TC03732

Appeal number: LON/2007/01221

Value Added Tax - MTIC Appeal - Whether the Appellant's deals were all shown to be connected to VAT losses - Whether all VAT losses were fraudulent - Whether the Appellant knew or ought to have known of connections to fraudulent losses, when those were established - Appeal dismissed

FIRST-TIER TRIBUNAL
TAX CHAMBER

E-TEL (UK) LTD

Appellant

-and-

THE COMMISSIONERS FOR HER MAJESTY'S REVENUE & CUSTOMS

Respondents

TRIBUNAL: JUDGE HOWARD M. NOWLAN
MR ANDREW PERRIN

Sitting in public at the Royal Courts of Justice, London on 5 - 24 February 2014

Leon Kazakos, instructed by Bark & Co, on behalf of the Appellant

Lucy Wilson-Barnes, instructed by the Solicitor and Attorney for HMRC, on behalf of the Respondents

DECISION

Introduction

1. This was a relatively simple Missing Trader or MTIC appeal in which HMRC had denied claims for input tax in respect of 57 deals undertaken by the Appellant between March and July 2006. All of the deals involved supplies of mobile phones. The cumulative input tax in dispute was approximately £2.7 million, the detailed figures being given in paragraph 19 below.

2. Any reader of this decision is almost bound to be familiar with the issues that arise in MTIC appeals. Stated shortly, however, HMRC contends that a fraudulent party has imported goods (mobile phones in this case) from an EU supplier on a VAT-exclusive basis; then sold them to a UK buyer in circumstances where HMRC allege that the importer failed to account to HMRC for the VAT which should have been accounted for in respect of the entire sales proceeds; the phones have then been sold down a chain of traders, each of whom has accounted for VAT on the fine margins made by each, the first thus claiming an input deduction for the VAT shown on its purchase invoice which was allegedly not paid to HMRC, with the present Appellant then exporting the phones out of the UK and reclaiming the VAT which, through the alleged fraud of the importer, has never been paid to HMRC. The resultant two issues for us to decide are:

- whether the Appellant's export deals were indeed connected to the transactions in which some other party failed to account for the VAT, and whether that default was fraudulent; and
- whether the Appellant knew or ought to have known of that connection.

The burden of proof falls on HMRC, so that we are required to decide whether, on the balance of probability, HMRC has demonstrated the two critical points just stated.

3. One minor, but simple, complication in this Appeal was that the Appeal involved not only the denial of input tax on the above *Kittel* grounds in respect of the great majority of the deals, but actual assessments of output tax liability in respect of 9 transactions where mobile phones had been sold for cash to an individual buyer who was expected to declare their export when leaving Gatwick airport. In the event, HMRC claimed that no proof of export had been demonstrated, such that the Appellant (that had initially treated the sales in question as not being liable for VAT) was assessed for the relevant output tax.

4. The respect in which all the deals challenged on *Kittel* grounds were simple is that the facts in relation to all of them were substantially similar. Notwithstanding that we were provided with 95 lever-arch files of evidence and documents, from the standpoint of the way in which the Appellant operated, there was little difference between the various deals. The Appellant's attention to detail and diligence in seeking to verify details and the credibility of its trading partners was poor. As a result there were detail slip-ups in certain transactions and thus minor differences, but these are best described as just examples of the poor attention to detail and reality.

5. While the facts in relation to the method of operation of the Appellant are simple, there are several reasons why we have found the Appeal to be a difficult one. This is partially because there has been no "give-away" point that in reality puts the issue of whether the Appellant must have known of the connection of its deals to fraudulent VAT losses beyond doubt, such that in this Appeal we must address more general indicators to reach and explain our decision. Additionally, the Appellant's counsel raised numerous points, disputing the claim that HMRC had traced all of the deals to fraudulent losses, sometimes questioning the tracing, and sometimes suggesting that defaults might not have been occasioned by fraud. In relation to the crucial issue of whether the Appellant must have known of such connections (where established), the Appellant's counsel challenged much of the FCIB evidence, and the respect in which it was sometimes claimed by HMRC that that evidence demonstrated that money had flowed round in complete circles, strongly indicating clear knowledge of the pre-planning by all parties in the circle.

6. One example of an absent "give-away" point is that there was no equivalent of the present Appellant having been supplied with extraordinary loans or credit in some other fashion in order to fund the Appellant's cash flow gap on buying goods on a VAT-inclusive basis and selling them on a VAT-exclusive basis. We were satisfied that while the Appellant only paid its suppliers in the vast majority of cases after receiving payment from its customers, it did immediately then pay the greater amount of VAT-inclusive price. It did not have to defer any part of the payment to the supplier until receiving its later VAT refund from HMRC, and it had received no extraordinary funding from some strange third party to make those full payments of VAT-inclusive price. It appeared incidentally that the available resources to meet the initial excess outflows seemed to have resulted from earlier deals (both UK to UK or "buffer" deals and "broker" deals that had not been challenged by HMRC).

7. We will deal in two ways with the Appellant's counsels' contentions in relation to the three issues of:

- tracing to VAT losses;
- considering whether the losses resulted from fraudulent conduct; and
- disputing circularity in relation to the FCIB evidence.

8. Particularly in relation to the first two topics, and to an extent the third, we will explain the more general grounds on which we arrive at our conclusions that HMRC has established connection to fraudulent VAT losses, regardless of any gaps in the tracing exercise that the Appellant has criticised. We will then separately deal with and reject various of the Appellant's challenges to the tracing to fraudulent losses on fairly general grounds. As regards the FCIB evidence we will also emphasise the manner in which we find this evidence useful, quite apart from the one issue of suggested circularity, and then we will explain why we consider some of the Appellant's challenges to the single issue of circularity of payments to be insubstantial.

9. Dealing very shortly with our more general approach to the first two areas of dispute, we first conclude that the overall circumstances - the strings of participants that have bought and sold the goods before the supply to the Appellant in the case of every single deal, generally all on the same day, and generally at utterly fictitious-

looking margins (generally at the same level in deal after deal), coupled finally with the Appellant making a vastly greater profit that cannot be explained on commercial lines – simply cannot be explained without pre-arrangement. Perfectly obviously nobody arranges such a string of artificial looking transactions in the context of *bona fide* grey market trading. In reality, therefore, there can be no other explanation for the pre-arrangement than that it is designed to facilitate the successful completion of a fraudulent evasion of VAT. The notion, for instance (one of the Appellant's counsel's suggestions) that the importer might have innocently failed to pay its VAT liability because it mistakenly paid its foreign supplier on a VAT-inclusive basis, having been invoiced only for a VAT-exclusive price, then gathering that its supplier refused to refund the excess, with the importer refraining from suing to recover because of the costs and uncertainties of international litigation is bewilderingly improbable. But, aside from that, our general point is that planners do not attach a string of artificial deals that are obviously pre-planned chain transactions to slips made innocently by idiots.

10. Our general point in relation to the Appellant's counsel's challenges in relation to the FCIB evidence, is that we learn more from the FCIB evidence than the single issue of whether money passes round in circles. The common MTIC feature of moneys being amalgamated in much larger balances at some of the steps outside the UK, the feature of the payment chains periodically skipping the defaulter and sometimes the initial two buffer companies as well, often without any documentation to authorise those third party payments, the feature that several parties (on one occasion the Appellant being one of them) sent their instructions to First Curacao International Bank ("FCIB") from computers using the same IP addresses as other traders elsewhere in the chain, all further re-confirm planning and pre-arrangement.

11. Logic then dictates that it is inconceivable that there can have been independent and quite separate planning of, firstly, the supply steps in the transfer of stock to the Appellant, and, secondly, those outside the UK, in relation to the subsequent sales or antecedent payments. The steps must all be part of one indivisible plan, and once the Appellant has then declined to give any evidence to the effect that he was unwittingly fooled into supplying goods purchased by him to some particular suggested foreign customer, or fooled in some way into sourcing goods to match a customer's order into sourcing them from some indicated supplier, we conclude that the Appellant simply must have been lying and must have known that its transactions were an integral and essential part of one single pre-arranged plan.

12. While we will thus explain our Decision in part by reference to those general points, which somewhat side-step the particular arguments advanced by the Appellant's counsel on the three points mentioned in paragraph 7 above, we will also deal with the Appellant's counsel's particular points but in general terms. Much of our rejection of all the Appellant's counsel's particular arguments is geared to the fact that many of the arguments are extremely far-fetched. It is not good enough to advance far-fetched and unreal suggestions as to how the transaction steps might be explained away so as to avoid arriving at a conclusion that there must have been a connection to fraudulent evasion of VAT. Our duty is to consider whether, on the balance of probability, the various *Kittel* tests have been demonstrated by HMRC, and when the surrounding circumstances suggest that the transactions very much appeared to involve MTIC frauds at every stage, our conclusion that on the balance of

probability that is indeed so is not going to be undermined by wholly unrealistic claims. This is not a case of assuming what we are required to demonstrate, an error that the Appellant's counsel naturally protested that we should avoid. It is rather a case of judging the proper issue realistically and correctly in the circumstances that prevail.

The format of the remainder of this Decision

13. In the remainder of this Decision, we will deal with the following matters in the paragraphs indicated:

- in paragraphs 14 to 18 we will make a short reference to those who gave evidence;
- in paragraphs 19 to 88, we will summarise the relevant facts;
- in paragraphs 89 to 109 we will explain the general grounds, referred to in paragraph 9 above as to why we decide that on the balance of probability all the Appellant's deals challenged on *Kittel* grounds were connected to VAT frauds;
- in paragraphs 110 to 120 we will explain why we reject the Appellant's counsel's criticism of HMRC's tracing exercise and HMRC's contention that, on the balance of probability, all the defaults were fraudulent;
- in paragraphs 121 to 127 we will dismiss some of the Appellant's criticisms of the FCIB evidence, and record our conclusions as to the significance of that evidence;
- in paragraphs 128 to 151 we will give formal findings of fact in relation to three separate matters. The second is the crucial point of whether we conclude that the Appellant must have known of the connection of its deals to fraudulent losses, the relevant finding immediately leading to our decision in relation to that matter. The third is whether, should the second conclusion be wrong, we find the facts to sustain the alternative decision that the Appellant certainly ought to have known of the connection of its deals to fraudulent VAT losses; and
- in paragraphs 152 to 155 we will give our decision in relation to the assessments to output tax in relation to the deals where the Respondents claimed that there was no or insufficient evidence of the exportation of the mobile phones sold to justify the Appellant's initial expectation that its supplies of phones to a Mr. Boumrah would be zero-rated or outside the scope of VAT.

The evidence

14. Considerable evidence was given in this case. The decisions denying input tax and the assessments to modest amounts of output tax were made in relation to the Appellant's monthly VAT periods from 03/06 to 08/06. The case officer for the 03/06 period was Ms Jayne Holden, whilst the case officer for all the remaining periods was Ms. Angela Williams. Both gave extensive Witness Statements and both were cross-examined at some length.

