved to terminate the loan arrangement with Marldon and obtain working capital from other sources. Regent repaid the moneys borrowed from Marldon in March 2006. Having done so, and ended its borrowing arrangement with Marldon, it then had no access to funds other than the capital introduced by Mr Belfield."

143. Mr Jones noted that it was unlikely given such a disagreement that Mr Belfield would go on to obtain finance for the Appellant from Lorimer given the company's links to Mr Nicholson.

144. Mr Sarocka reviewed the terms and commercial rationale of the loan from Lorimer to the Appellant. He found very little information available on Lorimer but noted that at the time of the agreement the parties were known to each other as a result of Lorimer's loan to Regent and at the time of the loan to the Appellant, Regent's loan to Lorimer had not been repaid.

145. The terms of the loan are virtually identical to that between Regent and Lorimer, the main differences being the amounts (£250,000 to Regent and £865,000 to the Appellant) and the fact that there is no nominated account into which the Appellant was to receive the funds.

146. The loan is stated to be *"for the purpose of financing the relevant transaction"* however *"relevant transaction"* is not defined in the agreement. Mr Sarocka noted that the lender had no real control over the use of the loan: *"the Lender shall not be obliged to make enquiry of the Borrower as to his use of the proceeds"*. The loan and any unpaid interest are due to be repaid in full on the maturity date. The date is defined as *"the date upon which the transaction is completed"* and is therefore vague as to when the loan and interest should be repaid and makes no provisions should the *"relevant transaction"* not be completed.

147. *"Net profit"* is not defined in the agreement despite the fact that it is crucial to the amount of interest the lender received on the loan. Furthermore the agreement states that *"any calculation of amounts due to the Lender under this Agreement shall be made by the Borrower whose calculation shall, in the absence of manifest error, be final and binding"* and no method is set out as to how a dispute regarding the net profit figure would be resolved. The agreement is also silent as to what would happen if no net profit was made.

148. Mr Sarocka concluded that the following features indicate that the loan was not made at arm's length on normal commercial terms: the purpose of the loan is not fully defined, Lorimer has no real control over the use of the loan, the loan is not secured even though the Appellant had very low net assets, the high percentage of net profit to which Lorimer is entitled could be due to the high risk involved in the loan however net profit is not defined. The agreement omitted a signature on behalf of Lorimer and a nominated bank account for the Appellant and appears to have remained unpaid at 30 April 2010.

149. In addition to Mr Belfield's involvement with Regent, HMRC also noted a further connection between the Appellant, through Mr Belfield, and Mr Nicholson.

150. Regent was originally called BHN Services Ltd. It was incorporated on 7 July 2002 and registered for VAT with effect from 30 January 2003. The directors at that time were Mr Duncan Howarth and Mr Adam Nicholson and in 2004 the company accountant was Mr Howard Nicholson – brother of Adam Nicholson. On 2 November 2005 the company changed its name to Megantic Services UK Ltd and then on 23 November 2005 to Regent. The company officials resigned and the new director was Mr Belfield.

151. The company secretary of Marldon was Mr David Waddington, who was also the company secretary for Megantic Services Ltd. Together with Mr Chris Ash who was a director of Fairfax Gerrard Holdings. Fairfax Gerrard Holdings was the previous director of the Appellant Company prior to it being taken over by Mr Belfield. Mr Jones also noted that a print from the alibaba.com website on 26 June 2007 showed the contact name for Megantic Services Ltd as Mr Belfield.

Awareness of MTIC Fraud

152. The Appellant was first notified about MTIC fraud by letter dated 6 December 2006 however Mr Belfield was already aware of the issues surrounding MTIC fraud at that point due to his role as director of Regent which was sent Public Notice 726, an MTIC fraud and verification letter by HMRC on 4 January 2006.

153. Mr Belfield's witness statement contended that Regent operated independently of the Appellant. Whilst HMRC accepted that the two companies were separate entities it is a matter of fact that Mr Belfield was director of both companies which received funding from Lorimer.

Inspections and Insurance

154. The goods traded by the Appellant were purportedly inspected at the premises of transport company Kuehne and Nagel Limted. Mr Jones noted that there was no charge for storage contained on any of the invoices from Kuehne and Nagel Limited.