15. Many other HMRC officers gave evidence in relation to the various companies that HMRC asserted had been the fraudulent defaulters. All such officers gave their

evidence fairly. We will not need to refer to much of the evidence in any detail since we will reject the Appellant's contentions in relation to lack of connection and lack of proof that VAT losses to which connection has been traced were fraudulent on the two approaches already mentioned.

16. As regards HMRC officers, we merely need to mention at this stage that Mr. Andrews gave evidence in relation to the FCIB banking evidence, and we consider that he did this in a measured way. He claimed to have shown circularity in payment flows in the case of some of the deals. In relation to others he very fairly said that with a few assumptions, particularly geared to cases where payments outside the UK were amalgamated into much larger balances, it seemed at least possible that the evidence suggested circularity, and there were yet others where he fairly said that he could not assert that the evidence exhibited circularity.

17. The only person to give any evidence on behalf of the Appellant was Mr. Nemish Mehta ("Mr. Mehta"). We should record that a considerable period had obviously elapsed between the events relevant to the Appeal, i.e. obviously events in March to August 2006 and the date of the hearing, so that Mr. Mehta can perhaps be forgiven for having forgotten certain facts. The Appellant's counsel also asked for somewhat longer transcription breaks during the hearing because he said that Mr. Mehta was suffering from stress and that the hearing itself had been deferred from earlier dates because of illness or stress suffered by Mr. Mehta.

18. Having said that, we should immediately record that in many respects we found Mr. Mehta's evidence to be unsatisfactory. We will explain that in later sections of this decision, but must say at this point that we felt unable to believe everything that he claimed and asserted.

The facts in some detail

The decisions and the assessments

19. HMRC issued various letters, deciding to disallow input tax and, in relatively modest amount, levying assessments where it was claimed that a customer who had bought goods for export had in the event not fulfilled the export requirements on leaving the UK at Gatwick Airport. The various challenges were for each of the Appellant's monthly return periods from 03/06 to 08/06. The total amounts of input tax denied, and output tax assessed for the various periods were as follows:

VAT period	***Input tax denied***	***Output tax assessed***
03/06	£795,073.13	
04/06	£1,132,066.20	£1,485.63
05/06	£709,216	£1,534.34
06/06	£28,612.50	£755.85
07/06	£36,137.51	£2,391.90
08/06		£353.72
Totals	**£2,701,105.30**	**£6,521.44**

20. We were told by Mr. Mehta that during the year 2006, UK to UK deals were also undertaken, those constituting between 50% and 80% of the Appellant's turnover in that year. Whilst documents were provided to us in relation to the total deals in the period, and indeed the deals, both UK to UK sales, and exports to the EU and exports outside the EU in periods prior to March 2006, we were not taken during the hearing or in any cross-examination to these deals. In now addressing the background to the transactions that are presently in dispute in the periods 03/06 to 08/06 we will make a further short reference to the trading in the earlier periods.

The background facts

21. Mr. Mehta had been involved with mobile phones in various capacities since 1986. From 1986 to 1991 he worked part-time for a retail computer sales business called Hi-Way Hi-Fi Limited, which had shops in the Edgware Road and Tottenham Court Road. In 1991 he was promoted to the IT department, setting up new computer systems and training. Between 1996 and 2000 he was promoted to the Exports Division run by Hi-Way Exports Limited.

22. From May 2000 to 19 December 2002 he was a director of a company selling mobile phones in the wholesale market called Smart-Tel UK plc ("Smart-Tel"). He was a 20% shareholder in this company, and acted as sales director, also being responsible for VAT filings. The Respondents claimed that various MTIC warning letters had been sent to Smart-Tel whilst Mr. Mehta was employed there, but Mr. Mehta claimed that the visits from HMRC officers were routine visits and that no input tax had been denied whilst he worked at Smart-Tel. He left Smart-Tel, following a dispute with the other directors about his remuneration on 19 December 2002.

23. The Appellant had been formed in late November 2001. The shares in the Appellant were owned in equal shares by Mr. Mehta and his wife, and at all times Mr. Mehta was the only director, and his wife the secretary, responsible it seems for a considerable amount of administrative and accounting work. There were never any other officers or employees.

24. The Appellant sought VAT registration on 4 December 2001, at which point it estimated that its turnover in the next 12 months would be £24 million. In fact the Appellant had not commenced to trade by September 2002. In its first VAT period from 1 October 2002 to 31 December, it reported turnover of £1.1 million and paid VAT of £1,175.40. Early in 2003 it sought and obtained consent from HMRC to report for VAT on a monthly basis and by 31 December 2003, its turnover had well exceeded the £24 million estimate, amounting to £65,249,132. The turnover in the following two years was roughly £87.5 million and £126 million, falling back marginally in 2006 to roughly £98 million, and then merely at £236,052 in 2007. We were told that the Appellant ceased trading at some point, but that by the date of the hearing trading had re-commenced at a modest level, and we were told that the company was said to be solvent.

25. The Appellant operated, presumably from the date the lease was taken in February 2003, from leased premises in a serviced office complex in Harrow. Reference was made to the fact that there was sufficient room in the premises for

stock to be held in the premises, though it seemed clear that in the case of all the deals in the contested period of 2006 where input tax was denied, the stock was dealt with whilst in the warehouse of a freight forwarder, and was never held in the office.

26. Whilst Mr. Mehta was somewhat evasive about admitting to having received information and warnings about MTIC activity from HMRC officers, we are satisfied that on a number of occasions relevant warning letters were sent to Mr. Mehta. Some had almost certainly been sent even when he was working at Smart-Tel, but we will ignore the issue of whether Mr. Mehta would necessarily have been involved with looking at letters received by Smart-Tel. Far more obviously he must have been aware of MTIC risks by 30 March 2004 because on that date he was sent a letter by HMRC informing him that the Appellant's VAT repayment claim for the period 02/04 was being subjected to extended verification, and informing him of HMRC's estimate of the losses to the Exchequer from MTIC fraud. More significantly, on 2 December 2004, the Appellant received a letter from HMRC refusing the reclaim of input tax for the period 08/04, contending that:

> *"The purchase and corresponding sales judged objectively were devoid of economic substance. They were not part of any economic activity. Accordingly the purchase was not a supply used or to be used for the purpose of a business and the sales were not supplies made in the course of a business for the purposes of VAT."*

27. Having quoted that letter to Mr. Mehta in cross-examination, HMRC's counsel put the following question to Mr. Mehta, which he answered as follows:

> *Question: "Would it be fair to say from the very early stages of E-Tel's trading it was coming into difficulties in relation to effectively the issue of fraud as contended for by HM Customs & Excise, because they actually categorise it as being devoid of economic substance?"*
>
> ***Mr. Mehta: Mm-hmm, reading at this, yes, correct"***

28. We were not given details of the outcome of the particular challenge. It seems that at one point there was a potential appeal to the VAT & Duties Tribunal, but it also seems that the challenge was dropped. Whether this was because HMRC progressively came to realise that their initial basis of challenge, geared to the contention that transactions had been outside the course of business, was running into difficulties we do not know for certain, but that is obviously a possibility.

29. One significant outcome of the challenge made of the 08/04 VAT return and of the fact that in November 2004 Mr. Mehta had been informed that one of his suppliers, TM Mobiles, had been de-registered, was that Mr. Mehta engaged the services of a specialist VAT consultancy called Borders VAT Services Limited ("Borders"), run apparently by a Mr. Holmes. Asked whether Mr. Mehta sought the services of Borders because of the difficulties that he had had during 2004 in reclaiming input tax, Mr. Metha replied:

> ***"That is exactly why I engaged Borders Services to carry out the necessary steps to protect E-Tel."***

The use that the Appellant made of the independent services available from Borders, Veracis Limited ("Veracis") and CreditSafe

30. In this section of our Decision we will simply record the facts in relation to the Appellant's use of services from the above three firms.

31. The significance of the fact that the Appellant used the services of these firms, principally Borders and Veracis, is that Mr. Mehta suggested that his reliance on independent professionals to improve the Appellant's standards, and the fact that the Appellant had to pay quite significant sums for the relevant services goes to indicate how seriously the Appellant treated the importance of its due diligence and its general professionalism. What we will have to assess, in giving our findings of fact below, is whether the appointment of these firms, and the conclusions from the various topics that we deal with in paragraphs 41 to 61 below, lead us to conclude that the appointment of these firms and the surrounding evidence suggests that the aim was to secure really genuine protection against the risk of becoming inadvertently involved in MTIC frauds, or whether the aim was to create a fabric and a smoke-screen of checks on immediate trading partners so as to impress HMRC and hopefully undermine claims that the Appellant was a knowing party in the overall pre-arranged planning.

32. We were told that Borders had been recommended to Mr. Mehta by other traders, and that Mr. Mehta later recommended Borders to some of his trading partners. Borders was plainly familiar with all the due diligence declarations that HMRC was suggesting that traders should obtain from their trading partners because it drafted perfectly accurate Declaration forms for the Appellant to use. Needless to say, the forms effectively repeated the suggestions made by HMRC. In retrospect we now know that because the exporters or brokers in MTIC transactions were insulated from the frauds by a string of buffer companies, the checks were virtually entirely pointless, since no frauds would ever be revealed in the immediate vicinity of the exporters. Nevertheless for what it was worth, the documentation was created, and often duly submitted to the trading partners.

33. One of Borders' recommendations, adopted by Mr. Mehta, was that he should improve his due diligence in relation to his suppliers and customers (the suppliers in particular) by appointing Veracis to visit the Appellant's potential trading partners, and prepare reports on their business practices and their credit standing, providing lists of the positive and negative indicators that Mr. Mehta might take into account in deciding whether those companies were suitable businesses with which he might safely trade.

34. Mr. Mehta was also given a free trial to take records from CreditSafe, a company that prepared reports on the credit standing of various companies, including many in the wholesale mobile phone sphere of activity.

Further contact from HMRC

35. Prior to summarising the standard of due diligence undertaken by Mr. Mehta in implementing his own due diligence checks on suppliers and customers, we should mention two events that have a bearing on this matter.

36. First, on 8 August 2005, two HMRC officers made a visit to the Appellant, and interviewed Mr. Mehta, who was accompanied at that meeting by Mr. Holmes, in order to ask many questions about the Appellant's method of operation. A written report was made of the interview, and it is noteworthy that Mr. Mehta was recorded as having given a number of responses at this interview which later events demonstrated were either untrue, or very misleading.

37. According to the HMRC report, Mr. Mehta claimed that he *"met with the suppliers and customers either at the premises of the supplier, customer or e-Tel. This was conducted over a meal or drink and was informal. Future visits were to be conducted by Veracis."* In cross-examination it emerged that Mr. Mehta had almost certainly not met the majority of the suppliers, and possibly any of the customers with whom he had done business in the period dealt with at the relevant interview. Following Veracis's appointment, we accept that Veracis did visit companies on which it provided reports, though it was sometimes unclear whether the visits had immediately or shortly preceded the provision of the reports.

38. Mr. Mehta also said that whilst goods were at the freight forwarder's warehouse, they were insured by the freight forwarder. It later seemed that this was true, but it certainly emerged that Mr. Mehta had no idea what the terms of, or level of, insurance cover were with the different freight forwarders. More relevantly Mr. Mehta claimed that whilst the goods were in transit they were insured by the Appellant. It later emerged that they were never insured during transit, so that Mr. Mehta's claim to the HMRC officers had been untrue.

39. Mr. Mehta also said that he paid for inspections of stock, usually effected by A1 Inspections, and that the inspections were 100% Inspections and that E-Tel received an inspection report. That was a considerable over-statement, if not simply untrue, as we will mention below. We do accept that the other statement was true, to the effect that A1 Inspections kept a database of IMEI numbers of phones that the Appellant had dealt with in the past and checked that none in the consignment currently being inspected had been dealt with by the Appellant before. In due course we will also comment on the significance of those IMEI checks.

40. The other event that occurred that we should mention before dealing generally with the subject of due diligence, the general attitude of Mr. Mehta to visiting and checking out his suppliers, and the consideration apparently given to the content of Veracis and CreditSafe reports was that in November 2005 and more significantly in January 2006, HMRC wrote to the Appellant notifying it that in the case of deals that the Appellant had undertaken through 13 suppliers, those deals had all be traced back by HMRC to tax losses.

Facts in relation to the Appellant's practice of visiting trading partners, taking references from referees, adhering to standards associated with the type of traders that the Appellant would and would not deal with, considering reports from Veracis

and CreditSafe, and reaction to indications from HMRC that deals undertaken through earlier suppliers had been traced to VAT losses

41. We will deal with all the points mentioned in the heading just given together because we consider that they all exhibit a similar indication of Mr. Mehta's attitude to the real significance of such matters.

Meeting suppliers and customers

42. Although Mr. Mehta claimed at the interview that we mentioned in paragraph 37 above that he met with his trading partners either at their premises or his, it emerged that there were many suppliers and customers that Mr. Mehta had never met. Quite apart from the material fact that Mr. Mehta's response to the HMRC officers at the interview dealt with above was largely untrue, we consider it more realistic to conclude that he very rarely met with any customers. He did periodically travel to Dubai, and several of his customers (and even one of his UK suppliers) were based in Dubai, and it was when he was in Dubai that we have the occasion of both Mr. Mehta and a Pakistani trader somewhere in the "hidden" foreign part of a particular chain of payments both logging on to the internet to give their payment instructions to FCIB on computers with the same IP address. That apart, however, as regards customers, it is closer to the truth to say that it was only in rare instances that he met any of them anywhere.

Taking (or rather not taking) references and providing references for others

43. Mr. Mehta said that he never took references on trading partners. He sought to explain this by saying that when he was asked to provide referees in relation to the Appellant's standing, he would never give one of his immediate trading partners as a referee in order to preserve the confidentiality of their identity, and would give some more remote party as his proffered referee. Since this would render any reference that might be obtained from such party to be of little use, he assumed that the same would be the case if he followed up references offered to him by trading partners. When asked, however, whether he would bother to take a reference from an accountant when a potential trader had volunteered their accountants as one of its referees, he still said that he would not bother to take up the reference.

44. His contempt for the significance of references went a step further than the points just mentioned because it emerged that when Mr. Mehta, in his turn, was asked to provide a reference for some trader where his name had been given as a referee, he was always prepared to provide a good reference, and so far as we could tell in standard and identical terms, regardless of whether he actually knew anything material about the trader in question. When asked effectively whether this was somewhat irresponsible, he seemed to indicate that his expectation was that as the person asking for the reference just wanted to fill in a bit of paperwork, he ought to provide the sort of answer that they would want, so enabling them to add a further bit of paper to their file of documents. If they really wanted to verify the reference they would probably ring him up.

45. Mr. Mehta's attitude was well illustrated by the questions put to him by the Respondents' counsel, and his answers, all in relation to one of the various references that he had given, when requested. The terms of the reference were as follows:

> *"**TO WHOM IT MAY CONCERN***
>
> ***Re: Globelink Communications Ltd***
>
> *Dear Sir/Madam*
>
> *Please take this is as a confirmation that I have conducted business with the above mentioned company and have found them to be an honourable company with good standing within the business community.*
>
> *I, therefore, have no hesitation in acting as a reference for them.*
>
> *Yours truly,*
>
> *Nemish Mehta"*

46. The cross-examination by the Respondents' counsel and the responses were as follows:

> *Q. Were you seriously in a position to be able to give that sort of reference for a company with which you had been trading for about three months in a trade sector which you knew to be subject to a high risk of fraud?*
>
> ***A. This is just a letter that I didn't consider in anything further than - besides giving a reference that he wanted that's all it was. There is nothing financial that I felt that I will be - under it that will harm me. For that reason, I've probably sent this letter out.***
>
> *Q. Did it not occur to you that there may be individuals within the description "to whom it may concern" that may be relying upon that reference?*
>
> ***A. I don't recall***
>
> *Q. The point is – I'm not asking you to recall, you wouldn't necessarily know to whom it had been sent - your answers a few moments ago suggested that you simply wrote it without giving too much attention as to how it might be used, because it didn't have any financial impact for you. The reality is it may well have a serious financial impact for somebody else, mightn't it?*
>
> ***A. That's up to somebody else, if they would have taken this seriously, they may have rung me. But that's about it, that's all that matters - that's all it stands, that I have written this letter, I accept it, but I have no idea what this - where this letter went, I can't remember, and I don't even remember, wherever this letter may have gone, if they had contacted E-Tel about this reference.***

Q. You said a few moments ago if they had taken it seriously. Is it the position that you didn't take writing this reference very seriously?

A. I think I just must have written it out with a reason that I don't remember."

47. Needless to say, and not least because several references in virtually identical terms were shown to us, we found this attitude to providing references, and more particularly the bewildering responses given to the Respondents' counsel's questions just quoted both extraordinary, and indicative of Mr. Mehta's disregard for reality, and dominant attention to providing, and in his turn, collecting, bits of paper.

48. It was accordingly impossible to reach any other conclusion than that Mr. Mehta considered that references were completely pointless. We accept that in many cases, HMRC were sending traders down a line of enquiry that was indeed likely to be fairly pointless, but Mr. Mehta certainly treated the subject with above-average contempt.

Careful selection of new trading partners

49. In his Witness Statements, Mr. Mehta claimed that he was careful in selecting new trading partners, and would not deal with companies that had been trading for less than a year, or companies whose trade designation for the purposes of their VAT registration did not specify something that clearly encompassed wholesale trading in mobile phones. He would also not deal with companies whose standards he considered to be insufficiently professional.

50. Beyond our obtaining the general impression that the Appellant traded with a number of companies about which Mr. Mehta knew very little, Mr. Mehta ended up having to agree, when the point was put to him by the Respondents' counsel, that in the case of 4 out of the 7 new trading partners with which the Appellant had traded in March 2006, those companies had not been trading for a year at the time of the deals with the Appellant. There were also examples of trade with companies with general trade descriptions in their VAT registration applications, and others where the trade category had only recently been changed.

51. More generally, as the Veracis reports indicated, it was difficult to describe any of the trading partners as substantial entities. The vast majority were of course effectively "one man bands", with a very poor credit score and relatively often reported deficiencies in their documentation or due diligence efforts.

52. We considered that the Appellant's choice of trading partners, and more particularly his claims about the rigorous standards adopted in deciding whether or not potential new partners were ones with whom it was suitable and safe to do business, did not live up to Mr. Mehta's claims.

The advice from Borders and the Veracis reports

53. We were given little information about the advice given by Borders, save that Borders presumably provided much of the deal documentation that we see in the March to August 2006 transactions, and the various required Declarations. When we deal with the documentation we will make some criticism of a few points but our more significant criticisms are far more related to the commercial improbability of certain of the steps (and to a certain extent, the resultant feature that some of the few trade terms glossed over the difficult points), rather than deficiencies in the documentation.

54. One of the contentions strongly advanced to support the *bona fide* nature of the Appellant's trading was the respect in which the Appellant had incurred considerable costs in taking business advice, and advice in relation to documentation, including questionnaires and declarations, from Borders, and more particularly costs in engaging the services of Veracis in vetting business partners. In this context, we consider that the attitude that Mr. Mehta exhibited in relation to the Veracis reports was somewhat remarkable.

55. We were shown several Veracis reports. They covered the obvious topics of the personnel, their business standards and documentation, accounting information if there was any, and a credit review. Towards the end there were generally lists of positive and negative indicators, there generally being many more negative indicators than positive indicators.

56. It was stressed, and indeed obvious, that Veracis did not purport to make the decision as to whether it was suitable for the Appellant to trade with the particular company being considered in each report. That was always Mr. Mehta's choice. When the Respondents' counsel cross-examined Mr. Mehta as to why he had thought it appropriate to trade with a company with poor credit standing, and numerous other negative indicators, Mr. Mehta's response was generally along the lines that it was a judgment that he would have taken at the time, and (as asserted by every appellant in MTIC appeals) he was unconcerned with poor credit standing whether he was looking at the supplier or customer. In the case of the supplier this was because he was receiving transient credit from the supplier, not giving credit. In the case of the customer, phones would never be released from the Ship on Hold constraint until the customer had paid for them. Accordingly even if they had been delivered to the customer's freight forwarder, facilitating inspection by or on behalf of the customer, they would still remain under the control of the Appellant (or actually of course often under the control of one of the earlier parties in the string of suppliers above the Appellant, none of whom would have been paid and none of whom would usually have fully released the goods when actually delivered to the foreign freight forwarder).

57. There were often other very marked negative factors referred to in the Veracis reports. The company might have been late in filing its accounts. The directors might have been reluctant to be interviewed. The company's documentation and adherence to the various recommendations made by HMRC in the numerous MTIC warning letters sent to traders might have been inadequate. When asked what reaction Mr. Mehta had had to a report full of such negative indicators, and whether indeed at the time of his subsequent deal with the company in question Mr. Mehta had actually read the report carefully, we received some very troublesome responses.

Beyond the general claim that the decision as to whether to trade or not was his, which he took at the time in a manner that he considered legitimate, Mr. Mehta actually suggested that at times he did not read the reports particularly carefully. He probably skim-read them. When asked what the point of obtaining the reports was if he was going to ignore everything about poor credit standing, and also ignore numerous other negative indicators, the constant refrain was that he treated the essential point of obtaining the reports as being that of confirming that the trader "was who it said it was". Having established this, whatever this meant, the important thing was to file the report.

58. In relation to reports, we mentioned that Mr. Mehta was apparently given a free trial of the provision of reports by CreditSafe. As we understood matters, he did not engage CreditSafe to provide further reports after the trial period, and his approach to the credit information provided by the CreditSafe reports that he did receive was of course the same as the attitude to similar information in the Veracis reports.

Reactions to information from HMRC that past deals with particular suppliers had been traced back to fraudulent losses of VAT

59. The final matter that we deal with in this section is the reaction of Mr. Mehta to indications from HMRC that past deals involving named counter-parties had been traced to tax losses.