155. The inspection report of SGS lists the serial numbers of the software and photographs of the product in its packaging. HMRC noted that there were no open box inspections carried out and the report did not provide any observations about the product.

156. The Appellant produced an annual policy insurance document which appeared to cover the goods whilst being transported by ship, air, road and rail however storage other than when the goods were in transit did not appear to be covered and the insurance cover did not start until 14 November 2006.

Mr Belfield's evidence

157. We were provided with a witness statement from Mr Belfield together with exhibits in support dated 6 January 2012. Mr Belfield explained that he was responsible for the day to day running and VAT affairs of the Company as its director. By way of background Mr Belfield worked for British Gas as a customer services administrator when he left school. He later moved to an IT Recruitment Agency called DP Support Services in Altrincham, Cheshire in a sales and business development role. His employment gave him an intimate knowledge of the industry and general commercial practices.

158. In 1997 Mr Belfield set up his own recruitment agency called People Power Recruitment which focussed on networking and communications industries. The company was dissolved in 2001 following a difference of opinion with the co-director. Thereafter Mr Belfield worked for HR Consultants and then as a managing director of a recruitment agency. In 2002 Mr Belfield joined Marsland Trading Ltd as a business development manager. The company was a subsidiary of Beatmark, a company involved in the trading of grey market IT and peripherals which used methods such as arbitrage to secure products at competitive prices. Mr Belfield put together deals and was involved in protracted negotiations as part of his role. The company restructured after the introduction of joint and several liability and Mr Belfield was made redundant. He used his experience to trade in grey market goods such as denim jeans, cement and DVD players and after a number of other roles Mr Belfield purchased the Appellant Company. He sought professional advice on the company's trading procedures and considered those implemented to be more than adequate.

159. The Appellant found an advert on IPT via Fairford. Mr Belfield took the opportunity to speak with Fairford and subsequently had a meeting to discuss opportunities. Due diligence was undertaken on Fairford which had developed a Linux based operating system called Rogue Penguin. Mr Belfield's witness statement explained that Rogue Penguin had been developed offshore in India and was being manufactured in the UK. His experience in supplying to the network and communications industry facilitated Mr Belfield's understanding of the dynamics of the product and the potential to users both technically and financially.

160. The Appellant decided to develop the possibility of becoming a distributor for Fairford which produced a standard distribution agreement which was sent to DLA Piper for consideration.

161. The Appellant then negotiated a distribution agreement with Fairford for a designated area and whilst negotiating the agreement, the Appellant was trying to secure some potential sub-distributors.

162. The Appellant advertised on global business portals such as Alibaba and Exporters and used their advertising agency to create a mailer for an email shot to all of the RedHat/Unix distributors based in Canada. Fairford used the CBit show in Germany and any leads they received they had confirmed they would pass to the Appellant.

163. Due diligence was important to the Appellant and included a non-disclosure agreement for all of its potential sub-distributors. Once a sub-distributor had met the due diligence criteria they were asked to sign a distribution agreement. The Appellant committed to assisting its sub-distributors with advertising and marketing.

164. Each deal entered into followed criteria which satisfied if not exceeded the requirements of HMRC. The Appellant also ensured that the product underwent strict inspection by SGS and insurance was obtained for the product whilst in transit. Upon delivery and once payment had been made the Appellant would supply the codes which would release the software for the Appellant's sub-distributor's customers.

165. After HMRC indicated that there was a possible loss of revenue the Appellant wrote to Fairford to outline that there were some issues and until such time as the situation had been rectified it refused to ship the product that had been paid for by its customer and for which it had paid Fairford. Fairford refused to refund the monies, stating that the product was fit for purpose. The Appellant was unable to sell the stock as it did not own it. The stock remains to this day at Kuehne and Nagel in Dagenham.

166. The Appellant purchased from a bona fide business based in the UK; a master distributor who bought direct from the manufacturer. Mr Belfield cannot understand how the purchases were traced back to alleged contra-traders.