60. There were instances where despite receiving such warnings, the Appellant continued to trade with one of the identified traders. In one example it was said that Borders had written to the relevant party, presumably indicating the respects in which it should tighten up its method of operation (albeit that we now know – in retrospect- that any such efforts would not necessarily have had any impact on the chances that goods purchased from such a company would or would not, at several steps removed, eventually be traced to a fraudulent default), and then the Appellant commenced trading with the relevant company again. There was considerable dispute, in cross-examination as to whether this letter had indeed been written, and whether Mr. Mehta had ever received a copy of it, though if he had received a copy of it, it had been lost.

61. The general point, however, is that Mr. Mehta appeared fairly indifferent to reports from HMRC that earlier deals with a particular supplier had been traced to tax losses, and this information did not preclude him from continuing to trade with such parties.

The documentation in relation to deals, and the consideration of the steps in the various deals

62. We will deal in this section with the numerous points relevant to the deal documentation, and the general implementation of deals.

63. Any reader of this Decision will almost certainly be familiar with the fairly standard nature of documentation and procedures in back-to-back trading where HMRC is claiming connection to MTIC frauds. Consistently with the normal pattern, we see in all the deals in this Appeal, the ordinary deal packs, (ignoring the order in which the documents were despatched and their terms) including customer

orders, the Appellant's invoices to customers, accompanied by Customer Declarations, the Appellant's orders for matching supplies from its supplier, accompanied by Supplier Declarations that the supplier was required to complete, coupled with invoices from the suppliers. There were then requests for inspections, usually sent to A1 Inspections; faxes to the Appellant sending the results of IMEI scans of the phones; release notes sent by the Appellant to the freight forwarder holding the goods in question, instructing them to deliver the goods to the freight forwarder to the foreign customer but subject to a "Ship on Hold" constraint until that constraint in turn was later said to be released. The final document was a document headed "Acceptance of Stock" which the Appellant had sent to the foreign customer, requesting the customer to confirm acceptance of the goods following their full release to the customer.

64. It was commonly the case that with the possible exception of the final document just referred to, all the documents mentioned in the previous paragraph will have borne the same date. Not that the Appellant would have known this at the time, the matching stock offers and invoices up the chain of suppliers almost always bore the same date as well. Payment from the customer, and subsequent payments to the supplier, and so on through the chain will often have been made a day or two later. Whilst it was maintained that enormous effort was required over the phone in arranging the deals, there was not a single fax or e-mail that evidenced the prior work of supposedly searching for suppliers to match a customer order, or searching for customers to take up stock offered to the Appellant from one of its suppliers.

65. We now expand on various features of the terms and documentation.

The origin of deals

66. Addressing the origin of deals, Mr. Mehta explained that deals generally commenced with some approach from a foreign customer, requesting particular stock. Mr. Mehta would then set about seeking to find a matching supplier for that stock, which he would do by ringing around to his various suppliers. He would first approach the suppliers who his experience led him to believe were most likely to have, or to trade in, the types of phone required by his customer.

67. On some occasions (though we gathered that this was less common) the deal commenced with a supplier offering stock, in which case Mr. Mehta would seek to match the offered supply by ringing around amongst his customers to see whether he could place the stock that he had on offer.

68. We expressly put the question, that we consider to be highly relevant, to Mehta as to whether when he received a customer request for stock, or a supplier offer of stock, either was ever accompanied by some indication or suggestion from anyone as to where and how he might manage to match the request for stock or the stock offer that the Appellant had received. Mr. Mehta said that there was never any such indication or suggestion and that it was always through his efforts, in ringing round to suppliers, or customers, as appropriate, and his skill in putting deals together, that he managed to arrange all the deals on a back-to-back basis.

69. We have a few criticisms of the Appellant's documents themselves, though as we indicated above, out concerns are greater in relation to the sheer improbability that the deals could have been entertained by a company acting in a *bona fide* manner, and the resultant oddity of some of the terms that inherently flowed from these more fundamental commercial concerns.

70. The Appellant's purchase Orders indicated a Delivery/Inspection Address, which was somewhat superfluous since almost inevitably the supplier or the indirect suppliers further up the chain of suppliers would have decided which freight forwarder was to hold and inspect the goods. The Purchase Order did, however, appropriately say *"Goods to be inspected by [the appropriate freight forwarder of inspection company] today"*, and then said *"Subject to Redhill & IMEI Verifications"*, which we consider to have been appropriate since failure to obtain satisfactory Redhill and IMEI verification would at least have enabled the Appellant to abort the deal with the supplier. Whether in that event the Appellant would be in embarrassing circumstances by still being contractually committed to supply the stock to the customer we will deal with below, but Mr. Mehta did advance a suggestion as to why he would not be subject to any risk in this regard.

71. The final text in the purchase orders said *"100% CHAPS upon Inspection/Release"*. This at least indicated that the Appellant would not be paying in advance, but the wording did not in fact accord with reality in two ways. Firstly, it would almost inevitably have been known that payment would be made via the internet banking facilities provided by First Curacao International Bank NV ("FCIB"), and more relevantly it was absolutely clear amongst all participants that suppliers would each be paid in turn after their respective customers had paid them first. So there was no intention to pay when the goods had been inspected, and more realistically *"Payment upon release"* might have been more accurate, had it said *"Release upon payment"*. No attention was ever given to whether the credit effectively given by each supplier was "limited recourse credit", under which the Appellant would only be required to pay the supplier if the Appellant's own foreign customer duly paid the Appellant, but certainly as regards timing, it was not in fact expected that that payment would be made, as the Purchase Order asserted, *"upon Inspection/Release"*. It seems possible that it was considered too embarrassing to draft the documentation so as to flag the way in which payments would flow sequentially along the line from foreign customer to exporter, to immediate supplier and so on.

72. Not that we blame the Appellant for this, we note that in some deals the supplier to the Appellant inserted a title retention clause until payment, whilst in others no such mention was made.

73. The Appellant sent a Supplier Declaration to its suppliers along with its Purchase Order. This contained a satisfactory list of the declarations that HMRC was inviting traders to request. It did of course reveal that it was implicit in these deals that the supplier would be expected to extract similar declarations from its supplier (with the equivalent assumption being made in the declarations sought from the Appellant's customer), so that the transaction documentation was obviously contemplating (realistically as we clearly now know) chain transactions, with never

any contemplation of anyone holding stock or acquiring stock as a retailer or for any purpose other than an immediate on-sale.

74. The Appellant's Invoices to its customer did contain some satisfactory terms in that they recorded the delivery destination of the customer's freight forwarder; they indicated that the goods would be delivered on a *"Ship on Hold"* basis, and they also contained the terms *"100% CHAPS on inspection"*, and *"Title to the goods remain with E-Tel UK Ltd until paid for in full"*. Whilst it was coherent to provide that title would not pass to the customer until the customer had paid for the goods, it is far from clear that when the customer had paid, title would indeed pass to the customer, as asserted, because at the point of receipt of payment by the Appellant, the Appellant would not have paid its supplier, and so on up the chain, so that if at any of those stages there were title retention provisions, the Appellant would not have title to pass to the customer. Indeed we are far from clear (in the absence of clear provisions that *"Title would only pass from the Appellant when it had (i) received payment from the customer and (ii) itself acquired title and release from its supplier")* whether the Appellant ever actually acquired or passed title to stock, or indeed supplied it at all. We ignore that latter point and accept that it is never analysed in MTIC appeals.

75. The Respondents' counsel levelled two main criticisms at the Appellant's documentation. One was that there were repeated instances of there being inconsistencies between the product description that a customer might request, and the Appellant's description of the product on its invoice, and similar inconsistencies between the terms of the Appellant's orders to its suppliers and their related invoices. For instance one might have referred to "CE spec" in relation to the phones, and the matching document might omit this reference. There might be a reference to the colour of phones on one document and no equivalent reference on the one that needed to match the first. The Respondents' counsel repeatedly contended that these point could lead to uncertainties, and potential disputes. Mr. Mehta said that the detail would have been discussed orally, and that while the paperwork may not have been perfect, the parties had known what was intended. Ignoring the possibility that the deals may have been pre-planned such that the descriptions were anyway superfluous, we are inclined to pay little regard to this point. The parties would be bound to have accepted the terms of the more specific and detailed document unless one of them had immediately said that the specific references were wrong and revealed a misunderstanding.

76. The Respondents' counsel also challenged Mr. Mehta for having changed the sequence of the documentary steps that he had indicated in his Witness Statements when he came to be cross-examined. We are not particularly troubled by these criticisms either. In the Witness Statements, Mr. Mehta had suggested that the first step in the transaction documentation was the customer's Purchase Order. In cross-examination he certainly said that one general point that always influenced him was that he did not want to incur the costs of inspection reports until he had a customer, so that this supported the proposition that it made sense for the first step to be the receipt of the customer's Purchase Order. At the same time, he appeared to want to keep his options open in case, having arranged the supplies from his supplier, he failed to secure Redhill verification of the supplier, or the inspection revealed that the IMEI numbers of the phones currently being traded matched numbers that the Appellant had earlier dealt with. He might then feel inclined to abort the deal with the supplier, and

would not wish to be contractually committed to supply to his customer in this situation. The evidence became fairly muddled, and Mr. Mehta perhaps understandably began to lose the thread of the questioning. We almost concluded that the end position was that although he had the comfort, at stage 1, of having received a Purchase Order from a customer whereupon he then inspected the offered stock, he might have sought to delay invoicing the customer until he had ascertained that the Redhill and IMEI checks produced no last minute problems. Whether this would have meant that the customer would not be contractually bound in the meantime to purchase we do not know. Since in most cases all the documents bore the same date, and there were not fax timings on many of the documents (even if one could rely on such timings) it was impossible to reach a firm conclusion as to the order in which all steps were accomplished.

77. The Appellant sent customers two additional forms along with its invoice. The second may have been faxed at a later point.

78. The first additional document was called the Customer Declaration which the customer was expected to fill in and return. It contained a number of representations on the part of the customer to satisfy the various requests made by HMRC about the VAT integrity of the customer (as one would expect in a document called a Customer Declaration), and then it concluded with the rather odd term:

> *"You will purchase the goods at the agreed price on the proviso that the goods are in the condition stated, and pass a 100% Inspection & IMEI check"*.

We considered that this clause came in an odd place, in that instead of being an additional representation by the customer in relation to the customer's supposed VAT integrity, it really amounted to an inserted condition into the Appellant's invoice, effective making the supply contract between the Appellant and the customer conditional on the customer's inspection and IMEI checks. Beyond noting that this term appeared to have been inserted into the wrong document, albeit that it was perfectly sensible, the reference to the IMEI check is a point to which we will revert below.

79. The other document that the Appellant sent to customers either with the invoice or, bearing in mind the reference to a phone conversation, probably at a slightly later point was a form headed *"Acceptance of Stock"*. After giving the relevant product description and the number of phones despatched, the form said:

> *"As discussed on the telephone with you today, please can you check the details above and sign/date/stamp this letter and fax back to me in order to confirm acceptance that you received the above mentioned goods from ourselves which we released to you.*
>
> *Please sign and date stamp this and fax back to me on +44 208 426 3980 to confirm you agree with this terms and conditions.*

This form appeared to be somewhat superfluous since the intention was that the customer was only required to pay after it had inspected the goods and performed any IMEI checks that it wished to make, so that receipt of payment would almost certainly

have confirmed the satisfaction of those conditions. Receipt of payment (or rather all payments) would then have led to a string of releases (the last by the Appellant to the customer). Accordingly once the Appellant had given the final release, it seemed superfluous to be requesting confirmation of acceptance, and satisfactory inspection and IMEI reports, when these were implicit once payment had been received. Seemingly the form was required principally just to give the Appellant some evidence of full acceptance of the supply, and to provide something else to add to the file of documentation.

80. Whilst the documentation that we have shortly summarised above was not particularly unsatisfactory, we agree with the Respondents' counsel's claim that there were several unsatisfactory features to the steps in the implementation of deals.

81. First there were a number of instances where matters were dealt with in the wrong sequence. For instance Declarations might be sent, or more often received back, out of sequence so that the deal had proceeded before they had been obtained. Occasionally Redhill confirmations had not been received prior to proceeding with deals. More significantly, the timing of documents often indicated that the available time for goods to be inspected, following the Instruction to the freight forwarder or A1 Inspections to inspect IMEI numbers made it astonishing that any inspections had been done when we were then shown the time that vehicles were logged into Eurotunnel or the Dover ferry port. Yet more significantly there were occasions when the customer made payment and even returned the *"Acceptance of Stock"* form that we have just referred to before the goods (needing to travel by lorry from Calais to a warehouse near Charles de Gaulle airport (on the outskirts of Paris) could possibly have arrived at the warehouse. This was made particularly evident on one occasion when payment was made and the form returned whilst the goods were still in the UK. The Respondents' counsel challenged Mr. Mehta for not having noted that this indicated either just a serious mistake, or the implicit acknowledgment that the deals were all pre-arranged and fictitious.

82. There were a number of unsatisfactory features to the topics of inspection reports and IMEI scans. There was firstly some dispute as to whether the Appellant asked for general inspections of any sort. Most of the documentation, and certainly the fax replies from A1 Inspections just referred to the electronic checking of IMEI numbers on the unopened wrappers that contained usually 10 mobile phones, and the reports virtually never referred to the condition of the packaging, or even the model types of phones. Mr. Mehta said that these matters were usually reported in phone calls, which we do not accept. Anybody paying for inspections of stock, in relation to condition or whether stock matched the claimed description, would want a written report of the results in order to have that evidence of the findings of the inspection company.

83. We accept that virtually all the consignments were scanned to check the IMEI numbers, and to verify that there had been no previous transaction in the phones in the then current deal.

84. There are, however, some awkward consequences that flowed from the IMEI checks and the clauses inserted into the documentation to address these consequences.

85. First, whilst we should perhaps concede that with no publicly available database, it would have been impossible for HMRC to request traders to do anything other than check their current despatches against a list of earlier despatches by the same trader, this "same trader" check was not particularly informative. We understand that when the Appellant's log of IMEI numbers was provided to HMRC, HMRC did ascertain that on both earlier and later occasions the phones traded by the Appellant had been sold in other deals by other traders. So, the Appellant's own IMEI log was of fairly limited assistance in controlling re-circulating deals.

86. Had an IMEI check, however, revealed that the Appellant had earlier dealt with the same phones, and had the Appellant though it prudent to rely on the term of its purchase order to abort the deal with the supplier, this would have posed a serious problem for the supplier (which might well never have traded in the phones before), and would also have posed the problem to the Appellant of whether it was or was not contractually bound to the customer to supply the phones. Mr. Mehta claimed that this was not an issue since he would not have been contractually bound to supply at this point. In the alternative scenario that the Appellant's IMEI check produced a clean sheet of no matches, there is the theoretical point that the customer might have returned the phones to the Appellant had its own IMEI check proved positive, relying of course on the clause referred to in paragraph 78 above.

87. While these potential points were potentially awkward, it emerged that whenever VAT details were checked with Redhill, and when IMEI numbers were checked, no problems were ever encountered. Whether this was because it might have been very obvious to the mastermind arranging deals that the immediate supplier to the exporter and indeed others in the chain always had to be chosen so that valid Redhill confirmations would be available, and product had never to be re-circulated to the same "broker" once it had been traded once by that "broker" we obviously do not know. Having regard to the way in which the deals can be seen in retrospect to have been arranged so as to pass the product through a string of buffer companies, and considering the obvious reason for the insertion of those steps, this explanation may be sound. Whether it is or not is not particularly relevant.

88. Our conclusion in relation to inspections of the condition, models and quantity of phones dealt in, is that there was virtually no evidence in the vast majority of deals that any inspections were carried out, beyond the electronic check of IMEI numbers. The only documentation in the vast majority of the deals related to the near pointless IMEI checks.

Our general ground for concluding that all of the Appellant's deals were connected to fraudulent losses of VAT, distinct from addressing the Appellant's contentions concerning failure to trace through deal logs and contentions that certain defaults had not been positively shown to have been fraudulent

89. Before giving our findings of fact, we will address first the whole issue of whether HMRC has satisfied the burden of proof in demonstrating that the Appellant's deals challenged on *Kittel* grounds had all been traced to fraudulent losses of VAT. It is of course the case that the Appellant will not have known (or at least we must definitely presume that it would not have known) the identity of any supplier above the Appellant's own direct supplier, and would not have known anything about

the defaulter, but there are still some aspects of the present enquiry into the tracing to fraudulent losses that have a bearing of the findings of fact that we have reached, which is why we deal with this issue first.

90. In the present case the List of Issues in dispute indicated that the Appellant was challenging the connection to tax losses in some cases, and the contention that the losses resulted from fraudulent conduct in others. Moreover, as the Respondents complained, the Appellant's counsel virtually doubled the number of deals in which he challenged these points when he provided his Closing Submissions from those indicated in the list initially given.

91. The assumption underlying the Appellant's claim that HMRC had failed in the case of certain deals to show a connection between the Appellant's transactions and a failure to pay VAT on an importation from the EU was virtually that this feature could really only be demonstrated by HMRC providing a chain of invoices, or at least deal sheets or logs that went right back to an identified non-UK seller, selling to the claimed defaulter. It was then also asserted on various grounds that even where there were defaults those defaults might not have been fraudulent.

92. We consider that this overstates the issue that we must determine. Properly stated, that issue is simply whether, on the balance of probability, we conclude that the Appellant's transactions were connected to a fraudulent non-payment of VAT. We can address that question in any manner that we show to be cogent, and we are not necessarily confined to the sole approach of analysing deal logs, and indeed to asserting certainty that the defaulter actually acquired the phones from a supplier outside the UK.

93. The evidence given by the Respondents in relation to "connection" failed on some occasions to indicate that the supplier to the alleged defaulter had definitely been the foreign entity supplying on a VAT-exclusive basis such that the alleged defaulter was definitely the party that had no input deduction, and thus the liability to account for VAT in respect of its entire sales proceeds. On some occasions the Respondents' evidence was given on a third or fourth hand basis in that the particular officer giving evidence was referring to findings by other officers, or even by private detective agencies engaged by HMRC to seek to trace defaulters. There were occasions when, even if it was clear that at the level of one particular company, there was a default, it was not clear whether the directors of the company had been responsible for the default, or whether alternatively other, and possibly unidentified parties, had effectively hijacked the VAT details of the alleged defaulter, either with some omission by the directors, or possibly with no omission or connivance at all.

94. The first highly material point to note is that it is hardly surprising that evidence in relation to the defaulter may sometimes be vague. The essential point in MTIC frauds is that the buyer from the defaulter must have an invoice showing the defaulter's VAT number, and an invoice purportedly indicating a full charge for VAT, and there is thereafter no need for the defaulter to provide additional documentation or to remain available to be questioned. Manifestly the defaulter must have ceased to hold any element of proceeds sufficient to pay the VAT either by simply extracting the money and disappearing, by paying an excess (i.e. VAT-inclusive amount) to its supplier, or by the payment mechanics in fact skipping the defaulter, and possibly

some of the early buffers so that none of them have the VAT element in the first place, and no need to pay it away.

95. Defaulters will only obviously remain "above the parapet" where they have both exported and imported as "contra-traders" because those steps will have been inserted in order to seek to categorise the non-payment of VAT in relation to the importation as being entirely justified, and to do this the contra-trader must be available to seek to sustain its matching export deal. In all other circumstances, however, the feature that there are doubts about the defaulter, and that the chain of invoices or deal-logs goes "cold" is not suspicious, but simply obvious and inherent in the very feature that beyond supplying a VAT invoice, the defaulter's best option is to disappear without trace. In many cases it will only be where release notes provided to the freight forwarder establish the further chain of supplies that it will be clear that the supplier to the alleged defaulter was definitely a particular foreign supplier supplying on a VAT-exclusive basis.

96. Equally it is obvious that the task of HMRC in amassing the evidence of defaults will involve input from numerous officers. We might doubt third or fourth hand evidence where it is asserting something improbable. Where however it appears to have been provided efficiently and professionally, and where it strongly indicates a familiar pattern consistent with fraudulent defaults, we reject the notion that we should dismiss such indirect evidence.

97. Having now asserted that we must expect there to be some gaps in the "tracing" evidence geared to deal logs and invoices, we now turn to other available evidence that convinces us that all the deals currently challenged on *Kittel* grounds must have been connected to fraudulent VAT defaults.

98. As we indicated in paragraph 9 above, the first highly significant point that we note in the context of this enquiry is that in the case of every deal challenged on *Kittel* grounds in this Appeal, we have been shown evidence that demonstrates that the Appellant's immediate supplier always sourced its product through a chain of several identified "intermediate parties" (i.e. buffers) and that those intermediate parties all regularly made modest and theoretical-looking profits. Such profits were often at the level of 20 pence per unit at the steps furthest from the Appellant, rising progressively to 25 pence, 50 pence, and possibly £1 at the later steps. Beyond those steps we also know that the Appellant itself made a very significantly greater unit profit, albeit that in many other deals the Appellant had participated in UK to UK deals where its margins had been at the much lower level.

99. Looking at the facts of the first deal, undertaken on 9 March 2006, identified by the Appellant's invoice number 2689, we see that the Appellant made a unit profit in relation to each unit in a sale of 3000 phones of £15, whilst the suppliers in the chain above the Appellant had made unit profits (from the Appellant backwards) of 50 pence, 50 pence and 20 pence. Significantly it appeared from release notes provided by Pauls Freight, the freightforwarder, that earlier releases had been of 3000 phones, whereas the supplies down the chain to the Appellant had come by two different routes, 2000 phones passing down one route and 1000 down the other. The Appellant had then merged the purchases of identical phones and sold 3000. The

significant point, however, is that the intermediate buffer companies down each chain both made identical profits at each step.

100. Whilst the monotonous string of fictitious looking minor profits obviously suggests pre-arrangement, this is far from the only ground for concluding that the participation by the buffer companies must have been pre-arranged. The feature that all the deals take place on the same day, and that all the parties knew that they must pay their suppliers shortly after receiving payment, regardless of what vague and inconsistent payment terms in the invoices suggested, further supports this conclusion.