167. The purchases were not back to back and a great deal of negotiation took place. The stock value in transit was worth very little as it was only after payment was made that the activation codes were released; the insurance was therefore adequate. The bank used by the Appellant enabled 24 hour secure access and does not indicate contrivance. The Appellant's due diligence went far beyond that required by HMRC.

HMRC's submissions

168. There was no challenge to the admissibility of HMRC's evidence nor any challenge to that evidence once admitted. Mr Jones was a credible witness which should be preferred to the unsworn and untested written evidence of Mr Belfield.

169. There are numerous features of the Appellant's case which indicate his knowledge that the deals were contrived to fraudulently evade tax, such as the loan which lacks commercial rationale, the product itself and the nature of the Appellant's trading including its due diligence checks.

170. The statement of Mr Belfield contains errors and statements which are inconsistent with other evidence, for example the assertion that Rogue Penguin was manufactured in the UK when it has been demonstrated by HMRC that it was imported from Hong Kong and that the product was developed by Fairford when in

fact it was developed by Sphere Impex. There is no independent evidence to support the Appellant's contention that DLA Piper reviewed the distribution agreement and no evidence of any negotiations with either Fairford of the Appellant's customers.

171. The statement's set out in Mr Belfield's witness statement are contradicted by the expert evidence of Mr Vogler, for example there was no evidence of any advertising or marketing of the product.

172. All of the features of the Appellant's trading indicated that it, through its director Mr Belfield, must have known that the transactions were connected to fraud or at the very least should have known.

The Appellant's submissions

173. The Appellant's letter dated 11 March 2013 requested that the Tribunal take into account the following representations:

- The Appellant refutes any involvement in anything spurious;
- The Appellant did not use the FCIB; it used PCL and the Royal Bank of Scotland;
- Upon being notified by HMRC that there was a possible issue with its supplier, the Appellant refused to ship the stock to its customers and invoked a clause in the distribution agreement to do so and demanded a refund from Fairford;
- Fairford refused to refund the money paid by the Appellant for the stock which remains in a warehouse in Dagenham;
- The Appellant paid for stock with VAT correctly accounted for and should be able to claim its VAT back.

Decision

Findings of fact on whether the Appellant knew, or should have known, that its transactions were connected to fraud.

231. We carefully considered the law, oral and written evidence available to us in reaching the following findings of fact.

Witness Evidence

174. We found Mr Jones to be a credible and reliable witness. We were satisfied that he had conducted a thorough analysis of all aspects of this case and we accepted his evidence.

175. We considered the written evidence on behalf of the Appellant Mr Belfield's witness statement provided scant detail on issues such as the due diligence checks he carried out, his understanding of the product or how the company came to be financed

by Lorimer. The Tribunal was unable to assess Mr Belfield as a witness and there was no opportunity for HMRC to test the veracity of the contents of his witness statement. In those circumstances the evidence of Mr Belfield provided limited assistance to us in determining the issues in this case and we attached little weight to it.

The Deals

176. We found as a fact that there were a number of indicators pertaining to the deals that demonstrated contrivance. The Appellant achieved consistent mark-ups in each of the deals; 6.5% when the customer was Canair Telecom and 6.56% when the customer was Nordic Trade/Commerce Nortique. There was no evidence of negotiations with trading partners and no explanation as to how the Appellant was able to achieve such high mark-ups as compared with that achieved by Fairford, which had worldwide distribution rights, of 2.24%. Whilst we concluded that the Appellant would not necessarily be aware of the price paid by Fairford for the goods, Mr Belfield was aware of the price at which the goods were purchased and sold by him yet no evidence was provided as to why he was able to sell the goods at a much higher price seemingly without adding anything to the product.

177. As regards the distribution agreement, there was no evidence in support of the Appellant's assertion that the document was considered on his behalf by DLA Piper or that it had been negotiated in any way with Fairford. In the absence of any such evidence we accepted the unchallenged evidence of HMRC that the document was, in the main, identical to that used by Fairford in earlier VAT periods for deals involving different software products. Whilst the Appellant may not have been aware of the earlier use of the document by Fairford, we were satisfied that Mr Belfield's use of Fairford's document as his own demonstrated that the deals were not at arm's length and that the Appellant was aware of the contrivance. Our view was strengthened by the Appellant's statement to HMRC on 14 December 2006 that he had not previously dealt with Fairford but had *"met whilst out and made an agreement"*. We noted that this contradicted Mr Belfield's evidence contained in his witness statement that he had found Fairford on the IPT website, however irrespective of how Mr Belfield came across Fairford, we were satisfied that any reasonable businessman seeking to protect himself from fraud and ensure the legitimacy of his trading would not have simply adopted the document of a trader barely known to him without further checks.

178. The business plan produced by the Appellant whereby payment was made in stages did not reflect the reality of the situation demonstrated in the PS&L evidence and in the absence of any evidence from the Appellant to explain this anomaly, we inferred that the business plan was an artificial exercise designed to lend credibility to the Appellant's business. Furthermore the anomalies in the deals, for example the delays in payments of 80 days and 113 days by the Appellant's customers and the Appellant's failure to pay Fairford within the 60 days stipulated in the distribution agreement, remain unexplained by the Appellant. In those circumstances the only reasonable conclusion we could reach was that the transactions were contrived; each party knew there was no risk of non-payment and payment terms were meaningless.

179. The evidence regarding an alleged refund from Fairford to the Appellant as a result of the former's non-payment of tax was contradictory. The Appellant informed HMRC on 14 May 2007 that it had demanded a refund from Fairford and a credit note confirming cancellation of the transaction was subsequently produced in support of this assertion, yet Mr Belfield's witness statement contended that Fairford refused to refund the Appellant. We found as a fact that this was an example of the unreliable nature of the Appellant's evidence and we queried why there was no evidence of any action taken by the Appellant's customer, which had purportedly paid for the goods with which it was never provided.

Due Diligence

180. Despite the Appellant's claims that due diligence was of the utmost importance to the company, we found as a fact that the checks undertaken raised a number of issues which would have been followed up, or at the very least queried by any reasonable trader seeking to verify his trading partners. In respect of Canair Telecom the Equifax report could not contact the directors of the company and insufficient data was available to reach any meaningful assessment of the company's financial standing. Similar financial issues were raised in respect of ZZ Telecommunications Ltd and Commerce Nortique.

181. As regards Fairford, the Appellant's supplier in each of the transactions which are the subject of this appeal, the Appellant's due diligence appeared to have been obtained from Fairfax Gerrard Holdings Limited yet no explanation was provided by the Appellant to explain why the report forming the basis of his due diligence checks suggested this. We found as a fact that further features of the report would have raised concerns in the mind of any reasonable businessman, for example the fact that caution is warned as the current/previous director or company secretary had been struck off the Register of Companies. That the Appellant appeared to take no action in respect of the negative issues raised in the reports was, in our view, indicative of the fact that he was aware of the contrived nature of the deals.

182. We considered all of the due diligence documents exhibited by the Appellant and concluded, in the absence of Mr Belfield, the photographs provided no assistance in terms of the checks carried out by Mr Belfield and information he gleaned from such checks. The substance of the checks was contained in the Equifax reports which in our view were rendered meaningless given the failure of the Appellant to act on the reports from which no real assessment of the veracity of his trading partners could be made.

183. We found as a fact that had the Appellant carried out any meaningful or thorough due diligence, Mr Belfield would have been aware of the associations between its customers Canair Telecom and ZZ Telecommunications.

Product

184. We accepted the unchallenged evidence of HMRC that UK sub-distributors would have to provide software support to end users and, in the absence of any

explanation from Mr Belfield, we found that this contradicted the Appellant's evidence in the distribution agreement that such services would be provided by Fairford. We were satisfied that our view was supported by the lack of any evidence from the Appellant showing how the additional service of software support was paid for by the Appellant.

185. We noted the evidence of HMRC that Mr Dick had stated in a telephone call on 20 October 2006 that the Appellant's sales would take place in the UK. There was no evidence on behalf of the Appellant as to the role Mr Dick played in the Company or his level of involvement and we concluded that this evidence did not assist us in determining knowledge of fraud or otherwise on the part of the Appellant.

186. We accepted the unchallenged evidence of Mr Vogler, whose report was provided a helpful and detailed analysis of the Rogue Penguin Software and we found his conclusions as fact.