101. Of yet more relevance, however, is the feature that it is highly improbable that all the traders would have taken the risks, in relation to such huge sums of money involved (at least when contrasted with the low net worth and poor credit standing of the bulk of the buffer companies) of trading as they traded had the deals not been pre-arranged. We will amplify those risks below, when looking at the risks undertaken, but ignored, by the present Appellant, and simply assert at this point that all the same risks applied to every single buffer trader, albeit magnified when the buffers made such insignificant profits. Everything made sense of course if the deals were pre-arranged, and all parties had the confidence that everything would proceed smoothly, for then the buffers would receive a small profit for effectively doing nothing. But it is inconceivable that commercially minded *bona fide* traders would have undertaken the transactions undertaken by the buffer companies on the relevant terms.

102. The cumulative picture of the totally artificial and monotonous pattern of these intermediate deals, the feature that all the deals were executed on the same day, the feature that it always proved feasible to match supply and demand exactly, the uncommercial nature of the deals and the feature that the Appellant, the exporter, was then able to make a very substantially greater profit than the buffers, leads us to conclude that the deals must have been pre-arranged.

103. In further confirmation of this conclusion, the steps that we do see are remote from the steps that we might expect to see in the case of *bona fide* grey market trading. In those deals we would expect to see parties seek to minimise seemingly utterly pointless intermediate parties. We would expect to see some reasonably obvious commercial rationale to the transactions, such as major *bona fide* traders (the supermarket groups for instance) dumping near obsolete stock in the expectation that grey market traders would perhaps split block purchases (paid for inevitably in advance of delivery) and seek to sell smaller parcels of stock to African or other third world customers. We would certainly not expect to see chains of pointless transactions, with multiple parties, selling back phones to Europe which logically ought not to have been in the UK in the first place.

104. Once we conclude that the clear evidence indicates pre-arrangement, and pre-arrangement that culminates in the Appellant making a large profit that we will suggest shortly can only derive from a VAT fraud, it becomes obvious that the chain of supplies must trace back to a fraudulent VAT loss. No mastermind arranging the deals puts the buffer deals in place behind an honest transaction where the importer has duly paid the VAT. Equally no mastermind puts the chain of deals in place on the basis that some ignorant importer might innocently and mistakenly pay an excess amount to its supplier, such that it fails to pay its VAT liability on account of loss of

funds and innocent error. It simply must follow, unless someone can point to some credible, and not staggeringly improbable, other explanation for the chain transactions that they are later steps in a planned VAT fraud.

105. We suggested to Mr. Mehta that in an honest deal chain (not that there is much occasion for a chain in honest transactions), there would be no logical reason why the exporter would make materially larger profits than the earlier participants selling to UK buyers. We found Mr. Mehta's suggested explanation for this feature to be wholly incredible. He suggested that there was great competition in the UK market so that margins were very tight. He then said that since manufacturers and authorised distributors sent their supplies of new phone models first to the UK rather than to the Continental European market, there tended to be great demand for such phones from the Continental European market since it was starved of supplies of new models of phone. Therefore very large profits could be made on selling to that market. There was no indication that any or all of the mobile phones traded were in fact new models at the time of the deals. More relevantly, Mr. Metha's suggested explanation was obviously incredible since the phones being supplied were invariably ones with "CE spec", with plugs and manuals suitable for the Continental European market so that it was hardly likely that commercially minded manufacturers and authorised distributors would have delivered phones unsuitable for the UK market to the UK so that they could be sold at large profits into the market for which they were obviously intended in the first place.

106. Equally it is obvious that in honest transactions, if phones are purchased by a UK importer for £100, and then sold to a UK customer for £121 (i.e. sufficient to fund a margin of £1 and provide the cash to pay the VAT liability) and then sold back to Europe on a VAT-exclusive basis, they are likely to command a price of approximately £101 or £102, which will still leave the exporter in a broadly neutral position once it has recovered the VAT of £20. Equally HMRC would have received the VAT and later paid it back. There is no reason to suppose that in Continental Europe the market price would have suddenly rocketed from £100 to £106 to £108, that being the implicit conclusion on the facts of virtually all the deals in this Appeal.

107. Pursuing the example in the previous paragraph, but now assuming that the transactions were all steps in a VAT fraud, the obvious maths is that the importer would still sell the phone to the first UK buffer for £121, but would not account for the VAT. The phone would then pass down the chain of buffers, inserted by some mastermind to distance the exporter from the fraud, and to ensure that all the final sales in the steps culminating in the supplies to the exporter were made by companies with valid VAT registrations and some ability to complete due diligence enquiries. The exporter would then sell to the customer for roughly £106 to £108, making therefore a good profit if the VAT was refunded by HMRC. The profit justifies the risk of ending up with a significant loss if HMRC declines to refund the VAT. Implicitly at some point in the hidden steps outside the UK, the EU customer or one of its customers would sell the phones at a loss and recover the amount of the loss out of the cash seized by the defaulter, so that the phone would effectively be back at the previous VAT-exclusive price in the region of £100.

108. A further factor that yet further confirms pre-arrangement is that the Appellant's own transactions were ones that we consider cannot have been effected

on genuine commercial lines, and must again have been part of the pre-arranged cycle. We will not expand on that observation at this stage, but simply assert that it is yet a further step in the logic that all the deals must derive from fraudulent VAT losses.

109. Our conclusion, therefore, is that when all that the Appellant has asserted is that by one method HMRC has been unable to demonstrate a consistent chain or deal log to a defaulter, and the Appellant has never advanced a remotely credible alternative scenario that might explain the Appellant's deals, the factors that we have now indicated amply justify our decision that on the balance of probability there can be no other explanation for the Appellant's deals but that they were connected to fraudulent losses of VAT.

Facts, contentions and conclusions material to the grounds on which the Appellant disputed either the connection of the Appellant's deals to any loss, or that losses were fraudulent

110. As we indicated at the outset we will now consider, but only in fairly general terms, some of the grounds that the Appellant's counsel advanced for challenging connection to fraudulent VAT losses, or that losses had indeed been fraudulent.

111. Most of the challenges in relation to "connection" simply referred to gaps in the deal chains. As regards these, we consider it entirely legitimate for HMRC officers conducting investigations, and we in our turn, to make reasonable assumptions derived from the surrounding circumstances in then concluding that connection has been demonstrated to the required standard of the balance of probability.

112. The unrealistic nature of the Appellant's contentions is better illustrated when considering the grounds advanced for questioning whether admitted defaults had been shown to be fraudulent or not.

113. Several of the "defaulter-officers" were taken in cross-examination through various questions, designed to establish that if an importer imported goods on a VAT-exclusive basis for £100, and sold them to a UK buyer (using the present 20% rate of VAT) for £121, there was no way in which the £20 element, representing the liability to VAT was HMRC's money or money held in trust for HMRC in some way. We accept that point in theory, and we accept that an honest and hard-pressed trader might well feel compelled to use the entire receipt for trading purposes, hoping to be able to pay the VAT on the due date out of later receipts. In those circumstances, if the trader failed to receive the later funds, and failed to pay the VAT, his default might well rank as one resulting from cash flow difficulties or near insolvency, rather than fraud.

114. In the case of the present deals, it will inevitably be the case that the pre-arrangement will in some way have ensured that the intended defaulter had been stripped of the £21 in the above example in one of the ways that we have already mentioned.

115. Reverting to the "non-trust money" points referred to in paragraph 112 above, it would be virtually inconceivable for an importer in the importer's realistic circumstances honestly to apply its £21 in other purchases (without providing for the VAT) on the supposed basis that later deals might still fund the VAT liability. For on the pattern of deals in this case, the next deal of the same nature would need to involve a purchase at £100 and a VAT inclusive sale at well in excess of £140 to pay the VAT on both the earlier deal and the then current deal. All of this is just ridiculously far-fetched, and we unhesitatingly reach the conclusion that if in any way a defaulter had paid the £121 in the above example to its foreign supplier, particularly when in some cases we see invoices to the defaulter for £100, these are steps in a fraud and any other suggestions are dismissed.

116. The Appellant's counsel's above suggestion was taken a step further with his suggestion that the importer might have mistakenly paid a VAT-inclusive price (say of £121) to its foreign supplier even when it had been invoiced for £100. It might have then found that the foreign supplier refused to repay the excess mistakenly paid, and it might have concluded that suing the foreign supplier in foreign courts would have been expensive and potentially fruitless, such that it simply failed (sadly!) to pay its VAT. We consider that suggestion to be ridiculously far-fetched. Beyond that conclusion, masterminds who arrange transactions do not generally attach transactions involving a chain of artificial buffers and an exporter to a transaction by a wholly incompetent entity that only ends up defaulting on its VAT liability through unanticipated stupidity.

117. The Appellant also challenges the claims of fraudulent loss in some cases by pointing to the fact that the directors of a supposed defaulter may not have been interviewed extensively, and that there is some question as to whether they were in control of the company concerned, or whether somebody else had either hijacked its VAT number or somehow operated its invoicing and payment mechanics so as to import goods, sell them on in a UK/UK transaction and then default in paying the VAT. The claim, then, is that there is no proof that the company, acting through its proper directors, condoned or facilitated the fraud, so that the claim of fraudulent default should be dismissed.

118. We do not accept this proposition. It is perverse in the sense that it seems to concede that there has been a fraud, in that at worst someone else has hijacked the VAT details of the supposed defaulter and perpetrated a fraud even if it happens that the actual directors were entirely innocent, and not remiss. We accept that if the company itself successfully appealed against assessment or simply convinced HMRC that it had been altogether uninvolved with the deal and had received none of the payments, then it would not have been liable for the VAT. If then HMRC had indicated that there had still been a fraud, indeed a fraud by persons unknown and that the supply of the phones had then been channelled down the chain of buffers to the Appellant, there would have been no objection to denying the Appellant its refund, assuming the "knowledge" point also to be satisfied, regardless of the fact that nobody would have known who had provided the false documentation. In the case where the company just does not bother to do anything and disappears with some vague claim that somebody else rather than the directors perpetrated the fraud, we consider it entirely realistic to treat the company in those circumstances as having been the defaulter. Whether one says that the default was "by the company", or "by persons

unknown in falsely operating the company", if the company fails even to approach HMRC to explain the circumstances, we consider it entirely realistic for HMRC to treat the company as having been the fraudulent defaulter. We reject the Appellant's contentions that seemed to dispute this.

119. We also dismiss contentions that a fraudulent loss had not been established when the defaulter appeared to have been a contra-trader making various exports on a zero-rated basis to some entity in Italy that emerged not to exist. We consider that that fact pattern is entirely consistent with the contra-trader having been fraudulent, and that the suggestion that the loss resulted only from some dubious challenge by HMRC of the Italian transaction that had thrown the Appellant's deal chain into unanticipated, but honest, loss is far-fetched.

120. Our overall conclusion is that the Appellant's counsel has not advanced a single point that provides some credible alternative explanation for the entirely realistic conclusion that we reach, namely that all of the Appellant's deals that have been challenged on *Kittel* grounds must, on the balance of probability, and indeed to a standard of proof well in excess of that, derive from fraudulent VAT losses.