187. There was no evidence to support the Appellant's assertion that the product had an RRP of £4,150. We were satisfied that Rogue Penguin is a standard version of a free software system with amateurish programming and as an obsolete version its value is nil. We accepted Mr Vogler's evidence that the modern equivalent can be downloaded for free of purchased on CD or DVD at a cost of under £5.00 and that the value of Rogue Penguin was less than £10 which meant that the price at which it was sold by the Appellant represented a mark-up of between 5000% and 25000%. We noted that despite the Appellant's assertions that his career history had assisted in his understanding of Rogue Software, there was no convincing evidence that he had any detailed understanding of the product he was trading.

188. The fact that the Rogue Penguin License Agreement and Limited Product Warranty Sphere Impex Pvt Ltd referred to "Rouge" not "Rogue" throughout the document, which was also seen in the bank account transfers between parties, was in our view indicative of the lack of commerciality in both the product itself and the deals.

189. We adopted Mr Vogler's findings that "*no sane customer would buy it*" and its "*obsolescence makes Rogue Penguin unsaleable except to ignorant or gullible customers*" and we found as a fact that this was further evidence that the product traded formed part of a contrived scheme to defraud the Revenue and had no commercial value, a fact of which the Appellant must, or at the very least should have known.

Turnover, Loans and Banking

190. The turnover achieved by the Appellant over such a short period, taken together with the company's limited trading history, lacked credibility for genuine trade when viewed against all of the other features present in the transactions. We were satisfied that the only reasonable explanation was that the deals were connected to fraud and that this was a matter about which the Appellant must have been aware.

191. We accepted the unchallenged evidence of Mr Sarocka of HMRC in respect of the finance received by the Appellant from Lorimer and we were satisfied that the evidence further demonstrated that the Appellant, through its director Mr Belfield, was aware that the deals were contrived as part of a fraudulent scheme for the following reasons; the loan agreement was in identical terms to that with Mr Belfield's other company, Regent, save for names, dates and addresses and that loan to Regent remained outstanding at the time at which the loan to the Appellant was made. Furthermore, the loan lacked commerciality in that it had not been signed by a representative of Lorimer, no bank account was provided by the Appellant and it failed to define important terms such as *"net profits"* and *"relevant transaction."*

192. We considered the fact that Mr Belfield knew Mr Nicholson not only via the loan previously made to Regent but also that which could be inferred from the close associations of Mr Nicholson as accountant and brother of a director of Regent prior to Mr Belfield taking over the company and Mr Belfield's link with Megantic Services Ltd, the former name of Regent. We should note at this point that whilst we were not influenced in any way by the decision of the Tribunal in Regent which is not binding upon us, we found it a relevant background against which to assess the Appellant's knowledge or means of knowledge. In the absence of any evidence from the Appellant we accepted HMRC's submission that if, as Mr Belfield told the Tribunal in Regent, there had been a disagreement with Mr Nicholson it was unlikely that he would seek finance for the Appellant from Lorimer. If there was no such disagreement, we queried why Lorimer would provide a loan when Mr Belfield, through Regent, owed a significant debt to Lorimer. Furthermore there was no evidence that either of the loans have, to date, been repaid or that Lorimer have taken action against either company to recoup the money. We inferred from this that the loans were not arm's length transactions and for the reasons set out above we concluded that Lorimer's loan to the Appellant lacked commercial rationale and had been provided to facilitate the Appellant's part in the fraud.

193. As regards the Appellant's use of the PS&L bank, we accepted that it provided the Appellant with a 24 hour banking service. That said, we noted the unchallenged evidence of HMRC regarding circularity of funds within the bank, the fact that HMRC are unaware of anyone having ever withdrawn or deposited funds and that it was used by all parties who traded in Rogue Penguin. Taken together with the link between the bank's website and Rogue Penguin, we were satisfied that the use of PS&L indicated contrivance. In the absence of any evidence to the contrary we were satisfied that the Appellant must have been aware that it could not make withdrawals and we queried how he came to use the bank. It appears that in addition to failing to notice that Rogue Penguin was incorrectly referred to as "Rouge" by his customers, Mr Belfield also incorrectly referred to the bank as "PCL" in his letter to the Tribunal dated 11 March 2013. We inferred from all of these factors that the Appellant's use of PS&L was a necessary part of the fraudulent scheme and indicated that he was aware of the fraud in which he was participating.