The conclusions that we derive from the FCIB evidence

121. As we indicated in paragraph 16, Mr. Andrews gave the evidence in relation to the FCIB banking statements. Evidence was not given in relation to every deal and detailed evidence giving the relative timing of payments (nobody of course being clear as to which particular time zone the times referred to) and the IP addresses from which traders logged onto the internet in order to make payments was only given in respect of a few of the deals. As we said in paragraph 16, circularity of payments was not claimed by Mr. Andrews in respect of some of the payments; it was claimed in respect of some, and in others circularity was a distinct possibility if certain assumptions were made when at foreign parts of the chain, payments had been amalgamated into larger balances.

122. The Appellant's counsel's challenge in relation to all the FCIB evidence was always on the single topic of whether Mr. Andrews' evidence did or did not establish circularity, and we might say "establish" to a degree of near absolute certainty. For instance it was asserted on several occasions that circularity could only be established if each payment received by each trader was definitely received by the trader before that trader then made its own payment, so that one might then regard the same money as having been passed through the particular trader. Accordingly it was said that circularity was undermined if it happened, as it did periodically, that one trader paid before receiving its payment from its own customer, even if it then transpired that within a very short period the relevant trader received the exact amount expected (according to the invoices) from the customer, itemised in the banking statements to relate to the deal in question, which clearly matched the amount pre-paid and again itemised in a similar way, that the trader had paid to its own supplier. We consider that that timing mismatch is irrelevant. The relevant question is whether there is a chain in the transactions, such that either the goods go round in a circle and end up where they started, or that certainly the money so circulates. This need not be based on some sort of FIFO or LIFO type analysis as the Appellant's counsel suggested, but can easily be sustained when there are clearly matched payments and receipts at each

particular point in the circle. It will obviously generally be the case that receipts will precede payments for the two reasons that FCIB never allowed customers to go into overdraft and certainly when considering the Appellant and the buffers, it would almost always be the case with the Appellant, and invariably the case with the buffers, that they could not possibly have paid until they had their relevant receipt.

123. While we conclude that circularity was established to our satisfaction in some of the deals, we consider that the constant attention to this point detracted from the more general significance of the FCIB evidence.

124. The FCIB evidence illustrated, for instance, that on several occasions the payments skipped several of the parties, and most obviously the defaulter and often the immediate subsequent purchasers from the defaulter. Particularly where there was no evidence concerning prior authorised third-party payments (in other words authorisation that actually anticipated that the payments would skip one or more of the parties), the very feature of payments deviating from the chain that one would have expected from the chain of supplies and invoices was of itself highly significant. For had each supply been a genuine sale, with the buyer only ever expecting to pay the seller and being oblivious to the identity of other parties, it would have been impossible for the payments to skip some of the parties in the way that they did. Accordingly this feature plainly confirmed pre-arrangement.

125. The feature that payments were amalgamated in the hands of various of the foreign parties in the chains, and often in the hands of parties involved in several of the chains, is also entirely consistent with the pattern of payments regularly seen in MTIC chains. Such amalgamation may make it more difficult or indeed impossible to be able to trace a chain of payments, though on occasions Mr. Andrews put forward a convincing case for saying that on some reasonable assumptions circularity of payments still looked likely. Our principal response to that however is that whether the amalgamation of payments did or did not mask the possibility of circularity of payments, it was further support, if needed, for the proposition that the various payments were still pre-arranged payments, and the feature of payments being amalgamated in the hands of one company outside the UK, and one seen to be a participant in several of the deals that we are concerned with is a feature seen in many MTIC payment cycles.

126. There were also a number of instances (in the relatively few cases where IP addresses from which traders had logged onto the internet to make their payments were shown to us) where different traders had used an identical IP address, and some where the IP address number had been one digit away from the IP address number used by others, and even one instance where the Appellant itself had logged onto the internet to make its payment with the identical IP address to that also used by a Pakistani trader in the hidden foreign part of the same payment chain. Mr. Mehta was unable to account for that though he did say that at the time he might have been in Dubai. While we can draw no firm conclusions from those facts, it does appear highly suspicious first that the two traders in one and the same payment chain used the same IP address, and that as we know several of the Appellant's customers, and even indeed one of its suppliers were based in Dubai. Moreover while he had little contact with other suppliers and customers, and happily dealt with them without meeting them, he did obviously visit Dubai.

127. The only conclusions that we seek to draw from the FCIB evidence are first that the fact that payment chains did not always, or even perhaps often, establish circularity is not particularly significant, and secondly that all the other evidence that we gleaned from the FCIB evidence was entirely consistent with the common form of MTIC payments, and certainly consistent with pre-arrangement.

Findings of fact and our decision

128. We will now record some formal findings of fact. Since we consider this case to involve no difficult legal issues, and simply an analysis of the facts, the findings of fact in relation to the points at the second and third bullet points essentially conclude with our decisions. We will deal with these in order and in relation to the following topics. These are:

- our finding as to whether the Appellant took all its various steps in relation to due diligence, and appointing Borders and Veracis in order to make a genuine effort to avoid innocently becoming implicated in fraudulent deals, or alternatively to provide a smokescreen of fictitious evidence to convince HMRC of its innocence, and to provide a dossier of documentation;
- our findings in relation to whether the terms and pattern of the Appellant's deals were consistent with deals undertaken by an honest trader on commercial lines, or whether they must have been pre-arranged deals, so justifying the conclusion that the Appellant must have known of the connection to fraudulent VAT losses; and
- our findings in relation to whether the Appellant, assuming no actual or implicit knowledge of the connection of its deals to fraudulent VAT losses ought to have known of that connection.

Whether the due diligence was a smokescreen

129. Our first finding of fact is that there was a consistent thread to every topic relevant to due diligence, considering with whom it was prudent to deal, taking advice from Borders, instructing Veracis to provide their reports, paying regard to warnings from HMRC, and in particular to indications that earlier deals had been traced to MTIC frauds. The impression that we gained from the evidence about these matters in March to August 2006 and the general impression that we also gained from the way in which Mr. Mehta gave his evidence before us was that none of this information was ever considered and properly weighed up. It was either ignored or it went "right over Mr. Mehta's head". The constant refrain was that he skim-read the Veracis reports; he obtained them in order to check that the counter-parties were who they said they were, and when he had proceeded to effect deals with parties whose credit-standing and credibility were extraordinarily poor, he would have made a decision at the time to trade, even if he could not now remember what his reasoning had been. He was also entirely absorbed in doing what he was good at which was putting deals together, and so he had little time for, and gave little attention to, scrutinising reports or worrying about due diligence and credit-standing of counter-parties.

130. In the light of Mr. Mehta's clear knowledge of MTIC risks, dating from his work at Smart-Tel, and having to deal with an earlier challenge of the Appellant's

deals on the basis that they were wholly uncommercial, Mr. Mehta knew full well that he was trading in a highly risky area that was fraught with fraudulent evasion of VAT. In the light of this clear knowledge, the way in which he gave no serious attention to any warning flag of any sort, and just blundered on oblivious to the risks, must utterly undermine any claim that he was seriously seeking to insulate the Appellant in a genuine manner from MTIC risks. We conclude that the appointment of Borders and Veracis, and all the attention to improving and filing documentation was designed to provide a fictitious smokescreen of conscientious conduct, when in reality he ignored everything, and treated the document file and his supposed reliance on Borders and Veracis as his defence to HMRC's possible claims of knowing involvement.

Whether the Appellant's deals could have been bona fide deals in which Mr. Metha managed always, and unaided by others, to match purchases and sales or whether the Appellant must have known of the connection of its deals to fraudulent VAT losses

131. As we indicated above, we are not particularly influenced by features such as the mismatch of product description in orders and invoices, and the fact that Mr. Mehta appeared to have some difficulty in explaining the order of, and reality of, some of the transaction steps.

132. The more fundamental point that seems to us to be critical is the issue of whether it is remotely credible that the Appellant's deals could have been *bona fide* commercial deals.

133. Whilst the Appellant had sufficient net worth to be able, without outside finance, to top up receipts from its customers so that it could subsequently pay the greater VAT-inclusive amounts to its supplier (albeit that it always needed the customer's payment to be able to fund its own payment), it was not disputed that the Appellant's net worth was only modest, and also that whenever credit reports or Veracis reports indicated anything about the credit standing of the Appellant's suppliers and customers, the position was always that all had a very poor credit rating. Whilst, with every broker in export deals, Mr. Mehta protested that the Appellant was unconcerned about credit risk because it was providing no credit (albeit that it was in any event providing credit in a sense to its customer), it seems inconceivable to us that a commercially minded trader would have been untroubled by all the following issues.

134. Assuming the Appellant to be fully liability (albeit with credit for some period) to pay its supplier, would the commercially minded Appellant have relied in most deals on a virtually unknown foreign customer to make its critical payment to the Appellant in order to fund the bulk of the Appellant's liability to its supplier? When the Appellant knew that the great majority of its customers had poor credit standing (assuming that he derived this much information from the reports about which he was little concerned), and the Appellant inherently had no knowledge of any subsequent sale by the customer that might fund the customer's payment to the Appellant, was it not risky to ship the goods, even on a "ship on hold" basis, in these circumstances? Was the Appellant bound to be able to recover the goods in the event of non-payment by the customer? It had no or little knowledge of the standing of the foreign freight forwarder, and we have the Appellant's counsel suggesting that

an original defaulter who had stupidly paid a VAT-inclusive price to its supplier might refrain from commencing expensive and uncertain foreign litigation if the foreign supplier refused to refund the mistakenly paid excess price. Would not the commercially minded company in the position of the Appellant have worried about those risks in actually delivering goods out of the jurisdiction to a company about which it knew little, other than that the credit standing of the only customer on which it had to rely was almost certainly woeful?

135. In the context of the Appellant's purchase from its supplier, might not a commercially minded purchaser in that role have wondered how a supplier with no material net worth and no credit standing had managed, or would manage, to source vast quantities of product? Would not the purchaser wonder why the supplier was prepared to release goods (at least for inspection, and with no control on the Appellant despatching them abroad), before receiving payment? The present Appellant certainly knew that its credit standing was not such that a supplier supplying a very considerable quantity of phones could have had any confidence in the Appellant's credit standing. Inherently the supplier also had not the slightest knowledge as to what the Appellant was going to do with the phones, and indeed whether if they were despatched abroad, they would only be sent on "Ship on Hold" terms, or whether indeed they would be paid for. There were many instances where the supplier's invoices did not even insert a title retention clause.

136. Furthermore, with some credit being provided by the supplier to the Appellant, would not one or other of them have thought it more appropriate to insert credit terms into the Appellant's purchase order or the supplier's invoice that would actually make sense in all circumstances? If the Appellant's customer had failed to pay the Appellant and the Appellant was unable to recover the goods which had by then been shipped abroad, what did the term *"Payment upon Inspection/release"* actually mean? Would the Appellant have been liable to pay the supplier because it had inspected the goods (or at least would have fictitiously inspected the goods and despatched them abroad), or would the Appellant claim that it did not have to pay because the supplier would not have given its final release instruction, following receipt of payment, simply because it had indeed not received payment. There is clear doubt on these issues and these are not minor matters of detail. They go to the heart of the reality that these deals were only in fact cogent if parties could rely on the fact that everything would proceed smoothly, and that all payments would flow up the chain of suppliers without hic-cup. It is therefore perfectly obvious that all the parties who all shared the feature that none of them was credit-worthy could only proceed with these deals either if they were all stupid or if they all had faith in the pre-arrangement.

137. We reject the suggestion that when the Appellant received a purchase inquiry or order from a foreign customer, Mr. Mehta first contacted his supplier who dealt regularly with the particular phone ordered. No single supplier in any of the deals held any stock, and D eventually managed to supply to the Appellant because it sourced from C, from B and from A.

138. The feature that it always proved possible to match supplies of stock and demand in identical numbers was of course also quite incredible. We know why, in retrospect, it was achieved, but Mr. Mehta would, had he been an innocent and honest trader, have begun at some point to think that he was being extraordinarily lucky in

his unaided ability to match deals in a back-to-back way in deal after deal. Any honest trader would have found it fairly incredible even on the first occasion if and when this was achieved. To achieve it in deal after deal is obviously inconceivable.

139. We reject Mr. Mehta's claim as to why margins were very fine in UK to UK deals (because of the intense competition) and that greater profits could be made in exporting because of the greater demand for new products in the enormous continental European market because manufacturers and authorised distributors sent their new model phones first to the UK. Beyond being self-evidently ridiculous, since it is inconceivable that sophisticated manufacturers and distributors would be unaware of the level of demand in all markets, the notion of sending unsuitable phones, always with continental European plugs and manuals, to the UK so that they had to be exported back to the continent at a considerable profit, is again ridiculous.

140. While we have just suggested that pre-arrangement apart, the Appellant and its counter-parties would have been entering into very risky deals, and we mentioned in paragraph 100 above that we would relate this point back to all the buffer companies, we conclude that exactly the same points about severe credit and transaction risk would have attached also to all the buffer deals, but for the great likelihood that all the buffers were fully aware of their role in planned transactions. The risk, as we indicated earlier, is in fact all the more marked in the case of the buffer companies in that they took the same transaction risks that the Appellant took but for trivial margins. The Appellant conceded that much more of its turnover in 2006 took the form of UK to UK deals, and at small margins (ostensibly explained in the manner that we have just rejected), all of which indicates that the Appellant and the numerous buffer companies were all trading for the trivial margins either taking serious commercial risks, or on the basis of their confidence that the pre-planning would ensure that everything proceeded smoothly.

141. We turn now to an analysis of the question that is crucial to the *Kittel* issue of whether the Appellant had, or rather logically must have had, actual knowledge that its deals were pre-arranged, and thus inherently connected to fraudulent losses of VAT.

142. A critical starting point to this enquiry is that it simply must follow that the pre-planning of these deals (ignoring the issue at this stage of whether the Appellant was aware of the pre-planning) must be that the pre-planning simply had to involve all the steps, in other words the supply chain down to the Appellant, and the identity of the purchase by the foreign customer, and subsequent supplies of the phones, or prior payments of purchase price in the "hidden foreign" part of the deals. The obvious reason why the planning must include every step is that otherwise the numbers would never match up. The defaulter retains the VAT element of 17.5%. The foreign supplier has supplied to the defaulter for a VAT-exclusive price of £100. When the foreign customer from the Appellant then buys at £106 to £108, with the £6 to £8 paying for the various costs and margins and the Appellant's large profit, one or other foreign participant must have dealt at a wrong price. Perfectly obviously part of the defaulter's effective theft of the £17.5 is returned to the original foreign supplier for having supplied at an under-value or provided to the foreign purchaser to subside it for having purchased at an over-value. No other explanation can explain the figures.

143. Having reached that conclusion, how is it that the Appellant might conceivably have been inserted into the middle of these single chain transactions, with everyone having to be confident that the Appellant would buy from and sell to the required parties?

144. We deliberately asked the Appellant whether in any way it had been suggested to him that he might source product from a particular supplier when he had received a customer order for it, or whether in the reverse situation he had ever been offered stock, receiving some sort of intimation that a particular customer might wish to purchase it. Had he in other words been innocently manipulated to match orders and supplies in a way that would achieve the critical objects of the planning without the Appellant being aware that he was being manipulated? His answer was that this had never occurred, and that he had always matched supplies to orders by ringing round to his various suppliers, and by exercising his skill in putting deals together.

145. We would certainly have been highly suspicious of the Appellant, with his considerable awareness of MTIC frauds, had he claimed that he had been innocently duped into matching orders and supplies in deal after deal, but when he disclaimed any reliance of having been duped in this manner, the next question is whether there is any other conceivable basis on which the Appellant could invariably have performed his role of exporting product in the middle of chain transactions, without actually having been fully aware that he was just performing a play-acting role in fictitious and fraudulent transactions. The only conceivable remaining innocent explanation would be that the fraudster organising the deals had relied on the fact that it would be known that in order to match a particular customer order, there would inevitably only be one source that could possibly match the order (i.e. the obviously planned one) and that even if the Appellant was going to make phone call after phone call amongst known counter-parties and others appearing on the IPT web-site, he would eventually, and seemingly innocently, hit the jackpot and identity the only potential supplier. Beyond this suggestion being extraordinarily improbable (with no fraudster being remotely likely to protect its circulating cash by relying on this dubious procedure), it still raises the question of whether it is suggested and conceivable that every single buffer would also have found its place in the chain in a similarly innocent manner. Particularly in the light of the trivial margins made by the buffers, and the numerous buffers required to perform their roles in transaction after transaction, this is inconceivable. It is then worth noting that the Appellant had regularly traded in UK to UK deals at fine margins, whereupon it would seemingly follow that the Appellant would have been familiar with the expectations on the part of the buffer companies.

146. In reality, this line of enquiry has now gone well beyond reality. There can, in our judgment and to a standard of proof well in excess of that of reasonable probability, be no doubt that the Appellant can only have played its role in the middle of these plainly pre-planned transactions if it had known precisely what it was doing. And what it was doing simply must have been participating in pre-planned transactions inherently connected to VAT frauds.

147. Our conclusion and decision is that the Appellant must have known of the connection of all its transactions, challenged on *Kittel* lines, to fraudulent VAT losses, and that its Appeal to recover input tax is disallowed.

Whether in the event that the former conclusion is wrong, the Appellant ought to have known that its transactions were connected to fraudulent VAT losses

148. Were we wrong in our conclusion that the Appellant must have known (i.e. did know) that its deals were connected to fraudulent VAT losses, we also reach the conclusion that it ought to have so known.

149. We accept first that in order to sustain the above conclusion, it is not sufficient for us to conclude that the Appellant ought to have known that its transactions might be connected to fraudulent evasion of VAT. It must be shown that there can have be no other reasonable conclusion than that its transactions can only be explained by reference to connection to VAT frauds, and that the Appellant ought to have known of this.

150. We accept also that in addressing this question, we cannot place reliance on the factors, such as the technical and artificial nature of the buffer deals, that are plainly relevant to factual matter of connection to VAT losses, but irrelevant to the present issue. The Appellant probably had no knowledge of these deals, and must be presumed to have had none.

151. Having said that, it is nevertheless the case that:

- the Appellant had participated in numerous UK to UK or buffer deals in the past;
- Mr. Mehta had had countless warnings about MTIC risks;
- Mr. Mehta had been involved in wholesale trading in mobile phones at his previous employer and at the Appellant, and certainly in the course of his employment at the Appellant he had had input tax initially denied on grounds of operating in a non-commercial manner, and he had been warned on more than one occasion that deals involving numerous of his suppliers had been traced back to fraudulent VAT losses;
- we certainly re-confirm the findings of fact given in paragraphs 129 and 130 that Mr. Mehta pursued his due diligence and his appointment of Borders and Veracis not to avoid involvement in MTIC transactions but to provide a smokescreen of defence against HMRC that would enable him to claim ignorance;
- the features of not insuring goods in transit, effectively failing to procure any inspections of stock, ignoring every indication of the poor standing of trading counter-parties and participating in deals in a wholly uncommercial manner (ignoring credit and transaction risks that no honest trader would have ignored); and
- supposedly failing to note that by the most remarkable of coincidences in every single deal he managed (seemingly without any great difficulty) again and again precisely to match quantities and descriptions of phones so as to match orders and supplies on a back-to-basis,

the Appellant manifestly ought to have appreciated that its transactions could only be explained by connection to fraudulent VAT losses. There was no warning flag to which the Appellant ever gave attention. He ignored every warning and every

obvious indication. Whilst we are in fact clear that the circumstances are so clear that the Appellant must have known of the connection to fraudulent transactions, were that not so, it certainly ought to have so known.

The export deals

152. Relatively little attention was given to the deals in which rather than export goods directly, the Appellant on a number of occasions sold minor quantities of phones to an individual, Mr. Boumrah, on a zero-rated basis in the expectation that he would have been declaring them for export when he carried the phones with him on leaving Gatwick airport.

153. This matter is quite distinct from the *Kittel* challenge, and in relation to this matter, the burden of proof is on the Appellant to show that it does have the evidence of export. This needs to be obtained by providing Mr. Boumrah with various forms which need to be presented by him on leaving Gatwick airport. When the forms are presented, some of the copies of the forms are retained by the Border authorities and Copy 2 of the form is intended to be return to the Appellant as proof of export. If this is not done, and if export cannot thus be proved, the Appellant becomes liable to pay VAT in respect of the original supplies that were initially treated as being zero-rated.

154. In the present case the evidence was that the Appellant had not received Copy 2 of the form back but had received another copy that should have been retained by the Border authorities, and secondly the Border authorities, who keep a record of the occasions when departing travellers at the airports presented the various forms evidencing export had no record of ever having received the particular numbered forms that had been handed to Mr. Boumrah. They did have records of forms filed by other departing travellers who had left Gatwick at the time that it was asserted that Mr. Boumrah had departed, but they had none of the forms applicable to the goods sold by the Appellant to Mr. Boumrah.

155. In the light of the fact that the burden of proving export falls on the Appellant; that the Appellant does not have the forms that it should have had and that there was no record of the presentation of the forms by Mr. Boumrah at Gatwick Airport, we conclude that the conditions for sustaining the zero-rated treatment of the sales to Mr. Boumrah have not been satisfied, and that the Appellant's appeal against the assessment of output tax in respect of the relevant sales is dismissed.

The cost of photo-copying

156. The parties asked us to nominate the price that we considered reasonable for HMRC to charge for photocopying the vast bundles of evidence and documents, that identified cost presumably to be shared on an equal basis between the parties. We consider that the cost of 6p per page is the reasonable figure, recognising that this cost should reflect not just the cost of the actual copying but also the cost of the lever-arch files.

Right of Appeal

157. This document contains full findings of fact and the reasons for our decision in relation to each appeal. Any party dissatisfied with the decision relevant to it 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.

HOWARD M. NOWLAN
TRIBUNAL JUDGE

RELEASE DATE: 19 June 2014