Awareness of MTIC Fraud

194. There was no suggestion by Mr Belfield that he was unaware of the prevalence of MTIC fraud and we were satisfied that in his role as director of Regent Mr Belfield had been informed by HMRC about such fraud on a number of occasions. We noted Mr Belfield's contention that he operated Regent independently of the Appellant however we were satisfied that the knowledge gained via Regent was a relevant factor against which to assess the Appellant's knowledge in this appeal.

Inspections and Insurance

195. We found as a fact that the inspections undertaken were basic and provided no information about the condition of the goods. We queried why there was no evidence of storage costs and why the Appellant had insured the goods whilst in transit but not in storage, particularly given Mr Belfield's assertion in his witness statement that the stock value during transit was very little. We also noted that the insurance cover the deals carried out on 31 October 2006. In the absence of any evidence or explanation from the Appellant we concluded that the inspections and insurance were no more than "window dressing" obtained to assist the Appellant in making his repayment claim from HMRC.

General

196. On the basis of the evidence before us, it was clear that the Appellant failed to query obvious features of its transactions which would have led to the clear indication that the transactions were connected to fraud. The type of questions which we would expect any reasonable businessman to have asked, and which in our view are as applicable to this case as one involving mobile phones, are set out in *Mobilx* (at paragraph 72):

"(1) Why was BSG, a relatively small company with comparatively little history of dealing in mobile phones, approached with offers to buy and sell very substantial quantities of such phones?
(2) How likely in ordinary commercial circumstances would it be for a company in BSG's position to be requested to supply large quantities of particular types of mobile phone and to be able to find without difficulty a supplier able to provide exactly that type and quantity of phone?
(3) Was Infinity already making supplies direct to other EC countries? If so, he could have asked why Infinity was not making supplies direct, rather than selling to UK traders who in turn would sell to such other countries.
(4) Why are various people encouraging BSG to become involved in these transactions? What benefit might they be deriving by persuading BSG to do so? Why should they be inviting BSG to join in when they could do so instead and take the profit for themselves?"

197. We agreed with and had regard to the comments of Judge Bishopp in *Calltel Telecom Ltd v HMRC* [2007] UKVAT V20266 (at 52):

"…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 at paragraph 51 of the judgment in Kittel*."*

198. We were satisfied that in looking at the overall pattern of the Appellant's trading there were numerous objective factors which indicated the contrived nature of the transactions which were within the knowledge of Mr Belfield, for example the lack of commerciality of the loan, the high value deals with previously unknown trading partners, the Appellant's lack of experience, the consistent profits and mark-ups made which were significantly greater than those of Fairford which had worldwide distribution rights and the absence of any meaningful due diligence into trading partners or the product itself.

Conclusion

199. We were satisfied that HMRC had established fraudulent tax losses and that there was an orchestrated scheme for the fraudulent evasion of VAT connected with each of the transactions which form the subject of this appeal.

200. We did not focus unduly on the issue of due diligence, and we took into account all of the surrounding circumstances in reaching our decision that the Appellant knew that each of its transactions were part of an artificial scheme. In doing so, we concluded that the Appellant had actual knowledge that the transactions were connected to fraud and that, by its purchases, it was taking part in transactions connected with the fraudulent evasion of VAT. We were also satisfied that the factors identified above would also support a finding of means of knowledge.

201. We found that some reasons carried more weight than others and we did not base our decision solely on one reason but rather the cumulative effect of our findings viewed in totality.

202. HMRC has proved that the Appellant's means of knowledge was such that the transactions fell outside the scope of the right to deduct input tax. Accordingly we found that the decision of HMRC to deny the Appellant's input tax was correct and is upheld.

203. The appeal is dismissed.

Costs

204. We direct that the Appellant is to pay HMRC costs of, incidental to and consequent upon the appeal, to be the subject of detailed assessment if not agreed.

205. 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.

J. BLEWITT
TRIBUNAL JUDGE

RELEASE DATE: 6 September 2013